STATE OF HAWAII
DEFERRED COMPENSATION PLAN
BOARD OF TRUSTEES

OPEN SESSION MINUTES
MEETING # 419

Date: February 15, 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
Jason Minami, Ex-Officio Member
Laurel Johnston, Ex-Officio Member (arrived at 9:26 a.m.)
Roderick Becker, Employee Member
Kenneth Villabrille, Employee Member (arrived at 9:32 a.m.)
Kalei Rapoza, 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, Carol Blumenthal, and Gabe D'Ulisse, Prudential Retirement – via conference call

Absent: Kanoe Margol, Employee Member

Call to Order: There being a quorum present, Chairperson Brian Moto called the meeting to order at 9:15 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 noted that Trustee Margol is excused from today's meeting and Trustees Johnston and Villabrille are expected to arrive later. He opened with introductions beginning with the new incoming Board member designee, Trustee Minami. Chairperson Moto noted best wishes on the retirements of former Trustee James Nishimoto from DHRD and former Trustee Wesley Machida from B&F. Trustee Minami provided a brief introduction. Chairperson Moto stated that there were no guests from the public in attendance.

Agenda
Item # 1: New Business

a. Approval of Minutes No. 415, 415-ES, 416, 417, and 418

Chairperson Moto stated that the minutes numbers 415, 416, 417, and 418 were distributed, along with copies of 415-ES which were confidentially sent.

A motion was made by Trustee Rapoza and seconded by Trustee Becker to adopt Minutes Nos. 415-ES, 416, 417, 418, as presented, and 415, with noted edits.

Discussion: Trustee Becker commented that his remarks in the discussion notations on page 6 related to Agenda item number 1.c., be edited to clarify his point that with the small number of participants invested in the Fund and the small percentage of assets invested in the Fund, one should look at the cost benefit perspective of whether there is value in replacing the Fund or removing the Fund.

The motion passed unanimously.

Chairperson Moto moved to Agenda Item no. 2 and turned the discussion over to Mr. Ezard.

Agenda
Item # 2: Ongoing Business

a. Performance Evaluation Report for the Fourth Quarter 2017 by Segal Marco Advisors, including but not limited to:

i. Overview of Funds Currently on the Watch List: Victory Institutional Diversified Stock Fund

Mr. Ezard provided some comments on the capital market environment and some highlights of the Plan:

- The performance of equities currently is at where we were at the end of the year; and the performance is positive now.
- The economy was weaker during the Fourth Quarter than had been expected; but employment growth was steady.
- There was a tightening in the labor market; wage growth is trending slightly above inflation.
- For the full year, CPI was at 2.1%.
- The stock market had a very low volatility last year.
- The market value of the Plan's assets as of December 31, 2017, was at $2.36 billion.

- The Stable Value Fund represents 39% of the Plan's assets which is a significant portion.
- The S&P 500 Index Fund represents the next highest portion at 14.5% of the Plan's assets.
- The SSGA Real Return Fund was added as a stand-alone fund and has an allocation within the LifeCycle funds, to replace the J. P. Morgan Diversified Real Return Fund.
- The BlackRock Total Return Fund replaced the PIMCO Total Return Fund during 2017.
- The fees for the LifeCycle funds tend to be higher in cost compared to the peer group. As such, an RFP has been initiated to address some of the fee concerns.
- The Victory Institutional Diversified Stock Fund continues to be on the watch list. The fund had a good performance last year and was at the top 4% of the peer group. However, the 3-year performance continues to show a lag. Action to address the concern on the fund's underperformance has been taken, and a replacement fund will be added.
- Despite the quarterly underperformance in 2017, the performance of the Wellington Research Value Fund is up a bit. There is not a significant underperformance relative to the peer group and the benchmark. The risk level is around median and is in line with the benchmark. Segal will be monitoring the Fund's performance in the coming quarters.
- The index funds are coming in below median, but there are no material concerns. The returns for active strategies are coming in good.
- The Stable Value Fund yield is at 2.84%; the trend will likely continue to go up through this year. As the yield goes up, the trend will likely show the market-to-book value in a downward decline.

Trustee Johnston raised a concern about market declines so asked how the Plan communicates to participants so they do not panic. Mr. Malmud stated that there is ongoing education within the Plan to educate participants on the asset allocation programs within the Plan to diversify their investments which would spread the risk and concerns. These programs are being utilized by participants so they have not experienced a lot of calls.

Trustee Becker remarked that in addition to the information on the investments that is posted on the Plan's website, the Investment Consultant's report would be helpful for participants who are trying to reallocate their investment funds. The information in the report provides a more in-depth data on the investments, and asked whether the report could be made available on the Plan website.

Some comments and considerations raised on posting of the Consultant's report:

- The report is a point-in-time analysis report that is provided to the Board;
- If the Consultant's report is posted, it should be made clear that disclaimers are noted that the report is dated.
- Mr. Malmud commented that with the information that is available, the educational approach of the counseling team is to have participants focus on the diversification and weighting of asset classes for risk and age which are what drives the performance over the performance of any particular fund. This is a different responsibility than those of the Board's responsibilities. He has not seen this level of information made available to participants.
- The Board may want to look further at the benefits and potential risks of making the report available on the website;
- The potential risks could go up when this type of information is made available as participants could state that they relied on the report and it affected their investment results.
- Prudential does provide other reports and information on the investment options that are specifically designed for participants.

Chairperson Moto recommended deferral of further action and discussion to a future meeting. There were no objections.

b. Other Investment Fund Updates

i. Status on Victory's Settlement Offer for the Retroactive Revenue Sharing

DAG Jayaram provided background and an overview on the status of Victory's Settlement Offer:

- In 2008, Victory entered into an agreement with the State to provide the Victory Institutional Diversified Stock Fund to the Plan.
- In 2013, Prudential entered into a TPA agreement with the State and an agreement with Victory that would provide fees (e.g., revenue sharing) to the Plan. In accordance with the TPA agreement, those fees would be passed on to the Plan.
- In 2016, there was discussion raised by Prudential, as a result of an analysis conducted by Segal, that revenue sharing fees were not being collected from Victory. Victory agreed to pay revenue sharing fees going forward but refused to pay any retroactive revenue sharing fees.

- In 2017, Victory offered to settle with half of the retroactive revenue sharing fees, and the Board decided to seek the remainder amount of the fees from Prudential. The Board directed Staff to discuss with Prudential, and Prudential agreed to make up the difference so that the entire amount of the retroactive revenue sharing fees would come back to the Plan. The Settlement Agreement has been drafted accordingly.

- The retroactive revenue sharing fees would cover the period 2013 to 2016 and would come back to Plan participants.

A motion was made by Trustee Rapoza and seconded by Trustee Johnston to move into Executive Session at 10:20 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)(4) and (5). The motion passed unanimously.

EXECUTIVE SESSION

All guests were excused.

Meeting Reconvened: **A motion was made by Trustee Johnston and seconded by Trustee Rapoza to move out of Executive Session at 10:30 a.m. The motion passed unanimously.**

All guests rejoined the meeting. The meeting resumed at 10:30 a.m., and Chairperson Moto proceeded to Agenda item #2.b.i.

b. Other Investment Fund Updates

i. Status on Victory's Settlement Offer for the Retroactive Revenue Sharing

A motion was made by Trustee Becker and seconded by Trustee Rapoza to accept the Settlement Offer from Victory to provide the retroactive revenue sharing amount, and to authorize the Chair to execute the Settlement Agreement between Victory, Prudential, and the State. The motion passed unanimously.

ii. Status on RFP No. DCP-16-2, for an Active U.S. Large Cap Core Equity Investment Option to Replace the Victory Institutional Diversified Stock Fund

Ms. Akiyoshi reported that the contract with the new fund manager has been completed and are preparing plans on the transition between Victory and the new replacement fund manager, Capital Group. We are working with Prudential to arrange the date and transition meeting, along with the preparation of communication materials to announce the fund changes, as well as the necessary termination notice to Victory and the notice to proceed to Capital Group. The target for the transition and fund replacement will be before the end of the Second Quarter 2018.

c. Plan Administrator's Report

i. Plan Highlights

Ms. Klassen provided an overview of Plan's highlights:

- As of December 31, 2017, the Plan's assets totaled $2.36 billion. There was $124 million in the LifeCycle series which represents 5.2% of the assets. The Board is currently conducting a replacement search for this investment option. The GoalMaker represents 7.7% of the assets.
- The Stable Value Fund held 39% of the total Plan's assets; this percentage has dropped from 2 years ago. The rate for the Stable Value Fund for the First Quarter of 2018 is at 2.84%. The Stable Value Fund is co-managed by Prudential/Jennison and INVESCO.
- There are spikes in distribution numbers during the First and Fourth Quarters, primarily due to required distributions and participant behavior.
- The Second and Fourth Quarters show higher enrollment numbers due to the Local Office outreach and other activities such as the Benefits Fairs.
- The J.P. Morgan Diversified Real Return Fund was replaced within the allocations of LifeCycle fund series with the Vanguard Wellington fund, and removed from the core investment menu line-up. The State Street Real Return Fund was added within the core investment menu line-up and made available on December 26, 2017.
- The Plan audit by N&K CPAs is continuing.
- The tax overhaul measures do not so far appear to impact the section 457 plans. Technical corrections are anticipated and

Prudential will be monitoring.

- Information is provided on cyber security. There are some participants who think it is safer if they do not go online; however, this may be counter intuitive. The Plan website has authentication protocols in place, and educational campaign encourages participants to look at and monitor accounts online to identify any suspicious activities.

Mr. Malmud reported on highlights on the Local Office activities:

- The number of attendees at the various events held during 2017 totaled 13,000.
- 2017 accomplishments:
  - There was a 17% increase in enrollment from the prior year; the highest annual total since the transition.
  - There was a 13% increase in the number of election changes.
  - There was an increase in the number of vacation pay deferrals, mainly due to the Maui hospital transition out of the State jurisdiction, and 1-time payout of UPW pay adjustments.
  - There was a 9% increase in the number of rollovers from the prior year.
  - The GoalMaker assets rose to 7.7%.
  - One initiative that Prudential has been working on to increase the participation rate involved partnering with DOE to conduct a DOE EZ enrollment campaign to all 20,000+ employees to increase Plan awareness and retirement security.
  - Participated in UPW's section 8 meetings to coincide with the planned lump sum payouts pursuant to agreements, and to encourage employee members to set aside monies for retirement needs.
  - Conducted mini-fairs within the UH system between the Benefits Fairs.
  - Held other activities such as open house events, along with webinars.
  - Outreach to union partnerships; attended the recent HSTA event.
  - Have exceeded the group and individual meetings contractual goals.

Mr. Malmud stated that a reason for focusing on DOE and UH is due to the low participation rate in these jurisdictions; the counselors are going out to do outreach to all employees on all the islands. And, for example, Plan counselor Tom Kalili who is based on Hawaii Island does make sure to cover all state and county areas on Hawaii Island.

Chairperson Moto asked whether Plan assets could plateau since the amount of distributions appear to be rising. Mr. Malmud responded that due to the age of the Plan, the Plan is top heavy with participants that have/are starting to retire. There is a focus to educate those participants on staying in the Plan to mitigate heavy outflows through current efforts. He noted that the level of growth will vary but does not foresee that Plan assets would plateau over coming years.

ii. Discussion on the Handling of Missed Contributions and Associated Gains and Losses with Retroactive Deferrals

Ms. Klassen summarized that an error was discovered for a Maui County employee during the Plan audit, whereby contribution increases were missed during prior calendar years. The deferral change was sent over by Prudential but the changes were not made on its payroll feed by the payroll office. She reviewed the corrective options available under EPCRS (Employee Plans Compliance Resolution System) which is used for best practices. Maui County is awaiting further direction on handling of the error for the prior calendar years.

Ms. Blumenthal added that Maui County acknowledges the error. Maui County has changed the deferral increase for 2017, as per employee's request to make the deferral change going forward for the remainder of 2017. Maui County has been told of the 3 corrective options and are awaiting a decision on the next steps to be taken. She explained how the auditor discovered the discrepancy by comparing the amount of contributions made by the employee against Prudential's reports.

DAG Jayaram noted that as a preventative control measure, Prudential has added processes to periodically provide guidance and instructions that would remind the county payroll agencies and users on using the Plan sponsor site to validate payroll changes and information.

DAG Jayaram stated that although the corrective options under EPCRS are only required for 401(k) plan compliances, the Board has discretion on deciding on a corrective option. He stated that, covering 50% of the missed contributions, plus earnings was

EPCRS correction for 401(k) plans.

He also relayed that he did look into the statutory language that addresses the Board's powers and responsibilities and noted that the Board is authorized to determine any matters pertaining to the Plan and can give instructions/directions to county agencies, as they are parties to the Plan pursuant to a MOU. He recommended that Prudential work first with the payroll agencies on handling of the error rather than having the Board issue any instructions.

A motion was made by Trustee Rapoza and seconded by Trustee Minami to move into Executive Session at 11:18 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)(4). The motion passed unanimously.

EXECUTIVE SESSION

All guests were excused, except for Mr. Malmud, Ms. Kanai, and Ms. Blumenthal.

Mr. Malmud, Ms. Kanai, and Ms. Blumenthal were excused at 11:25 a.m.

<u>Meeting Reconvened</u>: **A motion was made by Trustee Rapoza and seconded by Trustee Johnston to move out of Executive Session at 12:03 p.m. The motion passed unanimously.**

All guests rejoined the meeting. The meeting resumed at 12:03 p.m.

c. Plan Administrator's Report

ii. Discussion on the Handling of Missed Contributions and Associated Gains and Losses with Retroactive Deferrals

Trustee Minami asked Prudential to clarify whether Prudential is following up once a request is received from a participant on a deferral change to ensure that the counties are processing the payroll change actions once the change is initiated. Ms. Blumenthal reported that there is a manual process on the Plan sponsor site to check off the transactions that are done; however, Prudential conducts training on the sponsor system but does not oversee and check. The County of Maui is manually processing payroll now but are looking to move to an automated system. This move will eliminate/reduce this type of problem.

Additional questions raised:

- Trustee Minami asked whether there is a statute of limitation for looking back at corrections. Ms. Blumenthal stated that there is no statute of limitations for how far back to look at corrections under EPCRS. EPCRS provides that the corrections go back to the point of discovery.
- Trustee Becker asked about how far would Prudential allow going back (e.g., 10 or 20 years) to make corrections if there is no statute of limitations. Ms. Blumenthal remarked that Prudential would then rely on the Employer or Employee to provide documentation, if the time period is beyond 10 or 20 years.

DAG Jayaram stated that he would present questions to Prudential on how the corrective retroactive contribution amounts by the Employer would be made and sent to the Plan, and come back at the next meeting.

iii. Discussion on the Rights of a Deceased Beneficiary

Ms. Klassen explained that the current policies within the Plan Document states than upon death, the designated beneficiary has the same rights as the Plan participant. Prudential has a practice which allows a beneficiary of a deceased participant to name a beneficiary that seems to be consistent with the language in the Plan Document. However, this was not permitted by the prior TPA. The change to allow this practice has in place with Prudential since 2013. Mr. Malmud noted that the concern with no other named beneficiary after the designated beneficiary has passed away is that the account balance would then go to the beneficiary's estate, with the potential problems of probate. Another point raised was how far the Plan allow for beneficiaries to name future beneficiaries. Ms. Blumenthal added that the potential for the benefits to be carried out for many years may be limited and restrictive because of time-sensitive requirements related to taking minimum distributions and non-spousal distributions.

A motion was made by Trustee Rapoza and seconded by Trustee Johnston to permit Prudential to continue its current practice to allow beneficiaries to name beneficiaries. The

motion passed unanimously.

Trustee Johnston was excused at 12:23 p.m.

d. Staff Administrative Report

Ms. Akiyoshi presented the Staff Administrative Report on the monthly activities related to projects with the Third-Party Administrator, the Investment Consultant, the Investment Fund managers, and to the PTS Plan. She did not have anything to add to the written report but pointed out that she is monitoring the County of Maui situation related to exiting the Plan and exploring other deferred compensation plans. She summarized that subsequent to the County of Maui Council Committee meeting, the Board submitted written testimony, and the Maui County Council met in October 2017 and passed a resolution to urge the mayor to explore alternate deferred compensation plans. She noted that she is not aware of any further developments.

Agenda Item # 3: PTS Plan Ongoing Business

a. Approval of Report on Funds Not Deposited in the State/County Treasuries for the Periods Ending September 30, 2017 and December 31, 2017

b. Quarterly Management Reports for the Periods September 30, 2017 and December 31, 2017

Ms. Akiyoshi presented the Reports on Funds for the periods ending September 30, 2017 and December 31, 2017, for the Board's approval. She reported that commencing with the September 30, 2017 reports, the financial data has been included for the County of Kauai contributions into the Plan. County of Kauai rolled out the Plan to its employees on September 1, 2017 and the first contributions into the Plan were for the September 30, 2017 payroll. There were no questions on the Quarterly Management reports.

A motion was made by Trustee Villabrille and seconded by Trustee Rapoza to accept the Report on Funds Not Deposited in the State/County Treasuries for the periods ending September 30, 2017 and December 31, 2017. The motion passed unanimously.

c. LSW's Annual Letter on the Reimbursable Amount Available in the PTS Plan Expense Account for 2018

Ms. Akiyoshi reviewed LSW's letter on the amount set aside for reimbursable Plan expenses based on the percentage of the amount collected in premiums for 2017, which is in accordance with the contract agreement. The balance in the PTS Plan expense account is $54,166.82, as of December 31, 2017. Expenses that were authorized from the account in 2017 were related to the costs for the public hearing notices on the amendments made to the Administrative Rules to include references on participating counties.

d. Notification on New Interest Rate Effective July 1, 2017

Ms. Akiyoshi announced that the new crediting rate for the PTS Plan that is effective January 1, 2018 is at 2.60%.

Agenda Item # 4: Other Business/Announcements

a. Discussion and Consideration on Renewing the Agreement for Third Party Administration Services with Prudential Upon the Expiration Date of June 30, 2018 for An Additional Three-Year Period

Ms. Klassen and Mr. D'Ulisse expressed their appreciation for the opportunity to extend the partnership with the State for another 3-year period, and to offer a reduction in the TPA fees. Mr. D'Ulisse stated that Prudential is proud of all of the accomplishments and they remain focused to continue to achieve better outcomes for participants' retirement desires. He added that he has had a personal relationship with the State and this Plan since 1988. He also commented that Prudential provides dedicated services for this particular zone; the pricing is not the highest and is not the lowest. Demographics and location are factors with unique service needs compared to other plans.

A motion was made by Trustee Rapoza and seconded by Trustee Villabrille to move into Executive Session at 12:41 p.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)(4) and (8). The motion passed unanimously.

EXECUTIVE SESSION

All guests were excused.

Meeting Reconvened: **A motion was made by Trustee Rapoza and seconded by Trustee Villabrille**

to move out of Executive Session at 1:21 p.m. The motion passed unanimously.

All guests rejoined the meeting. The meeting resumed at 1:21 p.m.

A motion was made by Trustee Rapoza and seconded by Trustee Minami to renew the contract agreement with Prudential for the period July 1, 2018 to June 30, 2021, in line with the new fee rate and terms expressed in Prudential's February 15, 2018 letter; and the Board also requests that Prudential prepare a report to the Board capturing the goals and performance metrics during the initial 5-year contract period.

Discussion: The Board noted that the report should capture quarterly updates and compile to show progress. In addition, the Board asks that Prudential provide an explanation of how the 11 basis points fee expense was derived. The Board noted that this discussion in the future should be held prior to the 180 day notice of non-renewal as provided for in the contract agreement, for example, the Board should begin discussions in 2020, before the contract renewal expires on June 30, 2021.

The motion passed unanimously.

b. Upcoming Schedule Board Meetings

Ms. Akiyoshi stated that the meetings that are scheduled and confirmed are on March 5, 2018, March 20, 2018, and May 24, 2018. Dates will be sent out to hold a meeting during the month of April.

c. Review of Bills for 2018 Legislative Session

i. Board Appointments Subject to Confirmation

Ms. Akiyoshi stated that the terms for Board members Moto and Villabrille expired on June 30, 2017, and the Senate Labor committees held meetings on their appointments at the end of 2017. Their appointments are subject to the full Senate floor vote expected during this current Legislative session.

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

Chairperson Moto adjourned the meeting at 1:32 p.m. The motion passed unanimously.

(NOTE: Signed copy on file.)