

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

**OPEN SESSION MINUTES
MEETING # 380**

Date: March 18, 2014

Place: Department of Human Resources Development
14th Floor Director's Conference Room
235 South Beretania Street
Honolulu, HI 96813

Present: Wayne Chu, Chairperson
Neal Miyahira, Employee Member
Michael Okumoto, Employee Member
Kenneth Villabrille, Employee Member
Brian Moto, Employee Member

Others: Rodney J. Tam, Deputy Attorney General
Cynthia Akiyoshi, DHRD Staff
David Williams, Alex Williams, Mercer Investment Consulting - via conference call
Tom Conlon, Andrea Cummings, Prudential/Plan Administration Office-Scranton
Office – via conference call
Kevin Malmud, Jeanne Kanai, Prudential/Honolulu Office
Julie Klassen, Deborah Baran, Prudential Retirement

Absent: Barbara Krieg, Ex-Officio Member
Kalbert Young, Ex-Officio Member

Call to Order: There being a quorum present, Chairperson Wayne Chu called the meeting to order at 9:18 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 Prudential staff, and asked for introduction of attendees participating via the conference phone line.

Chairperson Chu asked Board members on moving Agenda Item #2 to after Agenda Item # 7. There were no objections.

Agenda

Item # 1: Approval of Minutes Nos. 369, 370, 375, 376, and 379

A motion was made by Trustee Chu and seconded by Trustee Miyahira to approve Minutes Nos. 369, 370, 375, 376, and 379, as drafted. The motion passed unanimously.

Agenda

Item # 3: Performance Evaluation Report by Mercer for 4th Quarter 2013, Period Ending December 31, 2013, including but not limited to:

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

Mr. Williams provided a report on the market environment:

- It was a great year for equities.
- For the past quarter, equities were up, except for emerging markets.
- In the fixed income arena, it was flat.
- Alternatives were flat, except for hedge funds.
- For the year, saw mid-30% range for U.S. equities.
- International equities were just below that range.
- Predictions for economic growth around 3% for U.S., global growth around 2%.

Mr. Williams reported on manager updates:

- American Funds submitted a request for changing from an EAFE Index to ACWI ex-US Index and this request was approved by the Board at the last meeting. ACWI includes both Canada and emerging markets.
- Reviewed the American Funds allocation to emerging markets; ACWI is a better benchmark for American Funds since EAFE does not have an allocation to emerging markets.
- PIMCO announced the departure of Mohammed El-Erian as the CEO and co-CIO, leaving Bill Gross in the CIO role. Mercer is not recommending placing the strategy on watch, but they are monitoring the strategy and will report if there are any changes to its opinion.
- Wellington Management Company announced a change in CEO, but there should not have any negative impact.
- Capital Research and Management Company (American Funds) announced the departure of Stephen Bepler who was managing about 12% of the EuroPacific Fund. Mercer is monitoring the strategy.

- MFS announced that Barnaby Weiner is stepping aside and noted he was a strong architect of this strategy. Mercer does not have any issues with the named replacement. Mercer has dropped the rating from A to B+ due to the loss of the long-term portfolio managers and the rising asset base. Mercer will be monitoring for any performance issues over the next year.

Mr. Williams provided Plan highlights and fund performance evaluation:

- Plan assets are at just under \$1.9 billion as of year end, up about \$220 million for the quarter.
- The Stable Value Fund is at 45% of Plan assets, last year was at 51% of Plan assets.
- The fees for the investment options were reviewed, and noted that the average expense ratio was a low of 32 basis points.
- The performance of the Harbor Small Cap Value Fund has continued to improve over the last two (2) year period, and satisfies the performance requirements for the three (3) year period. Mercer recommends removing Harbor from the watch list. Recommends keeping the Victory Institutional Diversified Stock Fund on the watch list and a search is in process for the Century Small/Mid Cap Growth Fund.

A motion was made by Trustee Miyahira and seconded by Trustee Moto to remove Harbor Small Cap Value Fund from the watch list. The motion passed unanimously.

- Lifecycle Portfolios had a solid performance over the past year.
- The index funds are all performing in line with their respective indices.
- The non-U.S. index funds had a slight deviation, but over the long-term have been in line.
- The Stable Value Fund has a market to book ratio of 104%, and has been strong relative to other stable value products.

Trustee Miyahira raised the concern on the future of the Stable Value Fund if wrap providers leave the market, so what is the status or are there any changes with the wrap providers. Mr. Williams stated that it hasn't changed. The wrap providers on the Hawaii portfolio have not changed. They are seeing new entrants into the wrap market which allows for additional wrap capacity. Typically with the new entrants you will see higher fees and tighter controls around the investments.

- In reviewing the investment strategies, over the year, there were good results from most of the investment managers having a solid year.
- With the exception of removing the Harbor Small Cap Value fund from

the watch list, Mercer does not have any other recommendations.

Agenda

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

Mr. Williams provided a background to review the structure of the Lifecycle Portfolios. Each year, Mercer provides an analysis of the allocations. The objective is to review the allocations and update the current assumptions.

The longer dated portfolios (e.g., 2045 and 2055 portfolios) will see little change; they expect bigger changes in the near dated portfolios (e.g., 2015 and 2025 portfolios), shifting from equities to safer investments. They are designed on a through basis, and not where you would land on a retirement date and move directly into the Income Portfolio.

Trustee Okumoto asked about considering a 2020 portfolio, to add a 5-year increment portfolio. Mr. Williams responded that when target date funds were launched around 2000, the portfolios started in 10-year increments. Vanguard started offering 5-year increment portfolios. During the last 7 years within the industry, Mercer started to see plans offer more 5-year increment portfolios. Narrow bands are more important when people start heading into retirement. Trustee Moto noted that he would agree that offering a 2020 portfolio (a five-year band) makes sense because of the increasing number of people who are retirement-eligible or who can retire now but have delayed retirement.

Mr. Williams responded that the biggest concern would be effectively communicating to participants that it is not an addition of an investment option as much as offering participants more choice. When considering 5-year increments, you would look to broadening the portfolios for the longer run, so potentially you may be offering twelve (12) Lifecycle portfolio options. There would then be a need to address the impact of cost with Prudential to create any additional custom portfolios.

Mr. Williams reviewed the current allocations, the current capital market assumptions, and presented recommendations for 2014: (1) to shift investments towards more conservative investments; and (2) a decrease to the diversified inflation fund and a move to fixed income and equities.

A motion was made by Trustee Miyahira and seconded by Trustee Moto to approve and adopt Mercer's recommendations on the new Lifecycle Portfolio allocations for 2014. The motion passed unanimously.

Agenda

Item # 5: Plan Administrator's Report

a. Plan Highlights

Ms. Klassen reported on the highlights of the Plan:

- Year-to-date updates, for past two (2) months, the Plan assets increased from \$1.78 billion to \$1.89 billion.
- Referenced the information shown on the Plan assets chart, in particular the statement that the Plan average deferral percentage is based on Plan population deferring percentage and does not include Plan population deferring a dollar amount. Ms. Klassen noted that this is not a full representation of all the activity. They will be working on these data elements to provide a better representation of this data.
- There is a large concentration of activity is within the 50+ age band which represents about 83% of the Plan assets.
- Enrollments within the past two (2) months totaled 132.
- Provided data on market timing activity, managed account activity, self-directed brokerage account activity, fund utilization, and GoalMaker activity within the Plan.

The Board discussed the average account balances in the Plan in comparison to the Prudential's book of business. The distinction noted was that the survey of plans is based on national statistics and across all spectrums that include non-governmental plans and plans that do not have a defined benefit plan at all.

Trustee Miyahira raised issue of the growing number of prospective retirees and communicating the importance of educating participants on the benefits using the Plan to manage their assets. Mr. Malmud confirmed that Prudential does strive to focus on retiree communication at several of the State's pre-retirement sessions, at the Benefits Fairs, and in the general educational workshops. They are developing other workshop topics targeting retirement planning and strategies.

b. Updates on Communication Outreach

Mr. Malmud briefed the Board on some outreach that Prudential is doing with the employer union groups. They conducted its first HGEA presentations, and are arranging with HGEA to participate in its upcoming HGEA event at Waiakoloa. Also, they are confirmed to participate in an HGEA union stewards meeting.

In addition, they have an invitation to a HSTA Teacher's Institute Day event in October 2014. Besides the union meetings, they are also

participating in meetings at OHA.

c. Updates on Benefits Fair Planning in May 2014

Ms. Baran stated that site visits are being planned so more details to follow. They are also exploring more topics for the workshop sessions with new material. Planning is underway for the Fair and the blessing that is scheduled the same week for the Local Office.

d. Other Issues

Ms. Klassen provided information on Prudential's global mutual fund trading policy. She reported that Prudential has a global policy to monitor participant trading that most mutual fund managers have accepted. A few of the mutual fund managers monitor their own trading activity. Although the information the fund managers see is at an omnibus level, they are able to inquire when they see certain activities taking place and information is shared with them.

Ms. Klassen is recommending that the Board accept the global level policy that would have Prudential monitor trading activity across all investment funds, and that Prudential will provide additional communication on this policy to monitor all the investment funds in the Plan.

DAG Tam added that in the past, only specific investment funds had policies addressing market timing restrictions, whereas, now all investment funds would be monitored for trading activity. Ms. Akiyoshi stated that in 2006, there were notices by specific investment managers to notify investors of penalties and restrictions in instances of frequent trading. Currently, only the EuroPacific Growth fund has a trading restriction within its policy. Others reserve the right to restrict excessive trading.

Ms. Klassen stated that there are currently fifteen (15) participants engaged in frequent trading activity and have a restriction. It is not a significant number; however, the expectation is that the TPA to have a system in place to provide the restrictions. There is some movement within the industry to have some standardization. There is a brief disclosure on the fund fact sheets. She will reconfirm whether it is contained in each trading agreement.

Mr. Williams commented that this was evident some years ago associated with the short term trading scandals, and has not seen such policies adopted recently. He stated that if we are not getting a push back from the

investment managers then we may not want to rush to adopt a new policy. He noted that he can review the list of various policies and trading fees and can make a recommendation.

Trustee Moto asked if some additional information can be provided in a future report on the participant trading activity such as in which investment fund options and whether activity is across all the investment funds.

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

a. Status on American Funds Request to Change its Benchmark

Ms. Akiyoshi reported that a letter was received from American Funds to request a change in its benchmark, a meeting was held with Michael Bowman, and at the meeting he was informed of the Board's decision to approve their request for the benchmark change. A formal letter on the approval of their request was issued.

b. Status on Amendments to the Plan's Investment Policy Statement

Ms. Akiyoshi reported that the amendments to the Plan's Investment Policy Statement were finalized to incorporate all the revisions regarding the new investment options and the change in the American Funds benchmark.

c. Status on the Board's Letter of Support to the Legislature on DHRD's Request to Establish a Position for the Plan

Ms. Akiyoshi reiterated that Trustee Krieg had submitted a position request to the Legislature as part of DHRD's budget request which would establish a dedicated position for the Plan. Letters of support were sent in to the House Finance committee and to the Senate Ways and Means. Testimony was submitted for the WAM hearing.

Ms. Akiyoshi also reported on conducting expanded outreach with DOE to try to set up meetings with DOE administrators, its Personnel Regional officers, and district level officers. DOE is assisting in arranging a Prudential presence at their monthly meetings in an effort to develop an effective communication plan within DOE schools.

Highlights on other activities:

- A UEW direction letter has been completed and issued.
- Planning is in progress for the May 2014 Benefits Fair.
- RFP for the Small/Mid Cap Growth Fund has been issued.
- Aside from the meeting with American Funds, a manager meeting was held with Winslow Capital on the MainStay Large Cap Growth Fund.
- Held a conference call with Victory Capital Management..
- A courtesy meeting was held with Loomis Sayles on their organization.

Agenda

Item # 7:

PTS Plan

- a. Approval of Report of Funds Not Deposited in the State/County Treasuries for the Period Ending December 31, 2013
- b. Quarterly and Annual Management Reports for the Year Ending December 31, 2013

Ms. Akiyoshi reported on the PTS Plan activities and reporting requirements, including the 4th Quarter Plan Asset report, the 4th Quarter Management Report, and the Annual Management Report for the year ending December 31, 2013.

A motion was made by Trustee Miyahira and seconded by Trustee Villabrille to approve the Report of Funds Not Deposited in the State/County Treasuries for the 4th Quarter ending December 31, 2013. The motion passed unanimously.

The Board discussed reviewing the need to handle another bad address search to help clear some of the inactive accounts.

- c. Annual Letter on the Reimbursable Amount Available in the PTS Plan Expense Account

Ms. Akiyoshi stated that LSW provided their annual letter to report the amount available for reimbursement for 2014. The total amount available is \$17,356.00.

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Item # 8:

Other Business/Announcements

- a. NAGDCA

Ms. Akiyoshi stated that NAGDCA has come out with information on its upcoming annual conference in September 14-17, 2014, to be held in San

Antonio, Texas.

A motion was made by Trustee Miyahira and seconded by Trustee Moto to allow the Board's staff to also attend the conference, based on available funding. The motion passed unanimously.

Agenda

Item # 2: Status on Request For Proposals for the Small/Mid Cap Growth Equity Option to Replace the Century SMID Growth Fund

A motion was made by Trustee Miyahira and seconded by Trustee Villabrille to move into Executive Session at 11:16 a.m. to discuss procurement matters and consult with legal counsel. The motion passed unanimously.

Prudential staff was excused from the meeting. Mercer consultants joined via conference call.

EXECUTIVE SESSION

Meeting

Reconvened: **A motion was made by Trustee Miyahira and seconded by Trustee Villabrille to move out of Executive Session at 11:26 a.m. The motion passed unanimously.**

Chairperson Chu stated that the Board has reviewed Addendum No. 1 to respond to questions received on the RFP for the Small/Mid Cap Growth Equity Option.

A motion was made by Trustee Miyahira and seconded by Trustee Villabrille to adopt Addendum No. 1 related to RFP No. DCP-FY-14-1. The motion passed unanimously.

Chairperson Chu adjourned the meeting at 11:27 a.m.

(NOTE: Signed copy on file.)