

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

**OPEN SESSION MINUTES
MEETING # 448**

Date: May 1, 2023

Place: Department of Human Resources Development (DHRD)
14th Floor Merit Appeals Board Conference Room
235 S. Beretania Street, State Office Tower
Honolulu, HI 96813

Present: Kalei Rapoza, Chairperson
Brenna Hashimoto, Ex-Officio Member
Roderick Becker, Ex-Officio Member
Lance Larsen Jr., Employee Member
Reiko Matsuyama, Employee Member
LiAnn Tokuda, DHRD Staff
Doreen Kuroda, DHRD Staff
Jeffrey Nipp, Segal Marco Advisors
Kevin Malmud, Plan Administrator Staff (Empower)/Honolulu Office
Julie Klassen, Empower

Others via

Teams Link: Kalbert Young, Employee Member (arrived at 9:05 a.m., left at 10:30 a.m.)
Randall Nishiyama, Deputy Attorney General (arrived at 9:20 a.m.)
David Greengard, Segal Marco Advisors
Rob Luciani, Empower
Carol Blumenthal, Empower
Jeanne Kanai, Empower
Lisa Hoxha, Empower

Absent: Ken Kitamura, Employee Member

Call to Order: There being a quorum present, Chairperson Kalei Rapoza 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.

Agenda

Item # 1: Welcome and Introduction of Board Members

Chairperson Rapoza welcomed everyone and proceeded with the introductions of the Board members, Board staff, and other guest attendees. He reviewed some housekeeping items.

Agenda

Item # 2: Public Testimony

There was no one from the public in attendance to offer testimony. Chairperson Rapoza moved on to the next Agenda Item.

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Item # 3: Approval of Minutes No. 447 for the March 3, 2023, meeting

Chairperson Rapoza proposed a correction to the minutes. In the first paragraph on page 8, it states Chairperson Rapoza remarked that the “Board has not expressed their displeasure”. Chairperson proposed to strike the word “their” from the minutes.

There were no other comments or changes offered by the Board members.

A motion was made by Trustee Matsuyama and seconded by Trustee Larsen to approve Minutes No. 447, with the corrections as noted. The motion passed unanimously.

Agenda

Item # 4: Performance Evaluation Performance Report for the First Quarter 2023 by Segal Marco Advisors, including:

Mr. Nipp reviewed the report from Segal for the Board for the First Quarter 2023.

a. Review of Market Environment

- The US added 236,000 jobs and the unemployment rate fell to 3.5%.
- US stocks rose in March; however Large Cap was the only category to make gains.
- Inflation remains high, but the Fed has slowed its pace of rate increases. Rate increases have decreased from 75-basis points to 25-basis points from 2022. Another 25-basis point increase is expected by the Fed.
- Commodities slipped as energy prices declined and gas prices lowered.

b. Review of Investment Option Performance

- The actively managed Bond strategy outperformed the Broad Market in the first quarter.
- AMCAP Funds performed well in the quarter, outperforming the

benchmark S&P 500.

- The Mainstay Large Cap Growth Fund was outperformed by its benchmark the Russell 1000 Growth Index. Mr. Nipp explained the index is dominated by certain stocks and if the Fund does not own an equal number of stocks as the index, it will lag.
- All the Vanguard Target Date Funds met or outperformed its benchmark. The more aggressive funds with more equity performed slightly better than the conservative funds.

c. Review of Investment Option Fees

- Compared to the Median Expense Ratio, every fund's fee ratio is below the median.

There were no questions from the Board.

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Item # 5:

Segal Marco Advisors Investment Fund Equity Investment Options Review and Action Thereon, including:

a. International Large Cap Value Equity Search

Mr. Nipp and Mr. Greengard summarized the Equity Investment Structure Issues they presented on at previous meetings.

- US Equities:
 - There is a style overlap between AMCAP Fund's "Large Cap Core" and Mainstay/Winslow Fund's "Large Cap Growth" options.
 - AMCAP is on a Watch List for poor performance against its benchmark and peer groups and for its style mismatch with its "Core" role in the portfolio.
 - Mr. Nipp and Mr. Greengard have met with Capital Group to discuss the performance and style mismatch of the AMCAP Fund.
 - Mr. Greengard explained that the Board was informed at a previous meeting that Wellington will be reducing their management fee by 5-basis points for the Wellington Research Management Fund. The fee reduction is due to an outflow, leaving the Plan as the sole holder of the fund. There is another Wellington vehicle the Plan can move into that has the same strategy as the current fund and other holders, reducing any risks to the Plan.
- International Equities
 - There is limited utilization, or 0.2% of Plan assets, in the Emerging Markets investment option.

- The Plan's Investment Policy Statement (IPS) defines the actively managed investment options as Value and Core. Core lies in the middle of Value and Growth styles. Core could have a mix of Value and Growth, but it does not have a style bias.
- The MFS International Intrinsic Value Fund and the American Funds EuroPacific Growth Fund are respectively the Value and Core investment options in the Plan. However, Morningstar categorizes both funds as Large Cap Growth funds thus creating a style mismatch.

Mr. Nipp and Mr. Greengard presented their alternative recommendations to the IPS and the investment options to the Board.

Alternative #1

- Policy Structure
 - The policy structure would include three categories: US Large Cap, US Small/Mid Cap, and International Equity.
 - In each of these categories, there would be a Passive Core, Active Value, and Active Growth option.
 - This structure provides a total of 9 Equity Options: 3 US Large Cap, 3 US Small/Mid Cap, and 3 International Equity as opposed to the 11 Equity Options currently offered in the Plan.
- Implementation
 - Remove AMCAP Funds and map the assets to the S&P 500 Index Fund.
 - Remove the Schroder Emerging Markets Fund and map the assets to the Non-US Equity Index Fund.
 - The MFS International Intrinsic Fund would be replaced by a style consistent ACWI ex-US International Value Fund and the assets mapped to this new fund.
 - Switch the Wellington Research Value Fund to the other Wellington vehicle with the same strategy.
 - Switch the American Funds EuroPacific Growth Fund from a Mutual Fund to an Insurance Company Separate Account.
 - The IPS would be updated to reflect the new investment option structure.
 - This alternative provides limited changes to the existing structure while providing 9 style specific equity options.

Trustee Becker asked what other reasonings there were in removing the Schroder Emerging Markets Fund besides the low utilization. Mr. Nipp explained the other International Equity options in the Plan have Emerging Markets exposure and removing the fund would provide a consistent structure.

Chairperson Rapoza asked if the Board would need to select a new US International Value Manager for this alternative. Mr. Nipp confirmed and

explained that Segal has recommendations to present to the Board for the new manager.

Alternative #2

- Policy Structure
 - The policy structure would include the same three categories as alternative #1: US Large Cap, US Small/Mid Cap, and International Equity.
 - In each of these categories, there would be a Passive Core and Active Core.
 - This structure provides a total of 6 Equity Options: 2 US Large Cap, 2 US Small/Mid Cap, and 2 International Equity.
- Implementation
 - Remove AMCAP, MainStay Large Cap Growth, and Wellington Research Value Funds.
 - Hire a new active US Large Cap Core Manager and map the existing active US Large Cap assets to this new option.
 - Remove Harbor Small Cap Value and William Blair Small/Mid Cap Growth Funds.
 - Hire a new active US Small/Mid Cap Manager and map the existing active US Small/Mid Cap assets to this new option.
 - Remove MFS International Intrinsic Value, Schroder Emerging Markets, and American Funds EuroPacific Growth Funds.
 - Hire a new active ACWI ex-US International Core Manager and map the existing assets from the MFS, Schroder, and EuroPacific Funds to this new option.
 - The IPS would be updated to reflect the new investment option structure.
 - This alternative provides a simpler structure without Growth and Value styles.

Trustee Matsuyama questioned if participants prefer more investment options. Mr. Nipp replied it is difficult to balance having enough options versus too many. He explained the Plan offers the Vanguard Target Date Funds (TDFs) and these TDFs are a default option for participants. So, only the participants not utilizing the TDFs will be affected by these fund changes. Mr. Malmud commented the participants that choose to “Do it Themselves” are more sophisticated investors and do not require much counseling. Also, the Plan offers a Self-Directed Brokerage Account (SDBA) option for participants that want to invest in specific funds. Mr. Malmud further stated the changes in alternative #1 is less disruptive and would be easier to communicate to participants.

Trustee Hashimoto asked about the timing of the fund changes. Mr. Nipp recommended prioritizing the fund changes, so it is completed before the Plan migrates to the Empower platform in 2024. Ms. Klassen added that regular fund changes, including communications to participants about the change, takes about

60 days to complete. However, complex fund changes can take about 90 days to complete. So, the timeframe would be 60 to 90 days, however if the Board decided on an alternative at this meeting, there is sufficient time to complete the fund changes before migration.

Chairperson Rapoza asked the Trustees if they had a preference between the two alternatives presented, and the Trustees responded they prefer alternative #1. Mr. Nipp presented Segal's candidates for a new International Value Fund Manager to the Board for alternative #1.

- Mr. Nipp and Mr. Greengard worked with Segal's Management Research Team on recommendations for potential replacements for the MFS International Intrinsic Value Fund.
- The three candidates are:
 - Brandes International Equity Fund (BIERX).
 - The headquarters is in La Jolla, CA. Founded in 1974, Brandes is a privately owned firm with no sub-advisors.
 - The Net Expense Ratio is 0.75.
 - Dodge & Cox International Stock Fund (DOXFX).
 - The headquarters is in San Francisco, CA. Founded in 1930, Dodge & Cox is a privately owned firm with no sub-advisors.
 - The Net Expense Ratio is 0.52.
 - Dodge & Cox is the largest of the three candidates.
 - Oakmark International (OAZIX).
 - Oakmark headquarters is in Chicago, IL. Founded in 1976, Oakmark is owned by Natixis Investment Management with Harris Associates L.P. as a sub-advisor.
 - The Net Expense Ratio is 0.75.
 - Oakmark tends to have less in Emerging Markets Equity than the other candidates.
- The Holdings-Based Style Map of the three candidates shows all three are Value Funds.
- All three candidates have performed well against the benchmark.
- For performance over a rolling 3-year period, Brandes outperformed about 61%, Dodge & Cox outperformed about 70%, and Oakmark outperformed about 68%.

Trustee Becker asked how many funds Segal reviewed before selecting these three candidates. Mr. Nipp responded Segal's Management Research Team probably reviewed over a hundred funds before selecting the three candidates. Trustee Becker questioned if the fund performance data is net of the expenses and Mr. Nipp confirmed it is.

Chairperson Rapoza asked for Segal's opinion on which of the three candidates they prefer. Mr. Nipp said he prefers Dodge & Cox because their portfolio is

consistent, and the fund performance does not dramatically differ from the benchmark. Mr. Greengard agreed that Dodge & Cox is the best fit for the Plan. Trustee Becker questioned if the Board usually interviewed the Fund Managers. Chairperson Rapoza confirmed the Board would interview the Fund Managers during a formal process, but this is the first time the Board is conducting this type of selection. Mr. Nipp commented that interviews with the Fund Managers can be arranged for the Board. Trustee Young stated that of the three candidates, he supports Dodge & Cox because of its cost ratio, fund size, and volatility of the fund. Trustee Matsuyama agreed with Trustee Young and supports Dodge & Cox.

Trustee Becker asked how Dodge & Cox compares to the MFS Fund based on performance. Mr. Nipp stated the difference in style will affect performance because over the last decade, Growth has outperformed Value, and Dodge & Cox is a Value fund while MFS is a Growth fund. Comparing both funds' ten-year performance, MFS is 8.2 and Dodge & Cox is 5.1. Trustee Becker questioned if the EuroPacific Fund is better than the MFS Fund for Growth funds in the Plan and Mr. Nipp explained the EuroPacific Fund fills the role of a Growth fund better. He also commented that he has met with MFS, and they also agreed the MFS Fund is not a good fit as a Value fund in the Plan's structure.

Trustee Larsen questioned what the demographics of the participants investing in the Value funds were. Ms. Klassen commented this demographic information is reported in Empower's report. Using Empower's report, Mr. Nipp answered as of December 31, 2022, the MFS Fund held 1.7% of Plan assets and participants between the ages of 45 and 64 are the highest contributors to the Fund. Ms. Klassen commented the naming convention of the MFS Fund implies it is a Value fund, but it is allocated in the Large Growth Asset Class. Trustee Becker asked if Plan materials lists the MFS Fund as a Value fund and Ms. Klassen responded it lists the name MFS International Intrinsic Value Fund, but it is allocated as Growth. Trustee Becker inquired if Segal has any relationships with the three candidates the Board should be aware of, and Mr. Nipp replied that Segal does not.

Chairperson Rapoza asked what options there are for participants that want to continue to invest in the MFS Fund. Mr. Nipp explained there are two options. If participants wanted to invest in a Value fund, then the first option is to map their assets to the new Value fund the Board selects. If the participant wants to invest specifically in the MFS Fund, the second option is participants can utilize the SDBA option in the Plan. Trustee Becker questioned if the MFS Fund is listed as a Growth fund in the Plan, why would the assets be mapped to a Value fund and not the EuroPacific Growth Fund. Mr. Nipp explained the MFS Fund is categorized as a Growth fund, but it has "Value" in the name, so he believes participants do not perceive this fund as a Growth fund.

Trustee Larsen asked if participants wanted to continue to invest in the MFS Fund, they could use the SDBA option in the Plan. Ms. Klassen confirmed they can use the SDBA option. Chairperson Rapoza asked about the fees in the SDBA

option. Ms. Klassen explained the fees will vary, but participants will lose the potential advantage on the fees if the fund was included in the Plan.

There were no further questions from the Board.

A motion was made by Trustee Larsen and seconded by Trustee Matsuyama to accept the recommendation from Segal to remove AMCAP and map the assets to S&P 500 Index Fund; remove Schroder Emerging Markets and map assets to Non-US Equity Index Fund; replace MFS with style-consistent ACWI Ex-US International Value Fund and map the MFS assets to Dodge & Cox; switch Wellington Commingled Fund for US Large Cap Value option; switch EuroPacific Growth Fund from Mutual Fund to Insurance Company Separate Account; and update Investment Policy Statement to reflect new option structure. The motion passed unanimously.

Agenda

Item # 6: Plan Administrator's Report, including:

Ms. Klassen presented the Commentary, Key Plan Data, Plan Demographics, Asset Allocation by Funds, and Participant Count by Fund by Age Group sections of the Plan Administrator's Report.

a. Commentary

- Empower Migration Activities
 - Empower is working on an Agreement Addendum package that will be released several months before migration date.
 - The SDBA will be addressed in the Agreement Addendum package. Prudential Retirement utilized a platform called NFS, however Empower uses their Empower Financial Services Inc. platform. So, a new agreement amendment to cover the change from the NFS platform to the Empower platform is needed.
 - The framework for GoalMaker will slightly change after the migration to Empower. The Empower iteration of GoalMaker will look like a Target Date Fund, making the glidepath smoother for participants. Existing account balances will be rebalanced on a rolling bases based on each participant's birthdate. There will also be participant level reporting. Ms. Klassen expressed that Empower could present a web demonstration to the Board of Empower's iteration of GoalMaker at a future meeting.
 - Increased participation in Managed Accounts by Morningstar is anticipated because it will be more integrated on the Empower recordkeeping system. The Plan has an agreement with Morningstar for the Managed Accounts, however Morningstar has a direct agreement with Empower Advisory Services as an investment advisor, so also included in the

Agreement Addendum package is an agreement amendment with Empower instead of Morningstar for the Managed Accounts.

- Communications about payroll processing will be distributed to State departments and agencies.
- Plan Level Participant Activities
 - Empower is working with Board Staff to implement the Roth option in the Plan.
 - Empower is working with Board Staff on Hybrid Benefits Fair.
- SECURE 2.0 implementation
 - Increased age for Required Minimum Distributions (RMD) to age 73 effective 2023. The RMD age will increase to 75 effective 2033.
 - “Rothification” of Age 50 Catch Up Provisions requires age 50 catch up contributions be made into a Roth account for participants earning \$145,000 or more a year. This “Rothification” does not apply to the special 3 year catch up.

b. Key Plan Data

- Eligible number of participants for the Plan is 52,925 as of December 31, 2022.
- Additional tools will be available for participants after the Empower migration to assist participants with their decumulation strategies.

c. Plan Demographics

- In the Fourth Quarter 2022, there was over \$23 million in total contributions and over \$42 million in total distributions.
- There was a Market Value Gain of over \$130 million in Fourth Quarter 2022 compared to a Market Value Loss of over \$82 million in Third Quarter 2022.
- Total Participant Balances as of December 31, 2022, was over \$2.7 billion.

d. Asset Allocation by Funds

- This item was discussed in the prior Agenda Item.

e. Participant Count by Fund by Age Group

- This item was discussed in the prior Agenda Item.

f. Communications and Education Update

Ms. Hoxha presented the Communications and Education Updates of the report to

the Board.

- Fourth Quarter 2022 Newsletter
 - The newsletter open rate was 66%, which is two times the financial services industry average.
 - The newsletter click rate was 15%, which is five times the financial services industry average.
- Webinar Campaign
 - Beginning January 2023, a custom quarterly webinar campaign was developed for the Plan. The campaign encourages participants to attend retirement planning webinars hosted by Empower.
 - Weekly webinars are conducted throughout each month of the quarter and focus on important retirement planning topics.
 - There was a total of 13 webinars for First Quarter 2023 with 558 total attendees and average webinar attendance of 43.

Chairperson Rapoza asked if the webinars are live or recorded. Mr. Malmud explained the webinars are not recorded, but there are pre-recorded versions of certain topics available on the Plan website. Chairperson Rapoza asked if Empower has metrics on whether the live webinars are driving traffic towards the available pre-recorded versions. Ms. Hoxha explained they do not have those metrics, but they are able to gather the data for future webinars.

g. Local Office Activity

Mr. Malmud presented the Local Office Activity of the report as of December 31, 2022.

- Retirement Counselors assisted 643 participants with their Post Separation Vacation Pay Deferral elections for a total of \$7.9 million in additional contributions to the Plan.
- Retirement Counselors assisted with 166 rollovers into the Plan totaling \$7.8 million in additional assets rolled into the Plan.
- Total enrollments for the Plan were 698, there was 3,516 contribution increases, 589 GoalMaker elections, 242 rollovers into the Plan, and a total of \$9.4 million rolled into the Plan.
- Ongoing Initiatives
 - First in-person UH event occurred April 20 and 21 consisting of a series of group and individual counseling sessions at the Manoa campus.
 - Continued outreach with DOE to establish on-campus meeting at largest high schools on Oahu.
- Transition to in-person engagement and impact
 - Compared to First Quarter 2022 which was mostly virtual outreach, First Quarter 2023 with hybrid outreach saw an

increase in group meetings from 49 to 238, an increase in enrollments from 181 to 226, and contribution increases from 875 to 1,059.

- Mr. Malmud provided a few participant testimonials to the Board.

Chairperson Rapoza asked if participants know they can keep their assets in the Plan. Mr. Malmud explained that knowledge of the Plan varies by participant which is the reason targeted communications and participant outreach is important.

Trustee Larsen asked if the Plan participates in the State's retirement planning events. Mr. Malmud confirmed the Plan participated in past events on the neighbor islands, however, is not aware of such event occurring since the pandemic.

There were no further questions from the Board.

Agenda

Item # 7:

Approval of Payment to DHRD for the Two Special Funded Positions for Fiscal Year 2024

Ms. Tokuda presented the Bill for Collection to fund the two positions that provide administrative support to the Board.

- This Bill for Collection is for Fiscal Year 2024.
- One position is for the Human Resources Specialist IV Level position and the other is for the vacant Human Resources Specialist V Level position.
- The funding request is for both positions based on the salary schedule for Fiscal Year 2024 effective July 1, 2023, and the funding amount includes fringe benefit costs referenced in Finance Memorandum No. 21-11 from the Department of Budget & Finance.
- The amount is needed by June 30, 2023.
- Any excess amounts not used by the end of the fiscal year will be returned to the Plan.
- The balance of the Pan Expense Account as of March 31, 2023, is approximately \$1.9 million.

Chairperson Rapoza asked how the recruitment for the Level V position is going. Ms. Kuroda stated the request will be submitted that day.

Trustee Becker questioned if the two positions work exclusively on the Plan and Ms. Tokuda confirmed.

Trustee Hashimoto asked if both positions were filled at the same time. Chairperson Rapoza confirmed both positions were filled for approximately a

year. He also stated that any unused funds will be returned to the Plan and this funding approval is done every year.

There were no further questions from the Board.

A motion was made by Trustee Matsuyama and seconded by Trustee Larsen to approve the funding to DHRD from the assets of the Plan for the HRS V Level and HRS IV Level positions in the amount of \$158,808.17 and \$99,152.55, respectively, for a total amount of \$257,960.72, for Fiscal Year Ending June 30, 2024.

The motion passed with four Trustee votes, and one vote by Trustee Hashimoto to abstain.

Agenda

Item # 8:

Discussion of the PTS Plan reports, including:

Ms. Tokuda presented the PTS Plan reports to the Board.

- a. Notification of New Interest Rate for the PTS Plan, Effective April 1, 2023

The New Interest Rate effective April 1, 2023 is 2.24%. The rate is slightly up from 2.22% in the first quarter.

- b. Approval of Report on Funds Not Deposited in the State/County Treasuries for the Period Ending September 30, 2022

Ms. Tokuda reported items 8b and 8d together. The total combined asset balance in the PTS Plan as of September 30, 2022, totaled \$143,140,471.91. The corresponding Quarterly Management Report was provided to the Board members for their review.

A motion was made by Trustee Hashimoto and seconded by Trustee Larsen to accept the Report on Funds not Deposited in the State/County Treasuries for the period ending September 30, 2022. The motion passed unanimously.

- c. Approval of Report on Funds Not Deposited in the State/County Treasuries for the Period Ending December 31, 2022

Ms. Tokuda reported items 8c and 8e together. The total combined asset balance in the PTS Plan as of December 31, 2022, totaled \$143,319,621.39. The corresponding Quarterly Management Report was provided to the Board members for their review.

A motion was made by Trustee Hashimoto and seconded by Trustee Matsuyama to accept the Report on Funds not Deposited in the State/County Treasuries for the period ending December 31, 2022. The motion passed unanimously.

d. Quarterly Management Report for Period Ending September 30, 2022

Board Staff previously reported on this item.

e. Quarterly Management Report for Period Ending December 31, 2022

Board Staff previously reported on this item.

There were no questions from the Board.

Agenda

Item #9: Other Business/Announcements

a. Update on the 2023 Employee's Benefit Fair

Ms. Tokuda provided an update on the 2023 Employee's Benefit Fair to the Board.

- At the previous Board Meeting the Board decided to have a Hybrid Benefits Fair.
- The Fair will be held at Aloha Tower Market Place on Friday, August 4 with the Board Meeting on Thursday, August 3.
- Board Staff is working with Empower to plan the Fair.

Trustee Hashimoto asked if parking will be provided at the Fair. Mr. Malmud confirmed validated parking will be available for attendees.

Chairperson Rapoza asked if the Governor approved work time to attend the Fair. Mr. Malmud confirmed at past fairs, the Governor approved two hours of work time to attend. Ms. Tokuda confirmed she is working on getting Governor's approval on work time to attend the Fair.

Mr. Malmud mentioned Retirement Education Counselor Kapena Kim will be retiring at the end of the year.

Chairperson Rapoza thanked everyone for their participation in today's virtual meeting. He adjourned the meeting at 11:07 a.m.

(NOTE: Signed copy on file.)