

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

**OPEN SESSION MINUTES
MEETING # 364**

Date: July 31, 2012

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

Present: Wayne Chu, Chairperson
Barbara Krieg, Ex-Officio Member
Scott Kami, Employee Member
Kalbert Young, Ex-Officio Member
Neal Miyahira, Employee Member
Wesley Machida, Employee Member
Michael Okumoto, Employee Member

Others: Rodney J. Tam, Deputy Attorney General
Cynthia Akiyoshi, DHRD Staff
Troy Saharic, David Williams, and Andrew Ness –
Mercer Investment Consulting – Via Conference Call
Todd Egger, INVESCO – Via Conference Call
Brian Merrick, ING/Boston Office – Via Conference Call
Melody Takacs, Grace Baracao, and Jeanne Kanai, Plan Administrator Staff
(ING)/Honolulu Office
Harry Mattson, ING
Lisa Hoxha, Great West Retirement Services
Jonathan Spiker, Department of the Attorney General

Call to Order: There being a quorum present, Chairperson Wayne Chu called the meeting to order at 9:00 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 and Introduction of New Trustee to the Board

Chairperson Chu welcomed everyone and provided brief remarks on the emergency procedures established by DHRD. Chairperson Chu opened the meeting with introductions of Board members present and attendees on the conference phone line from ING, INVESCO, and Mercer. Chairperson Chu also introduced newly appointed Trustee Michael Okumoto from the County of Hawaii Finance Department. Trustee Okumoto, who previously served on the Board from July 2010 through June 2011, has been appointed in an interim capacity effective July 2, 2012.

Agenda

Item # 2: Approval of Minutes Nos. 355, 361 and 362

Chairperson Chu reported that this item will be deferred to the next meeting.

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Item # 3: Wrap Provider Contract Requirements

- a. Report by INVESCO on Guideline Requirements for Wrap Contract Providers
- b. Report by Mercer on Capital Preservation Asset Classes

Chairperson Chu reported that this agenda item is a follow-up item from a prior meeting in which the Board had questions on the waiver request submitted by INVESCO. INVESCO will be presenting information in response to the Board's questions.

Mr. Egger summarized that two (2) of the three wrap contract providers that INVESCO uses for the Plan's stable value fund portfolio had been downgraded. They asked to amend the guidelines to allow INVESCO to optimize the wrap contract providers for the Stable Value Fund.

Mr. Egger explained the role of the wrap contract providers which is primarily to:

- 1) Provide the book value accounting feature;
- 2) Keep the crediting rate from going below zero and preserve the principal of the fund; and
- 3) Provide that the financial security to cover a shortfall, if needed.

INVESCO has identified the following solutions:

- 1) Enhance the monthly reporting by INVESCO, which is already being

done, to prominently display the wrap provider ratings on its reports;

- 2) Amend the guidelines to broaden universe of potential wrap provider contracts which would allow INVESCO to keep the fund as is, and allow INVESCO to diversify as needed in the future.

Mr. Egger explained the challenges to comply with the current guidelines, and as INVESCO does its due diligence, he provided a high-level summary on the probabilities of default by companies providing book value accounting as defined by the credit rating downgrades. Mr. Egger concluded with the following recommendations for the Board to consider: (1) to amend the guidelines that would limit purchases of new wrap contracts to providers on INVESCO's approved list and have claims paying ability of at least A- by Moody's, S&P, or Fitch; and (2) to enhance the monthly reporting requirements of INVESCO.

Mr. Saharic provided Mercer's report on Stable Value Fund Analysis and Capital Preservation Asset Classes. Mr. Saharic provided some history on the Stable Value Fund and the risks being with a single provider, discussions on splitting the portfolio allocations, and the addition of INVESCO. INVESCO's portfolio is set up as a fund of funds structure which allows the diversification of the wrap providers and the underlying managers.

Other points reported by Mr. Saharic:

- There are currently four (4) wrap contract providers. Prudential retains one wrap contract provider and INVESCO retains three (3) wrap contract providers.
- The Market-to-Book ratio is very healthy at 108 percent as of March 31, 2012 as compared to other plan sponsors. The wraps amortize the gains and losses within portfolio and allow the participants to exit at book value.
- The crediting rate has come down to 3.61%.

Mr. Saharic also explained the structure of the portfolio and the components, and other alternative options if there's a decision to unwind the Stable Value Fund. He reported on the current stable value market environment, the outstanding implications of the Dodd-Frank Act, managing wrap capacities, continuing wrap fee increases, and the 2008 financial crisis impact.

Mr. Saharic presented some capital preservation investment options and the pros and cons of the options, for consideration if the Board has continued concerns. Mercer's recommendation is to continue discussion with the two (2) wrap contract providers that the Plan has now, and to have the managers report when they are out of compliance with the investment guidelines.

DAG Tam summarized and confirmed with INVESCO on the amendments needed to revise the contract.

Agenda

Item # 4: Review of Annual Reallocations of Lifecycle Portfolios by Mercer

Mr. Williams provided an annual review of the Lifecycle Portfolios. He explained that the objectives of doing an annual review are to reduce the risks of the portfolios as they move closer to the targeted maturity dates and to incorporate the two (2) new asset classes. The new asset classes will provide the diversification that is being sought. In general, based on current assumptions, the longer dated funds will see lower levels of risk and a higher level of return. The constraints used in the modeling show existing constraints for international equities at no more than 50% of total equity so it looks like a 50/50 split between U.S. and non-U.S. equities which was carried over; the other is that small cap/mid cap at no more than 30% and no less than 20% of total domestic equity. Mr. Williams stated that they have come up with additional constraints for the new asset classes that were added, and explained the proposed constraints and changes in the allocations.

A motion was made by Trustee Young and seconded by Trustee Machida to accept the recommendations made by Mercer and implement the new proposed allocations for 2012, as soon as administratively feasible. The motion passed unanimously.

Agenda

Item # 5: Plan Administration Reports

a. Reporting of Plan Budget accounts

Mr. Merrick reported on the Plan Budget Summary for Plan Year ending June 30, 2012. Based on the current pattern of expenditures, the Board can expect that there will be available funds at the end of the current Contract, and the Board will need to decide what to do with the available funds.

b. Follow-up on Cost Estimates for a Plan Audit

ING has had discussions with three (3) potential CPA firms to perform an audit of the Plan. Two of the companies have decided not to bid. ING received a proposal from N&K CPAs for \$44,000 per year for next two years. N&K is based in Honolulu and has previously done financial audits for the Plan. He asked the Board to authorize ING to proceed with the audit and pay the audit expenses from the accrued audit budget.

Trustee Machida asked to be recused from the voting. DAG Tam stated that since the audit budget has a remaining balance of approximately \$228,000, there is a sufficient balance to cover the projected \$88,000 to conduct audits for the specified two (2) Plan years.

A motion was made by Trustee Kami and seconded by Trustee Miyahira to accept the recommendations made by ING and have N&K provide the audit services for two (2) years: for Plan Year ending June 30, 2012, and for Plan Year ending June 30, 2013. The motion passed with one abstention by Trustee Machida.

Mr. Merrick stated that ING will contract directly with N&K to get the audit started.

c. Results of the Customer Satisfaction Survey

Mr. Merrick summarized the results of the survey that was done in April 2012. ING engaged SMS Research based in Honolulu. The objective was to quantify customer satisfaction and identify areas of unfilled needs and areas of improvement. ING did a call out survey and contacted 813 Plan participants. Overall satisfaction was good and showed a high level of satisfaction. The three key components that were looked at were customer service, the Plan's website, and the local office service. ING is looking at next steps for each of the three channels for what drives participant satisfaction, including assessing training needs for associates/call center representatives and tools that are available to associates/call center representatives.

Chairperson Chu expressed appreciation to ING for the great feedback through the survey.

d. Ratification of Chairperson's Decision on Nomination Submittal for Leadership Recognition Awards to NAGDCA

Chairperson Chu reported that at the last Benefits Fair there was a Communication campaign on diversification education that required participants to take a diversification lei card to each of the investment providers' tables to stamp and he thought that the campaign helped participants approach the investment providers' tables and engage in conversations with them. So, he approved the submittal of the nomination write-up on this campaign to NAGDCA. He asked for the Board's ratification of this decision.

A motion was made by Trustee Krieg and seconded by Trustee Kami

to ratify the Chairperson's decision to send a nomination in to NAGDCA for its Leadership Recognition Awards. The motion passed unanimously.

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Item # 6: Updates for the October 2012 Benefits Fair

Ms. Akiyoshi provided the compiled results of the surveys taken at the May 2012 Benefits Fair and the overall responses were positive and that the participants like the location and venue of the Fair. Out of the 600 attendees at the Fair, approximately 13% of the attendees who completed the surveys indicated that they were not participants. It was noted that the Fair has been and continues to be an excellent method in providing outreach to employees not participating in the Plan.

For the October Fair, the proposed date is October 16, 2012 at the Maui Arts and Cultural Center next to the Maui Community College. Changes to the Fair hours are also being proposed to expand the time to 5:00 p.m. to accommodate the employees at the DOE schools and other employees coming after work hours. The proposed date for the Semi-Annual Board meeting is on the following day, Wednesday, October 17, 2012, and the proposed location is at The King Kamehameha Golf Clubhouse in the Wailuku area. The Board did not have any objections to the proposed dates and locations.

Chairperson Chu asked that Agenda Item no. 8 be taken out of sequence and follow with item no. 7, which will be done in Executive Session. There were no objections.

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Item # 8: Other Business/Announcements

a. 2012 NAGDCA Conference

Chairperson Chu stated that the NAGDCA conference is coming up, from September 29 through October 3, 2012, and will be held in San Diego, CA. Two trustees have responded that they plan to attend. He noted the benefits of learning from other plans and the information that is presented during the conference. He asked that trustees interested in attending respond back to Ms. Akiyoshi.

Chairperson Chu noted that the Board has sent the staff to attend the conference to learn and network with other plan sponsors. Chairperson Chu asked the Board to consider allowing the Board's staff to attend this year's conference.

A motion was made by Trustee Chu and seconded by Trustee Young to authorize the Board's Staff to attend the 2012 NAGDCA conference. The motion passed unanimously.

b. Upcoming Scheduled Board Meeting(s)

Ms. Akiyoshi stated that the next scheduled Board meeting will be held on October 29, 2012, and the following meeting will be the Semi-Annual Board meeting on October 17, 2012.

Chairperson Chu asked for a motion to add an additional item under "Other Business" to discuss amendments to the RFP for Third Party Administration Services which will be held in Executive Session.

A motion was made by Trustee Machida and seconded by Trustee Kami to add an item 8.c. to the agenda on the RFP for Third Party Administration Services. The motion passed unanimously.

A motion was made by Trustee Machida and seconded by Trustee Young to move into Executive Session at 10:53 a.m. to confer with legal counsel on procurement and contract matters. The motion passed unanimously.

ING and guests were excused from the meeting. Mercer consultants were available via conference call.

EXECUTIVE SESSION

Agenda

Item # 7: Status Report on Contract Award for RFP No. DCP-11-3, Request For an International Large Cap Value Equity Investment Option

Meeting

Reconvened: **A motion was made by Trustee Miyahira and seconded by Trustee Krieg to move out of Executive Session at 11:42 a.m. The motion passed unanimously.**

A motion was made by Trustee Miyahira and seconded by Trustee Krieg to authorize staff to proceed with amending the INVESCO guidelines, as proposed by INVESCO and to add additional provisions on reporting requirements. The motion passed unanimously.

Chairperson Chu adjourned the meeting at 11:44 a.m.

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(Note: Signed copy on file.)