STATE OF HAWAII
DEFERRED COMPENSATION PLAN
BOARD OF TRUSTEES

OPEN SESSION MINUTES
SEMI-ANNUAL MEETING
MEETING # 433

Date: October 28, 2019

Place: Kaua'i Marriott Resort
3610 Rice Street
Kaua'i Ballroom - Halelea'a Room
Lihue, Kaua'i, HI 96766

Present: Brian Moto, Chairperson
Ryker Wada, Ex-Officio Member
Kalei Rapoza, Employee Member
Kalbert Young, Employee Member

Others: Randall Nishiyama, Deputy Attorney General
Cynthia Akiyoshi, DHRD Staff
Craig Chaikin, Segal Marco Advisors
Wendy Carter, Segal Marco Advisors
Kevin Malmud, Plan Administrator Staff (Prudential)/Honolulu Office
Jeanne Kanai, Plan Administrator Staff (Prudential)/Honolulu Office
Grace Baracao, Plan Administrator Staff (Prudential)/Honolulu Office
Julie Klassen, Prudential Retirement
Deborah Baran, Prudential Retirement
Carol Blumenthal, Prudential Retirement
Michael Knowling, Prudential Retirement
Scott Greenspan, Prudential Retirement
Sean Klock, MorningStar Investment Advisory Services
Doug Kryscio, William Blair & Co.
Todd Egger, INVESCO
Sean Dailey, INVESCO
Sam Kaplan, Jennison Associates
Vince Ortega, Capital Group/American Funds
Sue Walton, Capital Group/American Funds
Robert Atwell, Harbor Funds
Matt Westhoven, MFS

Jeff Budd, New York Life (Mainstay Investments)
Mike Trovato, Wellington Management Co.
Alexander Zurflueh, Wellington Management Co.
Ed McGettigan, Vanguard
Sarah Browning, Schroders
Jeremy Kish, BlackRock
Erin Lloyd, BlackRock
Kimberly Cook, State Street Global Advisors
Trevor Santoro, MorningStar Investment Advisory Services
Ata Azarshahi, Life Insurance Company of the Southwest
Dan Adams, National Life Group
Nathan Glassey, National Benefits Services
John Thorne, National Benefits Services
Peter Eddy, Prudential Retirement
Kapena Kim, Prudential Retirement
Tom Kalili, Prudential Retirement
Al Lee, Prudential Retirement

Absent: Robert Yu, Ex-Officio Member

Call to Order: There being a quorum present, Chairperson Moto called the meeting to order at 9:04 a.m.

Agenda: The agenda for this meeting was filed with the Office of the Lieutenant Governor, as required by Hawaii Revised Statutes section 92-7.

Chairperson Moto opened the meeting noting that all trustees present, except for Trustee Robert Yu who is excused from today's meeting. He welcomed all attendees and opened with introductions of the Board members and guests. There were no guests participating via conference call, and he stated that there are no attendees from the public who are present to testify. Chairperson Moto briefly covered some housekeeping items.

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

Presenting from Prudential Retirement are Ms. Julie Klassen, Mr. Michael Knowling, and Ms. Carol Blumenthal.

Mr. Knowling opened with remarks on Prudential's partnership with the State of Hawaii, and the accomplishments by the trustees on its educational initiatives towards financial security, as recognized by the National Association of Defined Contribution Administrators (NAGDCA) and by the New York Times. He also extended an invitation to the Board members to Prudential's client conference which will be held in May 2020 to hear about other solutions within other plans.

Ms. Klassen opened with remarks and commentary on Plan activities, asset allocation and data on Plan participation:

- The financial wellness digital platform was launched. There were 2,379 unique visitors to the site. There are 15,061 views on the financial planning content. Year-to-date there were 9,190 who re-registered their accounts.
- Prudential has co-sponsored longevity studies in 2016 and 2018 and found that generational shifts and gender inequalities affect financial decision-making. Studies indicate that changing behavior is needed to get employees to start saving early. These are the objectives of the local office team.
- The age demographics of the Plan is of an older generation. The approach is to attract the younger generation through digital capabilities and onsite assistance. Prudential has started virtual counseling to attract the younger demographic group.
- There is an increase in the use of asset allocation tools such as Goalmaker, target date funds, and managed accounts.

Ms. Blumenthal reported on the progress of some program enhancements which have been made to the payroll system administration:

- Worked on the migration to the HawaiiPay system;
- Working with departments on the transmission of data:
  - working with the Hawaii Health Systems Corporation on a change to their method of transmission for a quicker exchange of the demographic information for Plan participants;
  - working with DOE on testing of both in/out bound transmission feeds since the move to the HawaiiPay system, and on the feasibility to receive more frequent data feeds from semi-monthly to weekly;
  - working with UH on the feasibility to receive more frequent data feeds from monthly to weekly; and
  - working with the County of Maui and the County of Kauai on moving to enhanced file layouts.

Ms. Baran reviewed the marketing activities and Mr. Malmud reported on the local office activities:

- The Vanguard Institutional Target Date Fund series were introduced and launched in April 2019.
- The Spring Benefits Fair was held in May 2019 on Oahu, and attendance

totaled approximately 500 completed registration cards.
  - Over 90% of Fair attendees who were surveyed indicated that they were able to get the benefits information they were looking for.
  - 33% of Fair attendees took action at the Fair.
  - The Go-Green campaign was introduced to encourage e-delivery to move to environment friendly methods and help reduce paper. 533 participants registered their accounts and 523 electing e-delivery.
- Email delivery of notifications on the availability of the quarterly newsletter has been launched, and it resulted in a 76% open rate.
- The Summer Lunch-n-Learn workshops here held and were expanded to the neighbor islands. There were 18 workshops scheduled across the 4 islands over 6 days, and a total of approximately 250 attended the workshops out of approximately 350 who signed up or walked-in for the sessions.
- The ongoing initiatives for 2019-2020 will be to continue the Benefits Fairs, financial wellness education, outreach education to participants on the multiple target date fund holdings, the promotion of the Prudential app, and the virtual counseling appointments.
- Efforts by the local office resulted in the year-to-date enrollments increasing by 25% in 2019 over the prior 2018 year.
- For the new retiree engagement program, the counselors have started to make callouts to terminated participants to review their accounts and remind participants about the benefits of the Plan.
- The counselors have also begun callouts to participants with multiple target date funds to review their asset allocations.
- The counselors are also holding virtual counseling appointments. Calls with participants enable both counselor and participant to look at the same screens simultaneously. As an example, it allows the counselor to walk the participant through the website and forms.
- The counselors are also taking documents via DocuSign for the electronic signing of documents to expedite the processing of actions and to provide a more secured method of transmitting documents.
- The impact of counselors through counselor-assisted interactions with the participants have resulted in the large percentage of completed participant actions and reaching activity goals. Situational examples through participant testimonies have demonstrated a value in counselor engagement with participants.

Mr. Klock, from MorningStar reported on the Plan's activities:

- The benchmark against other industry providers shows that MorningStar is a leading provider of managed accounts.
- The managed accounts program offers customized portfolios.

- The managed accounts take data and assigns to a portfolio based on age, balance, salary, and savings rate.
- Through participant engagement and obtaining greater individual data, the results are an 87% level of dispersion around the target date fund.
- Usage trends in the Plan illustrate 44% are male users, 56% are female users.
- As of October 2019, there were 1,332 participants using the Managed Accounts service, and with about a 40% engagement.

Agenda
Item # 2: Performance Evaluation Report for the Third Quarter 2019 by Segal Marco Advisors, including but not limited to:

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

Mr. Chaikin reported on the Third Quarter 2019:

- Equities performed well during the Third Quarter.
- The Federal Reserve decreased the rates two times during this year.
- The dramatic decline in the yield curve is the most startling to see.
- The year has shown a very good performance in bonds.
- Because of the inverted yield curve, there is a concern about protecting economic growth. Growth still remains positive.
- The Stable Value Fund continues to have the largest portion of the Plan's assets.
- For the Vanguard Wellington fund, lead portfolio manager, John Keogh, retired as of June 30, 2019. Segal does not have any concerns. Dan Pozen was added as a co-portfolio manager on the portfolio.
- The Plan's assets totaled $2.5 billion as of September 30, 2019.
- Core funds have had a good year-to-date performance.
- For the MainStay Funds, performance has been more of a short-term dislocation rather than a long-term one.
- The Wellington Research Value fund has shown outperformance and good year-to-date results. The fund has been on the watch list for about one year; Segal will have more recommendations to report at the next meeting.
- For William Blair, they announced the addition of Jim Jones as a co-portfolio manager in preparation for the retirement of Rob Lanphier who is expected to retire in 2021.

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, introduced Mr. Adams from National Life Group and Mr. Glassey and Mr. Thorne from National Benefits Services who provide the recordkeeping administration for the Plan, and presented highlights for the PTS Plan:

- An independent Plan audit was performed by Traveller & Company for the Plan Year ending December 31, 2017. There were no deficiencies found during the audit.
- The County of Kauai was added during the latter part of 2017. The Plan is going well for the county.
- The County of Kauai started with 156 participants and increased to 220 participants. Assets for the county are at $142,000 for this year. The county has saved about $115,000 since joining the Plan.
- As of June 30, 2019, the total Plan assets were $135,470,000 which is an increase of $6.6 million over the prior year.
- The crediting rate as of July 1, 2019 is at 2.54%.
- The State savings is $8.2 million for this year; the savings since inception is about $155 million.
- The total number of participants is approximately 97,000; most of the participants are with the Department of Education.
- The escrow account is reviewed in the months of January and July; the assets in the account are at $140 million to cover the Plan's assets.
- The ratings of the National Life Group are very strong; and the company has $31 billion in assets under management.

Mr. Azarshahi mentioned that he does not see that the rates will improve and go up. Participants currently in the Plan are benefiting from the current rate because of the older holdings that are in the portfolio.

Chairperson Moto called a break at 10:20 a.m. The meeting resumed at 10:48 a.m.

Chairperson Moto expressed the Board's appreciation for the participation by the Investment fund managers at the Board meeting and at the upcoming Benefits Fair, and to Prudential for the coordination of both the meeting and the Benefits Fair. Through their partnership and support at these events, the Plan reached the mark of $2.5 billion in assets as of October 15, 2019.

Agenda Item # 4: Panel #1 Presentation by Capital Group, MFS, and William Blair

Presenters: Matt Westhoven, MFS; Doug Kryscio, William Blair; and Sue Walton, Capital Group.

Mr. Chaikin stated that the panel discussion will focus on generational, gender and socioeconomic considerations when designing a defined contribution plan and investment line-up and in determining ways to get employees engaged.

Ms. Walton opened with remarks on what are the influences and drivers of the thought processes spanning the generations of the 28,000 participants in the Plan.

- The heavier representation within the Plan is with the older population.
- The baby boomers, which range about 16,000 participants in the Plan are influenced by the Cold War, the sixties, and the post-war boom. They are optimistic and have a strong professional work ethic.
- By contrast, the Gen X, which is a smaller representation, are influenced by the end of the Cold War, the fall of the Berlin Wall, and introduction of the personal computer. Divorce was on the rise and made this group more independent and they are in the workforce about 5 to 7 years. This group are more loyal to the profession than to a particular employer, and they strive for a work-life family.
- The smallest representation is the snowflake generation and they are very unique and individual and are influenced by 9-11. Having been influenced by play station games, this generation is very into technology and social media. This is more of a work-life generation and who work with you and not for you. They are in their jobs between 18 and 24 months.
- For the Gen X population, they are worried about just having enough to retire; the baby boomers are not worried a whole lot except for long-term care; and millennials are worried about everything.
- In the history of the S&P, millennials have seen and experienced the least amount of disruption, compared to the baby boomers and Generation X.
- Millennials look for investments in the market that would promote wellness and health and would have an impact on the environment and climate, compared to the older generation who look for the traditional investment qualities that drive longer term results.
- Women face challenges in the investment arena because they may earn less, are taking care of family, are living longer and may live alone and be saving less. Based on their challenges, the influences and values that drive their investment decisions are somewhat similar to millennials in terms of not settling for traditional values but an opportunity to engage as it relates to health and wellness and ESG perspectives.

Mr. Westhoven discussed the generational groups in the workforce:

- The factors that have influenced the millennials that play into investment and retirement savings center around technology, student debt, concerns about the environment, and life expectancy.
- Millennials are edging out the Gen X population and are becoming the

larger group in the workforce.

- Two-thirds of the assets are still held by those participants approaching retirement.
- In a survey conducted by Morgan Stanley on how interested are investors in sustainable investments, responses show about 72% of general population said yes, but jumps to 90% for millennials.
- There are examples of the younger workforce rallying around social causes and pushing back within companies.
- There are different approaches to sustainable investing. One is to look at product choices and the other is to look at and do a due diligence on the integration of ESG considerations within the investment process.

Mr. Kryscio provided comments on the defined contribution plan trends:

- In review of the Plan, the Plan has done an excellent job in meeting its objectives, having the fundamentals of investing, having a tier line up within the core menu, and conducting ongoing management.
- The Plan does not technically have a qualified default investment alternative because it is a voluntary plan but if the participant does not make an election, the participant will be directed to go into a target date fund with Vanguard.
- The Plan has a stable value and major asset classes.
- The Plan has within the core menu a mix of active and passively managed funds.
- The Plan has a self-directed brokerage window with specialty funds.
- The Plan has a variety of investment vehicles from mutual funds to separate accounts.
- The Plan and MorningStar managed account service do provide for financial wellness and overall retirement planning.

Trustee Wada asked about how to address women investors and the wide disparity. Ms. Walton explained that from a millennial's and women's-based investment objectives, the industry is seeing committees start to consider incorporating key values into not just a specific investment opportunity but as part of the overall investment process, and whether the committees take some of the factors into consideration even if it is not an exclusionary ESG fund. Plans are being mindful of the considerations and the first step from an investment process and selection standpoint is knowing how the companies within the Plan approach this issue and can relay that to the investment values of the participants. Mr. Chaikin added that what he has seen is that plan sponsors are taking a more active role in the voting of the proxies for mutual funds and looking more at the "G" or governance in ESG since the data for the "E" and "S" opportunities are more difficult to evaluate.

Trustee Young surveyed the investment managers in the Plan to ask who offers an ESG fund. Mr. Kryscio remarked that although an investment manager may have an ESG fund, it was important instead to look at whether the investment companies are integrating ESG into their processes.

Mr. Chaikin raised the topic of how to design a plan and communicate to a population of diverging interests to get them engaged. Comments raised were:

- Have a solid diversified line-up that would meet the needs of the different generations and provide the tools to those who want the help and in the language that would engage them.

- Trustee Rapoza remarked how on the UH campus they recognize and communicate to the diverse groups and commented that for an integrated approach on ESG, it could be for the Board to determine what it would be willing to entertain and formalize into policies.

- On the topic of retirement income solutions and to consider what that may look like, for many there is no single, best solution from a retirement income perspective. Stable value could work because we recognize the interest rate on that option or for some it could be a target date fund with downside protection as it goes through retirement. Mr. Chaikin added that the State does also have a defined benefit program to provide a guaranteed income stream through retirement.

Chairperson Moto thanked the panelists for their presentations.

<u>Agenda Item # 5</u>: <u>Panel # 2 Presentation by INVESCO, Jennison Associates, and BlackRock</u>

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

Mr. Chaikin stated that the next discussion would focus on what a plan line-up could look like and look at practices that are being used within defined benefit plans.

Mr. Kaplan provided comments on practices being used within defined benefit plans and what could potentially be used in a defined contribution plan:

- The defined benefit retirement plan promises an employee a specified monthly income for life based on a formula. The investment risk is on the employer.
- To meet the pension liabilities in the future, a good benchmark for defined

benefit plans is the long duration and positive convexity to manage the risk exposure. Zero risk for a defined benefit plan is a U.S. Treasury portfolio which is cash-matched to the liabilities but works if the plan can be fully funded.

- In the past decade, there has been a shift in the defined benefit world and a combination of regulations has led to the freezing of most plans and has given rise to LDI (or liability driven investing) to help meet future liabilities.
- Another is pension risk transfer (or PRT) which has grown in the defined benefit world. This allows the plan to off load some obligations to other insurance companies by buying annuity contracts to provide a guaranteed income stream.
- In defined contribution plans, the focus is on asset growth and favoring riskier assets. Fixed income assets make up about 7.4% of assets but represent about 34% in defined benefit plans.
- Defined benefit plans do tend to take more risk with the fixed income investments while defined contribution plans favor more stable and safer assets and fixed income because participants are looking for more stability.
- Considerations for incorporating defined benefit plan practices in a defined contribution plan are:
    - If it makes sense for defined contribution participants to calculate their desired income and life expectancy and to manage their assets. Using LDI in a defined contribution plan world has been much more difficult to put into practice.
    - If it is possible to create an annuity stream and convert the retirement nest egg into income without using up the retirement savings. Using PRT has not been a best practice yet as there are complex issues and cost issues.

Mr. Kish provided comments on practices being used within defined contribution plans:

- Having an open architecture income solutions and guaranteed income solutions is where the market is trending.
- Feels that organizations are making some headway on retirement income.
- Participants would feel more confident in saving and would save more with a guaranteed income option.
- Aside from an annuity as a guaranteed income option, a way of having a guaranteed income option is through a target date fund.

Mr. Dailey provided comments on solutions to provide for longevity risk:

- Plan sponsors are asking more about retirement income and how to solve for longevity risk.

- Plan sponsors are waiting for more on the pending legislation from the SECURE Act related to fiduciary relief around adding retirement income as a product.
- Awareness on the different products out in the market such as annuities, guaranteed minimum withdrawal benefits and understand the trade-offs of each, and target date funds.
- White labeling within the menu is designed to customize the options:
  - Have a tier 1 of target date funds as a solution.
  - Have a tier 2 of core funds. There would be a stable value fund, income fund, and growth funds.
- Have seen a misuse of target date funds. Participant sentiment is that they do not want to solely invest in a target date fund because they do not want to put all their eggs in one basket.
- Alternatively, as another asset allocation solution, there are risk-based funds that could potentially sit alongside of the target date fund offerings and core funds. This works best with white labeling.
- There are different ways to structure the options to meet the needs of participants.
- Feels that there is an unmet need for professionally managed portfolios tied to risk tolerance.

Trustee Young commented on whether in the next 15 years what will be learned about the participants who are invested in the target date fund 2020-2025 and whether the fund will serve that population adequately. As the current participants are coming up to the target date milestones, do we feel they have fared better versus if they felt they should have needed more knowledge to select from the core menu. Mr. Malmud remarked that on average the majority of participants, who have selected an asset allocation method such as GoalMaker, target date fund, or managed accounts, are way ahead.

Chairperson Moto thanked the panelists for their presentations and discussions.

Agenda Item # 6: Other Business/Announcements

a. Approval of Minutes No. 432, for the August 5, 2019 meeting

Chairperson Moto stated that Minutes No. 432 was distributed for review and action.

A motion was made by Trustee Rapoza and seconded by Trustee Wada to adopt Minutes No. 432, as prepared. The motion passed unanimously.

There being no other announcements, Chairperson Moto closed the meeting by expressing thanks to everyone for attending today's meeting.

Chairperson Moto adjourned the meeting at 12:20 p.m.

(NOTE: Signed copy on file.)