

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

**OPEN SESSION MINUTES**  
**MEETING # 388**

Date: November 24, 2014

Place: Department of Human Resources Development  
14<sup>th</sup> Floor Director's Conference Room  
235 South Beretania Street  
Honolulu, HI 96813

Present: Wayne Chu, Chairperson  
Kalbert Young, Ex-Officio Member (arrived at 1:45 p.m.)  
Cindy Inouye, Ex-Officio Member  
Kanoë Margol, Employee Member  
Michael Okumoto, Employee Member  
Brian Moto, Employee Member  
Kenneth Villabrille, Employee Member

Others: Rodney J. Tam, Deputy Attorney General  
Cynthia Akiyoshi, DHRD Staff  
David Williams, Alex Williams, Mercer Investment  
Consulting – via conference call  
Julie Klassen, Carol Blumenthal, Prudential Retirement –  
via conference call  
Michael Chandra, John Miller, Taylor Alan-Lee, Jeff Helsing, PIMCO –  
via conference call  
Kevin Malmud, Jeanne Kanai, Grace Baracao, Prudential Honolulu Office

Call to Order: There being a quorum present, Chairperson Chu called the meeting to order at 1:39 p.m.

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

Chairperson Chu welcomed the Trustees, the Prudential Honolulu Office team present, and those attendees via conference phone. Chairperson Chu opened the meeting to thank everyone for attending today's meeting.

Chairperson Chu asked to take Agenda Item #2 out of sequence. There were no objections.

Agenda

Item # 2: Review and Discussion of Request for Proposals for Investment Consultant Services

Chairperson Chu stated that Agenda item #2 will be taken in Executive Session since it relates to procurement.

**A motion was made by Trustee Margol and seconded by Trustee Inouye to move into Executive Session at 1:42 p.m. The motion passed unanimously.**

All guests were excused.

EXECUTIVE SESSION

Meeting

Reconvened: **A motion was made by Trustee Inouye and seconded by Trustee Margol to move out of Executive Session at 2:21 p.m. The motion passed unanimously.**

PIMCO, Prudential representatives, and Mercer consultants rejoined the meeting in person and via conference call.

**A motion was made by Trustee Inouye and seconded by Trustee Moto to accept the draft RFP for Investment Consultant Services, with noted comments and edits, to establish the entire Board as the Evaluation Committee, and to use the median method of scoring during the scoring phase for the RFP for Investment Consultant Services. The motion passed unanimously.**

Agenda

Item # 1: Further Discussion on Board's Decision to Terminate the PIMCO Total Return Bond Fund

The Board asked PIMCO to start with updates to the recent outflows, liquidity, and performance situation. Mr. Miller reported that the outflows have been manageable, and as addressed in Morningstar's report the redemptions have not materially impacted the Fund's performance.

In addition, the Fund's performance for the short-term during November (from November 1 through end of November 23) is above the benchmark (Barclays US Aggregate) by 33 basis points, and is in the 99<sup>th</sup> percentile of the Morningstar peer universe. Since the departure of Mr. Gross, the Fund was in the 95<sup>th</sup> percentile. Mr. Miller offered that PIMCO will make smart, prudent decisions to achieve

outperformance, and that the redemptions have not impacted their ability to outperform the index. He also added that they do not feel there will be a second wave of redemptions.

Mr. Williams stated that Mercer is continuing its discussions with PIMCO and they are continuing to monitor the stability of the organization. They are in agreement with PIMCO's comments. Mercer's October 16, 2014 memo continues to remain the basis of their stated recommendations that were provided to the Board.

In response to Trustee Margol's question on addressing the remarks made by PIMCO, Mr. Williams responded that Mercer does not have a reason to doubt the validity of PIMCO's updates and the information on the asset flows are consistent with the information that Mercer has and is in Morningstar's report. Once defined contribution plan sponsors got together to review the information and make their own independent decisions, he stated that one would not see those redemptions pick up until late December, January, or February.

Trustee Moto commented that PIMCO has faced substantial outflows even before Bill Gross' departure. It appears PIMCO's assets experienced outflows since May 2013. Mr. Williams commented that the PIMCO outflows of \$315 billion around May 2013 were attributable to the feds report on the tapering of the fed stimulus program and as such many bond fund managers were experiencing the same. The substantial amount of outflow within PIMCO is in large part due to the large size of the PIMCO fund.

Mr. Miller responded that all bond funds saw redemptions and that PIMCO's redemption was consistent with redemptions of the other funds. Mr. Miller added that the peak of the outflows reached \$290 billion. The outflow level at the end of October 2014 was consistent with a 25-30% decline in assets under management. The Total Return Bond Fund is still seeing outflows but the pace declined from 4-5 weeks ago.

In response to Trustee Moto's question on the current rating, Mr. Miller confirmed that in fact the rating did decline from gold to bronze according to Morningstar. The Star level, in terms of performance, is still a 4-star rating by Morningstar which is consistent to where it was six (6) months ago. The 12-month trailing performance does reflect an underperformance against the benchmark which has been driven by the investment strategy; however, the long term performance objective is to outperform over to a full market cycle; on a 3-year basis the fund's outperformance is by 2% and the 5-year basis is slightly under 1% (a positive 1% relative to the index).

Trustee Moto asked Mr. Miller to comment on the report that Bill Gross was received a \$290 million bonus. Despite not able to generally give comments on

compensation, Mr. Miller did state that when Bill Gross sold the company fifteen years ago the profit was left in tack. So the total compensation that Mr. Gross likely received included that residual portion from the sale of the company.

Mr. Miller concluded by thanking the Board for its diligence in considering all the information related to PIMCO's situation.

**A motion was made by Trustee Margol and seconded by Trustee Inouye to move into Executive Session at 2:44 p.m. The motion passed unanimously.**

All guests were excused.

#### EXECUTIVE SESSION

#### Meeting

Reconvened: **A motion was made by Trustee Margol and seconded by Trustee Villabrille to move out of Executive Session at 3:20 p.m. The motion passed unanimously.**

Prudential representatives and Mercer consultants rejoined the meeting in person and via conference call.

**A motion was made by Trustee Young and seconded by Trustee Inouye to: (1) rescind the Board's decision made at the October 27, 2014 meeting to terminate PIMCO as the fund manager, transfer of assets to BlackRock and initiate a RFP to replace PIMCO. The decision to rescind the Board's decision is based on the information provided by Mercer and the updated information by PIMCO and Morningstar. Further, the motion is to move to: (2) place the PIMCO Total Return Bond Fund on the watch list; (3) begin the search process for a potential new bond fund manager; and (4) re-evaluate the status of the PIMCO Total Return Bond Fund's outflow and performance in 60 to 90 days.**

Trustee Moto noted that he stands in opposition to the motion since the Fund has lagged in performance for more than 1 year; with the departures of the second-in-command and Mr. Gross, many things have happened such as more than a third of the assets have left, the Fund continues to see outflows, and the firm has paid outrageous salary amounts to its top executives even by Wall Street standards. In addition, other plans have or are considering termination of the Fund, the Fund has been downgraded to a bronze rating by Morningstar, and the decision is contrary to the recommendation provided by the Plan's consultant.

**The motion passed with 6 votes in favor and 1 vote in opposition (Trustee Moto).**

The Board discussed preparation of an announcement in the Plan's newsletter regarding the Fund's placement on the watch list and the circumstances of the decision.

Agenda

Item # 3: Old Business/Announcements

Ms. Akiyoshi referenced the upcoming RFP for Investment Consultant services and asked for the completion of the Attestation form by each Board member.

As Trustee Young indicated that he will likely not be continuing on as the Director of Budget and Finance and plans to leave as of December 1, 2014, or as long as the transition may require his presence, a resolution and lei were presented to Trustee Young for his service to the Board and Plan.

Ms. Akiyoshi stated that this is the last meeting that is planned for this year and no other meetings are expected for the remainder of the year.

Mr. Malmud ended with sharing a new termination/pre-retirement communication brochure that was prepared as an overview for retiring/separating employees on the distribution options available upon separation from the Plan.

Chairperson Chu adjourned the meeting at 3:39 p.m.

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