

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

**OPEN SESSION MINUTES  
MEETING # 426**

Date: September 7, 2018

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  
Ryker Wada, Ex-Officio Member  
Ken Kitamura, Ex-Officio Member  
Roderick Becker, Employee Member  
Kalei Rapoza, Employee Member  
Kalbert Young, Employee Member  
Kenneth Villabrille, Employee Member

Others: Krishna Jayaram, Deputy Attorney General  
Cynthia Akiyoshi, DHRD Staff  
Craig Chaikin, Segal Marco Advisors  
Kevin Malmud, Plan Administrator Staff (Prudential)/Honolulu Office  
Grace Baracao, Plan Administrator Staff (Prudential)/Honolulu Office  
Julie Klassen and Carol Blumenthal, and Mark Bojanowski,  
Prudential Retirement – via conference phone  
Wendy Carter, Segal Marco Advisors – via conference call

Call to Order: There being a quorum present, Chairperson Brian 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 welcomed everyone and proceeded with introductions, including the new lead investment consultant, Craig Chaikin, with Segal Marco Advisors. Introductions continued with the Prudential staff and attendees participating via the conference line. Guests in attendance from the public included Mr. Lawrence Chew and Ms. Patrice Sumikawa from N&K CPAs.

Chairperson Moto moved to Agenda Item no. 2.

Agenda

Item # 1: Welcome and Introductions of New Lead Investment Consultant at Segal Marco Advisors

Chairperson Moto welcomed Mr. Chaikin who replaces Mr. Glenn Ezard as the lead investment consultant.

Agenda

Item # 2: Approval of Minutes No. 425 for the August 10, 2018 meeting

Chairperson Moto stated that the Minutes No. 425 is for the open session minutes for the August 10, 2018 meeting. Ms. Akiyoshi stated that there is a correction that is needed on page 10, on the motion for Agenda item no. 7, to replace Trustee Margol's name. There were no other corrections.

**A motion was made by Trustee Wada and seconded by Trustee Rapoza to adopt Minutes No. 425, with noted changes. The motion passed unanimously.**

Agenda

Item # 3: Presentation by N&K CPAs and Approval of the Independent Audit Report for the Plan Year July 1, 2016 to June 30, 2017

Ms. Chew presented the Financial Audit and Internal Control reports prepared by N&K CPAs, along with Ms. Sumikawa. N&K CPAs did conduct an independent audit previously for the fiscal year ending June 30, 2014. The report is for the audit covering the beginning balance as of July 1, 2016. The opinions and conclusions expressed are in accordance with the U.S. Government Accounting Principles. Supplemental information is provided in the Management Decision and Analysis section of the report. In addition, internal findings are provided. Ms. Sumikawa presented the findings which are recurring findings that were raised from past audits that were conducted. The findings state that the Plan Document, Article 6.1, should be amended, and the related Administrative Rules for the same reason.

DAG Jayaram stated that he will provide some solutions for the Board's consideration related to making the necessary amendments to the Plan Document and Administrative Rules later in the meeting.

**A motion was made by Trustee Young and seconded by Trustee Villabrille to accept the report that was prepared by N&K CPAs, for the Plan Year ending June 30, 2017, as presented. The motion passed unanimously.**

Agenda

Item # 4: Presentation Evaluation Report for the Second Quarter 2018 by Segal Marco Advisors, including but not limited to:

- a. Overview and Updates on Investment Options
- b. Potential Action on any recommendations

Mr. Chaikin provided a brief background on himself and noted that he is based at the Denver office having moved from the New York office. Since 2008, he has been running the record keeper searches while at Segal. Mr. Chaikin provided the Second Quarter 2018 quarterly highlights:

- Although it has not felt like a good year for equities, and the market has been volatile, from an equity perspective, equities have been good.
- GDP has been positive and for the Second Quarter the GDP was up 4.1%; the unemployment rate is about 4% and the economy and corporate earnings have been good.
- Washington policies and the renegotiation of NAFTA are introducing more volatility to the market.
- With the fixed income rates, Feds are looking at and expected to raise the rates at least two more times to stimulate economic growth.
- There is a stronger demand for longer term bonds.
- Growth has been led by tech stocks, and growth has been outperforming value over the last decade. Value stocks typically are more likely to lag in a bull market. The market may see at some point value start to outperform growth stocks.

Mr. Chaikin reviewed the investment options:

- As of June 30, 2018, about 39% of the Plan's assets are invested in the Stable Value Fund; approximately 15% in the large cap index fund; and approximately 45% across the remaining investments.
- AMCAP fund replaced the Victory Institutional Diversified Stock Fund during the Second Quarter.
- A selected selection was made for the Target Date Fund series, and we are still in the contracting phase.
- The Wellington Research Value fund has been lagging the benchmark and peer group. The consistency of the underperformance has been over the past several quarters. Therefore, Segal is recommending that the Fund be placed on the watch list. Segal will continue to monitor over the next 2 to 3 quarters. There are no negative effects of placing the fund on the watch list. The watch list is an elevated step in the monitoring and evaluation process that has been established.

**A motion was made by Trustee Becker and seconded by Trustee Wada to accept the recommendations by Segal to place the Wellington Research Value fund on the watch list. The motion passed unanimously.**

Agenda  
Item # 5:

Overview of Proposed New Asset Classes by Segal Marco Advisors, which include Global Equity, Liquid Alternatives, and Retirement Income Solutions, and Potential Action Thereon Related to the Plan's Investment Policy Statement

Mr. Chaikin discussed the three (3) asset classes proposed for addition to the Plan's investment structure. The asset classes include Global Equities, Liquid Alternatives, and Retirement Income options. Mr. Chaikin reviewed the capital market assumptions and correlations for different asset classes which provide diversification benefits.

Currently, the Plan offers seventeen (17) investment options (i.e., 16 core investment options plus the LifeCycle series as one single option). The number of options in the Plan is on the higher side, so any investment changes should be done without increasing the number of options. Mr. Chaikin explained the asset classes.

Global Equities:

- Equities include investment products that invest around the globe.
- Indices are typically 50% U.S. equity, international equities of 30% developed and 20% are in emerging markets.
- 46% of the revenues within S&P 500 companies are generated from overseas or sales occurring outside the U.S.
- The asset class offers expanded opportunities regardless of location and sectors and can add more value over time.
- This asset class would be a one-stop shop for participants.
- Global equities have an attractive return versus expected risk.
- For the new replacement Target Date Fund series, the asset allocation would align with its 60%/40% allocation to U.S. equities and non-US. equities allocations which are maintained across the glidepath. The fixed income allocation would have a 70% allocation to U.S. exposure and 30% allocation to non-U.S. exposure across the glidepath.
- The comparable benchmark for this asset class would be the MSCI All Country World Index.
- The benefit for participants would be that they could get this exposure without actively thinking and making the individual allocations.
- Currently, there are four (4) international strategies which are a combination of active and passive funds, and there is one (1) emerging market strategy. He noted a possible consideration of consolidating these options.

The Board expressed a concern about the removal of funds to reduce the number of options. Ms. Akiyoshi remarked that the concept of moving to a white labeled structure to reduce the number of funds has been introduced at past meetings. The funds would be consolidated as underlying funds under one generic fund option, like the Hawaii Stable Value Fund.

Liquid Alternatives:

- These strategies are like private equity and hedge funds in a liquid format.
- These strategies are generally publicly traded funds with significant weightings in stocks and bonds but have other trading strategies. It offers a diverse array of trading strategies and profiles. The strategies could hold currencies.
- It tends to have a risk/return profile of stocks and bonds.
- It can be used as an inflation hedge.
- It is a fully liquid daily traded investment options.
- It has a lower fee level than a typical hedge fund.
- The option is good for adding to a white-labeled structure because it would be a good diversifier.
- This asset class may be difficult for participants to understand if this is offered as a stand-alone option.
- This asset class provides alpha to portfolios.
- For larger plans that have a white-label structure, you may see more of these types of strategies but not as a stand-alone option.

Retirement Income Solutions:

- There are two (2) types of Retirement Income Options: 1) non-guaranteed funds which target a specific payout that occur every year through a combination of stocks and bond exposure. The payout will vary based on the market value, so there is no guaranteed level of income; and 2) guaranteed income stream which is less liquid and the income is fixed. It is not portable on the Plan level.
- This option offers participants help with their payouts.

Ms. Klassen added that the Plan currently does offer an annuity shopping service which is an out-of-plan option. The account assets are converted to an income stream and the payout is based on the mortality rates.

Mr. Bojanowski explained that for an in-plan option, there is liquidity available within the option.

Mr. Chaikin stated that the costs for these solutions generally run about 120 to 150 basis points for a flexible option versus a traditional annuity. Mr. Bojanowski provided an example of the Prudential Income Flex solution which has an all-in institutional pricing of 134 basis points, compared to a similar

annuity on the retail options side which would have a fee of around 275 basis points.

Mr. Chaikin commented that the Board would need to look at some considerations if deciding to move forward:

- Whether to consider a guaranteed income option or a non-guaranteed option.
- Consider drafting changes to the Investment Policy Statement for the Board's consideration and recommends providing broader language and flexibility in offering of future investment options and/or and removal of existing options.

Additional comments raised by the Board included that the Retirement Income solution which would address payout options for participants and would be a benefit due to the aging demographics within the Plan; that the Plan has a lot of options already and there are participants who feel overwhelmed by the number of choices; and that if other asset classes such as the Global Equities were to be offered that the investment menu line-up be sized down. For example, if the Wellington Research Value Fund were to be removed from the Plan, the line-up could be changed whereby the fund is not replaced. DAG Jayaram noted that in the past funds that were removed were replaced with similar like-funds.

Mr. Chaikin stated that the current Investment Policy Statement (IPS) states what the Plan offers. He recommended that the IPS be revised to state what potential offerings the Plan may offer and that would allow for more flexibility in aligning with latest industry trends or adding options without making further amendments to the IPS. He stated that the IPS could be amended just to outline different line-up structures.

Trustee Young commented that contemplating the addition of an asset class such as the global equity strategy may be a way to streamline and reduce the number of investment option choices. In that way, if the Board decides to take action on an underperforming fund such as the Wellington Research Value, the fund can either be replaced or removed. DAG Jayaram clarified that in those cases, under the existing IPS, the Wellington Research Fund would need to be replaced.

Chairperson Moto asked, if the Board had no objections, for Segal to prepare and present draft revisions to the IPS for the Board's consideration at a future meeting. The Board had no objections.

Agenda  
Item # 6:

Plan's Administrator's Report

a. Plan Highlights

Ms. Klassen provide commentary and summary highlights:

- Prudential is preparing for the implementation of the new Target Date Retirement series to replace the current LifeCycle Fund series and provided some utilization data.
- Preparation is underway for the Semi-Annual meeting and Benefits Fair in October.
- Prudential has been in discussions with some parties on the possible addition of a Roth option.
- Prudential is looking to integrate distribution counseling which would assist and support the local office staff in educating and reaching out to separated employees regarding questions on staying in the Plan and withdrawal options.
- Prudential is looking at enhancing their digital capabilities with respect to Financial Wellness capabilities that look at participants holistically and which would focus on individual's abilities and desires for saving through the intuitive tools and services. Prudential is planning to launch the Financial Wellness online capabilities in November 2018. The plan is to complement what is available now.
- In reviewing the cash flows within the Plan, asset retention has been a challenge. The outflows have increased compared to inflows to the Plan. Contributions generally tend to be higher in the beginning and at the end of the year due to adjustments due to vacation pay deferral payouts to the Plan versus mid-year periods. Mr. Malmud added that Prudential is working on targeted communication campaigns for the age 55+ population on the distribution options at retirement and the benefits of staying in the Plan during post-retirement years.

Mr. Malmud presented the local office highlights:

- Prudential is participating at the HGEA general assembly that is being held yesterday and today, for the first time. This will be a recurring event.
- The Lunch-n-Learn workshops were held in August throughout Oahu and were well-attended.
- The local office field representatives are holding recurring quarterly mini-fairs at the University of Hawaii – Manoa campus.

Agenda  
Item # 7:

Staff Administrative Report

Ms. Akiyoshi provided some brief highlights of the monthly activities:

- The independent audit of the Plan has been completed by N&K CPAs and their report presented earlier at this meeting.

- The HI Pay Modernization Project has presented a number of payroll issues for the Plan. Since the deployment, the payroll reports that are sent to DHRD and used to reconcile the file with Prudential's file and the wire transmittal from B&F Treasury to Prudential continues to be delayed. The payroll report for the 8/20/2018 pay date was received on 8/20/2018 which is too late to resolve any discrepancies before the monies are wired by B&F Treasury to Prudential on the pay day.

There have been a number of payroll deferral issues that have been reported back to the HI Pay Team and ETS.

- There have been a number of vacation payout deferral issues:
  - On 7/20/2018 pay date, there was 1 vacation pay deferral that was not processed and was reprocessed for the 8/20/2018 pay date. There was a one-month delay in the posting of the investment contributions for the participant.
  - On 8/3/2018, 7 vacation payout deferrals were not processed. 5 of the 7 employees received their excess vacation payouts via checks. One employee did not receive a vacation payout via a check or a deferral. Some employees chose to keep the checks and not have the payout reprocessed as a deferral to the Plan.

ETS/HI Pay Team had stated that the reason that the vacation payout deferrals were not processed was because of late receipt of the payroll files. DHRD checked with the respective departments and the TPA and confirmed that the files submitted by the parties were submitted timely according the schedules from DAGS. All vacation payout deferrals were included on Prudential's payroll change files.

Chairperson Moto stated that if the problems are not corrected there will see many more cases if preventive measures are not taken.

- On 8/20/2018, 1 of the 11 vacation payout deferrals was not processed. In this situation, the employee had a regular contribution deferral to the Plan, and it is not clear why the employee had a regular deferral since the employee has already separated from service.
  - On 9/5/2018, 1 of the 14 vacation payout deferrals was not processed and remains outstanding.
- There are other deferral pay issues that were reported to ETS as coding issues which are resulting in employees being reported as ineligible for the Plan on the Census Error Report that is transmitted to Prudential. There is a deferral issue that is still unresolved where the employee initiated a deferral change to reduce the deferral amount for the 8/20/2018 pay date

and the deferral amount remains unchanged. There are some employees who are having deferrals come out of two payroll systems resulting in excess deferrals, and situations involving recalls to correct double deferrals.

The Board expressed a concern as the missed deferrals impacts the participants' investments resulting in potential investment losses based on market values. The Board requested that a memo be prepared to notify ETS of the Board's concerns and request for a confirmation on whether ETS is addressing these issues and taking preventative measures.

**A motion was made by Trustee Rapoza and seconded by Trustee Kitamura to prepare a memo to ETS regarding the Board's concerns related to the payroll issues that have been occurring and request a confirmation that corrective measures are being taken to prevent any further payroll issues. The motion carried with 2 abstain votes by Trustees Wada and Becker.**

- Summer Lunch-n-Learn sessions were conducted in August; communications were prepared to promote the sessions.
- Preparations are underway for the Semi-Annual meeting and Benefits Fair on Maui.

Agenda  
Item # 8:

Other Business/Announcements

a. Status on Proposed Initiatives for the 2019 Legislative Session

Ms. Akiyoshi reported that the draft amendment to HRS 88E-12 to add the Roth option to the Plan was transmitted to DHRD for consideration for the 2019 Legislative Session.

DAG Jayaram stated that the Administrative Rules/Plan Document would also need to be amended in order to add a Roth option. He projected that the amendments would take at least a year to complete due to the number of anticipated updates and changes.

N&K CPAs did report that amendments are need to the Plan Document and the Administrative Rules. So, he is suggesting that the Board consider outsourcing the work to amend the Administrative Rules/Plan Document to outside legal services through procurement. The amendments would satisfy the compliance findings in the Plan audit report citing that updates are needed to the provisions in the existing Plan Document and Administrative Rules, including amendments to provide for Roth contributions to the Plan. After determining cost estimates on procuring

outside legal services, he will provide and discuss the projected cost estimates with the budget sub-committee for budget planning purposes. He confirmed with Board members that he would start looking into procuring legal services and discuss with the Budget sub-committee. There were no objections by the Board.

Trustee Young mentioned that the City and County of Honolulu Deferred Compensation Plan reached an opinion that they could not implement automatic enrollment because the State has anti-garnishment laws. DAG Jayaram stated that he is not aware of any specific law but will check with the City and County of Honolulu as to what the specific exclusion states.

There were no status reports on the other legislative initiatives.

b. Schedule of Upcoming Board Meetings and Events

Ms. Akiyoshi reported that NAGDCA conference is coming up in the next couple of weeks and that there are 3 attendees from the Board and staff, and 1 from DHRD Benefits office who are planning to go. One of the topics at the conference will be on ESG which was an area that the Board had previously raised questions on. Therefore, in coordination with Segal and the panel groups, panel discussions will focus on the topic of ESG at the upcoming Semi-Annual meeting. Mr. Chaikin added that ESG could be added into the Investment Policy Statement.

The Semi-Annual meeting is scheduled for October 22, 2018 on Maui, and the Benefits Fair is scheduled for October 23, 2018 at the Maui Arts and Cultural Center.

Agenda

Item # 9:

Status on Contract Award for RFP No. DCP-17-1, Request for Proposals for a Target Date Fund Investment Option

DAG Jayaram reported that a draft contract was sent for review to the selected fund manager, and they provided edits but were asked to reconsider edits on certain provisions. The draft contract will be presented to the Board for consideration after discussions are complete.

There was no other business. Chairperson Moto thanked everyone for attending today's meeting.

**A motion was made by Trustee Rapoza and seconded by Trustee Young to adjourn the meeting at 11:25 a.m. The motion passed unanimously.**

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