

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

**OPEN SESSION MINUTES  
MEETING # 410**

Date: March 10, 2017

Place: Department of Human Resources Development  
14<sup>th</sup> Floor Merit Appeals Board Conference Room  
235 South Beretania Street, State Office Tower  
Honolulu, HI 96813

Present: Brian Moto, Chairperson  
James Nishimoto, Ex-Officio Member  
Wesley Machida, Ex-Officio Member  
Roderick Becker, Employee Member  
Kanoë Margol, Employee Member (arrived at 1:37 p.m.)  
Kalei Rapoza, Employee Member

Others: Rodney J. Tam, Deputy Attorney General  
Cynthia Akiyoshi, DHRD Staff  
Glenn Ezard and Wendy Young Carter, Segal Marco Advisors  
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 and Deborah Baran, Prudential Retirement  
Carol Blumenthal, Prudential Retirement – via conference call

Absent: Kenneth Villabrille, Employee Member

Call to Order: There being a quorum present, Chairperson Brian Moto called the meeting to order at 1:31 p.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 welcomed everyone and noted that all trustees were present, except for Trustee Villabrille who was excused. He stated that there were no guests in attendance from the public.

Agenda

Item # 1: New Business

a. Approval of Minutes No. 408, 408-ES, 409, and 409-ES

Chairperson Moto stated that Minutes No. 408 and 409 were distributed in advance for the Board's review and is ready for the Board's action. Minutes Nos. 408-ES and 409-ES were distributed this afternoon. Chairperson Moto provided some changes to Minutes No. 408 and 409.

**A motion was made by Trustee Nishimoto and seconded by Trustee Rapoza to accept Minutes Nos. 408 and 409, with the noted changes, and Minutes Nos. 408-ES and 409-ES. The motion passed unanimously.**

b. Review and Approval of Segal Marco Advisors Proposed 2017 Annual Reallocations for the LifeCycle Portfolios

Mr. Ezard summarized that every year the targets for the LifeCycle portfolios are reviewed. The objective of the review is to de-risk the LifeCycle portfolios going forward by decreasing the equity options and increase the bond allocations.

For the proposed 2017 target allocations, Segal proposes to keep the same allocations within the Income fund. For the other LifeCycle portfolios, the targets roll forward and there is a shift in the allocations, generally with fixed income allocations going up and stock allocations going down.

Chairperson Moto noted that at the last meeting Trustee Machida remarked about the underperformance LifeCycle portfolios and being in the 90<sup>th</sup> percentile or at the bottom quartile. He asked whether the allocations will help improve the performance of the LifeCycle portfolios. Mr. Ezard noted that it will not necessarily change as the individual performance of the core mix within the LifeCycle portfolios does affect and has been dragging the performance of the portfolios. Segal can present some alternative options for discussion during the deep dive analysis.

Ms. Klassen added that Prudential is able to rebalance the LifeCycle portfolios around April 13, 2017.

**A motion was made by Trustee Becker and seconded by Trustee Nishimoto to approve the 2017 reallocations for the LifeCycle portfolios, as proposed by Segal Marco Advisors. The motion passed unanimously.**

Chairperson Moto moved to Agenda item # 1.c.

c. Discussion and Review of Segal Marco Advisors Annual Deep Dive Plan Analysis and Potential Action on Recommendations

Ms. Carter explained that the purpose of the annual service is to do a strategic review, legal analysis, and review of last year's observations. She noted that the focus is to keep abreast of the trends, understand the current environment, have the Plan function well, and look for areas of improvement. She provided an overview on:

- Regulatory updates:
  - Last year, the IRS issued regulations and guidance on section 457 plans; however, there is little impact to the section 457(b) plan.
  - For section 457 plans, updates on the Rules related to the Roth contributions; updates related to housekeeping duties; and a clarification added that for the first of the month rule, it applies to cessation of or changes to deferral elections.
  - There were clarifications to regulations for leave pay plans.
  - The Dept. of Labor has been looking at the issue of lost participants. As plans mature, more attention is being given to this issue, especially when Plans are not getting responses to mailings.
  
- New Fiduciary Regulations
  - We are in a 60-day hold period; regulations became final on April 10, 2016.
  - Requires work by financial service advisors to bring operations into compliance. They were given a one-year period.
  - Regulations state that for Plan sponsors who provide general information it is not considered giving advice.

Ms. Klassen added that for Prudential, they are reminding Plan participants that the Goalmaker tool is educational and does not provide advice.

Mr. Malmud added that he has observed participants coming to counselors with questions about other outside investments. They do not have a clear understanding of the costs involved for these outside investments, and realize they want to change their prior investment transactions. However, the action is too late and noted that he hopes the new regulations help participants with decisions on outside investments through financial service advisors.

- Litigation
  - There are an increasing number of lawsuits occurring within

defined contribution plans. Government plans are not necessarily a target, especially those with an oversight Board and quality effort in overseeing the Plans. However, there is one suit that involved a plan which did not look at cost-efficient means and they did not solicit bids but just negotiated with the provider.

Ms. Carter noted that the State's Plan is well documented through the preparation of meeting minutes, soliciting bids, and conducting periodic deep dive analysis of the Plan.

She presented on the Roth IRA feature which is gaining attention. She remarked that when the feature was first established and allowed to be offered in defined contribution plans, corporations jumped on the feature because it was attractive to highly compensated employees. Millennials also find the feature appealing and interesting. The NAGDCA organization reported that 65% of defined contribution plans permit both the Roth and pre-tax contributions; and 35% of the plans have pre-tax only. The Roth IRAs are with IRA providers. The Roth 457 feature permits Roth contributions within a plan up to section 457 limits which can be split between the Roth and the pre-tax. The contributions are after-tax and the earnings are tax-free. There are no taxes on contributions if held for five years after the first contribution.

The pros are:

- The feature is attractive to the younger population.
- The utilization rate across the industry is generally about 3% to 5%.
- Allows for higher contribution threshold than a typical Roth IRA.
- There is no RMD for a Roth IRA.
- Roth 457 makes loans available, if loans are permissible within the Plan, versus not being permitted by a Roth IRA.
- The capability of adding the Roth feature is included in Prudential's service agreement.

The cons are:

- Would need to have the payroll capability with the existing payroll system.
- There are administrative and technical issues.
- For In-Plan conversions, there has not been much interest because of the manual transactions that are necessary. Many plans do not permit In-Plan conversions, and can be complex to administer.

- Would need to make changes to the various Plan documents.

Trustee Margol asked what would be the reasons for not moving forward to add a Roth 457 feature. Trustee Nishimoto commented that there has not been a formal proposal before the Board. The State is only now starting to revise the State's central payroll system which is old and antiquated, and the State has now started the process of making enhancements to the existing payroll system. There are issues with executing complex issues of manually handling both pre-tax and post-tax within the current payroll system. Trustee Becker stated that he would take this functionality issue to the payroll project team working on the enhancement project to ensure that this capability is considered.

Trustee Machida noted that it may be more cost-effective to offer the Roth feature if the Plan waited for the new payroll system to be implemented versus the State putting more costs now into an upgrade of the current system, especially if the State is anticipating a new payroll system within a couple of years.

Ms. Carter stated that the information on the Roth is an expansion of the discussion from the last deep dive. If the Board decides to offer, then there are benefits to offering the feature.

DAG Tam remarked that he would need to look at the current State law to determine whether there would be any changes needed to allow for after-tax deferrals into the Plan. DAG Tam will review and report back.

Trustee Nishimoto stated that the Board may want more information on the practical and statutory limitations first and then look at the capabilities within the payroll project.

Mr. Ezard presented his deep dive analysis on the target date portfolios:

- The performance of the LifeCycle portfolios could be better.
- An option would be to go to off-the-shelf portfolios versus custom portfolios.
- Currently, the current allocations consist of the core stand-alone options.
- Overview and observations:
  - Move to off-the-shelf because of simplicity and is turnkey and strong incentive for investing through time.
  - Individuals have different goals and objectives through their careers.
  - Creates diverse opportunities over the asset classes.
  - Adds inflation protection.

- Over time, there will be a transition from human capital to financial capital and a movement to de-risk towards retirement.
- The younger population has a higher risk tolerance and can save more over time.
- The older population has less time and their risk tolerance is lower.

Mr. Ezard explained there are different key risks:

- Market risk: returns of individual investments will be volatile; mitigate risk through diversification.
- Inflation risk: spikes in inflation will decrease purchasing power; holding of inflation hedging assets will help to mitigate the risk.
- Behavior risk: target date funds could help to mitigate risks when poor decisions are made by investors.
- Longevity risk: individuals could run out of monies during retirement.

Trustee Machida was excused at 3:06 p.m.

Mr. Ezard commented that the fees for target date funds are generally good and is an effective tool. If the Board decided to go with an off-the-shelf option, he believes that we would get more competitive fees. Key reasons for off-the-shelf options are better fees, better structure for LifeCycle funds than the current funds and the outcome would be better, and could have dynamic allocations. The current LifeCycle portfolios would be mapped over to a new target date strategy.

Chairperson Moto thanked Mr. Ezard and Ms. Carter for the analysis, and asked the Board members for considerations.

The Board discussed timelines and plans to continue the discussions during the summer for both the target date options and the Roth feature. During the interim, additional information can be explored and brought back to the meeting. Trustee Becker noted that the number of investment options within the Plan are becoming overwhelming for participants, as there are many investment options that appear similar. When there are many investment options to select from, it makes it difficult for participants to decide or take any action.

Chairperson Moto called a break at 3:19 p.m. Trustee Margol was excused at 3:19 p.m. The meeting resumed at 3:28 p.m.

Chairperson Moto moved to Agenda item #2.a. and turned the lead over to Mr. Ezard.

Agenda

Item # 2: Ongoing Business

- a. Performance Evaluation Report for the Fourth Quarter 2016 by Segal Marco Advisors, including but not limited to:
- i. Overview of Funds Currently on the Watch List: MainStay Large Cap, Victory Institutional Diversified Stock Fund, and PIMCO Total Return Fund

Mr. Ezard provided a brief overview on the Plan's investment funds and corresponding expense ratios, and noted:

- The Stable Value Fund remains the largest allocation within the Plan's total assets.
- For the individual scorecard, the inception-to-date returns have been added.
- The Victory Institutional Diversified Stock Fund continues to underperform back to inception. It is the Board did make a decision to conduct a search for a replacement fund.
- PIMCO's performance has slightly improved recently.
- The performance of the MainStay Large Cap Growth Fund continues to underperform. The Fund has performed well since its inception and for the current quarterly period the fund is doing well. The MainStay Fund performance will vary more around the benchmark than the other strategies and can swing above the benchmark quickly.

b. Other Investment Fund Updates

- i. Discussion on the Announcement from Victory Capital regarding Management Changes and Potential Actions on Recommendations related to the Victory Institutional Diversified Stock Fund

Ms. Akiyoshi reported that Victory released an announcement to say that there were management changes made due to the retirement of Mr. Larry Babin and Mr. Paul Danes. Mr. Babin, who launched the Victory fund, had named Mr. Danes as his successor in 2014 when Mr. Babin said he was planning to retire. Additionally, in 2014, Victory Capital's parent company acquired Munder Capital Management. Now, because both Mr. Babin and Mr. Danes plan to retire, Victory plans to have Mr. Gura from Munder Capital take over the responsibilities of managing the

Victory Fund. Two options have been presented for Board consideration:

- Keep the assets in the Victory Fund until a new investment provider is selected.
- Move the assets in the Victory fund to the existing BlackRock U.S. Large Cap Index Fund. However, if assets are moved to the BlackRock U.S. Large Cap Index Fund, there would be a zero balance to transition to the new product.

A motion was made by Trustee Nishimoto to go with Option #1, to keep the assets in the Victory Fund until a new investment provider is selected. There was no second to the motion.

Discussion: The Board commented that a search has been initiated and underway to replace the Victory Fund. If there is no action, DAG tam remarked that it is the same as Option # 1. The Board agreed not to take any action and the assets would then remain in the Victory Institutional Diversified Stock Fund until a new investment provider is selected.

ii. Discussion and Potential Action on Victory's Settlement Offer for the Retroactive Revenue Sharing

Ms. Klassen reported that although Prudential has requested that Victory provide its offer on the retroactive revenue sharing in writing, there is still nothing in writing from Victory. The Prudential investment team continues to be in discussion with the top senior management of Victory on the total amount of the retroactive revenue sharing and has scheduled a meeting for March 17, 2017 to come to a resolution.

iii. Delegation of Authority to Staff to Act on the Proxy Vote Related to the MFS Funds

Ms. Akiyoshi announced that a shareholder proxy vote was received from MFS funds asking shareholders to submit a vote in favor of the recommendation to elect the nominees to the Board of MFS Funds. In the past, shareholder proxies that relate to the election of the nominees being considered for the Board of Directors of various fund companies have been submitted, as recommended by the fund companies.

Trustee Becker stated some concerns and reservations on voting on behalf of the Plan's participants just based on the information that



is provided. The Board discussed there may be instances that the Board may want to vote, in other cases if the Board does not vote it would be taken as a vote in favor of the Fund's recommendation.

**A motion was made by Trustee Rapoza and seconded by Trustee Moto to delegate authority to the Board staff to submit the shareholder proxy vote in favor of Option # 1, in accordance with the recommendations as proposed by MFS Funds.**

**Trustees Rapoza and Moto voted in favor of the motion and Trustees Becker and Nishimoto voted in opposition. The motion failed to pass.**

Based on the motion failing to pass, the shareholder proxy will not be submitted.

c. Plan Administrator's Report

i. Plan Highlights

Ms. Klassen provided an overview and summary highlights of the Plan:

- o The Plan's assets total \$2.14 billion through January 31, 2017.
- o The participation rate for the Plan is at 26.5%, which includes DOE and UH; and
- o The overall participation rate without DOE and UH is about 45.26%.

She reported that Prudential is making regional alignments to better service the Plan, and that Mr. Gabe D'Ulisse and Mr. Robert Luciani are planning to come out to Hawaii in May.

Mr. Malmud provided Local Office highlights:

- o Prudential is looking at structural aspects for improving enrollments.
- o To fulfill the initiative on increasing enrollment and participation, Prudential is looking at ways to send out information to employees.
- o To achieve this, he is looking to partner with: the County of Kauai, HSTA – has been invited to attend the member services committee meetings, ERS, UH at Hilo, and the DOE.

ii. Discussion on Policy Regarding the Handling of Gains and Losses Due to Processing Errors

DAG Tam reported that a draft memo to the State and county agencies was drafted to convey the Board's policy when corrective actions are made to participants' accounts due to erroneous transactions, and how gains or losses due to market fluctuations would be handled. He noted that the resulting gains or losses from errors caused by Prudential would be handled differently than those errors caused by the departments.

In response to Trustees Machida and Becker's question on the authority to take contributions out of the trust in payroll scenarios, Ms. Klassen provided two authoritative cites that Prudential follows for taking contributions out of the trust. One is from EPCRS, which is an ERISA guidance. Government plans view EPCRS as a best practice for items related to government markets. The other is the IRS model amendments which allows for reasonable corrections and recalls to place participants in a position if the payroll error had not occurred.

She reviewed the model amendments as described in Revenue Procedure 2004-56, section 8.4, which describes putting participants back in the position as if the error had not occurred. The corrective method is a standard practice with Prudential's clients and in the industry.

The Board asked if the information can be placed into a policy format and transmitted from the Board Chairperson to the DHRD Director, and then for dissemination to the State and county agencies.

iii. Demonstration of the Plan Website Redesign Link

Ms. Baran presented the redesigned website that is being drafted together with the subcommittee members, Trustees Rapoza and Villabrille. She discussed the next steps which include another review of the content, followed first by a soft rollout before the upcoming Benefits Fair, and a promotion at the Fair. She indicated that she will share the link with Board members once the review and edits have been completed.

d. Staff Administrator's Report

Ms. Akiyoshi provided a summary on the various activities:

- Completed additional revisions to the 2017 Post Separation

Vacation Payout schedules and they were reposted to DHRD's website.

- The Governor has approved work time-off for employees to attend one Benefits Fair in 2017; preparation planning is underway and the location is planned for UH West Oahu on Wednesday May 17, 2017. There were no objections from the Board on the date or location.
- Coordination with Segal Marco Advisors on the U.S. Large cap Core RFP which is in progress. The deadline for the written proposals was on February 15, 2017. Segal Marco Advisors is currently reviewing and preparing its analysis.
- Invesco announced that they are anticipating changes to their IGT trust structure whereby they will be reflecting their underlying funds in their materials. We are awaiting further information from Invesco before determining any need for amendments to existing agreements. They also announced that they plan on making benchmark changes to some of their underlying fixed income funds.
- Meetings held with the new relationship manager with Wellington Management, Mr. Mike Trovato, who replace Ms. Sue Bonfeld upon her retirement; an introductory meeting with Legal and General Investment Management America; and with DoubleLine Capital.
- For the PTS Plan, prepared a notification letter to Kauai County to inform them that they would be able to start with the transition as soon as administratively feasible since a Memorandum of Understanding has been executed. Kauai County stated that they are targeting May 1, 2017 for the rollout. During the implementation and rollout, the completion of the Administrative Rules would continue.
- DHRD is continuing to work on completing the updates to the Plan booklet.

Agenda

Item # 3: PTS Plan Ongoing Business

- a. Approval of Report on Funds Not Deposited in the State/County Treasuries for the Period Ending December 31, 2016
- b. Quarterly Management Report for the Period Ending December 31, 2016 and the Annual Management Report for the Calendar Year Ending December 31, 2016

Ms. Akiyoshi presented the Plan asset report for the PTS Plan for the period ending December 31, 2016.

**A motion was made by Trustee Nishimoto and seconded by Trustee Rapoza to accept the Report on Funds Not Deposited in the State/County Treasuries for the period ending December 31, 2016, as presented. The motion passed unanimously.**

There was no discussion on the Quarterly and Annual Management reports.

c. LSW's Annual Letter on the Reimbursable Amount Available in the PTS Plan Expense Account for 2017

Ms. Akiyoshi reviewed LSW's letter on the amount set aside for reimbursable Plan expenses based on the percentage of the amount collected in premiums for 2016, which is in accordance with the contract agreement. The balance in the PTS Plan expense account is \$49,471.23, as of December 31, 2016.

d. Status on County of Kauai's Transition to the PTS Plan

Ms. Akiyoshi reported that County of Kauai plans to rollout the PTS Plan to their county employees on May 1, 2017. DHRD is continuing to work on the amendments to the Plan booklet which will be distributed to Kauai County for their PTS employees and redistributed to State agencies. A notification letter was prepared and provided to County of Kauai to inform them of the Board's findings and decision that the Kauai County would be able to proceed with the transition to the PTS Plan while the Administrative Rules are being amended, since the Memorandum of Understanding has been executed.

Agenda

Item # 4:

Other Business/Announcements

a. Upcoming Scheduled Board Meetings

Ms. Akiyoshi provided a reminder on the upcoming meetings scheduled for May 5, 2017 which is related to the U.S. Large Cap RFP, May 15, 2017 which is related to the U.S. Large Cap RFP, and May 16, 2017 (for the Semi-Annual meeting). The Benefits Fair is being planned to follow the Semi-Annual meeting. The location will be at UH West Oahu and the date will be May 17, 2017. There were no objections to the date and the location of the Benefits Fair.

b. Review and Status of Bills for 2017 Legislation Session

Ms. Akiyoshi stated she is monitoring Senate Bill 312 which was amended

as SD2 and relates to public agency meetings. She reviewed the proposed requirements listed in the bill draft. She noted House Bill 165, HD1 and SB 1277, SD2 are similar to Senate Bill 312. All bills are moving.

Ms. Akiyoshi added that there was an article in a recent Pension & Investments magazine that showcased the top 1000 largest retirement funds, and the list recognizes the State of Hawaii Deferred Compensation Plan as among the largest plans (the Plan is listed towards the middle, as number 663). The Plan is getting good exposure due to the efforts of the Board and its partners.

Chairperson Moto stated that the next agenda items will be in Executive session, thanked everyone for participating in today's meeting, and excused everyone except for Segal. Chairperson Moto called a brief recess at 4:51 p.m. The meeting resumed at 4:54 p.m.

Agenda

Item # 5: Status on Contract Award for RFP No. DCP-16-1, For an Active Core Fixed Income Investment Option (in Executive Session Pursuant to HRS sections 92-5, 103D-105, and 103D-303)

Agenda

Item # 6: Discussion and Review of Draft RFP for an Active Core U.S. Large Cap Equity Investment Option (in Executive Session Pursuant to HRS sections 92-5, 103D-105, and 103D-303)

**A motion was made by Trustee Rapoza and seconded by Trustee Nishimoto to move into Executive Session at 4:54 p.m. to confer with the Plan's legal counsel on items related to procurement. The motion passed unanimously.**

The Plan's consultant, Mr. Ezard from Segal Rogerscasey remained for the discussion. Other guests were excused from the meeting.

EXECUTIVE SESSION

Meeting

Reconvened: **A motion was made by Trustee Nishimoto and seconded by Trustee Rapoza to move out of Executive Session at 5:00 p.m. The motion passed unanimously.**

Chairperson Moto thanked everyone for attending today's meeting.

**A motion was made by Trustee Nishimoto and seconded by Trustee Rapoza to adjourn the meeting at 5:00 p.m. The motion passed unanimously.**

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