

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

**OPEN SESSION MINUTES  
MEETING # 346**

Date: November 23, 2010

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  
Georgina Kawamura, Ex-Officio Member  
Cindy Inouye, Ex-Officio Member  
Sandra Yahiro, Employee Member  
Wesley Machida, Employee Member  
Michael Okumoto, Employee Member

Others: Rodney J. Tam, Deputy Attorney General  
Cynthia Akiyoshi and Lily Chu, DHRD Staff  
Troy Saharic and John Bothwell, Mercer Investment Consulting –  
Via Conference Call  
Brian Merrick, Kristine Matthews, and Marilyn Mitchell, Plan Administrator Staff  
(ING)/Boston Office - Via conference call  
Melody Takacs and Jeanne Kanai, Plan Administrator Staff  
(ING)/Honolulu Office  
Lisa (Yoshioka) Hoxha, Great West Retirement Services  
Todd Egger, INVESCO – Via Conference Call

Absent: Scott Kami, Employee Member

Call to Order: There being a quorum present, Chairperson Wayne Chu called the meeting to order at 9:05 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.

Add Agenda

Item: **A motion was made by Trustee Kawamura and seconded by Trustee Inouye to add an item to the agenda on the complaint received in Heckman versus Jorgensen-Weber civil case. The motion passed unanimously.**

Agenda

Item # 1: Approval of Minutes No. 344

Ms. Akiyoshi reported that Minutes No. 344 was not complete yet, and requested that this item be deferred to the next meeting.

Agenda

Item # 2: Performance Evaluation Report by Mercer for 3<sup>rd</sup> Quarter 2010, Period Ending September 30, 2010

- a. American Funds EuroPacific Growth Fund A-Share Class Change
- b. Review of Reallocations within the Lifecycle Funds for 2011

Mr. Bothwell reviewed Mercer's memo dated November 10, 2010 on the change in the share class within the American Funds EuroPacific Growth Fund. The change in the share class to the R6 share class would decrease the net expense ratio by approximately 10%, and would eliminate the 12b-1 fees and sub-transfer agency fees. The fund would remain the same, as far as the management of the fund and the holdings. The change would be limited to a change in the ticker symbol.

Mr. Merrick, ING, confirmed that there should be no adverse impact on participants. Changes are limited to within the fund by the custodian.

Ms. Akiyoshi reported that this announcement will be featured in the upcoming Plan newsletter, informing participants about the share class change and new ticker symbol identification.

DAG Tam clarified that in the past 12b-1 fees were credited to participant accounts separately but now the process will change and participants will no longer see the rebate. The newsletter will explain the changes.

**A motion was made by Trustee Yahiro and seconded by Trustee Kawamura to switch from the Class A Shares to the Class R6 Shares within the American Funds EuroPacific Growth Fund. The motion passed unanimously.**

Mr. Saharic reviewed the reallocations within the Lifecycle Funds for 2011. For the custom Lifecycle Funds within the Plan, there is a glide path where over time the funds become more conservative. Mercer reviews the allocations once a year and changes the allocations and rebalances according to target allocations.

Mr. Saharic reviewed the current allocations and explained the factors that are analyzed to come to a recommendation. Mr. Saharic presented the recommendations for 2011 and explained how the allocations have changed.

ING confirmed that these changes can be completed in about one month.

**A motion was made by Trustee Yahiro and seconded by Trustee Kawamura to accept Mercer's recommendations on the 2011 Lifecycle Fund allocations, as presented on page 44 of its report, and for the changes to be completed as soon as administratively feasible.**

Trustee Machida raised some discussions from the ERS' fund managers who have said that they do not expect the fixed income market will do well in the next 3-5 years or so. Mr. Saharic noted that the proposed increase changes to the fixed income strategy are with a fund manager that has the ability to sector allocate among the different areas. PIMCO has proven to be astute with how they allocate among those areas, and can be nimble in today's environment.

After some Board discussion, Mr. Saharic concurred that the inflationary pressures could impact the Lifecycle Funds so to address the impact on the Income Fund, 2015 and 2025 fund, one recommended strategy is to introduce further diversification within the funds. The strategy would be to add an inflation hedging strategy such as TIPS, commodities, and global real estate securities, and an emerging market allocation. Mr. Saharic noted that other plans with custom Lifecycle Funds have been adding these types of strategies.

**The motion passed with 5 votes, and one opposing vote by Trustee Machida.**

The Board requested Mercer put together some educational information for the Board on the new asset classes for presentation at a future meeting. Then the Board can make a decision on whether to pursue procurement on these options.

#### Agenda

#### Item # 3: Discussion on INVESCO's Request for Fee Cap Increase

Mr. Bothwell summarized the state of the wrap market in the stable value industry. With the volatility in 2008, many insurance companies stopped wrapping new monies, and the demand increased for wrap providers. Subsequently, wrap providers began increasing fees. Monumental has asked for a higher fee, and others like Pacific Life may similarly request an increase too. INVESCO is planning to have discussions with other wrap providers.

Mr. Eggers, from INVESCO, confirmed that there have been less wrap providers and as a consequence wrap fees are doubling. Also, they are seeing that other providers are entering the market so they are seeing more interest of additional providers entering or re-entering the market, and this may stabilize the prices. With added capacity in time, this may ease the increase and provide more flexibility. Mr. Eggers referenced the October 13, 2010 letter from INVESCO explaining that Monumental will increase its fees on the first of the year, and Pacific Life will do the same on the

first of the year. When the fees are aggregated, it will push the aggregated fee up to about 33 basis points. Therefore, INVESCO is requesting a fee cap increase to 35 basis points from the 30 basis points to accommodate the increase wrap fees and provide a small cushion.

Mr. Eggers noted that if the proposal is not approved by the Board, then INVESCO would reject the wrap provider's fee increase and not continue to wrap that portion of the funds which amounts to about two-thirds of the fund. The Board discussed the problem on the possibility of having to raise the fee cap each time there is a demand to raise the wrap fees.

Mr. Saharic explained importance of having wrap provider contracts, and added that there has been an increase in wrap provider fees across the board and this is not unique to the State of Hawaii. If the Board decides not to approve the increase, the concern is that the Stable Value Fund will lose the wrap provider coverage. He added that even if the Board chose to replace INVESCO, the Board will likely face the same issues with other providers.

**A motion was made by Trustee Machida and seconded by Trustee Kawamura to go into Executive Session to confer with the Plan's legal counsel on the legal ramification of the request to increase the wrap fees at 9:49 a.m. The motion passed unanimously.**

ING staff and guests were excused from the meeting.

#### EXECUTIVE SESSION

#### Meeting

Reconvened: **A motion was made by Trustee Yahiro and seconded by Trustee Kawamura to get out of Executive Session at 9:58 a.m.**

ING staff and guests rejoined the meeting.

**A motion was made by Trustee Yahiro and seconded by Trustee Inouye to approve INVESCO's request to increase the fee cap from 30 basis points to 35 basis points. The motion passed unanimously.**

The Board asked that they be kept informed whenever there are increases beyond the increase today by the wrap providers. Mr. Eggers and Mr. Saharic confirmed that all fee increases changes by the wrap providers will be disclosed to the Board.

#### Agenda

Item # 4: Plan Administrator's Report

- a. Status on Plan Activities

Ms. Kanai reported that the only new accomplishment for the 3<sup>rd</sup> Quarter 2010 period is the creation of retiree workshops and individual photo magnets of the Plan consultants to use to enhance communications at the workshops.

Plan Highlights are:

- Total dollars transferred to ERS for the ERS Hybrid Upgrade program was \$149 million;
- Received 22 rollovers into the Plan in the amount of \$223,193;
- There were 18 rollovers in from ERS totaling \$772,812;
- There were 9 PTS transfers in of \$30,609;
- There were 78 vacation rollovers of \$1,081,807;
- Total rollover contributions totaled \$2,108,423;
- UEW requests for 3<sup>rd</sup> Quarter 2010 totaled \$1,314,382; in summary there were 103 applications and 100 were approved;
- There were 37 set-ups of \$1,759,182 in the Self Directed Brokerage Account;

Ms. Takacs reported on the activities within the Local Office:

- On track to meeting 2010 goals, held 195 group meetings with 1,078 attendees, and 2,441 individual meetings;
- Local office took in 341 walk-ins and 1,556 calls;
- Enrolled 122 State and county employees into the Plan;
- Provided workshop education at the State and County organized new employee orientations and pre-retirement workshops;

Ms. Mitchell provided highlights on the Investment Advisor service:

- Personal Evaluation campaign that began on September 20, 2010 through November 19, 2010;
- Campaign kicked off with pre-announcement newsletter, followed by personal evaluations, reminders and trial offer period;
- Total mailings to 17,518 participants;
- 973 participants responded during the campaign, about 5.5%;
- Increase of 619 PAM members, which is about a 71% increase;

b. Discussion on Roth 457 Provision

Mr. Merrick provided a recap:

- As a result of the Small Business Job Protection Act of 2010, section 457 plans are now able to add a Roth 457 feature, effective January 1, 2011;

- Designated Roth contributions are taxed as income in the year the contributions are made;
- Qualified distributions of Roth contributions and earnings are tax-free;
- For distributions to be qualified there is a 5-year rule that applies, in addition to Plan's distribution rules, once a Roth account is opened and funded the clock starts in the year that the contributions are made, and if there is a distribution prior to the 5 year period, the earnings are taxed and subject to a tax penalty;
- ING preparation and approach:
  - Utilize established procedures built for 403b and 401k plans;
  - Review payroll interfaces to determine the changes, and identify unique account set-ups like SDBA;
  - Create related communication materials and other changes;
  - Review plan documents and statutes that govern the Plan;
  - Set-up would include 2 separate accounts – one account for new contributions coming in; the other is a rollover account;
  - Each Roth account would have a new start date;
- Provision to convert pre-tax monies to Roth 457 became effective September 2010:
  - Requirement that a participant must have a Roth before conversion;
  - ING is still exploring and clarifying Roth conversion feature and ability to convert;
  - Active employees contributing pre-tax monies and who are not eligible to take a distribution would not be eligible to convert the pre-tax monies to a Roth 457; the participant must be eligible for a rollover distribution;
  - Feature is mainly to allow earnings to be tax-free, and help diversify tax situations in retirement;
- Estimated Fees to establish a program:
  - Mr. Merrick stated that initial quotes provided to clients have been typically between \$50,000 - \$70,000 per program, and no additional ongoing service fees for Plan and members.

Agenda

Item # 5:      PTS Plan

- a.      Approval of Report on Funds Not Deposited in the State/County Treasuries

Ms. Akiyoshi presented the asset report for the 3<sup>rd</sup> Quarter for the Board's approval.

Staff will check and provide responses back to the Board on: 1) why the information provided on page 5 of the Quarterly Management Report (that was distributed) shows the number of continuing actives increases in the month of September 2010 by approximately 2,000 if the new enrollments are only 1,000;

2) what options there are to address the accounts with small balances, and the fees that are assessed on keeping the accounts open. The Board requested DAG Tam check with the legal counsel for ERS on ERS' ability to turn over small de minimis accounts to Unclaimed Property the statute language for ERS.

**A motion was made by Trustee Kawamura and seconded by Trustee Machida to approve the Report on Funds Not Deposited in the State/County Treasuries for submission to the State Comptroller. The motion passed unanimously.**

b. Audit of the PTS Plan

Ms. Akiyoshi referred to the copy of the audit report and management letter with the findings. LSW gave a brief report at the last meeting on the findings and the deficiencies that LSW is working to correct. Ms. Akiyoshi gave some examples of the deficiencies and corrections. Ms. Akiyoshi also noted that regarding the Charter School employees being eligible for the PTS Plan, the question was raised to ERS to check on the Charter School employees' eligibility under ERS.

The Board discussed composing a letter from the Board citing the laws, after ERS checks on the membership of the Charter School employees.

Added

Agenda Item: **A motion was made by Trustee Yahiro and seconded by Trustee Kawamura to go into Executive Session to confer with the Plan's legal counsel at 10:50 a.m. on the complaint received in Heckman v. Jorgensen-Weber civil case. The motion passed unanimously.**

ING staff and guests were excused from the meeting. Trustee Machida was excused from the meeting.

EXECUTIVE SESSION

Meeting

Reconvened: **A motion was made by Trustee Kawamura and seconded by Trustee Inouye to get out of Executive Session at 11:06 a.m. The motion passed unanimously.**

Chairperson Chu called for a short break. The meeting resumed at 11:11 a.m. ING staff and guests rejoined the meeting.

Agenda

Item # 6: Other Business/Announcements:

- a. Presentation of Resolutions to Trustees Marie Laderta and Georgina Kawamura

Resolutions were read and presented to Trustee Georgina Kawamura and former Trustee Marie Laderta for their years of dedicated service to the Plan. Ms. Laderta was not able to attend the meeting; however, the Resolution will be forwarded to her.

Motion to

Adjourn:

**A motion was made by Trustee Kawamura and seconded by Trustee Yahiro to adjourn the meeting at 11:21 a.m. The motion passed unanimously.**

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