

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

**OPEN SESSION MINUTES
MEETING # 400**

Date: March 21, 2016

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

Present: Brian Moto, Chairperson
James Nishimoto, Ex-Officio Member
Wesley Machida, Ex-Officio Member
Roderick Becker, Employee Member
Kanoë Margol, Employee Member
Michael Okumoto, Employee Member
Kenneth Villabrille, Employee Member

Others: Rodney J. Tam, Deputy Attorney General
Cynthia Akiyoshi, DHRD Staff
Kevin Malmud and Jeanne Kanai, Prudential Honolulu Office
Julie Klassen, Prudential Retirement
Carol Blumenthal and Deborah Baran, Prudential Retirement – via conference call
Glenn Ezard and Wendy Young Carter, Segal Rogerscasey – via conference call

Call to Order: There being a quorum present, Chairperson Brian Moto called the meeting to order at 9:07 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 started the meeting with introductions. He opened with an introduction of himself as the newly elected Board Chairperson and introductions of Board members, staff, and guests in attendance, followed by attendees participating via conference line. No other guests were in attendance.

Chairperson Moto proceeded to Agenda Item #1.

Agenda
Item # 1:

New Business

a. Approval of Minutes Nos. 399 and 399-ES

The Board took a few minutes to review Minutes Nos. 399 and 399-ES.

A motion was made by Trustee Nishimoto and seconded by Trustee Becker to approve Minutes Nos. 399 and 399-ES, as prepared. The motion passed unanimously.

b. Review and Approval of Segal Rogerscasey's Proposed 2016 Annual Reallocations for the Lifecycle Portfolios

Mr. Ezard stated that a review was done of the 2015 allocations within the Lifecycle portfolios and which were run through the capital market assumptions model to show expected return and risk for each of the asset classes, and a correlations table. He included observations of other comparable funds that are commercially available that would align with the LifeCycle portfolios, and observations of what the Plan's LifeCycle portfolios would look like with alternative asset category options.

Highlights presented are:

- The investment funds show an average return, compound return (actual return that is expected to return), standard deviation, and expected returns over a 5 to 20 year horizon. With the higher allocation to equities, there is a much higher volatility in the longer term fund. In the horizon analysis, he noted also that what you see over time for the Income portfolio is a lower return versus higher return on a short term because of the lower interest rates and higher allocation to fixed income, and because of the way the yield curve is positioned.
- In comparison with other investment funds, other funds have a broader array of investment categories that is not included in the current LifeCycle portfolios.
- Allocations include a category of stocks and bonds and are similar and in line with other investment funds.
- The 2015 and 2016 LifeCycle portfolio allocations show slight variances and differences on each of the fund categories, as it moves towards the Income Fund.
- The Income Fund remains the same because rolling forward one year, the changes are only to the allocations to equities.
- In comparing the allocations, the performance of the funds with global REITS and commodities did not differ much than those funds without those asset allocations. The low policy rates have kept differences minimal. The use of alternatives would see a bit more difference in terms of risk adjusted returns.

A motion was made by Trustee Machida and seconded by Trustee Villabrille to approve the 2016 reallocations for the LifeCycle portfolios, as proposed by Segal Rogerscasey. The motion passed unanimously.

Chairperson Moto asked Prudential to confirm that the reallocations could be done in April. Ms. Klassen confirmed that the reallocations would be done around April 15, 2016.

Mr. Ezard discussed how the alternative investments would be expected to look like in the LifeCycle portfolios. He noted that the alternative options like hedge funds could change the outcome and improve overall risk efficiency. This would create the ability to get non-correlated funds into the asset mix that would result in the compound return to be slightly higher and reducing the risk. There are implementation considerations such as eligibility requirements and liquidity issues when adding an alternatives category.

In response to the Board's questions, Mr. Ezard responded that:

- Fees would be higher however this point would have to be accounted for in the analysis and could see improvement in risk adjusted return even after the fees.
- For a Fund-of-fund structure, there would also be higher fees due to management of the fund, but they will discuss this in detail later.
- The asset mix for the Income Fund could have different benefits versus longer dated funds because of the current low interest rates. The focus would be to aid the shorter term horizon.
- For longer dated funds the focus is on gaining additional return and getting the standard deviation to come down.

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Item # 2:

Ongoing Business

- a. Discussion and review of the Summary of Segal Rogerscasey's Deep Dive Analysis of the Plan's structure

Chairperson Moto informed the Board that the review of Segal's Deep Dive Summary Analysis is still ongoing, so this discussion item will be deferred to a future meeting. There were no objections to a deferral.

- b. Performance Evaluation Report by Segal Rogerscasey for 4th Quarter 2015, Period Ending December 31, 2015, including but not limited to:

- i. INVESCO Report on the Short-Term Investment Fund
- ii. Performance Updates and Overview on Funds Currently on the Watch List: MainStay Large Cap, Victory Institutional Diversified Stock Fund, and PIMCO Total Return Fund

Mr. Ezard presented highlights for the 4th Quarter 2015 end:

- The market has rebounded from the 3rd Quarter 2015, mostly related to China's economy. Other factors during the 3rd Quarter:
 - The U.S. Federal Reserves and interest rate decisions which impacted emerging markets.
 - Emerging market economies needed access to the U.S. dollar but the rise of the U.S. dollar made goods more expensive.
- During the 4th Quarter:
 - China's increased control to stabilize the market.
 - Backing off by the U.S. Federal Reserve in terms of the outlook on raising rates.
 - Fixed Income has not been as great but has been stable.
 - Overview of Funds:
 - Plan assets are just under \$2 billion at the end of the quarter.
 - Stable Value Fund has the largest amount of assets.
 - BlackRock index funds have the second largest pool of assets.
- Funds on the Watch List:
 - PIMCO Total Return Fund improved during the 4th Quarter, but slipped again in the current quarter-to-date.
 - Victory's performance has been lagging the benchmark for the 1-, 3- and 5-year periods; however, they recommend holding off on any actions through the quarter.
 - MainStay's performance has been trailing in the 5 year period; performance during the current quarter is underperforming and down by 7%. The fund is not looking good in the current quarter and will need to remain on the watch list.

Ms. Klassen gave some remarks related to the Victory Institutional Diversified Stock Fund:

- While gathering information for Segal's Deep Dive analysis, it was discovered that the Victory fund provides revenue sharing.
- Prudential has an agreement in place with Victory to pay revenue sharing of 10 basis points (0.10%) to Prudential but it is not being credited to the Plan.
- As the agreement goes back to the time that the Plan transitioned to Prudential, revenue sharing may be applicable from the time of the transition in 2013.

- In speaking with Victory about revenue sharing to the Plan from the point of transition, Victory stated that they would not go back retroactively, and if the Plan wants to have revenue sharing, the fund would need to be in a collective trust structure.

DAG Tam added that Prudential's trading agreement covers administrative expenses for services provided by a Third Party Administrator and was entered into at the time of the transition; however, the State is not a party to that agreement. The State's contract with Prudential states that the TPA is not allowed to keep these fees, and the Board's longstanding policy has been to refund these amounts back to participants in the fund.

The Board asked that staff proceed with getting written clarification on any revenue sharing fees for the Victory fund.

Trustee Machida commented that the performance of the BlackRock Non-U.S. Equity Index fund shows that the fund has been in the bottom quartile and has been underperforming. Mr. Ezard remarked that the Non-U.S. equity has not done as well as the U.S. Large Cap Index, and has been weaker due to the markets being less liquid and the volatility of the emerging markets. In comparison with Victory's underperformance, the underperformance of the Non-U.S. Equity fund has been primarily due to a functioning of indexing, and not due to stock selection.

Mr. Ezard reported that there are no further updates yet on the INVESCO's STIF strategy.

Mr. Ezard added that a meeting to give Victory an opportunity to present updates on the fund's performance and discuss their current strategy before any decisions or changes are contemplated.

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Item # 2:

Ongoing Business

c. Plan Administrator's Report

- i. Plan Report for the 4th Quarter 2015
- ii. Plan Highlights

Ms. Klassen presented commentary and highlights:

- Strategic Planning and establishing priorities:

- Prudential can partner with the Board and assist with any initiatives.
- Plan's participation rate is at 27% with approximately 58,000 eligible employees; excluding the DOE and UH population, the participation rate is at 46% which is slightly above the national average.
- Online Enrollment:
 - Automatic enrollment is impacted by legislative and bargaining unit agreements.
 - Process would involve receiving an eligible file.
 - Possible alternative in 2017 as a workaround that has been created for other governments to receiving an eligible file:
 - A custom interface would be developed on the front end of the Plan website;
 - Participant would load data and Prudential would send back to payroll; and
 - Have observed there are a lot of millennials who need to get started in saving.
- Deep Dive Considerations - Income Options:
 - In line with asset retention goals, considering income option solutions.
 - Currently, the Plan has an annuity shopping service option.
 - Income advice through Morningstar is available to help draw down retirement monies.
 - Other options: a new product available for income solutions like guaranteed minimum withdrawal benefits as a companion of LifeCycle or Goalmaker options.
 - The alternative to have automatic enrollment go through collective bargaining in lieu of statutory changes would need to be evaluated and researched. This option would allow funding for employees to start saving for retirement.
 - Plan has an annuity shopping service; the approved list of annuity insurance providers is available.
 - Other in-plan options like Income Flex which could be a component are considerations that would allow participants to allocate a portion of deferral towards an income stream and would not lock in participants.
 - Some drawbacks to fixed annuity options are that the participant would be locked in to an annuity and would not be able to make a change in the future, the other is that an annuity generally has higher fees.

Trustee Nishimoto was excused from the meeting at 10:53 a.m.

Ms. Klassen presented the following:

- Education:
 - The custom website changes are in progress.
 - Development of video content is in progress.
 - Development of a video storyboard for DOE and DHRD is in progress to increase awareness.
 - Local Office strategic initiatives regarding HHSC's transition to Kaiser.

- Plan Highlights:
 - There were more distributions noted during the 4th Quarter.
 - The participations rate excluding DOE and UH is at 46%.
 - Participation among the age bands reflect participants who are 45+ years and represent 93% of Plan assets versus the younger population which encompasses 19% of the Plan.
 - The total assets in the LifeCycle portfolios are over \$92 million which is about 5% of the Plan's assets.
 - It was noted that decisions made and the funds on the watch list affect the Goalmaker and participants in the Goalmaker.
 - The number of RMD payments total 1,060.
 - Improvements seen as there are more rollouts to ERS than to the registered broker dealers.
 - Report on nested funds in the LifeCycle portfolios:
 - Subplan 1 - State: \$1.7 billion with 22,808 participants
 - Subplan 2 - Hawaii County: \$85 million with 1,628 participants
 - Subplan 3 - Kauai County: \$64.8 million with 1,141 participants
 - Subplan 4 - Maui County: \$92 million with 1,783 participants
 - Subplan 5 - County of Hawaii Water District: \$11 million with 141 participants
 - Subplan 6 - Waialae C/S: \$448,000 with 8 participants.

 - Mr. Malmud presented the Communication and Education Highlights/Local Office initiatives:
 - The flyer for the HHSC mailing on the transition to Kaiser which generated lots of calls.
 - The beneficiary mailing generated over 400 calls to update account information.
 - Will be working with DOE as the video with DOE gets finalized; develop an easy enrollment card that will be

made available; and coordination with DOE's plans to do a mass communication to their employees with links and instructions.

- Conducting and replicating mini Fairs at various site locations, especially those sites with the lowest participation.
- Workshops are focusing on basic retirement planning concepts with a focus on retirees and pre-retirees.

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Item # 2:

Ongoing Business

d. Staff Administrative Report to the Board

Ms. Akiyoshi provided summary highlights:

- Activities with TPA, include:
 - (1) HHSC Transition to Kaiser: preparation and review of draft communication for distribution by HHSC to affected employees.
 - (2) N&K CPAs Plan Audit: They are working to complete their report for the Plan Year July 1, 2013 to June 30, 2014;
- Other Plan Administrative Activities:
 - (1) Century Capital Management Net Settlement Fund Distribution: Check received for pro-rata shares distributed for one of its security holdings. As the Century fund has been removed from the Plan's investment line-up, Prudential was instructed to deposit the monies in to the Plan's expense account.
 - (2) Confirmation on the Spring Semi-Annual meeting and the scheduling of the Spring Benefits Fair: The meeting is scheduled for May 13, 2016, and the Benefits Fair will be held at the State Capitol Chamber level on May 11, 2016.
- Consultant Activities: Staff is working with Segal to review the priority list of considerations from the deep dive analysis.
- Investment Fund Manager activities:
 - (1) Amendments to the Prudential GIC contract were completed and has been forwarded to Prudential for review.
 - (2) Meetings held with Victory on the departure of Lisa Rosenthal, and discussions with JP Morgan on the departure of Joel Damon.
 - (3) Other courtesy meetings were held with other investment managers.
- PTS Plan Activities:

- (1) The MOU with County of Kauai was circulated for review and signatures.
- (2) Working to amend the applicable sections of the Hawaii Administrative Rules to reflect the inclusion of county participation in the Plan.

e. PTS Plan

- i. Approval of Report on Funds Not Deposited in the State/County Treasuries for the Period Ending December 31, 2015
- ii. Quarterly Management Report for Period Ending December 31, 2015 and Annual Management Report for Calendar Year Ending December 31, 2015

A motion was made by Trustee Becker and seconded by Trustee Villabrille to accept the Report of Funds Not Deposited in the State/County Treasuries for the period ending December 31, 2015. The motion passed unanimously.

Ms. Akiyoshi noted that the Quarterly Management and the Annual Management Reports are presented for information. The new crediting rate beginning April 1, 2016 is at 2.72%, down from 2.76%.

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Item # 3:

Ongoing Business for PTS Plan

- a. Status on the Memorandum of Understanding Between the State and the County of Kauai
- b. Amendments to the Hawaii Administrative Rules Related to the State of Hawaii PTS Deferred Compensation Plan

Discussion was covered under Agenda Item #2.d.

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Item # 4:

Other Business/Announcements

- a. 2016 Legislation

Ms. Akiyoshi commented that legislation is being monitored, and that there are no bills that would directly impact the Plan. There are bills related to open meetings.

- b. Presentation of Resolution to Outgoing Trustee

Chairperson Moto read and presented a Resolution from the Board, along with a lei, to outgoing Trustee Okumoto who is retiring effective April 1, 2016. Trustee Okumoto gave some remarks, noting he was appreciative of his time during his tenure on the Board.

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Item # 5: Discussion and Review of Draft RFP for an Active Core Fixed Income Investment Option

A motion was made by Trustee Machida and seconded by Trustee Becker to move into Executive Session at 11:31 a.m. to confer with legal counsel on the questions and issues on the anticipated search process and timelines. The motion passed unanimously.

All guests were excused.

EXECUTIVE SESSION

Meeting

Reconvened: **A motion was made by Trustee Villabrille and seconded by Trustee Margol to move out of Executive Session at 11:56 a.m. The motion passed unanimously.**

All guests rejoined the meeting.

No decisions or actions were taken. There being no other business, Chairperson Moto thanked Segal Rogerscasey and Prudential for their reports and announced that a farewell lunch for Trustee Okumoto will follow this meeting.

Chairperson Moto adjourned the meeting at 11:58 a.m.

(NOTE: Signed copy on file.)