

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

**OPEN SESSION MINUTES
MEETING # 385**

Date: September 4, 2014

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

Present: Barbara Krieg, Ex-Officio Member
Kalbert Young, Ex-Officio Member (arrived at 9:12 a.m.)
Kanoë Margol, Employee 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
Julie Klassen, Lynn Whitmore-Christiano, and John Turk, Prudential Retirement –
via conference call
Kevin Malmud, Jeanne Kanai, Grace Baracao, Prudential Honolulu Office

Absent: Wayne Chu, Chairperson

Call to Order: There being a quorum present, Trustee Barbara Krieg called the meeting to order at 9:02 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.

Trustee Krieg opened the meeting and will chair the meeting in the absence of Chairperson Chu who is excused from today's meeting. Acting Chairperson Krieg acknowledged the Trustees present and welcomed the Prudential Honolulu Office staff and attendees via conference phone.

Acting Chairperson Krieg asked the Board if there are any objections on amending the agenda to take Agenda Item # 5 out of sequence and move item # 5 to follow Agenda Item # 8c. There were no objections.

Agenda

Item # 1: Approval of Minutes Nos. 383 and 384

Acting Chairperson Krieg stated that Minutes nos. 383 and 384 are presented for the Board's review and action.

A motion was made by Trustee Villabrille and seconded by Trustee Moto to accept Minutes nos. 383 and 384 as presented. The motion passed unanimously.

Agenda

Item # 2: Report by N&K CPAs on Plan Audit

Ms. Akiyoshi stated N&K reported that the Plan audit report is still in final review. There has been a delay on their side to get the review completed and apologized for this delay. N&K plans to complete the report for the next regular Board meeting.

Agenda

Item # 3: Performance Evaluation Report by Mercer for 2nd Quarter 2014, Period Ending June 30, 2014, including but not limited to

Mr. Williams provided an overview of the market performance for the 2nd Quarter 2014:

- The U.S. equities performed well; the Large Cap equities were up and moved forward.
- The Small Cap equities did lag a little.
- Non-U.S. equities performed well; Emerging market was up at 6% year to date.
- Fixed Income asset class rebounded; interest rates moved down and yields went up.
- Within the J.P. Morgan Diversified Real Return fund, REITs did well; commodities did lag.
- During post-quarter, the month of July was rough but market performance was strong during August.
- S&P 500 moved to an all-time high, up 9-10%.
- Year-to-date, fixed income did well.
- Mr. Williams noted that Mercer's expectations are anchored by valuations, and are expecting a lower rate of return environment moving forward over next 3-5 year period.

Mr. Williams provided a review of the Plan's investment option array and the 3 tiers within the investment structure. The Plan does offer all asset classes in the

majority of the defined contribution plans within the U.S.:

- Mercer is watching the changes within PIMCO, with the rehiring of Paul McCulley and who left PIMCO in 2010, and has come back and is taking on a new role within PIMCO. Mercer does not have a recommendation for a change.
- JP Morgan has made some portfolio changes within the Diversified Real Return Fund, and the changes may limit ability to add value relative to their index. Mercer does not have a recommendation for a change.
- Wellington Management has had some organizational changes but there is no direct impact to their strategy.
- American Funds announced the replacement of their portfolio manager, Rob Lovelace. Mercer does not have a recommendation for a rating change but will monitor the situation.
- Plan assets were just over \$1.9 billion at the end of the quarter, about \$43 million increase. Average account balance is about \$71,000.
- There were no changes to the fee structure, the average expense ratio remains at about 32 basis points.

Overview of performance in comparison to the investment policy statement compliance:

- The lower risk options did well; the Stable value, fixed income, Wellington Management and Vanguard funds did well.
- Mercer is recommending the removal of the Victory Institutional Diversified Stock fund from the watch list because it is meeting its performance standards, and has been improving over the past eighteen months.
- Mercer is recommending adding the MainStay Large Cap Growth Fund and the Harbor Small Cap Value Fund to the watch list as they are not meeting their performance standards. Mr. Williams explained the comparison of excess returns relative to peers over the last eighteen months in determining the removal of the Victory Institutional Diversified Stock fund from the watch list.

A motion was made by Trustee Moto and seconded by Trustee Margol to accept Mercer's recommendations to remove the Victory Institutional Diversified Stock fund from the watch list, and add the MainStay Large Cap Growth Fund and the Harbor Small Cap Value Fund to the watch list. The motion passed unanimously.

- The longer term performance of the Lifecycle Portfolios is in line with their benchmarks; during the last quarter there was a slight lag. There are no recommendations for any changes.
- The BlackRock passive funds are performing in line with the benchmark;

there are no recommendations for any changes.

- The market to book ratio for the Stable Value Fund is very strong at 105.7%.
- Most of the active managers did well: the PIMCO Fund did rebound due to tactical allocations during the quarter; the JP Morgan Fund outpaced both of its benchmarks; the Vanguard Wellington Fund had both good short and long term performance; the Wellington Research Value Fund had a strong quarterly performance; the Victory Fund finished ahead of the S&P 500 and had a solid performance due to broad stock selection; the MainStay Fund's performance lagged slightly year-to-date due to stock selection; the Harbor Fund lagged slightly on a relative basis and is behind in index and peers; the Century Small Cap Growth Fund will be replaced; the MFS International Value Fund had strong long term performance and short term performance lagged a little; the EuroPacific Growth Fund had an improving long term performance; and the Schroder Emerging Market fund performance has been in line and keeping pace in on a year to date basis.

Mr. Williams stated there were no other recommendations for changes.

Agenda
Item # 4:

Plan's Administrator's Report

a. Plan Highlights

Mr. Malmud provided highlights of the local office activities. He summarized the outreach initiatives that they have been working on:

- Outreach efforts through HSTA to participate in their Teacher's Institute Day events on Oahu and neighbor islands during October; have filed the necessary applications. They anticipate over 10,000 teachers in attendance.
- Outreach efforts through UH-OHR to hold a mini Benefits Fair with seminars on the campus.
- Development of an asset retention communication piece.

b. Fees Charged by Registered Investment Advisors and Policy of Assessing Fees Against the Plan Account

Ms. Klassen reported that the fees charged by Registered Investment Advisors can be paid directly from the SDBO account assets. There are no current requests for fees by participants to date. There are 153 SDBO participants, and 27 of those who have trading authorization forms in place. She noted that Prudential record keeps 209 retirement plans that utilize a SDBO, and of those there are 8 plans who allow payments to be made from the SDBO assets. So it is not widely utilized. In addition, the trading authorization forms have been revised to include indemnification

language as requested by the Board. With respect to establishing a policy regarding assessing fees against the Plan, Ms. Klassen covered options available to the Board.

The Board discussed and agreed that the Trading Authorization form to authorize RIAs should not be discontinued, and agreed that participants should make payments for any requests for RIA fee payments outside of the Plan.

A motion was made by Trustee Moto and seconded by Trustee Okumoto to adopt a Board policy with option # 2, as proposed by Prudential, to continue to allow the RIA option in the Plan and allow participants with RIAs to make payments outside of the Plan. The motion passed unanimously.

Ms. Klassen will check on whether any revisions are needed to the SDBO section of the agreements, and report back to the Board staff.

c. Follow-up on Plan Participant Issues

Mr. Malmud reported on a post-separation vacation payout that was processed incorrectly for a participant by a Department. An incorrect higher amount was processed by the Department, then reversed out, and a corrected lower amount was subsequently processed. The participant requested that the earnings during the time when the funds were not in the account (approximately one month after the Department reversed out the payout amount) be paid to the participant. Mr. Malmud stated that an analysis was done on the participant's account over the period of time when the erroneous amount was first deposited through the pay date when the corrected amount was adjusted, and it was discovered that there was a loss of approximately \$40. The Board's current policy is that whichever party caused the error, that party would be responsible for any losses.

The Board requested that Prudential communicate to the participant on the calculation of any losses and amount that may be due, and asked that Board staff work with the respective Department on recovering and remitting the amount of the loss back to the Plan.

With respect to other scenarios involving deferral errors, Ms. Christiano added that the general principle under the IRS guidelines for corrections is to make the participant whole and put the participant in a position as though the error had not occurred. To expedite the matter, Prudential offered to pay the \$40 to make the participant whole now, and proceed to seek reimbursement from the Department.

A motion was made by Trustee Young and seconded by Trustee Margol to accept Prudential's offer to pay the \$40 loss to the participant in this case, and have the Plan seek reimbursement to Prudential from the Department in question. The motion passed unanimously.

In a separate situation, DAG Tam and Ms. Akiyoshi explained an EVP issue that occurred with a DOH employee who later decided to not retire after the EVP was processed. The DOH asked if they were permitted to take the position that the EVP should be reversed out since the employee decided not to retire. Background was provided to the Trustees on the provisions of the EVP program and the deferral request by the participant.

The Board discussed the requirements for pre and post separation deferrals of vacation pay under the Internal Revenue Code and Treasury Regulations, the limits set by the IRS, and the involving collective bargaining as the State's Early Vacation Payout Program ("EVP") is described in Supplemental Agreements to various collective bargaining agreements. The Board noted that a determination of whether a deferral is ineligible or eligible resides with the Department and not the Board, but there may be a legal question on the Employer's obligations under the Supplemental Agreements.

A motion was made by Trustee Moto and seconded by Trustee Young to approve DOH's request to reverse the EVP deferral amount, and process the reversal with any gains or losses.

Acting Chairperson Krieg asked that DAG Tam research any legal implications that may affect the tax deferred status of the Plan.

The motion passed unanimously.

Acting Chairperson Krieg called a break at 11:03 a.m. The meeting resumed at 11:12 a.m.

Agenda

Item # 5: Status on DHRD's Request to Establish a Position for the Plan

Item was taken out of sequence and discussion followed item # 8c.

Agenda

Item # 6: PTS Plan

- a. Approval of Report on Funds Not Deposited in the State/County Treasuries for the Period Ending June 30, 2014

Ms. Akiyoshi presented the Report on Funds for the PTS Plan to the Board for review and action.

A motion was made by Trustee Okumoto and seconded by Trustee Margol to accept the PTS Plan Report on Funds for submission to the Comptroller covering the period ending June 30, 2014 as presented. The motion passed unanimously.

b. Quarterly Management Reports for the Period Ending June 30, 2014

Ms. Akiyoshi presented the Quarterly Management Report for the 2nd Quarter 2014. No further discussion.

Agenda

Item # 7: Staff Administrative Report to the Board

Ms. Akiyoshi provided highlights on the activities. Activities continue with no significant changes. Other highlights include:

- Staff is continuing to work on the Plan Document;
- Waiting for N&K CPAs audit report which is still pending a final review before presentation to the Board;
- Planning is underway for the Fall Semi-Annual meeting and Fairs. Staff is working with Prudential to explore sites for an additional Benefits Fair in the Kona area. Prudential was able to secure Sheraton at Keaahou Bay to hold the Benefits Fair. The site is in the central proximity to both State and County employees. Sheraton offered a big discount to use its facilities for the Benefits Fair. Additional promotion is being developed; a short video advertising is being produced through Olelo to encourage more attendees.
- Continuing to review the Plan Asset quarterly reports.
- The Supplemental Agreement to amend Century's Investment Management Agreement has been completed and is pending signatures.
- Monitoring and reviews of the PTS Plan reports are continuing.

Agenda

Item # 8: Old Business

a. Status Report on Revisions to Prudential's Current Trading Authorization Forms for use within the Self-Directed Brokerage Option

The Board discussed this matter earlier in the meeting.

b. Status on Amendments to Century's Investment Management Agreement

The Board discussed this matter earlier in the meeting.

- c. Follow-up on Adding a Benefits Fair Location on Hawaii Island

Ms. Akiyoshi asked if the Board members could provide their travel preferences for travel to the semi-annual meeting, and the Kona and Hilo Benefits Fairs.

Agenda

Item # 5:

Status on DHRD's Request to Establish a Position for the Plan

- a. Approval of Memorandum of Understanding (MOU) Agreement

DAG Tam reviewed the provisions in the draft MOU covering the terms of the agreement, applicable fringe benefits, compensation and the funding of the position.

A motion was made by Trustee Moto and seconded by Trustee Margol to approve the MOU as drafted and authorize the Chairperson to sign the MOU on behalf of the Plan. The motion passed unanimously.

- b. Status on Filling of DHRD Position and Approval of Conditional Offer (in Executive Session Pursuant to HRS sections 92-5(a)(2) and 92-5(a)(4))

A motion was made by Trustee Young and seconded by Trustee Moto to move into Executive Session at 11:27 a.m. to update the Board on the search to present a conditional offer and to confer with the Plan's legal counsel to discuss the evaluation reviews and proposed salary of the candidate filling the DHRD position. The motion passed unanimously.

EXECUTIVE SESSION

Guests and Board's staff were excused from the meeting.

Meeting

Reconvened: **A motion was made by Trustee Moto and seconded by Trustee Young to move out of Executive Session at 11:37 a.m. The motion passed unanimously.**

Board staff, guests and the staff from Prudential rejoined the meeting.

A motion was made by Trustee Moto and seconded by Trustee Young to approve the hiring of Ms. Cynthia Akiyoshi to fill the DHRD position. The motion passed with one vote by Acting Chairperson Krieg to abstain.

Acting Chairperson Krieg noted that Ms. Akiyoshi will fill the position effective October 1, 2014, and asked Prudential to expedite the payments to DHRD upon presentation of the bill as the payment is needed to start the funding. Bills will be submitted to Prudential in advance and stated that funding for the position needs to be in place prior to the effective pay periods.

c. Approval of Payment to DHRD for the Special Funded Position

Ms. Akiyoshi stated that because the monies in the special funded account will lapse at the end of the fiscal year (on June 30, 2015), Prudential was asked if they could accept any unused amounts to hold for the next fiscal year. Prudential noted that the monies need to be paid from an account in the name of the Plan. Ms. Christiano confirmed that the monies that are paid out of the Plan from the Plan Expense Account need to be set aside in the name of the Plan, and any monies that are not used can be returned back to the Plan. Otherwise it may be considered a distribution.

Acting Chairperson Krieg noted that DHRD will be funding the vacation leave accrual amount so the Plan would not be responsible for this amount, and this amount would lapse at the end of the fiscal year if Ms. Akiyoshi does not separate from service before this date. The unused monies would be sent to Prudential, and can be left at Prudential after the first year until such time the monies are needed.

Acting Chairperson Krieg explained the options available for the amount on the Bill For Collection in the event that there are any issues of possible lapsed monies.

A motion was made by Trustee Young and seconded by Trustee Margol to approve the Bill For Collection, up to the amount of the maximum of \$81,205.00. The motion passed unanimously.

Agenda

Item # 8d:

Status on Contract Award for RFP No. DCP-FY-14-1, For a Small/Mid Cap Growth Equity Investment Option (in Executive Session Pursuant to HRS sections 92-5, 103D-105, and 103D-303)

Agenda

Item # 9:

Review and Discussion on Request for Proposals for Investment Consultant Services (in Executive Session Pursuant to HRS sections 92-5, 103D-105, and 103D-303)

A motion was made by Trustee Margol and seconded by Trustee Villabrille to move into Executive Session at 11:54 a.m. to discuss the above procurement matters. The motion passed unanimously.

EXECUTIVE SESSION

Guests and Prudential staff were excused from the meeting.

Meeting

Reconvened: **A motion was made by Trustee Margol and seconded by Trustee Young to move out of Executive Session at 12:30 p.m. The motion passed unanimously.**

Agenda

Item # 10: Other Business/Announcements

- a. Legislative Proposal Initiatives

Ms. Akiyoshi stated that DHRD's deadline on legislative bills for the upcoming 2015 Legislative session is nearing. The Board confirmed that they do not have plans to submit any legislative proposal initiatives.

Acting Chairperson Krieg adjourned the meeting at 12:32 p.m.

(NOTE: Signed copy on file.)