

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

**OPEN SESSION MINUTES
MEETING # 378**

Date: December 11, 2013

Place: Hawaii Prince Hotel
Board Conference Room
100 Holomoana Street
Honolulu, HI 96815

Present: Wayne Chu, Chairperson
Kalbert Young, Ex-Officio Member
Barbara Krieg, Ex-Officio Member
Michael Okumoto, Employee Member
Brian Moto, Employee Member (arrived at 9:39 a.m.)
Kenneth Villabrille, Employee Member

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

Absent: Neal Miyahira, 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; Trustee Miyahira was excused from today's meeting. Introductions were made from Mercer and from Prudential Retirement.

Chairperson Chu asked that agenda item no. 2 be taken out of order and taken first on the agenda. The Board did not have any objections.

Agenda

Item # 2: Mercer Overview on Changing from the Existing Single Manager Investment Structure to a New Fund-of-Funds Investment Structure (i.e., a Multi-Manager Investment Structure)

Mr. Saharic provided a review on the trends that were occurring in the industry, and he stated that ongoing education has been provided to the Board on this type of structure in which plan sponsors offer multi-managers in single asset classes, as seen with the major pension plans.

Mr. Saharic discussed some trends:

- Defined contribution plan sponsors want to make it easier for participants. There is a movement to reduce down some of the number of options. In the early years, plans started with 3 types of options – a stable value, an S&P fund, and a balanced fund. In the 1990's, plans wanted different vehicles.
- Have seen that participants are confused by styles.
- Plan sponsors moving to white labeling of funds (generic naming convention); helps participants with diversification.
- Instead of one investment option in a category, plans are adding managers to offer diversification and this approach have helped to smooth out rate of return for participants. Average number in a defined contribution survey shows sixteen (16) investment options and the Hawaii Plan currently has eighteen (18), counting Lifecycle Portfolios as one. The Lifecycle Portfolios are an example of this type of structure, as is the Stable Value Fund.
 - Fund-of-fund allows a fund to develop that has multiple styles and covers a group of managers that complement each other.
 - Some benefits are: the ease to making changes, leads to higher returns, and access to lower cost managers.
 - Some cons are: the complexity of managing due to creating a daily NAV, difficulty level of communications to participants, difficulty in tracking the funds' daily performance, and higher costs.
- On the consulting side under one model, there is a charge per category to set-up, a one-time charge.
- Under another model, there is a discretionary model where discretion is given to the consultant to hire/fire managers.

Mr. Saharic stated that the reason these discussion points are being raised is because the Board will be replacing the Century fund and the consideration is whether to use a single manager or multiple managers.

DAG Tam commented that for the Board to consider this concept, we would need to know what all the additional costs there are. Mercer has mentioned its costs, so we

would need to determine what Prudential's costs would be.

Mr. Williams stated that there would be five (5) fund-of-fund classes, in addition to the Stable Value Fund and the Index funds. The long term educational goal for this objective is to focus participants on asset allocation.

Ms. Klassen added that Prudential would need to know the larger Plan structure and on fund arrangements, but a range on the costs would be around \$5,000 to \$12,000 per fund-of-fund.

The Board discussed the impacts to participants, the impact to the current GoalMaker tool within Prudential, and clarification on the procurement process if contemplating using the discretionary consulting model.

No action was taken on this Agenda item.

Agenda
Item # 1:

Review of Draft Request For Proposals for the Small/Mid Cap Growth Equity Option to Replace the Century SMID Growth Fund

A motion was made by Trustee Krieg and seconded by Trustee Moto to move into Executive Session at 9:50 a.m. to confer with legal counsel and discuss procurement matters pertaining to Agenda Item no. 1. The motion passed unanimously.

All guests, with the exception of Mercer, were excused.

EXECUTIVE SESSION

Meeting

Reconvened: **A motion was made by Trustee Young and seconded by Trustee Krieg to move out of Executive Session at 10:34 a.m.. The motion passed unanimously.**

All guests rejoined the meeting.

Agenda
Item #3:

Payment of the Plan's Legal Fees for 2013 - 2014

Ms. Akiyoshi stated that currently the Plan reimburses the Department of Attorney General for legal services provided to the Plan. The Board previously authorized for the last fiscal year July 1, 2012 to June 30, 2013. The bill for this reimbursement reflects the increased amount of \$30,000. DAG Tam completed a draft Supplemental Agreement for the approved increased amount for the Board's

review.

The Board requested that a new Memorandum of Agreement be prepared to reflect and authorize the amount of \$30,000 for legal fees as approved effective fiscal year 2013 (beginning July 1, 2012 to June 30, 2013), in lieu of continuing the existing Supplemental Agreements.

A motion was made by Trustee Krieg and seconded by Trustee Young to accept the bill and make payment upon execution of a new Memorandum of Agreement. The motion passed unanimously.

Agenda
Item # 4:

Proposed Establishment of New DHRD Staff Position for the Plan

- a. Proposed Funding for the New Position
- b. Payment of Administrative Support Fees for FY 2013-2014

Trustee Krieg explained that since the inception of the Plan, DHRD has provided a staff position to provide support to the Plan. A couple of years ago, the Board agreed to provide partial funding from the funds of the Plan to the department for its administrative services. A Memorandum of Agreement and Supplemental Agreement is in place to authorize the funding. Initially, the funding level was at \$40,000, and last fiscal year increased the amount to \$66,866 based on the amount of calculated percent of time spent. Over time, the staffing level has grown to be more than one person to provide staff support to the Plan. Other staff employees have additionally been assisting Ms. Akiyoshi. The department will be requesting in the budget to the Legislature, the establishment of a dedicated position to provide full-time staff services to the Plan and be fully funded by the Plan.

The invoice for the staff support services for this fiscal year is for the same amount as last fiscal year which is \$66,866.00 authorized under the current Supplemental Agreement. On an ongoing basis, the request to the Board is to seek approval to cover salary of the full-time position including fringe. Trustee Krieg added that the other staff employees would continue to provide support to the Plan as needed, especially for the increased communication effort being sought to promote the Plan. The full-time position would be effective July 1, 2014. The Board commented that this would be a part of a calculated approach to accurately document the amount of administrative support time that is provided to the Plan.

A motion was made by Trustee Moto and seconded by Trustee Villabrille to authorize payment on the bill of collection for DHRD staff administrative services to the Plan. There was one vote to abstain by Trustee Krieg. The motion passed.

Agenda

Item # 5: Performance Evaluation Report by Mercer for 3rd Quarter 2013, Period Ending September 30, 2013, including but not limited to:

- a. Performance Summary on Funds Currently on the Watch List: Century SMID Growth Fund, Harbor Small Cap Value Fund, and Victory Institutional Diversified Stock Fund

Mr. Saharic provided an overview of the market environment:

- Performance results provided are for the 3rd Quarter 2013 period.
- Added that in looking at performance after the end of the 3rd Quarter, October and November were excellent months;
- International equities have rebounded, which have benefited the Lifecycle Portfolios.
- Year-to-date performance, U.S. equities have been the driving force for the overall returns in the capital market.
- Fixed income has been flat. However, PIMCO has been doing well due to its opportunistic strategies like high yield, treasuries, etc.
- The economy is still in chaos, so can expect volatility.

Mr. Williams provided an overview on the Plan:

- Reviewed the current investment structure tiers: Tier One - Asset Allocation funds; Tier Two - Passive and Active Investment options; and Tier Three – Specialty funds (through the Brokerage Account).
- All asset classes are being covered currently.
- Currently working with staff on amending the Investment Policy Statement.
- Summarized the organizational updates within Victory Capital Management, Century Capital Management, and Capital Research and Management Company. No additional recommendations as a result of these updates at this time.
- Total Plan assets are just under \$1.8 billion; there was an increase of approximately \$62 million to date.
- Performance has been good; Victory and Harbor funds which have been on the watch list have seen significant improvement. Recommend keeping these funds on the watch list. The Century SMID fund continues to struggle and the Board is in the process of replacing the fund.
- The returns for the last one year period and long term periods have been favorable for the Lifecycle Portfolios.
- The market to book ratio for the Stable Value Fund has moved down a little, but ratio remains at a favorable rate at 105%.

- Reviewed the performance results of the active fund managers; active managers had solid performance for the year.

Agenda

Item # 6: Plan Administrator's Report

a. Plan Updates and Activities

Mr. Malmud provided updates on the Plan:

- Communications were prepared and are being issued regarding the Managed Accounts by Morningstar. The communications are being generated because of the questions arising from the last Benefits Fair on the approach used by Morningstar to determine the risk level of participants. The communication informed participants to check their accounts to determine if they are at a satisfactory risk preference. Participants cannot change the investor risk profile assigned by Morningstar, so participants would need to provide the additional data to change the portfolio mix to meet their risk tolerance and suitable for their risk profile.
- The survey feedback from the Benefits Fair was favorable for the Oahu and Kauai Fairs.
- The attendance at the group sessions at the Fairs went up because of the TPA transition that occurred.

b. Discussion of Stable Value Fund Fees Assessed for the Fourth Quarter 2013

Mr. Malmud reported on the Stable Value Fund fees that were assessed for the Fourth Quarter and explained how the fees are typically assessed. In most instances, the asset-based TPA administrative fees are deducted and applied to all the funds. The Plan has a history for the Stable Value Fund where the fees are not explicitly charged, and when it was discovered by Prudential that the TPA administrative fees were already included in the valuation, the TPA administrative fees assessed by Prudential were immediately reversed out for the 3rd Quarter of 2013. Prudential would like to propose that beginning with the 4th Quarter 2013 fees, Prudential assesses the fees rather than the Stable Value Fund taking it net of the crediting rate. This would make expenses more transparent across all assets. Administrative fees for the 4th Quarter 2013 would be taken on January 1, 2014.

A motion was made by Trustee Krieg and seconded by Trustee Moto to remove the TPA administrative fee from the Stable Value Fund calculation and make it an explicit fee by Prudential for the quarter beginning October 1, 2013. The motion passed unanimously.

c. Other Plan Issues

Mr. Malmud asked for the Board's consideration to change the hours on Saturday in the Honolulu Office to be by appointment due to the low volume of traffic and calls in to the Honolulu Office and the security arrangements for the building that closes the building to the public on the weekends. Further discussions will be held with Board staff before the Board makes a decision.

Mr. Conlon summarized a participant account incident that arose resulting from a system issue in generating the participant's confirmation. Testing occurred by the Prudential technology group on the account and the transactions moved over to a live environment. As a result, some transactions were generated in error and appropriate steps are being taken to prevent a reoccurrence. The participant was given a choice to correct the matter which resulted in a benefit for the participant rather than reversing the transaction as if it did not occur.

Agenda

Item # 7: Review of Prudential's Proposed Plan Document and Plan Adoption Agreement

Ms. Klassen stated that Prudential prepared a Plan-At-A-Glance document at the time of transition that captures the provisions permitted by the Plan and which allowed Prudential to transfer information to its record keeping platform. A specimen Plan Document and Adoption Agreement have been also drafted and will also include issues on DOMA and same sex marriage provisions.

Prudential has been working with staff to adopt these documents, and the staff is currently reviewing the documents, and will bring back to the Board at a later date.

Agenda

Item # 8: Staff Administrative Report to the Board

Ms. Akiyoshi reported on highlights of the activities which included: (1) working with Prudential on the review and development of the Plan Document and Plan Adoption Agreement; completion of the Plan Service Year report by ING; (2) completion of the Plan Budget report by ING; (3) reviewing Mercer's draft of the Investment Policy Statement to include the two (2) new investment options; (4)

monitoring reports by the Investment Fund managers on updates within their organization; (5) meetings with other Investment Fund company representatives to speak about their company and product offerings; (6) meeting with UAT Bloomberg on its Commission Savings Program which looks at fees that are charged by investment managers, they have approached ERS and Trustee Young noted that they have approached Treasury as well; (7) working on UIPA requests related to the RFP on the TPA search; and (8) reviewed the PTS Plan Asset Report and Quarterly Management reports for Third Quarter 2013 for Board approval.

Agenda
Item # 9:

Final Plan Year Service Review Report by ING for the Period of July 1, 2012 to July 24, 2013, and Final Budget Report by ING

Ms. Akiyoshi reported that ING has completed its Plan Year Service report for their contract year; pointed out the Plan Year asset value on June 30, 2013 at \$1.73 billion; the average Plan account balance of \$63,000; the Local Office met its goals for group meetings; and a report on the investment advisor usage.

Ms. Kanai provided clarification on Trustee Young's question, that the change in the number of employees of 894 reflects the change in the number of eligible employees as of June 30, 2013, and the change in the number of active participants reflects the number of inactive participants (most are inactive because of UEW requests).

Ms. Akiyoshi presented ING's final budget report which provides for the budget over the ten (10) year period of the contract, and pointed out the remaining balance that was transferred over to Prudential. The audit of the Plan is the remaining outstanding contractual item for ING.

Agenda
Item # 10:

PTS Plan

- a. Approval of Report on Funds Not Deposited in the State/County Treasuries for the Period Ending September 30, 2013
- b. Quarterly Management Report for Period Ending September 30, 2013

Ms. Akiyoshi represented the PTS Plan Asset report for the Board's approval and stated that the assets in the Plan total \$99 million. The Quarterly Management Report for the period ending September 30, 2013 is also presented for review.

A motion was made by Trustee Villabrille and seconded by Trustee Young to approve the PTS Plan Report on Funds for submission to the Comptroller. The motion passed unanimously.

Agenda

Item # 11: Other Business

Ms. Akiyoshi stated that she is surveying the Board members for available dates to schedule Board meetings in 2014. The Board agreed to the next meeting on January 30, 2014. Scheduling of tentative dates in May will be coordinated to plan for the Benefits Fair and the Semi-Annual Board meeting.

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

(NOTE: Signed copy on file.)