

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

**OPEN SESSION MINUTES
MEETING # 432**

Date: August 5, 2019

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

Present: Brian Moto, Chairperson
Ryker Wada, Ex-Officio Member
Robert Yu, Ex-Officio Member (arrived at 9:09 a.m.)
Kalei Rapoza, Employee Member

Others: Christopher Leong, Deputy Attorney General
Randall Nishiyama, Deputy Attorney General
Cynthia Akiyoshi, DHRD Staff
Craig Chaikin, Segal Marco Advisors
Jeanne Kanai, Plan Administrator Staff (Prudential)/Honolulu Office
Grace Baracao, Plan Administrator Staff (Prudential)/Honolulu Office
Julie Klassen, Carol Blumenthal and Deborah Baran, Prudential Retirement – via
conference call

Absent: Kalbert Young, Employee Member

Call to Order: There being a quorum present, Chairperson Brian Moto called the meeting to order at 9:02 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 everyone and proceeded with introductions. He noted that Trustee Young is excused from today's meeting and welcomed DAG Randall Nishiyama who has been assigned to the Board in a permanent capacity. DAG Nishiyama provided a brief background. Chairperson Moto stated that no one from the public was in attendance to offer testimonies.

Agenda

Item # 1: Approval of Minutes No. 431 for the May 30, 2019 meeting

A motion was made by Trustee Wada and seconded by Trustee Rapoza to adopt Minutes No. 431, as prepared. The motion passed unanimously.

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Item # 2: Discussion on the Proposed Resolution to Authorize the Standing Committee's Responsibilities and Authorities and Potential Action Thereon

Chairperson Moto summarized that at the March 8, 2019 meeting, the Board established a committee on Operations to assist in seeking out information and solutions and provide directions to Board Staff on issues and matters that may require immediate attention between Board meetings. Trustees Rapoza and Young agreed to serve on the committee.

A resolution on the scope of the committee's authorization is presented for consideration and adoption. Trustee Rapoza noted that the committee members were in agreement with the drafted resolution and did not have any additional comments. There were no other questions.

A motion was made by Trustee Yu and seconded by Trustee Wada to adopt the proposed Resolution of the State of Hawaii Deferred Compensation Plan Board of Trustees Establishing Its Standing Committee on Operations and Authorizing Its Responsibilities and Authorities, as prepared. The motion passed unanimously.

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Item # 3: Discussion on the Scheduling of an Independent Plan Audit for the section 457(b) Plan for the Plan Year Ending June 30, 2019 and Potential Action Thereon

Ms. Akiyoshi summarized that at the April 16, 2019 meeting, the Board discussed the scheduling of the next plan audit for either the Plan Year ending June 30, 2019 or Plan Year ending June 30, 2020. Since Prudential's current renewal extension period expires on June 30, 2021, the Board discussed and agreed on starting a discussion of the renewal in 2020 and a desire to have an audit conducted and completed for Prudential's renewal consideration. The last audit that was conducted was for the Plan Year ending June 30, 2017. Action is required to proceed with the audit for the Plan Year ending June 30, 2019.

Trustee Rapoza clarified that the Plan audit report for the Plan Year ending June 30, 2017, was in progress in 2018 but was not completed in time for the Board's past deliberation on Prudential's renewal extension that began on July 1, 2018. So, the Board wanted to have the completion of the audit in advance of the Board's next deliberations on Prudential's renewal extension on July 1, 2021. Conducting an audit of the Plan Year 2019 would allow sufficient time for the discussions and any questions.

Ms. Klassen stated that the scope of the audit covers the account balances and valuations criteria and inflows and outflows. Ms. Akiyoshi added that the

auditing firm generally examines the operations by recordkeeper and verifies the transactions executed by the participants and agencies related to contributions to the Plan and also confirms distribution transactions executed by participants. Ms. Klassen confirmed that the type of audit that is performed is of the financial standards and in accordance with generally accepted accounting principles and applicable under the Government Auditing Standards by the Comptroller General of the United States.

A motion was made by Trustee Yu and seconded by Trustee Wada to authorize an independent Plan audit to be conducted for the Plan Year ending June 30, 2019. The motion passed unanimously.

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Item # 4:

Status and Discussion on Act 86, HB 1007, SD1, Relating to Adding the Roth Option and Potential Action Thereon

Ms. Akiyoshi summarized that the Board initiated a legislative bill request to DHRD for submission for the 2019 Legislative Session related to adding a Roth option for the Plan. HB 1007, SD1 was signed by the Governor and became effective. Act 86 allows the Board to add a Roth option for the Plan, if the Board desires.

Chairperson Moto stated that since the legislation is now law, the Board would need to take formal action to say that a Roth option will be added. If the Board chooses to do so, then a plan design proposal would be developed by Board staff for the Board's consideration on issues and action steps for implementation.

A motion was made by Trustee Yu and seconded by Trustee Wada to add a Roth option for the Deferred Compensation Plan.

Discussion: Chairperson Moto commented that Board Staff will be developing a plan design proposal with timelines on the rollout for the Board's consideration at a future meeting.

The motion passed unanimously.

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Item # 5:

Discussion on the Proposal to Establish an Alternate Competitive Bidding Process for Plan-related Investment Product Searches and Potential Action Thereon

Chairperson Moto summarized that at the April 16, 2019 meeting, the Board adopted a proposed alternate competitive bidding process for conducting investment product searches in lieu of using the State Procurement process under Chapter 103D, HRS. All investment product searches would be handled by the Investment Consultant for the Board's consideration. The Board requested that the flowchart that was presented be prepared in a formal document.

DAG Leong stated that he drafted a process document on an alternate competitive bidding process from the flowchart that was presented earlier for consideration. Since the Board did take action to adopt a separate process, the process document would just memorialize the alternate competitive bidding process. In review, the new process would include a determination by the Board that an investment product is required; the Investment Consultant identifying the nature of the search; posting a notice; the Investment Consultant receiving the inquiries and proposals and identifying five potential providers from the Consultant's review and analysis; the Board inviting and interviewing at least two of the providers; and the selection by the Board based on the discussion. Execution of a contract with the selected provider would follow.

Mr. Chaikin commented and asked "Investment Consultant" be clarified and to make the wording more flexible on the timing of when the actions would be completed. He did not have any issues with the content.

Chairperson Moto asked that any other edits be provided to DAG Leong that would allow for adequate time to accomplish what needs to be done during the process. There is no further action since the Board has approved the alternate competitive bidding process. The final write-up will be filed for the Board's future reference.

There were no other questions.

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Item # 6:

Performance Evaluation Report for the Second Quarter 2019 by Segal Marco Advisors, including but not limited to:

- a. Overview of Funds Currently on the Watch List: Wellington Management Research Value Fund

Mr. Chaikin presented a commentary on the market and performance evaluation of the funds through the Second Quarter 2019, in addition to some commentary on updates on defined contribution plans, legislation, and litigation:

- The markets were up 4.3% through the Second Quarter 2019.
- International equities were up 3.6% for the Second Quarter 2019.
- Interest rates have generally declined in 2019, and that has been a good thing for fixed income and bond returns.
- The Feds have held the interest rates steady; however, within the week the Feds cut the interest rate by one-quarter of a percent.
- Currently, the Dow Jones is down.
- President Trump stated he is instituting additional tariffs which sent the markets into a tailspin and raised concerns on increased trade tensions.

- There are indications of an inverted yield curve, which means that short term rates are higher than interest rates on long-term bonds, and this generally indicates a possible recession.
- In 2008, when the markets fell, the Federal interest rate was 5.25%. Moving the 5.25% rate to zero is more impactful on spurring growth and spending than moving from 2.25% to zero.
- There are concerns internationally where there is a new prime minister in Britain and uncertainty on whether Britain will exit the EU (European Union), a slowdown seen in China, and trade tensions with Korea.
- Economic fundamentals still look good.
- The Plan's assets have been increasing up to just under \$2.5 billion through June 2019.
- The Stable Value Fund balance makes up around 38% of the Plan's assets.
- The LifeCycle funds were replaced by Vanguard portfolios. At the beginning of April, assets make up about 5.5% of the total assets. The weighted average of the expense ratio declined by .29% which represents about a \$300,000 in savings annually.
- The Wellington Research Value fund remains on the watch list. The fund has had a good quarter and has been outperforming by about 70 basis points which was driven by stock selection. The results have been encouraging but there is no recommendation to take the fund off the watch list at this time. Segal will continue to monitor.
- In reviewing the performance scorecard, many of the funds show an underperformance. The Vanguard Target Retirement funds use passive underlying investments to track the index, so generally will underperform the index because of the fees. This is how the fund works.
- The AMCAP fund has had a short-term underperformance due to stock selection but most of the underperformance has been concentrated over the short-term. There are no significant concerns.

Mr. Chaikin discussed defined contribution plan updates, and legislative and regulatory updates:

- The Secure Act is intended to make people better prepared to retire.
- The Act would increase the RMD (Required Minimum Distributions) from age 70-1/2 to 72.
- The Act would provide more safe harbor provisions for sponsors and making it easier to add annuity and income products.
- It is not known when the legislation will pass.

Mr. Chaikin stated that the Department of Labor has been focusing on:

- Finding missing participants. From a best practice perspective, a Plan should consider having a defined process in place to find the missing participants. Ms. Blumenthal remarked that Prudential does utilize a process to locate missing participants and beneficiaries. Mr. Chaikin added that it is not

necessarily whether the Plan has good results in locating missing participants but whether the Plan has a process in place for looking for them and whether you are following the documented process.

- There are pressures placed on plan sponsors since there have been lawsuits filed against ERISA plans for fiduciary breach related to decision-making and actions taken. He noted that our Plan maintains an oversight process and utilizes well-documented processes, so the Plan is much better protected.
- Recordkeeper administrative fees are being evaluated based on the number of participants. Among the Segal Marco Advisors clients, they have observed and consider a lot of variations such as the level of services provided and not just the asset size or the number of participants. Costs are generally less than \$100 per participant for most plans.

Trustee Yu asked whether there is an estimated value of assets held by the participants who cannot be located. Ms. Blumenthal stated that there are reports of those who do not have valid addresses, but the report does not reflect “lost” participants because assets continue to remain in the Plan.

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Item # 7:

PTS Plan:

- a. Approval of Report on Funds Not Deposited in the State/County Treasuries for the Period Ending March 31, 2019
- b. Quarterly Management Report for Period Ending March 31, 2019, and Annual Management Report for the Year Ending December 31, 2018

Ms. Akiyoshi presented the Plan asset report for the period ending March 31, 2019. The total assets are the combined assets for the State and the County of Kauai. The corresponding quarterly management report for the period ending March 31, 2019 is included, along with the Annual Management report for the Plan Year ending December 31, 2018.

A motion was made by Trustee Wada and seconded by Trustee Rapoza to accept the Report of Funds Not Deposited in the State/County Treasuries for the PTS Plan for the period ending March 31, 2019.

Discussion: Ms. Akiyoshi responded on the question whether there have been any issues on contributions to the Plan, that there have not been any issues with the PTS Plan contributions being transmitted to the Plan. Trustee Rapoza commented that the Committee on Operations would look at any deferral issues should it come up for the regular Plan and the PTS Plan.

The motion passed unanimously.

- c. Notification on New Interest Rates for the PTS Plan, Effective January 1, 2019 and April 1, 2019

Ms. Akiyoshi reported that the new crediting rate for the PTS Plan beginning July 1, 2019 has been set at 2.54%, which is down 7 basis points from the prior quarter.

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Item # 8:

Staff Administrative Report

Ms. Akiyoshi reported on some of the ongoing monthly activities:

- There has been no activity on the Maui County's decision to explore additional deferred compensation plans.
- Worked with the Committee on Operations to develop a resolution on the scope of the committee's authorization. Draft resolution was presented.
- Working on a proposal to outline a plan design and considerations for adding a Roth option.
- Continuing to track the Plan expenses for budget planning purposes. There are currently no sub-committee members assigned to the budget subcommittee.
- Worked with Prudential on the coordination of the scheduling and communications for the Summer Lunch-n-learn workshops. The purpose of the workshops is to bring the financial pieces together to provide a better forecast of what employees could rely on in retirement with proper planning. The workshops rolled out last summer on Oahu. This year the workshops are being additionally expanded to include sessions in Hilo, Kona, Maui, and Kauai.
- Worked with Prudential on the initiatives for the new Go-Green campaign that focuses on ways to be green and promote environmental awareness.
- The Plan Asset reports have been completed through Second Quarter 2019.
- Planning of the Spring Benefits Fair and Semi-Annual meeting has been completed. Planning is underway for the Fall Benefits Fair and Semi-Annual meeting.
- INVESCO reported that there was a change on the rating to one of the wrap contract providers. The change was on Moody's rating, noting an improvement on Prudential's quality grade from A1 to Aa3. As of June 30, 2019, the total market to book ratio is above book value at 101.28%.
- The PTS Plan monthly distribution reports have been reviewed and approved for processing through July 2019.

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Item # 9:

Other Business/Announcements

a. 2019 Annual NAGDCA Conference

Ms. Akiyoshi reported that this year's conference is being held in New Orleans. There are four trustees who are planning to attend this year's

conference. The four trustees are Trustees Moto, Yu, Rapoza, and Young, in addition to Board staff.

b. Upcoming Scheduled Meetings and Events for 2019

Ms. Akiyoshi stated that the next scheduled Board meeting is the Semi-Annual meeting on October 28, 2019. The Benefits Fair will follow on the next day, October 29, 2019. Both events are being planned at the Kauai Marriott Resort. Although the Kauai Marriott Resort compared to the Kauai War Memorial Hall is slightly higher in costs for the Benefits Fair, the indirect costs, that are not accounted for in the direct costs such as the time and labor to set up before the event and to break down and clean up, seem to justify the slightly higher costs.

There were no objections to the proposed locations for the events.

There was no other business. Chairperson Moto thanked everyone for attending today's meeting and adjourned the meeting at 10:16 a.m.

(NOTE: Signed copy on file.)