

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

**OPEN SESSION MINUTES  
MEETING # 438**

Date: March 5, 2021

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

Present via

Teams Link: Brian Moto, Chairperson  
Ryker Wada, Ex-Officio Member  
Robert Yu, Ex-Officio Member  
Kalbert Young, Employee Member  
Kalei Rapoza, Employee Member  
Reiko Matsuyama, Employee Member  
Ken Kitamura, Employee Member

Others via

Teams Link: Randall Nishiyama, Deputy Attorney General  
Cynthia Akiyoshi, DHRD Staff  
Fanny Takehara, DHRD Staff  
Craig Chaikin, Segal Marco Advisors  
Wendy Carter, Segal Marco Advisors  
Kevin Malmud, Plan Administrator Staff (Prudential)/Honolulu Office  
Julie Klassen, Prudential Retirement  
Carol Blumenthal, Prudential Retirement  
Deborah Baran, Prudential Retirement  
Jeanne Kanai, Plan Administrator Staff (Prudential)/Honolulu Office  
Grace Baracao, Plan Administrator Staff (Prudential)/Honolulu Office  
Ata Azarshahi, National Life Group/Life Insurance Co. of the Southwest  
Dan Adams, National Life Group/Life Insurance Co. of the Southwest  
Judy Dang, B&F/Treasury Division

Call to Order: There being a quorum present, Chairperson Brian Moto 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 Incoming Board Member(s)

Chairperson Moto welcomed everyone and proceeded with introductions and continued with the introductions of the Board members, Board staff, and other guest attendees.

Agenda

Item # 2: Public Testimony Period

There was no one from the public in attendance to offer testimony. Chairperson Moto closed the public testimony period for this meeting.

Agenda

Item # 3: Approval of Minutes No. 437 for the December 15, 2020 meeting

Ms. Akiyoshi communicated one correction to the minutes. Under Agenda item no. 6, the number 463 should be removed from the sentence beginning, "Prudential is doing outreach to the 463 participants who have not registered their accounts." There were no further comments or changes offered by the Board members.

**A motion was made by Trustee Wada and seconded by Trustee Matsuyama to approve Minutes No. 437, with the noted change as presented. The motion passed unanimously.**

Agenda

Item # 4: Presentation of the Annual Report for the PTS Deferred Compensation Retirement Plan for Part-time, Temporary and Seasonal/Casual Employees (PTS Plan) for 2020 by Life Insurance Company of the Southwest

Mr. Ata Azarshahi provided opening remarks and Mr. Dan Adams presented the report.

Mr. Adams reviewed the highlights of the Plan, including:

- The assets as of June 30, 2020 reached over \$141 million which is \$6 million higher than the prior year and represents a 4-1/2% growth.
- Contributions to date were just under \$197 million.
- Benefits paid to date were just over \$110 million.
- The interest credited to date totaled just under \$55 million.
- The credited interest rate effective July 1, 2020 was 2.37%; the current interest rate effective January 1, 2021 is 2.18%.
- The year-to-date savings totaled \$7.3 million; savings since the Plan's inception totaled approximately \$163 million.

- The total number of participants is 99,741, for both active and inactive combined.
- In accordance with the agreement, \$17 million has been added to the escrow account for a total of \$148 million to cover the assets in the Plan.
- For the County of Kauai, the assets totaled \$207,000, and there are approximately 245 participants; the amount of savings since they joined the Plan totaled \$186,000, and savings of \$68,000 over the last year.

Mr. Azarshahi noted that of the total number of participants of 99,741, there were on average 7,859 active participants per month, and this has been lower than usual which may have been due to the pandemic and travel restrictions.

In response to Trustee Yu's question, Mr. Azarshahi explained that the difference between the contributions to date and the savings to date, and that the contributions are the premiums from participants of 7.5% from their salaries, and the savings are from the FICA and tax savings that are not subject to tax treatment.

Trustee Rapoza commented that it shows the number of active participants decreased in May 2020 and appears that this coincides with the financial restrictions within the State. The UH Hilo campus and the other UH campuses had to look at the reduction of employees in this type of appointment due to the effect of the pandemic, so it does appear to correlate to the low numbers of active participants that Mr. Azarshahi reported. Chairperson Moto added that he confirms there was hiring freeze since the early spring at the Maui College campus so noted a similar decrease on the Maui College campus and that, in general, employment has been down.

#### Agenda

##### Item # 5:

##### PTS Deferred Compensation Retirement Plan for Part-time, Temporary and Seasonal/Casual Employees (PTS Plan):

- Approval of Report on Funds Not Deposited in the State/County Treasuries for the Period Ending December 31, 2020
- Quarterly Management Report for the Period Ending December 31, 2020

Ms. Akiyoshi reported that the Plan asset report for the PTS Plan, for the period ending December 31, 2020, is presented for the Board's review and action. The total combined asset balance in the PTS Plan as of December 31, 2020 has grown to \$143,815,346.84. The corresponding quarterly management report for his period is also provided for review and information.

In addition, Ms. Akiyoshi reported that for the year end, the total dollar amount of CRDs taken from the Plan through December 2020, for both the State and the County of Kauai, totaled \$814,708.37.

**A motion was made by Trustee Young and seconded by Trustee Yu to accept the Report on Funds Not Deposited in the State/County Treasuries for the period ending December 31, 2020. The motion passed unanimously.**

c. LSW's Annual Letter on the Reimbursable Amount Available in the PTS Plan Expense Account for 2021

Ms. Akiyoshi reviewed the letter from LSW on the amount available for reimbursement in the Plan Expense Account for calendar year 2021. Based on the amount of premiums collected, the total amount available is \$70,690.83.

d. Notification on New Interest Rates for the PTS Plan, Effective January 1, 2021

Ms. Akiyoshi reported that the interest rate for the Plan effective January 1, 2021 is 2.18% which is down from the 2.31% rate for the prior Fourth Quarter 2020.

Agenda  
Item # 6:

Discussion and Consideration on the Renewal of the Contract Agreement with Life Insurance Company of the Southwest upon the Expiration date of June 30, 2023, and Potential Action Thereon, including but not limited to:

- a. Election of a 5-Year or 10-Year Renewal Period
- b. Minimum of a Guaranteed Annual Effective Interest Rate

Chairperson Moto remarked that under the terms and conditions of the contract agreement with LSW, it calls for a decision by the Board to inform LSW whether the contract agreement will be renewed beyond June 30, 2023, and if so, whether the renewal may be for either a 5-year period or a 10-year period, otherwise, a search will need to be conducted.

Ms. Akiyoshi explained and reviewed highlights of the contract agreement with LSW:

- The master agreement became effective December 31, 2006, which included:
  - An initial 5-year period through June 30, 2011, and
  - A contract renewal period through June 30, 2013.
- On January 1, 2013, a Supplemental Agreement #1 was executed to amend the master contract agreement, which included:
  - Change to a new flexible premium group annuity contract effective July 1, 2013;
  - The Supplemental Agreement #1 being subject to:
    - On or before December 31, 2021, an election by the Board to renew the agreement, either for:

- A renewal period through June 30, 2028, for a 5-year period; or
- A renewal period through June 30, 2033, for a 10-year period.
- Beginning July 1, 2013, the asset management fee shall be 195 basis points.
- The investment product which is an annuity product, provides a minimum guaranteed annual effective interest rate:
  - From December 31, 2006 to June 30, 2013, the minimum effective interest rate shall not be less than 3%;
  - From July 1, 2013 to June 30, 2018, the minimum effective interest rate shall not be less than 2%; and
  - From July 1, 2018 to June 30, 2023, the minimum effective interest rate shall not be less than 1%.

Ms. Akiyoshi reviewed the interest rates between 2018 to 2020. The interest rates have been above 2% for each quarter which has been beneficial for the Plan's participants.

Ms. Akiyoshi presented the considerations for the Board:

- To renew the contract agreement with LSW, or not;
- If renewing, determine the period of the renewal:
  - For a 5-year period through June 30, 2028; or
  - For a 10-year period through June 30, 2033.
- The minimum guaranteed annual interest rate during the renewal period, as proposed by LSW.
- The asset management fee during the renewal period. The current asset management fee is 195 basis points, in place since 2013.

The independent audit report that was completed for the plan year 2017 is available to assist with the evaluation. Timing of an independent plan audit for the 2020 calendar year would not be completed in time for the Board to use in a decision before the end of the year.

Mr. Azarshahi expressed his appreciation for the long partnership with the State and the County of Kauai, and LSW is interested in continuing the agreement. He explained that there are benefits from the long-term relationship. Although the assets have been dropping because of the interest rate environment, the assets have been growing with new assets and this has dictated the resulting interest rates declared. He does foresee interest rates to come back up. He added that he is comfortable with the asset management fee at its current level of 195 basis points which remains at a fixed amount.

Mr. Azarshahi commented on the transparency of the arrangement of the crediting of the interest to participants less the spread for LSW. He remarked that the rates have been dropping because of the current interest rate environment. The length of the renewal, either for a 5-year period or a 10-year period, has an impact on how the company can invest the new incoming assets. There is a lot more earning power for the longer investments than the shorter investments. The period could

impact the rate of steepness going forward. Depending on what is used, it would dictate what the rate of the slope is because the new assets need to be invested in the current interest rate environment. Regarding the minimum guaranteed interest rate, the 10-year Treasury is at about 1.45%, and the 5-year Treasury is about half of that, so the 1% minimum rate is a reasonable place to be. With the costs associated with the Plan, Mr. Azarshahi stated that he was comfortable where the asset management fee is at.

Trustees Rapoza noted his preference to have a 5-year renewal period and Trustee Young echoed that he would support a 5-year renewal period versus a 10-year renewal period. The concerns raised were uncertainty about having a long-term commitment and what the advantages would be for a 10-year period for the State and the Plan.

Mr. Azarshahi stated that as of Wednesday the investment yield for a 10-year Treasury is 145 basis points and the 5-year Treasury is 75 basis points. The difference between going to a 5-year or a 10-year period is that the duration of the investments and the earnings power does impact the portfolio earn rate which in turn impacts the rate credited to participants. He explained the portfolio of products having older assets which are earning more; however, as new monies are invested, it is invested into the new assets that are available to buy. Currently, the decline is not as steep but could change, decline further, or fluctuate as rates are calculated.

Chairperson Moto commented that he would prefer the option of a 10-year renewal period because it gives access to a larger yield of instruments versus a 5-year renewal period would confine the State to those instruments with smaller yields.

In response to Trustee Yu's question on what would prevent LSW from investing in instruments with a maturity of 10 years if only renewing for a 5-year period and how it would affect the operations of LSW, Mr. Azarshahi explained that they calculate a duration of liabilities or risk and based on that they invest appropriately and make adjustments accordingly. If a new firm comes in upon the expiration of a 5-year renewal in June 2028, Mr. Azarshahi stated that LSW will pay the assets to the new firm from the Plan and release any reserves. The process is complex for liquidating the assets, but the liability duration should be close to the duration of the assets held.

In response to Trustee Young's question on whether the Supplemental Agreement allows for other optional renewal terms other than the option for a 5-year renewal period through June 30, 2028 or for a 10-year renewal period through June 30, 2033, Ms. Akiyoshi stated that those were the only two renewal period options in the Supplemental Agreement No. 1. Ms. Akiyoshi explained that after the master contract agreement was due to expire, Supplemental Agreement No. 1 was executed after a procurement search resulted in proposals that were not beneficial to the State, so the terms of the master contract agreement were renegotiated with

LSW. If the Board decided on a 5-year renewal period, then the Board would likely need to discuss further agreements or negotiations for new terms under a Supplemental Agreement No. 2, upon the expiration of June 30, 2028.

In response to Trustee Matsuyama's question on the possibility of increasing the rate through tiered rates from a 1% rate if extending over a 10-year period, Mr. Azarshahi stated that the minimum rate is a safety net, and that the Plan's rate has not been close to 1% yet. Over a 10-year period the minimum interest rate may go up but not likely for the near future. Mr. Adams added that it may add a risk for LSW if the rate is above 1% and it may affect or increase the asset management fee to offset the added risk.

Trustee Kitamura added that upon expiration of another renewal period, from a procurement perspective, the State could look at opportunities to test the market.

**A motion was made by Trustee Young and seconded by Trustee Yu to extend the renewal period with Life Insurance Company of the Southwest for a 5-year period to expire on June 30, 2028.**

**Discussion:** Trustee Young noted his agreement that Life Insurance Company of the Southwest has been good for the Plan and that the Board has been satisfied with LSW. He noted that in looking at the start date for the last extension, even the 5-year renewal option, the agreement would be for 15 years and a 10-year renewal would make the contract duration more than the 15 years. Trustee Matsuyama remarked that it does make sense to extend for a 10-year renewal period and would not be as beneficial if renewing for two 5-year periods. Mr. Azarshahi stated that there is a heightened risk that assets may move if renewing for two 5-year periods as the 10-year span will be watered down. Trustee Rapoza commented that he would like time to consider and would like additional information.

The Board asked for Mr. Azarshahi to provide examples of rates or a summary of the rates on a projected basis covering a 5-year expectation from members perspective and a 10-year expectation to help make a distinction and come to an informed decision.

Trustee Young withdrew the motion to extend the renewal period for a 5-year period, followed by an agreement by Trustee Yu. There were no objections by the Board, and the item will be deferred to the next scheduled Board meeting.

Agenda  
Item # 7:

Discussion on the Scheduling of an Independent Plan Audit for the PTS Plan for the Plan Year Ending December 31, 2020 and Potential Action Thereon

Chairperson Moto presented the background of the last Plan audit:

- The last Plan audit for the PTS Plan was for the Plan Year ending December 31, 2017.
- LSW engaged Traveller & Company to conduct the audit which was presented at the March 8, 2019 Board meeting.
- The audit has been typically conducted every three years. Under the agreement, LSW is responsible for the expenses of the independent audit.

In response to Trustee Matsuyama's question on the frequency of the past independent audits, Ms. Akiyoshi stated that the contract agreement does call for an audit every three years, and the past audits have been conducted approximately every three years.

**A motion was made by Trustee Yu and seconded by Trustee Matsuyama to conduct an independent Plan audit for the Plan Year ending December 31, 2020 and authorize Life Insurance Company of the Southwest to engage the services of an independent auditing firm. The motion passed unanimously.**

#### Agenda

##### Item # 8:

##### Report on Payroll Wire Delay from State for the July 2, 2020 Pay Date, and Potential Action Thereon

Chairperson Moto summarized the discussion that took place at the last Board meeting at which time the Board had requested a letter be prepared to the Department of Budget & Finance to notify them of the issue of the late posting of payroll contributions that occurred on July 2, 2020 and the resulting lost earnings to participants and whether there would be a remedy to reimburse the Plan to make participants whole. A response letter was received from the department.

Ms. Akiyoshi reported that Ms. Dang had relayed that they did have a meeting with the First Hawaiian Bank and the bank wanted expanded details on the calculations of the dollar amount of \$31,167.98 that was presented in the letter. The bank had stated that they did need to go back to their committee before they decide to reimburse the State.

Ms. Blumenthal reported that Prudential does have the summary details of the funding amount captured, without the participant information, and can provide the file to the Department of Budget & Finance.

The Board discussed the need to adjust the lost earnings amount again since the reimbursement amount potentially does grow over time with the ups and downs of the market and discussed whether the amount needs to be updated or limited to a fixed period of time which seems reasonable. Ms. Klassen commented that although there was a delay in posting, it is also whether it is unreasonably late and, therefore, needing to make a correction.



Ms. Dang reviewed the response letter in which the First Hawaiian Bank is asking for more information and details on reconstruction and calculations of the dollar amount of \$31,167.98. She added that the effect of the lost earnings from July 6, 2020 when the accounts were posted to present the amount may be de minimus amounts to be credited back to participants.

Ms. Blumenthal confirmed that the amount to reimburse individual participants does vary, some are a de minimus amount of less than a penny, and other amounts varies according to individuals' investments that would be larger amounts. Some participants' accounts were not impacted. She added that there would be some difficulty to compensate additional earnings up to the time of the funding reimbursement due to the changes that can be done by participants during that specified period.

Chairperson Moto concluded to say that Prudential will provide the additional information requested by the Department of Budget & Finance to relay to the First Hawaiian Bank. He thanked Ms. Dang for her assistance.

There were no other questions. Chairperson Moto called for a break at 10:32 a.m. Trustee Yu was excused from the meeting. The meeting resumed at 10:49 a.m.

#### Agenda

#### Item # 9: Performance Evaluation Report for the Fourth Quarter 2020 by Segal Marco Advisors:

Ms. Carter opened with some remarks on topics raised within the industry, such as the SECURE Act changes and cybersecurity. ESG and the topic on missing participants are also being discussed. Mr. Chaikin provided remarks and an overview of the Fourth Quarter 2020:

- The movement of the stock market has generally been in a positive direction.
- Equities have been in the double digits; the U.S. fixed income market has been slightly positive during the Fourth Quarter.
- The news of the vaccine in the Fourth Quarter has been helpful.
- In February 2021; the job numbers were good and showing signs of an awakening of growth.
- The markets are still ahead from an economic perspective considering the recent events.
- During the Fourth Quarter, small cap and emerging markets outperformed the large cap markets, and value outperformed growth. Trends appear to be continuing into 2021.
- Rates have been low. Observations noted a trend of rising yields on the longer end of the yield curve that has put a downward pressure on bond prices. The fixed income market has been challenging.

Overview of the Plan:

- During December 2020, Plan assets reached \$2.89 billion.
- Investment management fees continue to remain competitive.
- Performance issues among the fund managers are more due to style-related reasons rather than changing of philosophy, and stock selection did hurt the managers.

Mr. Chaikin stated that there are no recommendations for changes or watch list recommendations.

Additionally, Mr. Chaikin reported that he received information from INVESCO regarding their wrap contract providers who are reporting that the equity wash provision would no longer be needed. When INVESCO was added as a co-manager for the Stable Value Fund and a self-directed brokerage option (SDBO) was added to the Plan, an equity wash provision was put into place when moving assets from the Stable Value Fund into an equity option in the SDBO for a 90-day period. The provision was added because there was an expectation that assets could over 10% of total assets. They are seeing now that SDBO assets are between 2% to 2-1/2%, so the wrap contract providers reevaluated and do not feel the equity provision is needed at this time. There is a section in the Prudential contract agreement that requires Prudential to enforce an equity wash provision. Prudential confirmed that they are able to waive the equity wash provision. In discussion with DAG Nishiyama, this can be handled administratively, and a letter of mutual agreement can be prepared and sent to Prudential to not enforce the provision.

#### Agenda

#### Item # 10: Other Business/Announcements

##### a. 2021 Legislative Session

M. Akiyoshi reported on a couple of bills that were introduced during this Legislative Session. One is HB 790 which is related to the National Guard and grants eligibility for participation in the State Deferred Compensation Plan for State and County part-time, temporary, and seasonal or casual employees to members of the Hawaii National Guard who have been ordered into State active service. The staff of the Employee Assistance Office had a meeting with members of the Hawaii National Guard to discuss the intent of the bill. The distinction between the PTS Plan and a traditional defined benefit retirement plan, along with the Plan benefits were explained at the meeting. The Hawaii National Guard representatives noted that they would take the information back for further discussion. Ms. Akiyoshi reported that referral was to three committees; however, the bill did not move out of the first committee.

The second bill was HB 1292, HD1, relating to Hawaii National Guard benefits and described the proposed provisions. She reported that comments were submitted and an explanation on the nature of the Plan and that the department does not have the resources nor expertise to conduct a study and make such recommendations. Referral was to three committees and the second committee had recommended the measure be deferred.

She reported that testimonies have been submitted for Trustee Ken Kitamura's nomination to the Board, and his confirmation is pending the full Senate floor vote.

There were no further questions from the Board. Chairperson Moto acknowledged the DHRD and staff members who spent time reviewing the bills, studying the ramifications, and efforts to communicate the comments to the legislators. He thanked Trustee Kitamura for agreeing to serve on the Board and commented that he will be a great addition to the Board.

Chairperson Moto thanked everyone for attending today's virtual meeting and reminded everyone that the next regular meeting is scheduled for May 7, 2021. He adjourned the meeting at 11:20 a.m.

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