

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

**OPEN SESSION MINUTES  
SEMI-ANNUAL MEETING  
MEETING # 407**

Date: October 31, 2016

Place: County of Kauai  
Moikeha Building Conference Room  
4444 Rice Street  
Lihue, HI 96766

Present: Brian Moto, Chairperson  
Wesley Machida, Ex-Officio Member  
Kanoë Margol, Employee Member  
Kenneth Villabrille, Employee Member  
Kalei Rapoza, Employee Member

Others: Rodney J. Tam, Deputy Attorney General  
Cynthia Akiyoshi, DHRD Staff  
Glenn Ezard, Segal Rogerscasey  
Wendy Young Carter, Segal Rogerscasey  
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  
Lacey Lockward, Prudential Retirement  
James Headley, MorningStar Investment Advisory Services  
Stephen Weeks, William Blair & Co.  
Todd Egger, INVESCO  
Delia Roges, INVESCO  
Cheryl Lynch, Jennison Associates  
Sam Kaplan, Jennison Associates  
Greg Franzblau, J.P. Morgan  
Vince Ortega, Capital Research (EuroPacific)  
Jacob Gerber, Capital Research (EuroPacific)  
Matt Westhoven, MFS  
Tom Smythe, New York Life (Mainstay Investments)  
Sunita Patel, Wellington Management Co.

State of Hawaii Island Savings Plan

Minutes # 407

October 31, 2016

Page 2

Ed McGettigan, Vanguard  
Shawn Parris, Schroders  
Brendan Bowe, BlackRock  
Sean Lewis, BlackRock  
Ata Azarshahi, National Life Group/Life Insurance Co. of the Southwest  
Nathan Glassey, National Benefit Services  
John Thorne, National Benefit Services  
Jeanne Moser, National Benefit Services  
Kapena Kim, Prudential  
Al Lee, Prudential  
Peter Eddy, Prudential  
Tom Kalili, Prudential

Via  
Conference

Phone: Jeremy Stempien, Prudential

Absent: James Nishimoto, Ex-Officio Member  
Roderick Becker, Employee Member

Call to  
Order:

There being a quorum present, Chairperson Moto called the meeting to order at 9:01 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 Moto opened the meeting with all trustees present, and noted that Trustees Nishimoto and Becker were excused. He welcomed all attendees and opened with introductions, including those participating via conference call and attendees present. He acknowledged the County of Kauai and Trustee Villabrilie, for allowing the Board to use their facilities and noted there were no attendees from the public. Chairperson Moto 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. James Headley from MorningStar.

Ms. Klassen opened with an introduction and remarks, and provided the following summary overview:

Plan Data – eligibility and participation:

- After Segal's deep dive earlier in the year, Prudential worked on activities to increase new enrollments.
- There are different ways to look at the participation rate. The overall Plan participation rate, excluding the DOE and UH, as of the Third Quarter 2016 is 47% versus 46% in the Fourth Quarter 2015;
- In contrast, in comparison with the recent NAGDCA benchmarking survey on data of 62 plan sponsors show:
  - A participation rate of 52.6% where there is a competing plan across like government plans; and
  - A participation rate of 59.7% where there is no competing plan.

Asset Allocation and education:

- Goalmaker assets totaled 5.9% in the Third Quarter 2016 compared to 4.5% during the Fourth Quarter 2015;
- Custom LifeCycle portfolio assets totaled 4.8% in the Third Quarter 2016 compared to 4.6% during the Fourth Quarter 2015.

Ms. Klassen reported that participants are utilizing and taking advantage of the tools and educational materials that are available. New contributions to the Stable Value Fund through the Third Quarter 2016 totaled 31.2%. Prudential has been making efforts to make information easier for participants and in reaching the millennials. As a part of the open house activities during the National Retirement Security Week, an online game, Outsmart the Market, and online webinars were made available to educate and make the information more accessible and fun.

She noted that distributions were down in the Third Quarter 2016 compared to the Second Quarter 2016 period; there will be spikes but we are seeing the trend showing more inflows into the Plan.

Mr. Malmud reported on the Prudential Honolulu Office activities. The local office is on track to meet their meeting goal expectations.

- As Prudential has reached its 3-year anniversary, they have evaluated the value that has been added by Prudential since the last full year with ING/VOYA at Plan Year ending June 30, 2013. There has been on average:
  - 11% increase in attendance at the group meetings;
  - 24% increase in the number of one-on-one meetings;
  - 36% increase in the amount of total dollar rollovers in to the Plan;
  - 95% increase in the number of enrollments.

He added that the number of increases are due to the team's focus on the participant education process, on engaging participants to take actions, making tools available, and on expanding key relationships. The local office team has directed their outreach efforts on DOE and UH, and initiated activities like the open house events as a part of the National Retirement Security week celebration. The team has worked with Ms. Baran and the Board's staff on the communication planning. Results from the open house: there were 166 employees who responded to the automated link; 131 walk-in attendees came to the local office, and 61 employees attended the webinars, reaching a total of 192 employees. Actions taken included 27 enrollments, 25 contribution increases, 33 Goalmaker elections, and 12 rollovers into the Plan. Surveys received by the attendees were positive. He reported on the on-going initiatives such as the mini deferred compensation fairs, outreach to key union organizations, targeting departments with low participation, and meeting with local payroll agencies.

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

- New Cultural Presentation:

Ms. Baran reported that a new cultural presentation was developed and rolled out as part of the open house activities. Mr. Tom Kalili took the lead in developing a presentation.

- Plan Website Redesign:

Plans are underway to redesign the website in an effort to reach out to the millennials and generation X. Rollout is tentatively planned for October 2017.

- Production of videos:

The short video produced for DOE was shown. A similar video has been developed for all employees, as well as a pre-retiree video as employees phase into retirement.

Mr. Headley, from Morningstar, opened with an organizational update that beginning as of January 1, 2016, Morningstar and Ibbotson have combined into a single registered investment advisor as Morningstar Investment Management. He provided an overview of the managed accounts services which has seen an overall growth. For the Plan, there are 1,627 participants currently enrolled in the managed account service. Customized recommendations that are provided to participants are based on the information from Prudential as well as the

information provided by the participants. The average age of a participant that is using Morningstar's managed account service is age 56.

Mr. Headley discussed allocation comparisons between the Plan average, a sample target date fund, and how individual Plan participant users allocated their portfolios, and noted some findings that: (1) the allocation to equities was around 60%, in part for participants to get to a desired goal income for retirement; (2) the greater percentage of Plan participants utilizing the managed account service was between ages 51 to 60; and, (3) Plan participants in this age group tended to be more conservative in their investment allocations than the average target date fund. The impact of the managed account service shows 87% increased their savings rate after receiving recommended goals to get more in retirement.

### Agenda

#### Item # 2:

#### Investment Performance Presentation from Segal Rogerscasey Investment Consulting

Ms. Carter remarked that she will be observing and making notes during tomorrow's Benefits Fair, and will provide updates related to the deep dive analysis at the Spring 2017 Semi-Annual meeting.

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

Mr. Ezard provided a flash summary update on market activity during the Third Quarter 2016:

- GDP was a little stronger in the Third Quarter.
- Federal Reserve has been talking about raising interest rates.
- There was slow growth during the First and Second Quarters of 2016, and continued in the Third Quarter.
- The Bond market performed well during the Third Quarter 2016 due to slow increases in the interest rates; and the equities held up during the quarter. Overall performance among the investment funds were good.
- The Brexit had minimal impact in the couple of months after; however, it is having an effect on the UK and the economy has been slowing. The risk is stagflation where new trade agreements may create more slowing in the GDP. Global trade market volumes are down and may see more impact 18-24 months out.

##### b. Review of Investment Strategy and Fund Performance

Mr. Ezard provided comments on the funds on the watch list and an overview of the investments funds:

- The Victory Institutional Diversified Stock Fund and the MainStay Large Cap Growth Fund continue to lag their benchmark and peer groups.
- The Board is planning to consider options for the Victory Institutional Diversified Stock Fund.
- The MainStay Large Cap Growth Fund has been moving up and down and is harder to predict their performance.
- 43% of assets are allocated to the Stable Value Fund.
- 13% of assets are allocated to the BlackRock index funds.
- He noted that it was encouraging to see an increase in the percentages in the Goalmaker and LifeCycle portfolios.
- The performance of all asset classes were positive for the quarterly period.
- The year-to-date assets improved in the J.P. Morgan inflation hedged option. TIPS has improved a bit and is outpacing general inflation with low unemployment.

Agenda

Item # 3:

Annual Report from Life Insurance Company of the Southwest

Mr. Azarshahi presented highlights for the PTS Plan:

- Plan assets are over \$115 million, as of June 30, 2016.
- State savings for the current year are at \$8 million; and \$130 million since the inception of the Plan.
- The average number of actives in a one-month period is about 10,188.
- The amount of contributions has increased.
- The crediting rate as of July 1, 2016 is 2.70% which is the net rate.
- Escrow account information has been included. The recent update on the escrow account is the preparation of an agreement with the State, as requested by J.P. Morgan Bank to authorize LSW to add additional amounts to the escrow account. LSW has added \$21 million, so the total escrow assets are at \$120 million.
- The rating has been upgraded to A+.
- There are now about 70,000 inactive participants.
- LSW is working on Plan updates to add the county of Kauai to the Plan.

Chairperson Moto called a break at 10:16 a.m. The meeting resumed at 10:45 a.m.

Agenda

Item # 4:

Panel Presentation # 1 on Inside the Glide Path – Efficient Modeling for Retirement: by BlackRock, Prudential, and Capital Group

Presenters: Sean Lewis from BlackRock; Jacob Gerber from Capital Group; along with Jeremy Stempien from Prudential via conference call.

Mr. Lewis opened with his background at BlackRock and Mr. Gerber introduced himself and noted Capital Group's appreciation for the 20-year relationship of the EuroPacific Growth Fund in the Plan. Mr. Stempien joined the meeting via conference call.

Mr. Lewis discussed target date design ideas that would provide stable outcomes through LifeCycle funds. He talked about the design of a model glidepath that would include a higher allocation early and moving towards de-risking as you move towards retirement, and maintain a static portfolio. The objective is to maximize spending power through diversification. He explained how they populate the glidepath with asset classes to come up with the most diverse and efficient portfolio. The last component is implementation; consideration on whether to go passive or active. There is evidence that shows that over longer periods of time, outcomes are least impacted by the implementation component and everything is driven by the glidepaths and how much risk is taken. The least impactful is whether you decide to go passive or active. The optimal allocation is 40% allocation to equities in age 60's and consume through retirement. This age group tends to see events more short term and the focus would be to manage for long term.

Mr. Gerber presented on building and preserving wealth, addressing longevity risk, and on mitigating volatility. He presented an objective based glidepath and the considerations as you go through the accumulation, transition and distribution phases. He remarked that the growth funds phase out around 5 years post retirement and the focus is on stable generating companies. He described the S&P 500 5-year rolling returns as an example and the breakouts between value and growth and the low yield and high yield dividend paying companies. He notes that the volatility is roughly the same between growth and the value indices for the rolling 5-year returns, and explained the patterns of returns and volatility of the dividend paying companies. He also presented the thought processes on the fixed income side of a glidepath, with a focus on short-term, less volatile fixed income investments to preserve capital during retirement and to generate equity income.

Mr. Stempien discussed how managers optimize risk while creating customized glidepaths. Within the target date space, the concept is to optimize portfolios at different stages with different levels of risk. Target date funds are built for the masses, so the goal is to cast a wide net, to provide the best outcome, because people are different from one another. He discussed bridging the accumulation gap and transition into retirement. The primary objective of the target date funds in retirement is to preserve purchasing power. Because an individual and risk

change over time, they look at building a glidepath that reflects and addresses those risks to provide an optimized portfolio. He explained that a true asset liability modeling to get to a maximum draw-down is critical in the planning phase but can get challenging because of assumptions that fund managers must make on spending draw-down and unique situations.

Agenda

Item # 5: Panel Presentation # 2 on Upside Down World: Maintaining Principal Amid Low and Negative Interest Rates: by INVESCO and Jennison Associates

Presenters: Todd Egger from INVESCO and Sam Kaplan from Jennison.

Mr. Kaplan opened with introductions and comments on the low interest rate environment we are in and the forecast growth projections. There are 3 factors that play a role in their outlook: (1) federal economists have consistently forecasted a rosier prediction than actual data; (2) U.S. yields are higher when compared to the rest of the developed world, causing large amounts of foreign buying and U.S. debt. The Fed hike expected in December and central banks in easing mode which they expect to continue, and (3) long term trends in secular markets point towards lower yields. He described what the financial institutions are facing, how people are choosing to save versus invest, and the aging population. He opined that the Fed may be rising interest rates slowly and tightening may move slower, as seen last year when there was only one hike in the rates. He discussed global yield curves and observations on European fixed income investments.

Mr. Egger discussed maintaining principal and the outlook for interest rates. The benefits of stable value, which is designed to preserve principal and be responsive in the marketplace, in this low rate environment: (1) book value crediting rates are based on a formula; (2) wrap contracts have a 0% floor on the crediting rates and they will credit zero if rates drop into the negatives; and (3) daily book value transfers guaranteed for individual transactions. He described a 5-year case study on 5-year Treasury yields and impact on the stable value; and long-term returns and impact on stable value in a continued low rate environment. He explained the challenges that the stable value faces in the low rate environment, and what happens in a negative yield environment.

Agenda

Item # 6: Panel Presentation # 3 on Stock Picking and Cognitive Dissonance: by MFS and William Blair & Company

Presenters: Stephen Weeks from William Blair and Matthew Westhoven from MFS.



Mr. Weeks introduced himself and discussed the active management performance and perspectives in managing to outperform the benchmark in the SMID space. He described how plan sponsors are looking more at fees, the trend on fees, and how managers are evaluating products to be more competitive. He noted that fees will continue to be pressed downwards and more consolidation and acquisitions going on in the industry. As managers, they look at spending the money to continue to generate alpha. He discussed stock selections in a low growth environment and some examples in making changes in the small cap space which can then add alpha.

Mr. Westhoven discussed stock selection as an active manager of global equities. He illustrated the increase in passive management in the international space but with active management the cumulative return is much higher over time with patience and time in down and up markets. Over a 20-year period, profitable companies prove to be greater than unprofitable companies and returns are better with patience and time. He explained that it is best to look at profits and earnings when deciding to invest with companies. He noted that fundamentals drive cash flows and cash flows drive stock profits and profits drive stock prices. He commented and concluded that the key is getting through the noise, doing the research, and having the right process to find quality companies to invest in for the long-term.

Agenda

Item # 7: Other Business/Announcements

There being no other business or announcements, Chairperson Moto closed the meeting by thanking the providers for their reports and the fund managers for their presentations and for participation in the upcoming Benefits Fair. Chairperson Moto adjourned the meeting at 12:06 p.m.

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