

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

**OPEN SESSION MINUTES
MEETING # 376**

Date: August 13, 2013

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

Present: Wayne Chu, Chairperson
Kalbert Young, Ex-Officio Member
Barbara Krieg, Ex-Officio Member
Michael Okumoto, Employee Member
Brian Moto, Employee Member
Kenneth Villabrille, Employee Member

Others: Rodney J. Tam, Deputy Attorney General
Cynthia Akiyoshi, DHRD Staff
Troy Saharic and David Williams, Mercer Investment Consulting –
via conference call
Christine McHugh, Prudential Retirement - Scranton Office – via
conference call
Kevin Malmud, Jeanne Kanai, and Grace Baracao, Prudential/Honolulu Office
Greg Hodges, Julie Klassen, Deborah Baran, Prudential Retirement

Absent: Neal Miyahira, Employee Member

Call to Order: There being a quorum present, Chairperson Wayne Chu 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.

Agenda

Item #1: Welcome New Incoming Board Members

Chairperson Chu welcomed Trustees and guests, and opened the meeting with the introduction of two (2) new Trustees that have been appointed to the Board. Trustees

Brian Moto and Kenneth Villabrille are attending their first Board meeting as new Trustees. Chairperson Chu also congratulated Trustee Okumoto on his full appointment to the Board from an interim appointment. Trustees Moto, Villabrille, and Okumoto provided remarks. Introductions of Trustees, staff, and guests were made, including attendees participating via the conference phone line.

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Item # 2: Performance Evaluation Report by Mercer for 2nd Quarter 2013, Period Ending June 30, 2013

Mr. Williams provided highlights for the 2nd Quarter 2013, covering the market environment and overview of the Funds' performance:

- U.S. GDP expectations for 2013 are mixed with 2% growth; expect growth to pick up in the second half of the year with the lessening of the fiscal drag impacts;
- Unemployment remains unchanged at 7.6%;
- Personal income was up 3%, unlikely will enter into a recession during second half of the year;
- Outlook for Japan's economy has improved with new administration;
- Signs that the emerging markets are continuing to weaken slightly; Europe continues to struggle through their debt issues;
- Domestic equities continue to do well; strong year-to-date performances;
- Muted performance outside of the U.S.;
- No significant issues with the Plan's investment options array;
- Regarding BlackRock's indexing strategies, no substantial changes to Mercer's view;
- Winslow has been adding to its analyst team; Mercer did downgrade the strategy from A to B+, due to the departure of Bart Wear;
- Mercer recommends replacing the Century SMID Growth mandate which has been on watch since second quarter of 2010. Century has reported on its strategy at a prior meeting. The strategy has struggled for the last three (3) quarters. The trend has been moving toward the negative side. It will be difficult for the performance to get back in line with the performance standards.
 - Summarized some implementation options:
 - Option 1: conduct a search for another small/mid cap growth manager to replace Century within the current investment structure;
 - Option 2: consider creating a fund-to-fund structure. One alternative is to find 2 managers to fit into the growth space and allocate between the 2 underlying growth managers. The other option is to have a combined structure that includes the small cap value manager and a new growth

manager. It would move participants to more of an asset class approach and make it easier for the Board to make changes to a fund manager.

Mr. Saharic added some historical context to this topic which has been discussed in the past. The Board in the past did not consider this route because: (1) participant feedback indicated that they liked the individual investment options and tracking the individual managers; and (2) the Board would need to manage the underlying funds. The Board did want to be kept apprised by Mercer on the trends being observed with other plans in the industry. Mercer recommends moving ahead with the search and to keep the options in the RFP open on whether to add one or more managers.

DAG Tam summarized that the Board would need to decide whether to terminate Century Capital Management, and what structure does the Board want in the RFP. The added considerations for discussion are the cost factors (e.g., Mercer's start-up fees to analyze this structure, Mercer's fees going forward, and fees from the TPA), and with respect to the new TPA, there is a need to identify any effect or issues with the TPA if there's a change to a fund-of-fund investment structure (e.g., impact to Goalmaker so Goalmaker works properly).

Mr. Hodges provided comments on the Goalmaker tool. He noted that when there's a change to a fund, Prudential needs to make sure that the fund fits into the small/mid cap category based on Morningstar's asset classes. If the fund falls away from the asset classes, then Prudential has the Advisor Goalmaker which Prudential then needs to engage the services of Mercer to construct/authorize the use of asset classes outside of the standard. In his observations, when plans have used a non-traditional fund, there is an increase in call volume and an increase in the level of complexity. If a new fund-of-fund is added, upfront costs may be between \$3,000 to \$5,000 to establish the fund, and ongoing costs may be around \$5,000 per year, or may be up to \$7,000 to \$8,000 per year.

The Board discussed some observations with the Prudential team and Mercer on participant investing behavior and diversification strategies seen in the Plan and among other plans.

A motion was made by Trustee Young and seconded by Trustee Krieg to terminate the Century Small/Mid Cap

Growth Fund, as recommended by Mercer. The motion passed unanimously.

A motion was made by Trustee Krieg and seconded by Trustee Young to authorize staff to the start the RFP process to conduct a search for a small/mid cap growth strategy and leave the option open to select a single manager or more than one manager. The motion passed unanimously.

- Mr. Williams continued with the overview on the funds; the majority of the funds performed well.
- Index funds performed in line relative to the index.
- PIMCO and MainStay funds saw performance down a little; other funds' performance has been favorable.
- Harbor Funds performance has rebounded.
- Victory performance has rebounded in the short-term.
- Announcement by MainStay on a new share class that does not have revenue sharing; so the net cost of the new share class would be higher than the current I-share class.

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Item # 3: Plan Administrator's Report

- a. Transition Updates
- b. Other Plan Issues

Ms. Klassen opened with remarks and highlights of the activities during the transition period:

- Prudential has been working on executing several agreements including the TPA agreement, trust agreement, and the Investment Advisory agreement with Morningstar.
- Prudential has had discussions with Morningstar and they are interested in having a physical presence in the Plan's Benefits Fairs.
- A Plan at a Glance agreement has been signed to confirm the provisions of the Plan.
- Over 27,000 participant records were transferred over to Prudential. Ms. McHugh will continue to complete the remaining transitional items.
- Coordination was done with the different payroll agencies, as well as a meeting with the department's personnel officers.
- Participant servicing level, Prudential has retained seven (7) representatives at the Local office.
- She explained the roles of the Prudential team:

- She will be providing the reports to the Board on Plan-level initiatives.
- Andrea Prokop who will be providing the operational support to the Plan and is based in Scranton. She will be working with Ms. Kanai.
- Deb Baran and Bluford Birdsong will be leading the retirement security education efforts. Ms. Baran will be focused on ongoing strategies and Mr. Birdsong will be focused on the people aspect and working with the local office team.

Ms. Baran summarized the communication mediums that will be used for the Plan, and an overview on the transition meetings that were held. Ms. Baran stated that she will be preparing a communication strategy plan for 2014.

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Item # 4: Potential Rebate for the Lifecycle Portfolios

Ms. McHugh reported on the transfer of the assets of the LifCycle Portfolios and Prudential is reconciling the participant records versus assets received. Some differences that were explained by State Street were due to administrative fees. Prudential is still waiting for some responses back from State Street on detailed accounting on the fees so that the monies can be allocated back to the Plan.

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Item # 5: Staff's Administrative Report to the Board

Ms. Akiyoshi highlighted some activities:

- Have been working with Prudential on the transition activities,
- Have been working with ING on the reporting of the revenue sharing;
- Worked with ING on the second quarter Plan newsletter and was posted on the website, which includes a schedule of ING's key dates. Ms. Baran will check with ING to get approval to post the past archived Plan newsletters on to the Prudential website;
- Reported that ING has completed the second quarter and final Plan asset report;
- ING has completed the Plan budget report for the quarter. DAG Tam reviewed the report that included the accumulated contractual budget amounts, expenses incurred, and amounts remaining for Plan expenses. ING still needs to report on the amounts through the end of the contract period.
- ING will also be preparing a Plan Service Year report for the last Plan Year from July 1, 2012 through July 28, 2013. Completion and distribution of the report is planned for the October 2013 meeting.

Ms. Akiyoshi reported that the review and amendments to the Investment Policy statement is on hold for now.

Ms. Akiyoshi reported ongoing review and processing of the PTS Plan monthly distributions.

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Item # 6: PTS Plan

- a. New Crediting Rate Effective July 1, 2013

Ms. Akiyoshi reported that the new crediting rate is at 2.98% effective July 1, 2013

- b. Approval of Report of Funds Not Deposited in the State/County Treasuries for the Period June 30, 2013

Ms. Akiyoshi presented the PTS Plan Asset Report for the Board's review and approval. The Second Quarter Management Report is also provided for review and information.

A motion was made by Trustee Okumoto and seconded by Trustee Krieg to approve the Report on Funds for the PTS Plan for the period ending June 30, 2013. The motion passed unanimously.

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Item # 7: Other Business/Announcements

Chairperson Chu expressed appreciation to Prudential for their efforts during the transition.

- a. 2013 Semi-Annual Board Meeting and Benefits Fairs in October

Ms. Akiyoshi reported that the Board meeting and Fair will be on Kauai in October 2013. Ms. Akiyoshi stated that because it was decided to delay the spring Fair on Oahu and reschedule the Oahu Fair for October, a site has been secured for an Oahu Fair which will be at the State Capitol. The Board did not have objections on dates and locations.

- b. 2013 NAGDCA Conference

Ms. Akiyoshi reported that Trustees Young and Moto have registered for this year's conference, along with staff.

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Chairperson Chu adjourned the meeting at 11:06 a.m.

(Note: Signed copy on file.)