

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

**OPEN SESSION MINUTES  
SEMI-ANNUAL MEETING  
MEETING # 395**

Date: May 20, 2015

Place: Hawaii Prince Hotel  
Captain's Room  
100 Holomoana Street  
Honolulu, HI 96815

Present: James Nishimoto, Ex-Officio Member  
Wesley Machida, Ex-Officio Member  
Michael Okumoto, Employee Member  
Kanoë Margol, Employee Member  
Kenneth Villabrille, Employee Member

Others: Rodney J. Tam, Deputy Attorney General  
Cynthia Akiyoshi, DHRD Staff  
Troy Saharic, Mercer Investment Consulting  
David Williams, Mercer Investment Consulting  
Kevin Malmud, Plan Administrator Staff (Prudential)/Honolulu Office  
Grace Baracao, Plan Administrator Staff (Prudential)/Honolulu Office  
Jeanne Kanai, Plan Administrator Staff (Prudential)/Honolulu Office  
Julie Klassen, Prudential Retirement  
Deborah Baran, Prudential Retirement  
Carol Blumenthal, Prudential Retirement  
Bart Jefferys, Prudential Retirement  
Lacey Lockward, Prudential Retirement  
Joan Larsen, Prudential  
Charles Rowlan, MorningStar Investment Advisory Services  
Cliff Kalish, William Blair & Co.  
Delia Roges, INVESCO  
Todd Egger, INVESCO  
Robert Atwell, Harbor  
Maddi Dessner, J.P. Morgan  
Pat Carter, J.P. Morgan  
Michael Bowman, Capital Research (EuroPacific)

State of Hawaii Island Savings Plan

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Matt Westhoven, MFS  
Michael Chandra., PIMCO  
Bransby Whitton, PIMCO  
Lisa Rosenthal, Victory  
Tom Smythe, New York Life (Mainstay Investments)  
John Maschoff, Winslow/MainStay Investments  
Ed McGettigan, Vanguard  
Tom Atchison, Vanguard  
John Schadl, Vanguard  
Allan Duckett, Schroders

Via  
Conference

Phone: Sue Bonfeld, Wellington Management; Cheryl Lynch, Jennison Associates; Itai Lourie, Jennison Associates; Mark Lacey, Schroders

Absent: Wayne Chu, Chairperson  
Brian Moto, Employee Member

Call to  
Order:

There being a quorum present, Interim Chairperson Okumoto called the meeting to order at 9:16 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.

Interim Chairperson Okumoto opened the meeting with all trustees except for Chairperson Chu and Trustee Moto. He welcomed all attendees and opened with introductions, including those participating via conference call. Interim Chairperson Okumoto briefly covered some housekeeping items.

Agenda

Item # 1: Semi-Annual Report from Prudential Retirement

Presenting from Prudential Retirement are Ms. Julie Klassen, Ms. Deborah Baran, and Mr. Kevin Malmud; and Mr. Charles Rowlan from MorningStar.

Ms. Klassen opened with an introduction and remarks. Ms. Klassen followed with comments on the Benefits Fair that was successfully held and well-attended on Monday, May 18, 2015, at the Harbor View Center. There were 737+ attendees at the Fair, with 137 enrollments and 117 participants increased their contributions. Ms. Klassen provided the following commentary:

- Overall participation rate is at 26%:

The rate is based on all active employees over the number of eligible employees.

- Asset Retention:

Prudential looks at the reasons why assets leave the Plan. She noted that many large plans are challenged by asset retention. Some benefits for staying in the Plan are fee efficiency, good stable value rate, customized web communication, servicing by local representatives, and oversight by the Board.

Prudential is combating this challenge through the development of retiree information packet; the 457 plan versus 403(b) plan comparison document that focuses on cost efficiencies; and presentations by the retirement consultants.

- Comparisons with the 2015 NAGDCA Survey:

Ms. Klassen discussed the survey conducted by NAGDCA (National Association of Government Defined Contribution Administrators) and highlighted how the Plan compared with other plans who responded.

- Plan Overview:

Ms. Klassen reported that 42% of the Plan's assets are in the Stable Value Fund which is managed by Prudential/Jennison and Invesco. She noted that the anticipated change from the Century SMID Growth Fund, which has about \$45 million and about \$5 million nested with the Lifecycle portfolios, will impact about 5200 participants as the assets move to the William Blair Small-Mid Cap Growth Fund.

Ms. Baran provided updates on the communication and education activities.

- Plan Website activity:

The website is a resource for communication and education. The site has received almost 117,000 visits. There was a high traffic volume in January 2015. One trend observed is that participants are utilizing the website via smartphones and tablets. They will look at more ways to communicate electronically.

- NAGDCA Entries:

Ms. Baran indicated that she will be preparing entries on behalf of the Plan for submission to NAGDCA for its Leadership Awards to recognize the great work that is being done within the Plan.

For the Benefits Fairs, she will be exploring other engaging activities for the upcoming fairs.

Ms. Klassen reported that an inquiry was sent to Board members regarding Personal Information security. She noted that a call was made to the participant who generated the inquiry about how outbound information is sent out and that the social security numbers are masked in the communication. It is an industry standard to use social security numbers on their platform. In reviewing the last contribution confirmation statement that was sent to this participant, the participant had a unique situation where the last four digits of her social security were used, along with the Plan ID number. When these numbers were lined up with other coding, it looked like the other numbers in her social security number. Other preventive measures were implemented on her account to enhance security on her account.

Mr. Malmud presented highlights of the local office initiatives:

- The local office activities for the First Quarter 2015 resulted in 162 group meetings with 1,166 attendees at the meetings. The consultants held 1,738 one-on-one consultations. As a result, there were 337 enrollments, 341 GoalMaker election enrollments, and 1,528 contribution rate increases.
- A new Pre-Retirement kit was developed and rolled out at the Benefits Fair. Included are: a distribution options booklet, a pre-retirement checklist, and a white paper on maximizing social security benefits.
- Outreach efforts within DOE are being initiated with former Trustee Barbara Krieg, and a meeting is being scheduled within the month. They held a mini-fair on the UH campus in March which was successful, and are working with UH staff to continue holding meetings at various UH campus sites to increase participation at UH.
- Grace Baracao from the Prudential Honolulu Office received the administrative excellence award out of the 16 final candidates within the entire Prudential organization. The Board congratulated Ms. Baracao on her award.

Mr. Rowlan introduced himself and presented information on the tools available within Morningstar, usage within the Managed by Morningstar services, and new developments that will be available. There are two (2) tools to access

Morningstar: GoalMaker and Managed Accounts.

There are key differences between GoalMaker and Managed Accounts:

- GoalMaker platform is free tool to use and allows participants to get advice on which investments to use, based on risk tolerance and retirement date horizon.
- Managed Accounts is a tool with more customization based on a number of other financial factors such as salary, other accounts, what they may expect from retirement, etc. Also, there is a 35 basis points fee for using Managed Accounts.

Mr. Rowlan noted that although the number of participants enrolled in Managed Accounts decreased from one year ago, the total assets under management within Managed Accounts has increased during this one year time period. One reason for the decrease in the number of participants can be attributed to the number of retirees who are no longer using the tool in the Plan, and secondly, there are a lot of good tools available within the Plan such as the GoalMaker tool. Mr. Rowlan explained the redesign of its Managed Accounts interface on Prudential's platform that Morningstar has been working on to create a better user experience.

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##### Item # 2:

#### Investment Performance Evaluation Report from Mercer

##### a. Economic and Capital Market Environment

Mr. Williams provided a flash summary update on market activity since the end of the First Quarter 2015:

- GDP came in weaker than expected.
- Europe is doing well; Japan has been rallying based on the monetary stimulus program that was put into place.
- Performance in the U.S. was mixed result for equities.
- S&P 500 had a modest increase.
- Outside of U.S. saw strong performance returns; non U.S. equities rallied. Emerging markets did better than the developed markets.
- Fixed income was flat.

Mr. Williams stated all the asset classes are covered and there are no recommendations to add any others asset classes at this time.

- LifeCycle portfolios were ahead of its benchmark on a year-to-date but for the 1-month period is behind.
- Index strategies performed in line with its benchmarks.

- Seven of the eleven funds have outperformed its benchmarks on a year-to-date basis.
- International strategies were off to a good start on a year-to-date basis.

Investment Manager Updates:

- 1) Mr. Williams reported that Jennison requested a modification change to its guidelines pursuant to the investment management agreement. Mr. Lourie from Jennison explained the reasons for the change to its guidelines which would allow single ratings by agencies. This would allow more flexibility for single rating issues and would align with the methodology within the Barclays Indices. Currently, the guidelines do not permit holding securities with single ratings.

Mr. Williams added that a small proportion of approximately 2 to 3% are single rated securities so it was discussed with Jennison to add a cap/limit of 5% on the number of single rated securities so that it limits the issue overall. This was amenable to Jennison.

Interim Chairperson Okumoto reviewed the proposed changes to the guidelines.

**A motion was made by Trustee Machida and seconded by Trustee Margol to approve Jennison's request to modify the investment guidelines for the Stable Value Fund that would allow changes when securities are rated by the credit rating agencies and include a 5% limit on the number of securities for the securities that are only rated by one rating agency.**

Discussion Note: In response to the Board's inquiry on the price of the security when it was sold, Mr. Lourie stated that when the security was sold, the rating was AAA by DBRS, and was sold at a net gain of around \$30,000.00 to the Plan.

**The motion passed unanimously.**

- 2) Updates by PIMCO

Mr. Chandra provided an overview and updates on the PIMCO Total Return Fund, specifically the organization, flows, and performance.

- At the end of April, PIMCO hired Ben Bernanke as a senior adviser.

- PIMCO is refocusing equity efforts and expanding its partnership.
- Net outflows have continued but has slowed.
- Performance was down a little in April, but year-to-date have performed ahead of the benchmark.

3) Introduction of New Small-Mid Cap Growth Fund Manager, William Blair & Co.

Mr. Williams stated that Mercer and Board staff have been working with Mr. Cliff Kalish to develop a transition plan to move the assets from the Century SMID Cap Growth Fund to the William Blair Small-Mid Cap Growth Fund. Mr. Kalish introduced himself and provided some details on the transition of the Plan's assets to the new fund.

Interim Chairperson Okumoto called a break at 10:15 a.m. The meeting resumed at 10:30 a.m.

Interim Chairperson Okumoto acknowledged the sponsors for today's meeting and lunch. The Board wishes to thank Julie Klassen and the Prudential Retirement Team, Tom Smythe of MainStay/New York Life, Lisa Rosenthal of Victory Capital Management, Sue Bonfeld of Wellington Management, and Todd Egger and Delia Roges of Invesco.

Mr. Williams opened the panel discussions for today's meeting and commented that the panel will address risks in the equity market, potential macro risks and fundamental risks as we move into 2015.

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Item # 3:

Panel Presentation # 1 on Risks in the U.S. Equity Market: by Wellington Management Co., Victory Capital Management, and New York Life/MainStay

Presenters: Lisa Rosenthal from Victory Capital Management and John Maschoff from Winslow Capital, along with Sue Bonfeld from Wellington Management via conference call.

Ms. Rosenthal presented on interest rates and overview on the federal rate expectations. She explained that two (2) shifts are expected in the monetary policy for 2015 with an expected rate hike around September 2015. With the rest of the world reducing their rates, the Fed's are not expecting to raise rates as high as they anticipated. She further explained that what will determine the speed of the rate hike will depend on inflation and employment.

Mr. Maschoff presented information on exchange traded funds (ETFs) and their effect on market correlations and volatility. The ETFs industry has grown to \$2.3

trillion in the U.S. market. He illustrated historical stock correlations and said that today we are at very high levels. ETFs contribute to the high levels of correlations and represent 4% of the U.S. equity market capitalization and 25% of the trading volume in the underlying stocks of the ETFs. ETFs are used by investors because of their low cost and liquidity to adjust their market expectations going forward. He stated that studies have linked ETF arbitrage activity to higher stock volatility.

Ms. Bonfeld presented on macro events that can lead markets to sell off based on perceived risks. She focused on macro events in China which are leading to a slower growth. She felt that some of the structural reforms are encouraging and is a policy effort to link it economically to other major countries in the region.

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Item # 4: Panel Presentation # 2 on Washington Regulatory and Legislative Updates: by Vanguard

Presenters: Ed McGettigan and John Schadl from Vanguard.

Mr. Williams introduced the Vanguard panel who will address policy issues that are going on in Washington with respect to defined contribution plans. Mr. McGettigan introduced Mr. Shadl who is the head of the ERISA and Fiduciary Services group at Vanguard.

Mr. Shadl presented on updates on regulatory and legislative items and its effect on retirement plans. He explained that the focus is on the dynamics within the eighteen (18) months from the upcoming election with respect to the initiatives of President Obama and Congress. He described the reasons for why things are so broken in Congress such as intense partisanship, redistricting, and a focus on fundraising. Some things are moving in the right direction, and seeing some agreement in Congress. Some observations are a lack of engagement from the President with Congress and an anticipated low movement on tax reforms with respect to retirement plans. He illustrated some of the proposals being considered that may affect retirement plans and raise revenue.

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Item # 5: Panel Presentation # 3 on Market Effects of Lower Oil Prices: by PIMCO, J.P. Morgan, and Schroders

Presenters: Allan Duckett from Schroders, along with Mark Lacey via conference call. In addition, Bransby Whitton from PIMCO and Maddi Dessner from J.P. Morgan.

Mr. Williams introduced the third panel who will address the market effects of



lower oil prices and impact to investors.

Mr. Lacey described the macro outlook in the oil market and the market tightening that may result over the next twelve to eighteen months in the crude market with prices rising to \$85 per barrel. He pointed out there is a spike in gasoline demand in particular in the U.S., Europe, and Asia as a result of the fall of crude oil, the gasoline demand in China has been robust, and the U.S. shale production industry saw an 8% return on capital last year. He commented that the return on invested capital is projected to be less than 2% and is not sustainable, so the industry has cut capital expenditures by about 40%, and that with the collapse of oil prices, we will see significant unemployment in certain areas. He explained the oil prices versus the industry costs and the expectations of market tightening.

Mr. Whitton presented on the implications of the drop in oil prices and the pricing in the markets. He presented how inflation expectations are priced, reasons for lower inflation expectations and the drivers of inflation, and sources of volatility.

Ms. Dessner presented on the supply and demand, its effect on the marketplace, and the reactions to the changes in the oil prices. She raised the following points: (1) the significant increase from the production in the U.S. resulting in the oversupply situation in the global oil supply market; (2) who is supplying the oil supply, like the OPEC countries who have a lower cost margin; (3) the oil revenue is used from the sale of the supply goes to support their fiscal budget; (4) within the fixed income market, independent energy companies and oil field services affect the bond companies who perceive risks; (5) the market has seen wider spreads; and (6) different energy producers have resulted in both winners and losers in the market.

Mr. Williams asked about infrastructure spending and effects on employment. Ms. Dessner noted that depending on how the oil is transported (e.g., rail or pipeline), this leads to further discussions on the aging infrastructure. Mr. Lacey added that there are a lot of pipeline infrastructure, but the use of rail will decline. Pipeline infrastructure build out will provide a lot of the growth, and will expect to see more investments in petro-chemical plants in the U.S.

Trustee Margol asked about the timing on when oil prices will start to reverse and stabilize. Mr. Lacey expected that the rundown of capacity will be from now to year end; the next two quarters will see a draw down. Refineries will be in to maintenance and will be off-line in Q4 of this year; in the Q2 of next year (2016) will see timing of the deferred projects and the markets move to an equilibrium level.

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Item # 5:

Other Business/Announcements

There being no other business or announcements, Interim Chairperson Okumoto closed the meeting by thanking the providers for their reports and the fund managers for their presentations, and to everyone who participated in the Benefits Fair. Interim Chairperson Okumoto adjourned the meeting was adjourned at 12:00 p.m.

**(NOTE: Signed copy on file.)**