

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

**OPEN SESSION MINUTES
MEETING # 415**

Date: August 31, 2017

Place: Department of Human Resources Development
14th 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 (arrived at 9:08 a.m.)
Roderick Becker, Employee Member
Kanoë Margol, Employee Member
Kenneth Villabrille, Employee Member
Kalei Rapoza, Employee Member

Others: Mana Moriarty, Deputy Attorney General
Cynthia Akiyoshi, DHRD Staff
Darlene Yamada, DHRD Staff
Glenn Ezard, Segal Marco Advisors
Todd Egger, INVESCO
Julie Klassen, Prudential Retirement
Kevin Malmud, Plan Administrator Staff (Prudential)/Honolulu Office
Grace Baracao, Plan Administrator Staff (Prudential)/Honolulu Office
Jeanne Kanai, Plan Administrator Staff (Prudential)/Honolulu Office
Carol Blumenthal, Prudential Retirement – via conference call

Call to Order: There being a quorum present, Chairperson Brian Moto called the meeting to order at 9:03 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 welcomed everyone and noted that Trustee Machida will arrive shortly and all other trustees were present. He stated that there were no guests from the public in attendance. Chairperson Moto asked for a moment of silence to remember DAG Rodney Tam who passed away unexpectedly in July. He

expressed his appreciation to those who took time to attend the memorial services with his family.

Chairperson Moto stated that there is a full agenda and will begin with Agenda item #1.

Agenda
Item # 1:

New Business

- a. Approval of Minutes No. 411, 411-ES, 412, 412-ES, 413, 414, and 414-ES

Chairperson Moto stated that the minutes numbers 411, 412, 413, and 414 were distributed, along with copies of 411-ES, 412-ES, and 414-ES which were confidentially sent.

A motion was made by Trustee Nishimoto and seconded by Trustee Villabrille to adopt Minutes Nos. 411, 411-ES, 412, 412-ES, 413, 414, and 414-ES, as presented. The motion passed unanimously.

- b. Discussion and Consideration on Counties' Inquiries and Requests to Consider Establishing and Retaining Separate Third-Party Plan Administrators

- i. Invitation to the County Council of Kauai County to Join Deferred Compensation Plans Sponsored by Other Providers
- ii. Discussion and Consideration on Resolution Presented at the County Council of Maui County Meeting to Authorize the Mayor to Terminate the Agreement with the State of Hawaii Island Savings Plan and Procure a Separate Deferred Compensation Plan

Chairperson Moto stated that the Board's staff received inquiries from 2 counties, one from Kauai County and the other from Maui County regarding participation in the State Deferred Compensation Plan.

Chairperson Moto started with the first inquiry from the County of Kauai. Responses were prepared and provided to Trustee Villabrille, to questions received from the Kauai County Council. Trustee Villabrille provided a summary that the Kauai County Council submitted a request for information to their Human Resources, and had asked whether it was possible for Kauai County to exit the Plan. If so, what are the requirements. Information was provided to the Kauai County Council, and they are waiting for any further questions. Further action by the council was deferred. Trustee Villabrille stated that there was no further

discussions as to whether there was an indication by Council to exit and create a separate plan or to offer an additional plan to employees. Trustee Machida raised a question whether Kauai Council may be looking to add an alternative plan for county employees as another option. Trustee Villabrille responded that the question was not raised but whether the County would be able to exit the plan.

Mr. Malmud added that the request may have been generated as a result of NACo (the National Association of Counties) approaching the counties to join other deferred compensation plans that are sponsored by NACo. He further commented that the participation rate for Kauai County is approximately 60%, so it is hard to say that the reason for exiting the Plan is due to a lack of service.

Trustee Nishimoto asked if the Council had set timelines for decision-making. Trustee Villabrille responded that there is no timeline and their Human Resources has not been asked yet to make any presentations.

On the Maui County Council hearings, Trustee Nishimoto commended Trustee Moto and Mr. Malmud for responding and being present on short notice to address questions and to provide considerations about the Plan at the Maui County Council Committee meeting on August 8, 2017. In viewing the video taping of Maui County Council's meeting, the reasons and motivations by Council members for considering a separate plan were more apparent, which was to have the ability to have more local control over their Plan, notwithstanding the benefits to the members, additional costs, or who the provider would be. He noted that Council member Hokama has advocated for a separate plan for many years from the perspective of having been a member of the National Association of Counties.

Chairperson Moto summarized that he received a notification from Mr. Malmud on a meeting that was scheduled by the Maui County Council committee meeting to discuss a Resolution that was introduced by Council member Stacy Crivello to provide an additional deferred compensation plan. He stated that the Council did not send an invitation to him to attend the meeting. However, Mr. Malmud did add that a message from the Council staff was received at the local office to ask if a representative would be able to attend the meeting. The meeting of the Policy, Economic Development, and Agriculture Committee was chaired by Yuki-Lee Sugimura. Chairperson Moto said that at the meeting he was asked to say a few words; however, there was no discussion on the Resolution by CM Crivello. The discussion was then turned over to Council member Riki Hokama who had introduced a separate, alternative Resolution at the meeting. CM Hokama gave remarks and stated that it was time for Maui

County to have its own plan. Chairperson Moto noted that there were no negative comments or criticisms about the Plan given by the Council members. The council members asked about the agreement between Maui County and the State, and a copy was provided back to the Committee chair in response to their request.

Chairperson Moto stated that if Maui and/or Kauai counties decide to terminate its agreement with the State, the Plan could face large outflows. He asked for comments on the outflow impact from Prudential and INVESCO who are the Stable Value fund co-managers.

Mr. Egger, from INVESCO, explained the how the stable value fund is priced. Because it is a bond fund, it has a market value price and the distributions to participants are paid on book value. It is a smoothing of the market volatility. When market is below the book value, and there are outflows, participants would get paid out at the book value. The losses remain behind for the remaining participants in the Stable Value fund and those participants face the losses when the market value goes below the book value such as diminishing the future crediting rate. INVESCO would monitor to avoid negative situations within the wrap contracts.

Ms. Klassen added that Prudential also has withdrawal provisions, but it is not significant with the potential exit.

Chairperson Moto stated that if there are no objections from the Board members, he asked for the Board to move into Executive Session to confer with the Plan's legal counsel on the Board's powers, duties, privileges, immunities and liabilities with respect to the consideration of options to address Maui County's proposed resolution, as well as the next agenda item #1.c., is on the announcement by J.P. Morgan to dissolve the J.P. Morgan Diversified Real Return Fund. He asked that the Board move into Executive Session to confer with legal counsel on some comments, options, and recommendations. There were no objections. All guests were excused except for Segal Marco Advisors.

c. Discussion and Consideration on the Announcement from J.P. Morgan on the Dissolution of the J.P. Morgan Diversified Real Return Fund

A motion was made by Trustee Machida and seconded by Trustee Nishimoto to move into Executive Session at 9:47 a.m. to confer with the Plan's legal counsel to deliberate or make a decision upon a matter that requires the consideration of information that must be kept confidential pursuant to a state or federal law, pursuant to HRS §§ 92-5(a)(8), 103D-105, and 103D-303. The motion passed unanimously.

EXECUTIVE SESSION

All guests were excused except for Segal Marco Advisors.

Meeting

Reconvened: **A motion was made by Trustee Rapoza and seconded by Trustee Nishimoto to move out of Executive Session at 11:31 a.m. The motion passed unanimously.**

The meeting was resumed at 11:31 a.m. Chairperson Moto stated that the Board will return to Agenda items #1.b and 1.c.

- b. Discussion and Consideration on Counties' Inquiries and Requests to Consider Establishing and Retaining Separate Third-Party Plan Administrators
 - i. Invitation to the County Council of Kauai County to Join Deferred Compensation Plans Sponsored by Other Providers
 - ii. Discussion and Consideration on Resolution Presented at the County Council of Maui County Meeting to Authorize the Mayor to Terminate the Agreement with the State of Hawaii Island Savings Plan and Procure a Separate Deferred Compensation Plan
- c. Discussion and Consideration on the Announcement from J.P. Morgan on the Dissolution of the J.P. Morgan Diversified Real Return Fund

Chairperson Moto summarized that on Agenda Item #1.b., the Board has expressed concerns that the requirements and guidelines should be provided to Maui County, and Maui County needs to ensure there is adequate assumption of fiduciary responsibilities and governance, and that they will be able to offer a better fee structure and services for their current participants and employees. The Board is requesting that written testimony be submitted to the Maui County Council Policy, Economic Development, and Agriculture committee for its consideration at their September 5, 2017 meeting.

A motion was made by Trustee Rapoza and seconded by Trustee Machida to authorize the preparation of written testimony to be sent to the Maui County Council Committee Chair, along with copies to the other County Chief Executives of the neighbor islands to inform them of the Board's position of establishing separate deferred compensation plans. The motion passed unanimously.

Chairperson Moto stated that on Agenda Item #1.c., the J.P. Morgan Diversified Real Return Fund will close on December 8, 2017, and that a similar, temporary fund is needed to replace the J.P. Morgan fund on an interim basis.

A motion was made by Trustee Machida and seconded by Trustee Nishimoto to authorize the Plan's investment consultant, Segal Marco Advisors, to begin research on finding an interim replacement for the J.P. Morgan Diversified Real Return Fund.

Discussion: Trustee Becker commented that the amount of the State's assets in the Fund represents a twentieth of a percent, and he feels that the Board's resources can be better placed. He added that with the small number of participants invested in the Fund and the small percentage of assets investment in the Fund, one should look at the cost benefit perspective of whether there is value in replacing the Fund or removing the Fund.

The motion passed with 6 votes in favor and 1 vote in opposition from Trustee Becker.

d. Discussion and Consideration on the Submittal of the Shareholder Proxy Vote Received From Harbor Funds

Ms. Akiyoshi reported that another proxy voting ballot was received. The proxy materials are from Harbor Funds, which propose: 1) the election of 6 trustees; and 2) amendments to the Funds' Fundamental Investment Restrictions regarding borrowing and lending. The information was on the Funds' Proxy Voting Policy and Guidelines and on the investment restrictions regarding borrowing and lending were discussed.

Trustees Machida and Becker felt that the Board took a position at the past meeting to have a blanket agreement to not bring any future proxies for the Board's consideration. Chairperson Moto noted that during the last discussion there was not a decision to abstain from all proxy voting. Ms. Akiyoshi acknowledged that the Board had stated concerns on voting on behalf of participants with just the information that is provided; however, there were discussions on instances where they may want to vote. As there may be some uncertainties, proxies are continuing to be brought for case-to-case consideration. Mr. Ezard added that it is the Board's right to choose whether or not to vote, but remarked that when you do not vote, you would be basically surrendering your rights.

A motion was made by Trustee Nishimoto and seconded by Trustee Margol to authorize the submittal of the proxy to Harbor Funds in favor of the 2 proposals. The motion passed with 5 votes in favor, and 2 Trustees who abstained from voting.

Chairperson Moto called for a 5-minute break at 11:46 a.m. The meeting resumed at 11:53 a.m.

Chairperson Moto stated that for Agenda item #2.a., he will turn the lead over to Mr. Ezard.

Agenda
Item # 2:

Ongoing Business

a. Investment Fund Updates 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 some comments on the capital market environment and some highlights of the Plan:

- The market value of the Plan's assets as of June 30, 2017, was at \$2.2 billion.
- The average fees for the Plan's core funds were below median for their peers.
- The fees for the LifeCycle funds tend to be a little higher and are driven by allocations within the funds.
- The replacement for the Victory Institutional Diversified Stock Fund has been selected and is pending execution of the contract agreements.
- The PIMCO fund has been performing well; however, the search for a replacement for the fund has been completed and will be replaced soon.
- The MainStay fund has a good performance recovery; performance exceeds for the 1-year period but has been under for the 3-year period. Since the fund's inception, it has been strong and performing well.

Mr. Ezard recommended the removal of the MainStay Large Cap Growth Fund from the watch list. There were no objections.

- There is a positive spread between book and market value for the Stable Value Fund.

b. Other Investment Fund Updates

i. Discussion and Consideration on the Change to Off-the-Shelf Target Date Strategies to Replace the Plan's Current Custom

LifeCycle Funds

Mr. Ezard provided a recap of the Board's past discussions to explore off-the-shelf target date strategies.

Mr. Ezard remarked that there are strong options out there, so this may be a good time to look at some options versus continuing to use a mix of the Plan's core options. There is currently approximately \$100 million within the LifeCycle Funds.

A motion was made by Trustee Becker and seconded by Trustee Margol to begin a search for off-the-shelf target date funds. The motion passed unanimously.

Chairperson Moto turned over the lead to Ms. Klassen for Agenda item #2.c.

c. Plan Administrator's Report

- i. Plan Highlights
- ii. Updates on the Independent Audit of the Plan
- iii. Report on Victory's Settlement Offer for the Retroactive Revenue Sharing

Ms. Klassen provided an overview of Plan's highlights:

- The asset allocations of the Plan reveal that the largest portion of the Plan's assets remain in the Stable Value Fund.
- As of June 30, 2017, total assets in the LifeCycle funds were \$113.5 million; there was \$7.2 million in the J.P. Morgan fund.
- Prudential has been working on and targeting mid-October for the transition of the PIMCO Fund to the new bond fund manager. Communication to participants on the fund change will be prepared.
- The reduction of the BlackRock Index fund fees will have the same target date as for the PIMCO replacement and transition.

Mr. Malmud reported on highlights on the Local Office activities:

- Focus has been on the DOE educational campaign using an email listing to be provided by DOE. The email campaign will be directed to all DOE employees, along with the ability to access an "EZ" enrollment form. Target release is anticipated in September 2017.

Ms. Klassen provided updates on the independent audit for the Plan:

- Initially, N&K CPAs provided a range on the proposed fees to conduct

the audit services. The final cost for the audit will be \$52,000.

- The work has commenced and the engagement letter has been issued. N&K CPAs plan to have a completed report sometime in December 2017.

Ms. Klassen summarized and reported on the status on the settlement for the Victory retroactive revenue sharing:

- There was conflicting understanding between State, Prudential and Victory on providing revenue sharing. Victory had thought they were precluded from providing revenue sharing; Prudential felt Victory would be committed to providing revenue share under the trading agreements. Prudential had not been collecting the revenue sharing. The confusion was that Victory felt there should be more clarity on the passing through of the revenue sharing by Prudential over to the Plan.
- When the issue of revenue sharing was discovered in 2016, the request was made of Victory to provide the revenue sharing. After receiving approval from the State, Victory began to provide the revenue sharing to Prudential since 2016.
- Victory raised that because of a conflict in the agreement between Victory and the State, they did not agree to provide retroactive revenue sharing back to 2013 when Prudential took over the administration of the Plan. Victory needed clarification on the language in the agreement.
- Between 2013 and 2016, the retroactive revenue sharing amounts to approximately \$149,000.
- Prudential held discussions with Victory to pursue the retroactive revenue sharing. Victory responded with a verbal offer of approximately \$75,000 to be paid to Prudential and passed on the Plan participants.
- Victory responded that they would pay under an agreement with both Prudential and the State, and would not pay without an agreement. Victory initiated a tri-party agreement which Prudential provided to the State on August 30, 2017.

Trustee Becker questioned whether the State is owed the revenue sharing amount. Ms. Akiyoshi noted that in the past discussion, the Board left the retroactive payment issue with Prudential to see if they could collect the amount from Victory, since the State was not a beneficiary to the Prudential-Victory trading agreement. Trustee Becker asked if there is an obligation to collect the revenue sharing. DAG Moriarty responded yes; however, different minds can reasonably differ on the correct answer. That is why there is a dispute. He remarked that although it could be viewed that there may be an obligation, there are other disputes raised among the parties including whether the State can force the payment since

is not a party to the Prudential-Victory trading agreement. Trustee Becker also raised a concern that if the Board enters into an agreement, there should be room for negotiations. However, the Board discussed that this point could be disputed as the State is not a party to the agreement between Victory and Prudential. Also, any litigation could take years. There is also a concern on the timing of a settlement if the Victory fund is no longer in the Plan, and on the return of the revenue sharing monies to the proper beneficiaries.

Trustee Rapoza asked that this item be deferred to the next meeting to discuss some details in Executive Session on the cost and the terms that would be in the best interest of participants.

A motion was made by Trustee Rapoza and seconded by Trustee Nishimoto to defer a decision on Victory's settlement agreement and have the Board's staff review the settlement and provide a recommendation that will be in the best interest of the Plan's participants.

Discussion: Chairperson Moto expressed concern that the Victory Institutional Diversified Fund may be terminating soon. If there is a settlement, that a fair and just way be determined to return the monies to the rightful owners, and that our waiver of settlement of dispute will timely come with the actual payment.

The motion passed with 6 votes in favor and with 1 abstaining vote from Trustee Machida.

d. Staff Administrative Report to the Board

Ms. Akiyoshi reported on the following:

- The Office of the Auditor conducted an audit of the special, revolving, and trust accounts within DHRD. Two of the trust accounts are for the deferred compensations plans – one for the section 457 deferred compensation plan, and the other is for the PTS deferred compensation plan. Information was prepared for their report to the Legislature.
- The backlog of the Plan asset reports that are submitted to the Comptroller have been cleared, and the review and filings of the reports are now up to date through the First Quarter 2017.
- Working on the planning for the Fall Benefits Fairs. The Semi-Annual meeting is scheduled for October 26, 2017 at the Grand Naniloa Hotel in Hilo; and two fair sites have been identified. The Hilo fair will be at the Grand Naniloa Hotel on October 25, 2017, and the Kona fair will be at the Sheraton at Keauhou on October 27, 2017. There were no

objections on the locations identified for the proposed Fall Benefits Fairs on the Big Island.

- For the amendments to the PTS Plan Administrative Rules, the Rules are pending preliminary approval by the Governor's office.
- Rollout of the PTS Plan to employees of the County of Kauai is scheduled for September 1, 2017. The initial payroll feed will be on September 30, 2017.

Agenda

Item # 3:

PTS Plan Ongoing Business

- Approval of Report on Funds Not Deposited in the State/County Treasuries for the Periods Ending March 31, 2017 and June 30, 2017
- Quarterly Management Reports for the Periods Ending March 31, 2017 and June 30, 2017

Ms. Akiyoshi presented the Reports on Funds for the periods ending March 31, 2017 and June 30, 2017, for the Board's approval. There were no questions on the Quarterly Management reports.

A motion was made by Trustee Machida and seconded by Trustee Rapoza to accept the Report on Funds Not Deposited in the State/County Treasuries for the periods ending March 31, 2017 and June 30, 2017. The motion passed unanimously.

- Notification on New Interest Rate Effective July 1, 2017

Ms. Akiyoshi announced that the new crediting rate for the PTS Plan that is effective July 1, 2017 is at 2.64%, which is the same as the past quarter.

Agenda

Item # 4:

Other Business/Announcements

- Upcoming Scheduled Board Meetings and Benefits Fairs

Ms. Akiyoshi stated that the meeting for October is set for October 26, 2017 in Hilo. The locations of the Benefits Fairs on Hawaii Island were discussed in the prior Agenda item.

- Scheduling of a September Board Meeting

Ms. Akiyoshi stated that an email will be sent to confirm a meeting date for a September meeting to discuss follow-up agenda items. Ms. Akiyoshi noted that the next meeting may be scheduled on September 19 or 20.

Chairperson Moto noted that for the remaining agenda items nos. 5, 6, and 7, on the status of the contract awards for RFP No. DCP-16-1 and RFP No. DCP-16-2 and the RFP on the target date fund option, the Board will move into Executive Session to discuss with legal counsel.

Agenda

Item # 5: Status on Contract Award for RFP No. DCP-16-1, For an Active Core Fixed Income Investment Option

Agenda

Item # 6: Status on Contract Award for RFP No. DCP-16-2, For an Active U.S. Large Cap Core Equity Investment Option

Agenda

Item # 7: Discussion and Review of Draft Request For Proposals for Off-the-Shelf Target Date Fund Investment Options

A motion was made by Trustee Machida and seconded by Trustee Nishimoto to move into Executive Session at 12:44 p.m. to confer with the Plan's legal counsel and to deliberate or make a decision upon a matter that requires the consideration of information that must be kept confidential pursuant to a state or federal law, pursuant to HRS §§ 92-5(a)(8), 103D-105, and 103D-303. The motion passed unanimously.

EXECUTIVE SESSION

All guests were excused except for Segal Marco Advisors.

Meeting

Reconvened: **A motion was made by Trustee Machida and seconded by Trustee Margol to move out of Executive Session at 1:01 p.m. The motion passed unanimously.**

Chairperson Moto summarized that for:

- Agenda Item #5, for RFP No. DCP-16-1, the Board plans to execute a contract with BlackRock:

A motion was made by Trustee Nishimoto and seconded by Trustee Margol to authorize for RFP No. DCP-16-1, the execution of the contract with BlackRock. The motion passed unanimously.

- Agenda Item #6, RFP No. DCP-16-2, for the Active U.S. Large Cap Core Equity investment option, the indemnification section should remain a part of the terms of the contract. There were no objections.

- Agenda Item #7, the Board will have staff and legal counsel move forward and proceed with the RFP for the Target Date Fund investment option. There were no objections.

Ms. Akiyoshi stated that both Trustees Moto and Villabrille met with the Senate Labor committee regarding reappointment to the Board. Both trustees responded to questionnaires on their intentions to serve on the Board for another term.

DAG Moriarty concluded by saying that this meeting would be his last meeting and that there will be another Deputy Attorney General assigned to the Board. The Board expressed their appreciation to DAG Moriarty for his service to the Board.

Chairperson Moto thanked everyone for attending today's meeting.

A motion was made by Trustee Rapoza and seconded by Trustee Machida to adjourn the meeting at 1:11 p.m. The motion passed unanimously.

(NOTE: Signed copy on file.)