

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

**OPEN SESSION MINUTES
MEETING # 374**

Date: May 15, 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
Neal Miyahira, Employee Member
Wesley Machida, Employee Member
Michael Okumoto, Employee Member

Others: Rodney J. Tam, Deputy Attorney General
Cynthia Akiyoshi, DHRD Staff
David Williams, Mercer Investment Consulting - via conference call
Brian Merrick and Carol Cann, ING/Plan Administration Office-Boston Office – via
conference call
Melody Takacs, Jeanne Kanai, and Grace Baracao, ING/Honolulu Office
Greg Hodges, Julie Klassen, and Christine McHugh, Prudential Retirement
Brian Isobe and Patrice Inouye-Sumikawa, N&K CPAs, Inc.

Absent: Scott Kami, Employee Member

Call to Order: There being a quorum present, Chairperson Wayne Chu called the meeting to order
at 9:06 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 Chu welcomed Trustees and guests, and asked for introductions of ING
staff and guests present, and for introduction of attendees participating via the
conference phone line.

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Item # 1: Approval of Minutes Nos. 365, 366, 367, 368, and 371

Chairperson Chu stated that minutes are not available yet for review so this item will be deferred.

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Item # 2: Plan Administrator's Report

a. Plan Report for 1st Quarter 2013

Ms. Kanai provided an Executive Summary report for the First Quarter 2013:

- The diversification campaign called "Make Your Own Lei" received a 2013 Eddy Award at the P&I Defined Contribution Conference Awards ceremony in March 2013. The award recognized the special projects communication campaign to educate participants on diversification.
- AXWAY upgrade was completed by State ICSD and with ING on March 16, 2013 to improve security and service. No issues resulted.
- The reallocation of the 2013 Lifecycle Portfolio that was recommended by Mercer on March 25, 2013 was completed and went live on 5/15/2013 to rebalance participants' lifecycle portfolio accounts.
- Plan assets grew to \$1.7 billion as of March 31, 2013 from \$1.6 billion on March 31, 2012.
- Total rollovers into the Plan totaled over \$7 million. There were 155 vacation rollovers that totaled over \$2 million. For many of the State and County employees retire at the end of year, so the post separation payout is paid in the first part of following calendar year and this represents the amount paid during the First Quarter of 2013.
- There were 17 UEWs that were approved for the First Quarter 2013, totaling \$143,141.79. The number of UEW requests has decreased from the previous year as the furlough situations reduced.
- There were 27 new set-ups in the Self Directed Brokerage Account by TD Ameritrade.

Ms. Takacs reported on the Local Office activities:

- Conducted 178 group meetings with an attendance of 777 State and County employees.
- Supported 110 walk-ins and 1,075 calls into the office.
- Enrolled 166 State and neighbor island County employees into the Plan.
- Conducted 1,008 one-on-one consultations with State and neighbor island County employees.
- Working on a bad address file resulting from returned mail. Conducted searches for new addresses and sending out mailings to confirm and update accounts.

b. Report on Plan Audit

Mr. Isobe from N&K CPAs presented the audit financial statements report prepared on the Plan for the fiscal year ending June 30, 2012. Mr. Isobe stated that the audit was conducted in accordance with auditing standards generally accepted in the United States and with Government Auditing Standards. The accounting and reporting of the Plan is done under Government Accounting Standards. Along with the financial statements, there is the Management Discussion and Analysis which is done to review for consistency. An Overview of the Plan highlights is also included along with other required disclosures.

Mr. Isobe presented an additional separate report under Government Auditing Standards that is required which is on internal control over financial reporting and on compliance and other matters. There are two (2) compliance findings that have been noted in the past. There are some inconsistencies between the Plan Document and the law, as with the Administrative Rules and the law which should be updated accordingly.

Mr. Isobe acknowledged the cooperation and professional assistance from ING during the course of the audit to prepare and complete the reports.

c. Quarterly Budget Report

Mr. Merrick reported on the budget report through March 31, 2013 and on the line items in the report. There was a total of \$3.86 million expended on budgeted expense categories, leaving a remaining balance of about \$230,000 for the remainder of the contract period.

Mr. Merrick stated that since the contract with ING will be terminating,

the assumption that ING will pay the net of balance back to the Plan upon direction.

Mr. Merrick relayed that if there is the expectation that the contract continues beyond June 30, 2013, then ING would expect that the accruals and fees will continue until the end of that period. He would be prepared to reflect the changes in the next memo.

d. Other Plan Issues

i. Report on Erroneous Performance Data in the Monthly Fund Performance Reports Posted on the Plan Website:

Mr. Merrick reported that as a result of a participant complaint about the fund performance information that was posted on the Plan website, ING reviewed the data and discovered that there was erroneous data posted. The cause was due to a data entry error and resulted from how the data was being received and how the data was presented on the website. Quality control processes have been reviewed and revised.

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Item # 3:

Performance Evaluation Report by Mercer for 1st Quarter 2013, Period Ending March 31, 2013

Mr. Williams presented an overview on the economy and market environment, as provided in the Performance Evaluation Report, as well as on the performance of the investment funds.

Mr. Williams reported that since the Board has adopted the major recommendations by Mercer on the investment fund structure, so at this time, there is no major investment category that is missing in the Plan's structure. The Board may want to discuss the future of the investment structure at an upcoming meeting and some other considerations for the structure.

Mr. Williams noted some noteworthy organizational highlights:

- The Vanguard Wellington fund has gone into a soft close; participants in the Plan will continue to have access but Vanguard will not accept new accounts. There will not be changes to the investment process.
- Victory has announced a partnership with Crestview Partners to buy out the bank's ownership of Victory Capital Management. This is a good move for Victory.
- Winslow has announced the retirement of Bart Wear. Mercer feels

comfortable that Justin Kelly will continue to manage the strategy in a similar fashion as in the past.

- Asset strategies saw an increase in activity in the active management sectors over the quarter. General equity performance was a driver.

Mr. Williams reported that the Victory Institutional Diversified Stock fund is in violation of its performance standards and is recommending adding the fund to the watch list. There are no significant changes and it is in line with the benchmark. Both Harbor and Century are currently on the watch list. The Board may want to consider conducting searches to see other potential candidates.

A motion was made by Trustee Young and seconded by Trustee Krieg to place the Victory Institutional Diversified Stock fund on the watch list as recommended by Mercer. The motion passed unanimously.

Mr. Williams reported on Lifecycle Portfolios:

- The Income Fund has performed well relative to the benchmark, mainly driven by the allocation to the Stable Value fund.
- The 2015 Fund is doing well due to the PIMCO fund performing well.
- 2025 to 2055 Funds have a heavier allocation to equities.
- Allocations to the underlying funds such as AllianceBernstein up to the time the fund was replaced has dragged performance. In addition, the MainStay, Century and Harbor funds have also dragged performance.

Highlights of performance analysis on Century and Harbor funds:

- Century provided slightly less risk but also had a lower return; and is behind the benchmark from a performance standpoint.
- Has had improved performance trend two quarters ago, but has trailed off.
- Century has underperformed the benchmark 5 of the last 7 quarters.
- The Harbor fund performance is behind the benchmark in 3- and 5- year periods but is ahead of the universe; it is still meeting the performance expectations.
- Harbor has been consistently behind the benchmark on a rolling 3- year basis for last 3 years.
- Both funds have struggled relative to performance standards.

The Board discussed the concerns on the performance of the funds, and the considerations and options on conducting a search.

In response to Trustee Young's question on the reason why there is no recommendation for placing MainStay fund on the watch list, Mr. Williams

explained that it is not in technical violation of the Investment Policy statement because it is still in the upper half of the universe on a 3- and 5- year basis.

Mr. Williams noted that from a policy standpoint there are 3 things to look at:

- (1) Performance versus index on a 3- year basis;
- (2) Performance versus index on a 5- year basis;
- (3) Ranking within the upper half of the universe on a 3-year basis.

Mr. Williams stated that that Mercer can also provide an "A" rated list of fund managers to see if there are other strategies with a better performance to determine if a full search is warranted, but this would not satisfy the search requirements.

Mr. Williams stated that to look for other candidates out in the market, the Board may want to start the Request For Proposal (RFP) search process, or Mercer can provide an "A" rated list of investment managers out in the market that show a better performance. He added that the Board may want to get started since the RFP process takes at least six months before the transfer takes place. The list however does not guarantee that those companies would submit a bid.

Mr. Williams added that since Century and Harbor talked with the Board at last October 2012 Board meeting, nothing has changed. Performance has not gone their way in this market environment. Even if they came to talk with the Board again, it is unlikely that there will be anything new to add. Century's performance track record has been difficult. Harbor's performance has been mediocre.

The Board discussed that it would be significantly harder for Century to turn the fund around given it has been lagging the benchmark for a longer period, in comparison to the Harbor fund whose performance has been fluctuating and remaining closer to the benchmark

The Board asked Mercer for a list of the "A" rated managers for the small cap growth and value categories.

Mr. Williams reviewed some highlights on the other investment options. He noted that for the Stable Value fund which had good performance, the market-to-book ratio did come down from 109% to 108%. The Plan assets totaled \$1.7 billion and the averaged weighted expense ratio is at 32 basis points.

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Item # 4:

Update on Contract Award for RFP No. DCP-12-1

DAG Tam reported that on April 30, 2013, the Board signed an Agreement with

Prudential Retirement to be the new TPA for the Plan.

DAG Tam highlighted some Plan changes:

- Overall TPA fees to participants will drop from 19.3 basis points to 12.5 basis points.
- For the Managed Accounts fees, the fees will drop from 60 basis points to 35 basis points. Participants will see significant savings.
- The initial transition date was targeted to be July 1, 2013, but the date is being pushed to July 29, 2013 to afford more time for the transition.
- ING has agreed to be the TPA until July 29, 2013, and extend the local office services. Extension agreements will be prepared for same terms and conditions.
- Since Prudential does not have an agreement with TD Ameritrade and does not have sufficient time to enter into a new agreement with them, we are working with Prudential to enter into their product with Prudential Investment Management Services (PIMS) which is based on a Fidelity platform. The staff compared the two to ensure there would not be any differences for participants (e.g., trade the same products, same restrictions would apply, same fee schedule would apply, etc.). Prudential has agreed to waive the \$50 annual fee.

Mr. Hodges added that Prudential has reviewed the commission fee schedule side by side for the Self-Directed Brokerage Account and Prudential has either met or reduced the fees across the board.

- Prudential will have an office in Honolulu and are in the process of interviewing candidates for the local representatives and staff.
- Transition meetings will be held in later part of July and August.
- Ms. McHugh provided a recap of the various implementation and transition activities that include the exchange of files with the various payroll entities in an effort to minimize any disruptions and includes communications to announce the new TPA.
- Mr. Hodges stated that Prudential has received 40 applications that they are screening for the local office positions.
- The Board noted that they are impressed with the cooperation and professionalism demonstrated by ING during this transition phase, and in particular that Mr. Brian Merrick has been very accommodating and has demonstrated exceptional collaborative efforts to make the transition a smooth one.
- Ms. McHugh acknowledged the great partnership with ING in getting the necessary information for the conversion process.
- DAG Tam added that we will be working with ING on remaining items that include a Plan audit for the Plan year to verify the closing balances

upon transfer, review of the expense items, and the transfer of the remaining expense account amounts that are held at ING.

- DAG Tam stated that there are additional contracts that still need to be executed such as the trust agreement for custodial services, a managed account agreement with Morningstar, and extension agreements with ING and State Street.
- Ms. Akiyoshi added that there is a high level briefing scheduled with the departmental personnel officers this afternoon to provide advance information on the transition and an introduction of Prudential.

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Item # 5: PTS Plan

- a. Approval of Report on Funds Not Deposited in the State/County Treasuries for the Period Ending March 31, 2013
- b. Quarterly Management Report for Period Ending March 31, 2013

Ms. Akiyoshi presented the Report of Funds for the Board's review and approval, for the period ending March 31, 2013, along with the Quarterly Management Report for the same period.

In response to Trustee Miyahira's question on whether the volume of incoming phone calls to the local service office for the PTS Plan has been adequately addressed with both the Contractor and subcontractor, Ms. Akiyoshi reported that the local service office has addressed issue. The local service office has responded to the voicemail messages and has cleared the message box. In addition, the local service office has addressed and responded to the complaints received at the two legislators' offices to explain about the recent situation of the two benefit plan statements being mailed simultaneously which generated the increased volume of calls to their office. Measures to prevent a reoccurrence have been taken.

A motion was made by Trustee Miyahira and seconded by Trustee Okumoto to approve the PTS Plan Report on Funds for the period ending March 31, 2013. The motion passed unanimously.

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Item # 6: Staff's Administrative Report to the Board

Ms. Akiyoshi reported that the ongoing activities with ING and Prudential on the transition have been going well. Other activities summarized:

- A draft of the proposed Administrative Rules was provided by ING, and

will be reviewing the draft.

- ING relayed that the Lifecycle Portfolio allocations for 2013 were completed today.
- ING reported that the website has been updated with the quarter ending March 31, 2013 fund fact sheets.
- Working with ING on the topics for the Second Quarter 2013 Plan newsletter.
- Working on planning and coordination for the October 2013 Benefits Fair and Semi-Annual meeting.
- Will be working with ING on the final Plan Year Service Review report.

Ms. Akiyoshi reported on the monitoring of the Consultant's activities, and includes working with Mercer on the updates to the Investment Policy statement. The updates will be presented at a future meeting.

Ms. Akiyoshi reported on monitoring announcements on organizational changes occurring among the Investment Fund managers as covered by Mr. Williams. Ms. Akiyoshi provided information on INVESCO's quarter-end period.

Trustee Krieg acknowledged all the work that has been done by legal counsel and staff on the transition activities, along with other DHRD employees behind the scenes.

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Item # 7:

Other Business/Announcements

a. New Appointments to the Board

Ms. Akiyoshi reported that there are 3 appointments to the Board. Trustee Michael Okumoto has been appointed for a full term on the Board. There are 2 other new trustees whose appointments are effective July 1, 2013 - Mr. Brian Moto from Maui, and Mr. Kenneth Villabrille from Kauai.

b. 2013 NAGDCA Conference

The conference is from September 8 - 11, 2013 in Louisville, Kentucky. Ms. Akiyoshi stated that so far two trustees have responded that they are not able to attend, and one trustee has expressed interest. Ms. Akiyoshi will be reaching out to the 2 new trustees to determine their interest and availability. If interested, registrations should be completed soon and if trustees can respond back by the end of the month.

A motion was made by Chairperson Chu and seconded by Trustee Young to authorize the Board's staff to attend this year's NAGDCA

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conference. The motion passed unanimously.

Chairperson Chu adjourned the meeting at 10:40 a.m.

(Note: Signed copy on file.)