STATE OF HAWAII
DEFERRED COMPENSATION PLAN
BOARD OF TRUSTEES

OPEN SESSION MINUTES
SEMI-ANNUAL MEETING
MEETING # 427

Date: October 22, 2018

Place: Maui Arts & Cultural Center
Alexa Higashi Meeting Room
1 Cameron Way
Kahului, Maui, HI 96732

Present: Brian Moto, Chairperson
Ken Kitamura, Ex-Officio Member
Roderick Becker, Employee Member
Kalbert Young, Employee Member
Kalei Rapoza, Employee Member
Kenneth Villabrille, Employee Member

Others: Krishna Jayaram, Deputy Attorney General
Cynthia Akiyoshi, DHRD Staff
Craig Chaikin, Segal Marco Advisors
Wendy Carter, Segal Marco Advisors
Maureen O'Brien, 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, Prudential Retirement
Deborah Baran, Prudential Retirement
Carol Blumenthal, Prudential Retirement
Rich Gagne, Prudential Retirement
Mike Williamson, Prudential Retirement
Ankita Kapoor, Prudential Retirement
James Headley, MorningStar Investment Advisory Services
Sean Dailey, INVESCO
Todd Egger, INVESCO
Sam Kaplan, Jennison Associates
Michael Bowman, Capital Group/American Funds
Steve Caruthers, Capital Group/American Funds
Vidur Mehra, State Street Global Advisors
Matt McLaughlin, William Blair & Co.

Robert Atwell, Harbor Funds
Matt Westhoven, MFS
Jeff Budd, New York Life (Mainstay Investments)
Sunita Patel, Wellington Management Co.
Ed McGettigan, Vanguard
Sarah Browning, Schroders
Erin Lloyd, BlackRock
Jeremy Kish, BlackRock
Peter Eddy, Prudential Retirement
Tom Kalili, Prudential Retirement
Kapena Kim, Prudential Retirement
Al Lee, Prudential Retirement
Ata Azarshahi, National Life Group
Mike Duncan, National Life Group
Nathan Glassey, National Benefit Services
Jeanne Moser, National Benefit Services

Absent: Ryker Wada, Ex-Officio 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 welcomed all attendees and opened the meeting with introductions of the Board members, and guests. He noted that Trustee Wada is excused from today's meeting and stated that there are no attendees participating via the conference line and no public attendees present to testify. He briefly covered some housekeeping items.

Agenda Item # 1: Semi-Annual Report from Prudential Retirement

Presenting from Prudential Retirement are Ms. Julie Klassen, Mr. Mike Williamson, Mr. Rich Gagne, Ms. Deborah Baran, and Mr. Kevin Malmud; and Mr. James Headley from MorningStar.

Ms. Klassen introduced Mr. Williamson who opened with introductions and remarks on the long-standing relationship that Prudential has had over the 30+ years with the State's Plan. Mr. Williamson added that he is with Prudential Bank and Trust and has been assisting Mr. Malmud and Ms. Klassen with projects such as the audit requests, and that on behalf of the senior leadership team, he is very appreciative of the State's business. Mr. Gagne stated that he leads the retirement counseling team and extended his thanks for the partnership in delivering the mission of helping participants achieve retirement readiness.

Ms. Klassen reported that Prudential has been working to put together resources and efforts towards a financial wellness digital upgrade to help assist employees with financial issues and burdens. She noted research findings show that 65% of participants cannot cover normal expenses over a six-month period and 28% have financial issues that carry through their workplace. Prudential has put together digital education and enhancements that includes videos and demos, and financial wellness assessments. Ms. Klassen stated that emails would be sent to those participants' email addresses on file to ask participants to re-register to open up the new content. It will not be a take-away of the existing information and the custom website will remain. Tools include the ability to set budgets and be able to link other accounts or credit cards. Information is compiled on an aggregate and will be able to identify and report on stressors that are impacting participants. The target date for the launch is November 19, 2018. Ms. Klassen confirmed that this is part of Prudential's current service agreement and is not an added cost.

In response to Chairperson Moto questions, Ms. Klassen: (1) confirmed that participants will be offered guidance and will not have specific recommendations for Prudential products such as life insurance or similar offerings but will just have information on what will be needed in their household; (2) noted that on the new platform if participants already have other Prudential accounts they could link those accounts, otherwise, they will not be able to link to other Prudential offerings or products; and (3) stated that because this upgrade is an evolution Prudential will be gathering aggregate data on the findings to determine future actions in measuring the utilization and outcomes.

Ms. Baran provided a summary of the communication initiatives in 2018:

- The Benefits Fair in the Spring 2018 was successful and well attended with approximately 1,000 attendees. 16% of attendees took actions. Educational campaigns to address the millennial population were introduced and this trend will continue.
- A series of lunch-n-learn workshop sessions were held in August 2018 which focused on exploring the big picture to understand the sources of retirement income from the ERS and the Social Security, together with the Island $avings Plan. A new presentation was developed for these sessions and 16% of attendees took actions. Visual aids/props were used at the presentations to help influence behavioral changes.
- Workshops were held throughout the year to focus on millennials, new enrollments, understanding the big picture, and understanding market behavior which will continue into 2019.

- A new pre-retiree mailing has been developed and will be released in the Fourth Quarter.
- The Plan was recognized and presented with an award by NAGDCA in September 2018 in Philadelphia.
- Additional educational video on Morningstar's Managed by You investment advisory services has been added on the Plan's website in the Investments tab.
- In 2019, Prudential retirement counselors will continue with the Lunch-n-Learn sessions since participants are finding the sessions beneficial. The objective of the meetings will be to reach out employees who are not yet in the Plan. Ms. Baran stated that she is also exploring and working on a testimonial video to highlight what is available in the Plan.

Chairperson Moto noted that a New York Times reporter has been in touch with him to write an article about the Hawaii Plan's use of the Aging Booth technology as an activity at our Benefits Fairs and would like to be able to interview employees. A photographer may be sent out to the Fair to feature the display. The article is tentatively planned to be completed in November.

Mr. Malmud provided an overview of the Local Office activities:

- The local office team is on track and on target to reach its meetings goals.
- The counselors are continuing to do the Hawaiian culture presentations; continuing to be present and participate in the union events such as the HGEA General Assembly and HSTA events; continuing to hold the UH mini fairs that are recurring quarterly; and continuing to hold meetings with the payroll staff on the neighbor islands to review access and use of the Plan Sponsor website and work through payroll and transmission issues.

Mr. Headley reported on Morningstar's service and activities:

- He is working with Prudential on a video to explain who Morningstar is and how to access Morningstar's site about the investment advice services that are available. He noted that there has been a challenge on educating participants about the online investment advice services, so more education will be available on how to go online to find Morningstar's site.
- Morningstar's methodology remains the same; it is about personalization through the data that is provided.
    - 169 portfolios have been utilized out of the 589 portfolios created. There is room for more participants to get more customized.
- Participant demographics show that 55% of those enrolled in the Plan are female and 60% of those females in the Plan are enrolled in Morningstar. The average age is 55 years old.

Agenda
Item # 2: Investment Performance Presentation from Segal Marco Advisors:

a. Economic and Capital Market Environment
b. Review of Investment Strategy and Fund Performance

Economic and Capital Market Environment

Mr. Chaikin provided a flash summary update on market activity up through the Third Quarter 2018:

- The equity markets have declined due to concerns over interest rates. The Federal Reserve increased rates in September 2018 and project increases in December 2018.
- The yield curve is up, and the 10-year Treasuries are up. There is a concern with the change in monetary policy that is causing am impact on the equity markets.
- The economy appears to be in a good spot. The Second Quarter GDP was around the 4.1% range.
- The unemployment rate is low at 3.7% range, and corporate earnings remain strong.
- International equities are up for the Third Quarter 2018. There is strengthening in the U.S. dollar causing some headwinds.
- Volatility will likely continue moving forward.
- The expenses within the Plan reveal a weighted average expense ratio of 33 basis points which is extremely competitive.

Review of Investment Strategy and Fund Performance

- The drivers of performance were discussed at prior meetings; of note is that Segal is monitoring the Wellington Research Value Fund which was recently placed on the watch list. There are no organizational or team concerns to note.

Agenda
Item # 3: Annual Report from Life Insurance Company of the Southwest

Mr. Azarshahi thanked the Board for the relationship over the past 20 years and presented highlights for the PTS Plan:

- The Plan is a group annuity contract that has a 1% minimum guaranteed rate net of all expenses.
- The County of Kauai was added last year to the Plan, and the transition

went well.

- The total combined Plan assets are approximately $128.8 million, as of June 30, 2018.
- $58,558 in contributions are from the County of Kauai out of $177 million in total contributions.
- The total inception-to-date Plan savings totaled $147 million; and the savings for the County of Kauai totaled $48,700 of the $147 million.

Mr. Azarshahi introduced the team from National Benefit Services, Mr. Glassey and Ms. Moser, and also Mr. Mike Duncan who is the regional Vice President at National Life Group.

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- The average number of active participants is 9,593, and 135 participants are from the County of Kauai.
- The largest participation is from DOE and University of Hawaii, at a combined amount of 88.6%.
- The interest crediting rate is 2.58%, as of July 1, 2018.
- The escrow account is reassessed in the months of January and July and readjusted as needed.
- LSW has initiated the audit of the PTS Plan, as requested, and the target date for completion is in January 2019.
- Some background on National Life Group, they are the number one writer of index annuities within the employer marketplace and the 17th largest in insurance sales in the U.S.

Chairperson Moto called a break at 10:00 a.m. The meeting resumed at 10:20 a.m.

Agenda Item # 4: Panel Presentation # 1 on Understanding ESG Investment Criteria and Risks by BlackRock, Jennison Associates, and INVESCO

Presenters: Jeremy Kish, BlackRock; Sam Kaplan, Jennison Associates; and Sean Dailey, INVESCO

Mr. Chaikin explained that the panel group will be talking about what is ESG (Environmental, Social, and Governance), criteria for ESG, and the investment risks associated with ESG investing.

Mr. Dailey explained that ESG investing is an asset consideration and not an asset class; that ESG investing has grown to a $257 billion marketplace. He stated that ESG is an evolution of SRI (Socially Responsible Investing) which were stand-alone funds that were ESG solutions. The movement in the industry is inclusionary; it looks at companies' environmental policies, how they interact with communities, and their corporate governance policies. The movement is to bring a broader screening to the investment line-up and more responsible investing. He noted that there is a shift in assets on a generational front with millennials taking an interest and gender switches whereby there are more women controlling assets in the marketplace.

On a question from Mr. Chaikin of whether ESG is a fad or not, Mr. Kish noted that he does not believe that ESG is a fad and at BlackRock they look at it as a systemic change in investing. Mr. Kaplan remarked that at Jennison, they are looking at the analytics to provide solutions to clients; portfolio managers are best suited to look at companies and take into account their ESG scores from a risk/reward perspective.

In response to Trustee Young's question of whether products are easily found for clients with a specific capitalization size and have specific thoughts on what is socially conscious, and which fits their same perspective, Mr. Kish noted that coming up with a solution is a challenge because it is a broad spectrum but feels there are solutions that fit those appropriate capitalization scales.

Mr. Kish discussed the approach at BlackRock's whereby their Chairman writes every year to the Fortune 500 companies' CEOs on the topics of charging the CEOs with articulating or developing their social purpose of the company, and on BlackRock's stewardship teams which would be increasing over the course of three years and which would be taking a more active role with respect to proxy voting. BlackRock engages with over 1,500 companies annually on ESG matters. BlackRock feels it is important to have constructive dialogue to understand positions on sustainability and ESG and to look at goals and identify ways to reach the goals. In looking at criteria, look at low, medium, and high tracking errors to decide which path to go. BlackRock is using its own proprietary factors to look at ESG criteria and how to consider risk/return tradeoffs. They look at driving factors that can produce alpha. He added that for BlackRock, it is easier to use the market cap index as the benchmark.

Mr. Kaplan presented on potential investment risks of ESG investing, focusing on one, is there a cost to good investing in the form of lower returns or higher fees; and two, what are the implementation risks. In some consulting studies, it points out that some plans which do not incorporate ESG in their portfolios say it's due to risk to performance; and others say incorporating ESG leads to an underperformance.

In response to Mr. Chaikin's question on whether there is a significant cost to fund managers for the screening ESG criteria and the overall management of the portfolios, comments from investment managers present were that some do not feel there is more cost but there is more work; others feel that if you can find something that leads to results they would not look at it as an additional cost but look at it as an opportunity to drive more alpha; and others do pass on some small fees that are passed on for gathering data analytics.

Mr. Kaplan remarked that if a manager is going to say that they are not going to invest in this asset class because of ESG, then he feels that they are not trusting their active managers to make those decisions. At Jennison Associates, they take a bottom-up investing approach, so these factors are looked at when doing their own internal analysis to determine if it would be a solid investment. For a client who is hiring a manager from an ESG perspective, then they would not want companies that deal with coal or tobacco in the portfolios, so taking an exclusionary approach may lead to giving up return/performance. If you take an inclusionary approach, you do so knowing that the biggest holdings may be the ones with the lowest ESG scores and have the best opportunity for return. He added a cautionary note about picking the ratings agencies because each has their own proprietary methodologies on rating companies. If you use the wrong rating agency, it could mean the company would not be included that benchmark or your portfolio. The use of only ESG screening tools may not be adequate and the managers should be doing their own analysis.

Chairperson Moto called a break at 11:19 a.m. The meeting resumed at 12:10 p.m. Chairperson Moto acknowledged the investment managers and thanked everyone for coming out to provide the reports and education to the Board, and for everyone's participation in tomorrow's Benefits Fair and allowing Plan participants the convenience of direct access to you and your organizations. Chairperson Moto proceeded to the next presentation from Segal Marco Advisors.

Agenda
Item # 5: Segal Presentation on How Plans are Contemplating ESG

Ms. O'Brien provided background on herself and provided an overview of how other plans are looking at ESG:

- Components of ESG include the ES factors based on market demand, sustainability, and risk mitigation. The challenge is that there is no great data and although there is data it will take a long time to get data to be able to quantify. The other is the G factor which evaluates companies on governance especially in underdeveloped markets. For example, look to see if the Board members are independent; there is data on this metric to see if 2/3 of the Board is independent.
- There is data now emerging on employment differences between companies and environmental risks. In cases, differences may matter more locally and where you are.
- Plans could consider adding language in the Investment Policy Statement

to address ESG and through proxy voting you have the ability to influence and weigh in on small decisions.

- There are five principal ways to implement asset allocation: divestment; impact investing where you get a non-financial return; ESG integration where managers are looking ESG data; active ownership through proxy voting and talking with managers; and the positive tilt of heavily weighting companies.
- How plans can move towards ESG is by talking to managers on what they are doing and identify ESG factors that they are incorporating, and survey managers on how they are implementing ESG.
- Under ERISA, plans can look at ESG but do not have to sacrifice performance.
- On a question what the vision for a 5-year horizon would look like for this plan to be comparable to what may be asked for in this space, Ms. O'Brien commented that it may be environmental issues considering our location. You could ask your managers what they are doing on that and communicating that to your participants.
- Specific data and reports are available on specific companies' websites, but to get the data compared across the S&P 500 there is a price to get that data. At some point, ESG disclosure may become standardized.

Agenda Item # 6: Panel Presentation # 2 on ESG Philosophy, Management, and Enforcement and Compliance by MFS, Capital Group, and William Blair

Presenters: Matt Westhoven, MFS; Steve Caruthers, Capital Group; and Matt McLaughlin, William Blair

Mr. Caruthers presented on understanding managers' philosophy on ESG and remarked that the approach at Capital Group is to take an integrated ESG front and have managed funds that have exclusionary factors for a number of years. ESG is a part of the investment process. He explained the "MADE" approach as: "M" - meet with companies which helps to influence outcomes and to engage discussions; "A" – analyze all components to see if there are risks to be aware of; "D" – distinguish those companies with high conviction ideas; and "E" – engage by having analysts create relationships and vote on proxies with special requirements to address ESG.

Mr. McLaughlin presented on ESG management and explained that there are two sides for implementation strategies – making investments for financial decisions/risk return and the other is making investments for profit considerations. He remarked that methods to incorporate risk/return characteristics are negative and positive screening. Social considerations incorporate integration which involves making a decision that ESG matters; and taking a positive attitude and have it ingrained in the firm. He stated that for impact only investments, there are not many managers who make these investments publicly available.

The approach at William Blair & Company is a heavy emphasis on corporate governance and long-term sustainability of businesses. They stay away from MSCI ratings and instead create their own materiality map and identify what issues matter. They have also created a sustained-themed proxy voting policy.

Mr. Westhoven presented on ESG enforcement and compliance and explained that the integration of ESG factors should be a part of the investment process. The role of the investment manager should be through active management and ESG must be a part of the process. As companies are being identified, the decision is if the company should be a part of the strategy or not. An example of an auto company was examined to look at the ESG rating history on this company, the ESG score card, and the projection targets of the company. MFS did its own research and found serious operational issues within the company. Today the company is trading under par.

He continued to say that the role of the Plan Sponsor is as a fiduciary, to have a framework that will manage risk and improve performance, engage with the managers and have managers come with examples on how they are looking at the ESG scores.

In open discussion, some additional comments were raised to point out that managers should identify key factors for that industry, rather than relying on ratings agencies, to evaluate the companies for the long run; managers should ask companies good materiality questions; and that firms are making big strides in ESG since the younger generations (students) are the ones that companies are trying to attract in the recruiting pool.

Agenda
Item # 5: Announcements

There being no other announcements, Chairperson Moto closed the meeting by expressing thanks again to the providers for their reports and the fund managers for their presentations and for their participation in tomorrow's Benefits Fair.

There being no other business, Chairperson Moto adjourned the meeting at 1:20 p.m.

(NOTE: Signed copy on file.)