STATE OF HAWAII
DEFERRED COMPENSATION PLAN
BOARD OF TRUSTEES

OPEN SESSION MINUTES
MEETING # 399

Date: February 12, 2016

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

Present: James Nishimoto, Ex-Officio Member
Michael Okumoto, Employee Member
Roderick Becker, Employee Member (excused at 9:45 a.m.)
Kanoe Margol, Employee Member
Brian Moto, Employee Member
Kenneth Villabrille, Employee Member

Others: Rodney J. Tam, Deputy Attorney General
Cynthia Akiyoshi, DHRD Staff
Kevin Malmud, Jeanne Kanai, Grace Baracao, Prudential Honolulu Office
Julie Klassen and Carol Blumenthal, Prudential Retirement
Deborah Baran, Prudential Retirement – via conference call
Mark Bojanowski, Prudential Retirement – via conference call
Glenn Ezard, Segal Rogerscasey
Wendy Young Carter, Segal Rogerscasey

Absent: Wesley Machida, Ex-Officio Member

Call to Order: There being a quorum present, Interim Chairperson Michael Okumoto called the meeting to order at 9:00 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 stated that all trustees are present with the exception of Trustee Machida who is excused due to a meeting conflict. He opened the meeting with introductions of Board members, staff, and guests in attendance, followed by attendees participating via conference line.

Interim Chairperson Okumoto proceeded to Agenda Item # 1.

Agenda
Item # 1: New Business

a. Approval of Minutes Nos. 398 and 398-ES

The Board took a few minutes to review Minutes Nos. 398 and 398-ES.

A motion was made by Trustee Villabrille and seconded by Trustee Margol to approve Minutes Nos. 398 and 398-ES, as is. The motion passed unanimously.

b. Segal Rogerscasey Deep Dive Plan Analysis

Interim Chairperson Okumoto stated that the Plan's consultant, Segal Rogerscasey, has conducted a deep dive of the Plan and will be presenting their strategy review and observations.

Ms. Carter opened with the purpose of the deep dive analysis and commented that it was a way for Segal to get acquainted with the program and how the Plan compares with other plans, as well as present some trends in the marketplace:

- The survey information that is referenced is primarily from the NAGDCA survey, and noted that there is no other data source for public defined contribution plans. Respondents to the survey are limited from both the state and county levels, but information is still beneficial for benchmarking.
- The Hawaii Plan already includes many of the best industry practices.
- Plans should be legally compliant, operationally sound, and carefully and thoughtfully communicated to its participants.
- Some legal and legislative updates:
  - SEC released a letter on fee disclosures.
  - There are lawsuits in the corporate sector dealing with fiduciary responsibilities on monitoring investment options (e.g., U.S. ruling in Tibble vs. Edison)
  - IRS released a letter on maintaining records relative to loans and hardships.
- Plan Governance: plans should have a process and procedures. She noted that the Plan does:
  - Have a process and procedures. It is more important that the reasons can be supported through a decision-making process, regardless of the fund's outcome.
  - Hold regular meetings, etc.
- Plan governance structure should:
  - Have a formal Board of Trustees.

- Consider formation of subcommittees (e.g., investment committee, audit financial committee, participant education committee, etc.)
- Have minutes available/posted on the website.
- Provide an orientation and a trustee manual for incoming members.
- Make educational sessions available to Board members (e.g., today's meeting, attend conferences, etc.).
- Board members who bring practical experience to the Board; each could bring different perspectives and create an effective governance.

Ms. Carter noted that the Plan has/is doing most of these practices within its plan governance structure already.

- Service Provider review and oversight:
  - Selection for TPA (Prudential) was done through a formal competitive bid process.
  - A review of Prudential as the record keeper reveals that Prudential does have the basic qualifications that makes a good record keeper.
  - Fee benchmarking is an important part of governance and oversight. There has been lots of regulatory attention on fees in plans in recent years. On the government side, there is a challenge in coming up with a fee benchmark that compares apples to apples. It can be complex because of the various plan sponsors designs.
  - The Plan does have a detailed TPA contract agreement that spells out the expectations for the TPA, and which includes service commitments, performance standards, and SSAE (formerly SAS) reporting.
  - Prudential's service also includes conducting an independent Plan audit.
  - 80% of plans have service standards; the Plan's list of requirements are more comprehensive than other plans.

Ms. Carter noted her observations from the past that DAG Tam has produced very good service contracts, which serves the Plan very well.

- Plan Fees Disclosures by Department of Labor:
  - ERISA plans are required to file annual disclosures to plan sponsors.
  - Revenue shares are usually credited to accounts.
  - The float income and annuity commissions are subject to

    disclosures.
    - Ms. Carter noted that the Hawaii Plan complies with ERISA and seen as a best practice.
- Participant Fee Disclosures by Department of Labor:
    - The Hawaii Plan maintains transparency on fees.
    - Having transparency is beneficial for participants.
    - New York State has a good example of fee transparency; a fee document is posted on its website.
    - In a review of the Plan's participants' fees, Prudential assesses .125% (i.e., 12.5 basis points) for administrative fees and a fee cap of $90 per participant per year.
    - Seeing an increase in hybrid fee models. About 12% of plans waive fees for small balance accounts. 80% of plans have a cap on asset based fees for large balance accounts. It provides for more of a fee equity (fee levelization) since participants pay for the same services.
- Participation and Enrollment:
    - Reviewed state-wide participation rates; Plan participation rate without the educational institutions is at 46% and the rate inclusive of the educational institutions is at 29%.
    - The NAGDCA participation rate average is 40%.
- Automatic Enrollment:
    - Within the private sector, 60% of plans with $1 billion in assets have automatic enrollment. The private sector typically has matching contributions. 70% of plans do not have a match.
    - States are acting to expand retirement vehicles to small businesses. 70% surveyed said automatic enrollment was a good idea and find that those enrolled stay in the plan. Plans with automatic enrollment reveals that there is no difference in the numbers who opt out if the rate is between 2% versus 6%.
    - There are generally other outside factors/influences that affect a plan's decision to implement automatic enrollment.
    - Within the public sector, states are moving to automatic enrollment but generally requires enabling legislation.
    - This feature is already included in the Prudential contract.
    - Options on implementing automatic enrollment include just new hires, re-enrollments of investment allocation, etc.
    - There are challenges: transmitting information on eligible employees to the record keeper, and there may be administrative limitations; and impact from the number of cash-outs, more participants but see more numerous small average account balances, and fewer beneficiaries on file.
- Auto-escalation:
    - Feature addresses whether participants are putting in enough.
    - Has a significant impact on participants. Currently, the number

of Plan participants contributing fixed dollars is 87.4% which does not adjust for salary increases (e.g., raises). An example of 25 year olds at a fixed amount of $100/month will have 30% less at age 65 if there is no escalation over the years.
    - NAGDCA survey shows 25% of plans have auto-escalation.
- ROTH Feature:
    - Less than 30% of deferred contribution plans have a ROTH feature; has had a slow momentum.
    - Plans with ROTH have had low utilization stats.
    - ROTH has same contribution limits as 457 plan.
    - There are administrative complexities such as determining necessary payroll capabilities to withhold taxes on an after-tax basis and transmitting the deductions to the Plan, determining the holding periods and withdrawal provisions.
    - Targets population who are expected to be in a higher tax bracket when they are retired, so typically this feature is geared for a younger population who are in a lower tax bracket.
- Loan Feature:
    - 60% of plans have a loan provision.
    - Administrative considerations: Repayments are done through payroll. Some pay via ACH debit directly to the administrator.
    - The provision allows access to monies; access is beyond unforeseeable emergency withdrawals.
    - On the private sector side, plans with a loan provision have seen an increase in participation rates.
    - 56% of plans have a limit of one loan at a time.
- Attraction and Asset Retention:
    - The Plan is the most cost effective way to save for retirement since it provides an added benefit of institutional pricing.
    - Important to continue with the education on ability to rollover contributions to the Plan.
    - Studies of corporate plans show they have a policy for retaining retiree or terminated employees' assets.
    - Advantages of remaining in the Plan are having economies of scale and attractive features, ensuring funds are there at retirement, and providing bankruptcy protection.
- Participant Education:
    - The Plan has some unique aspects such as holding Benefits Fairs, utilizing take action methods at the Fairs, servicing by local office representatives.
    - Representatives conduct face-to-face meetings which are very effective.
    - Targeted mailings to focus on participants at various life stages is beneficial.
- Investment Education:

- 63% of plans offer computer based models.
- 45% of plans have access to a fiduciary advisor.

Trustee Nishimoto stated that in conclusion the Plan looks to be in a good position, and asked that Segal provide a summary to highlight the items that would bring additional enhancements to the Plan for the Board's consideration. Trustee Nishimoto acknowledged DAG Tam for his efforts to make the Plan legally and operationally sound.

DAG Tam noted that the items presented have been discussed with the Board in past meetings.

Mr. Ezard discussed Investment Option allocations, and explained the diversification of the funds across the asset classes, and the service delivery and the way participants access their investment options.

- Plan offers diversification and a number of good options. There are a lot of options in U.S. equities. He noted that you would get better diversification when moving out of stocks into real assets or alternatives. There is global exposure through the asset allocation programs (e.g., Lifecycle Funds and Goalmaker). Between global versus equities, it is not just U.S. versus non-U.S.
- Goalmaker versus Lifecycle: Offers global diversion; and access between these 2 are not too different. So, there is a slight overlap but deciding whether there is a need for 2 programs is not a priority now.
- Investment Option Gaps:
    - Within core funds, there is no global equity exposure. Global equities does offer opportunity for growth. Within the Lifecycle funds, there is global exposure.
    - Global fixed income:
        - With current rates, he doesn't feel that the Plan would be missing a lot if not offered.
        - From an equity investor perspective, the option may be missing.
    - Alternatives:
        - Have not seen many defined contribution plans add alternative options, mainly because it can be complicated. But it does offer a level of diversification and can smooth out returns in a volatile market.
        - This instrument can play a role in an investment portfolio.
        - A fund-to-fund structure can offer a good way to blend investment options to include alternatives.
    - Real Assets:
        - Examples are Treasury Inflation Protected securities

        (TIPS), commodities, REITS, etc.
        - Option has a significant presence in the Lifecycle funds.
        - Strategy would not be a priority consideration.
- Investment Challenges:
    - Global economic growth is slowing and is causing interest rates to be low.
    - In an environment of low interest rates and low inflation:
        - Returns will be challenging.
        - With a lack of alternatives, will be left with stocks and bonds.
        - Alternatives such as hedge funds strategies do not correlate with stocks and bonds; it can smooth out portfolio returns and provides downside market risk protection.
    - Liquidity issues which can be remedied through a fund-of-fund structure.
        - Include liquid investments in a fund-of-fund structure.
        - Current concept is shown in lifecycle and stable value options.
        - Able to introduce liquid funds and commingle the funds into a fund-of-fund structure.
    - Mr. Bojanowski commented on possibly how Alternatives could fit into a customized solution within the Goalmaker tool.

Mr. Ezard confirmed Trustee Moto's comments that the assumption that alternative investments is risker is not necessarily the case, but by diversifying the portfolio the overall risk exposure can be reduced.

Ms. Carter stated that next steps could be preparation of an executive priority summary of the main issues for further discussion.

Trustee Moto thanked Segal Rogerscasey for preparing the summary and consideration of options, and suggested including alternative and global investment options as a discussion points for further discussion.

Ms. Carter stated that other issues could include measures that could be easily implemented versus those that are not under the Board's control, and those that increase the success of the Plan.

<u>Agenda Item # 2</u>: <u>Ongoing Business</u>

a. <u>Investment Performance Summary Review</u>

Mr. Ezard presented a summary snapshot of the 4th Quarter 2015, along with some updates on the performance of the investment options within the Plan:

- The Victory Institutional Diversified Stock fund's performance slipped during the 4th Quarter.
- Stocks had a nice recovery; performance weakness around the bonds.
- Will continue to monitor the Victory Institutional Diversified Stock fund.

Ms. Akiyoshi noted that PIMCO has provided its performance updates for the quarter end December 31, 2015. Mr. Ezard commented that their performance has improved.

Interim Chairperson Okumoto called a short break at 11:23 a.m. The meeting resumed at 11:30 a.m.

Agenda Item # 3: Other Business/Announcements

a. Election of Board Chairperson/Vice Chairperson for 2016

Interim Chairperson Okumoto asked for nominations for a Chairperson and Vice Chairperson.

A motion was made by Trustee Villabrille and seconded by Trustee Margol to nominate Trustee Moto for Chairperson and Trustee Nishimoto for the Vice-Chairperson. The motion passed unanimously.

Interim Chairperson Okumoto stated that the change will take effect from the next Board meeting, on March 21, 2016.

b. Discussion on the Liquidation and Distribution of Proceeds to Named Beneficiaries Upon the Death of a Participant

Ms. Akiyoshi summarized a situation that came up through Prudential related to the RMD payments distributed upon the death of a participant.

- There are two beneficiaries on the participant's account. Both beneficiaries are brothers, and one of the brothers is the executor of the participant's estate ("Brother 1").
- Brother 1 informed Prudential about the participant's death about a year after the participant died.
- The remaining balance in the deceased participant's account in the

Plan was distributed equally between Brother 1 and the other beneficiary ("Brother 2").

- It was subsequently discovered that while alive, the participant made arrangements to have RMD distributions from his Plan account to be electronically deposited directly to his personal bank account.
- Prudential discovered that a number of RMD payments were deposited into this bank account between the date the participant died and the date the Plan was notified of his death.
- These RMD payments should have been returned to the Plan account before the remaining balance was distributed to the two beneficiaries.
- However, as executor of the deceased participant's estate, Brother 1 has since drained the bank account, and is currently unable and/or unwilling to return these funds back to the Plan for distribution to the two beneficiaries.
- Prudential is in the process of trying to recover the proceeds from Brother 1 in order to resolve the beneficiary dispute between the two brothers.
- Prudential asked whether the Board would be willing to use Plan expense monies to settle the dispute, and make Brother 2 whole.
- It was pointed out that the Plan relies on third parties (e.g., beneficiaries, executors, relatives, etc.) to notify the Plan about the death of a participant, and the Board is not aware of any law or rule that requires the Board or Plan to affirmatively search for participant deaths.
- A precedent could be set if the Plan were to use Plan assets to reimburse Brother 2.

A motion was made by Trustee Nishimoto and seconded by Trustee Villabrille to move into Executive Session at 11:39 a.m. to confer with legal counsel on the Board's powers, duties, privileges, immunities, and liabilities with respect to the disposition and use of Plan expense monies to pay beneficiary claims. The motion passed unanimously.

All guests were excused.

EXECUTIVE SESSION

Meeting Reconvened: **A motion was made by Trustee Moto and seconded by Trustee Nishimoto to move out of Executive Session at 11:54 a.m. The motion passed unanimously.**

All guests rejoined the meeting.

Agenda

Item # 3: Other Business/Announcements

b. Discussion on the Liquidation and Distribution of Proceeds to Named Beneficiaries Upon the Death of a Participant

Interim Chairperson Okumoto stated that the Board discussed the information presented, as well as several different options to resolve this matter. In summary, the Plan was not aware that the participant died. Neither the participant's estate, the executor of the estate, or anyone else notified the Plan about the participant's death. Thus at the time when both beneficiaries filed their claims, the Plan properly distributed the remaining balance in the deceased participant's Plan account to the two named beneficiaries, Brother 1 and Brother 2.

Based on the details provided by Prudential of their discussions with Brother 1, the Board understands that Brother 1 drained his father's personal bank account that contained some of the RMD payments (half of which appear to be owed to Brother 2) without Brother 2's consent. Thus, it appears that Brother 1 may have engaged in conversion theft, or some other criminal act when he took part of the RMD payments that are owed to Brother 2. Accordingly, Brother 1 appears to be the sole cause of the current dispute between the two beneficiaries. As a result, neither the Plan nor the Board are at fault in this matter. The Board therefore believes that it would be improper to use Plan assets to reimburse Brother 2.

The Board again commented that using Plan assets to reimburse a beneficiary when the Plan is not at fault sets a bad precedence. The Board further believes that the dispute about these RMD payments is a private matter between the two brothers, and Brother 2 should seek reimbursement from Brother 1. Finally, the Board suggested that if Prudential wanted to, it could use its own funds to reimburse Brother 2 and then seek reimbursement from Brother 1. Prudential indicated that they would discuss this matter internally, consider all of their options, and notify Brother 2 of the Board's decision.

A motion was made by Trustee Moto and seconded by Trustee Villabrille to not use Plan expense account monies to pay any unresolved claims, and that the dispute should be a private one between the two beneficiaries.

The motion passed unanimously.

The Board asked Prudential to respond back to the second beneficiary that he needs to pursue recovering the outstanding claim with his brother who is the other beneficiary. DAG Tam added that Prudential could continue to pursue recovering the unresolved payment amount from the estate, and/or Prudential could pay the claim upfront while attempting to recover the monies from the estate.

c. PTS Plan

i. New Crediting Rate Effective January 1, 2016
ii. LSW's Annual Letter on the Reimbursable Amount Available in the PTS Plan Expense Account

Ms. Akiyoshi reported that the new crediting rate that is effective on January 1, 2016 is 2.76%. Also, LSW has prepared its annual letter to report the amount available in the Plan's reimbursable expense account. There was a revision made to the expense account by LSW to correct and reimburse the account for an earlier credit made to pay for the Plan audit conducted in 2010. The cost of the audit was added back and the new adjusted available amount is now $43,602.24.

There being no other business, Interim Chairperson Okumoto thanked Ms. Carter and Mr. Ezard for their presentation. The meeting was adjourned at 12:00 p.m.

(NOTE: Signed copy on file.)