STATE OF HAWAII
DEFERRED COMPENSATION PLAN
BOARD OF TRUSTEES

OPEN SESSION MINUTES
MEETING # 450

Date: August 3, 2023

Place: Prince Waikīkī Hotel
Naio Room
100 Holomoana Street
Honolulu, HI 96815

Present: Kalei Rapoza, Chairperson
Brenna Hashimoto, Ex-Officio Member
Roderick Becker, Ex-Officio Member
Reiko Matsuyama, Employee Member
Lance Larsen Jr., Employee Member
LiAnn Tokuda, DHRD Staff
Doreen Kuroda, DHRD Staff
Randall Nishiyama, Deputy Attorney General
Julie Klassen, Empower
Kevin Malmud, Empower
Rob Luciani, Empower
Tim Grove, Empower
Jeanne Kanai, Empower
Grace Baracao, Empower
Kapena Kim, Empower
Tom Kalili, Empower
Peter Moraski, Empower
Peter Eddy, Empower
Jeremy Kish, BlackRock
Erin Lloyd, BlackRock
Vince Ortega, Capital Group
Sue Walton, Capital Group
Todd Egger, Invesco
Andrew Yurkewych, State Street Global Advisors
Geoff Crim, Vanguard
Carl Mariner, Vanguard
Clint Mortensen, Vanguard
Doug Kryscio, William Blair

Others via
Teams Link: Jeffrey Nipp, Segal Marco Advisors
Cyril Tuason, Empower

Jeffrey Budd, MainStay
Samuel Kaplan, Jennison Associates
Hannah Kim, BlackRock

Absent: Ken Kitamura, Employee Member
Kalbert Young, Employee Member

Call to Order: There being a quorum present, Chairperson Kalei Rapoza called the meeting to order at 9:10 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.

Agenda Item # 3: Approval of Minutes No. 449 for the June 28, 2023, meeting

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

A motion was made by Trustee Hashimoto and seconded by Trustee Becker to approve Minutes No. 449, as presented.

The motion passed unanimously.

Agenda Item # 4: Plan Administrator's Report, including:

Ms. Klassen presented the Commentary, Key Plan Data, Plan Demographics Summary, Participation by Department, Asset Allocation by Funds, and Contributions by Fund sections of the Plan Administrator's Report.

a. Commentary

- Empower Fee Reduction as Approved by the Board
    - At the June 28, 2023, meeting, the Board approved Empower's fee reduction offer to reduce the annual "all-in" record keeping fees from 0.085% to 0.075%.
    - The fee reduction is effective July 1, 2023, and will be collected "in arrears" quarterly. Participants should expect to see the reduced rate on their Fourth Quarter statement.
- Fund Change Implementation
    - At the May 1, 2023, meeting, the Board accepted Segal's recommendation to update the investment structure in the Plan's Investment Policy Statement (IPS) and update the investment options in the Plan to reflect the new structure.
    - Empower is working with Board staff to implement the fund changes approved by the Board, including participant communications about the fund changes.
    - Empower and Board staff are working on implementing the fund changes prior to the Empower migration targeted for First Quarter 2024.
- Setting Every Community Up for Retirement Enhancement (SECURE) 2.0 Impacts to Age 50 Catch-Up and "Rothification"
    - Under the current SECURE 2.0 legislation, mandatory "Rothification" of age 50 catch-up provisions begins January 1, 2024.
    - Plans that allow age 50 catch-up contributions are required to make those catch-up contributions as Roth contributions for any participant who exceeded $145,000 in FICA compensation with the employer in the prior calendar year.
    - There are many governmental plan advocacy groups petitioning to delay this "Rothification" provision.
    - As of 2022, there were about 1,000 participants who utilized age 50 catch-up contributions in the Plan.

b. Key Plan Data

- Plan participation excluding eligible employees from the University of Hawaiʻi (UH) and the Department of Education (DOE) is 42.85%.
- Overall Plan participation rate including eligible employees from UH and DOE is 25.79%.
- Of the approximately 24% of Plan Assets that are held in Asset Allocation Tools, GoalMaker holds about 13% of Plan assets, Vanguard's Target Date Funds holds about 7% of Plan assets, and about 4% is held in Managed Accounts.
- About 80% of the participants in the Plan are above age 55.

c. Plan Demographics Summary

- In 2023 Second Quarter, there was $23,335,821 in Employee Contributions and $2,966,207 in Rollovers into the Plan totaling $26,302,028.
- Total Distributions from the Plan decreased from 2023 First Quarter to 2023 Second Quarter with distributions totaling $33,549,499. About 3,100 participants in the Plan account for the total distributions.
- There was a Market Value Gain of $116,096,504 in 2023 Second Quarter due to S&P up about 17% and positive market returns.

d. Participation by Department

- County of Kauaʻi has the highest rate of participation in the Plan with 55.47% of eligible employees participating.

e. Asset Allocation by Funds

- As of June 30, 2023, 33.2% of Plan assets are held in the Stable Value Fund.

f. Contributions by Fund

- The Stable Value Fund, BlackRock US Large Cap Index, Mainstay Winslow Large Cap Growth Fund, American Funds EuroPacific Growth Fund, and BlackRock Total Return Bond Fund are the top five funds participants are contributing to. About 53% of contributions into the Plan are towards these top five funds.
- Ms. Klassen explained the contributions shows that participants are slowly diversifying their allocations.

g. Communications and Education Update

Mr. Malmud presented the Communications and Education Update and Local Office Updates or the report to the Board.

- Second Quarter Newsletter
  - The Newsletter was emailed to participants and posted to the Plan website.
  - The Newsletter email had a 64% open rate, which is 2.5 times higher than the industry average.
  - The click rate for the Newsletter was 12%, which is 4 times higher than the industry average.
- Weekly Webinar Campaign for 2023 Second Quarter
  - There was a total of 13 webinars in the quarter with a total of 332 attendees. Average attendance per webinar was 25 employees.

    - Second Quarter topics included: Understanding Market Volatility, Taking Control of Your Finances (Budgeting), and Island $avings Plan Overview.
    - Communication about the webinars was emailed to participants. The email had a 67% open rate, which is 2 times higher than the industry average, and a click rate of 6%.

h. Local Office Updates

Mr. Malmud re-introduced the Empower local team to the Board and provided brief descriptions for everyone on the team.

- Recent Activities
    - Empower held an in-person event at UH Manoa on April 20 and April 21, 2023. Twenty employees attended the event resulting in eleven counseling sessions.
    - An in-person event was held on June 5, 2023, for Kauai participants. Thirty-two employees attended the event resulting in thirteen individual counseling sessions, five enrollments, five contribution increases, and six follow up appointments.
    - An in-person event was held at UH Hilo on June 14, 2023. Empower held group presentations and individual counseling sessions.
    - Empower attended a new hire orientation event for the DOE at Farrington High School on July 10, 2023. They presented the Plan Overview for those present at the orientation.
- Measurements and Milestones
    - Empower was able to meet the June 30, 2023, contractual requirement of providing 630 group meetings and 7,000 individual counseling sessions for the first time since COVID began in 2020.
    - The number of group meetings have increased from 172 in Third and Fourth Quarter 2022 to 483 in First and Second Quarter 2023.
    - As of June 30, 2023, there have been:
        - 461 enrollments
        - 3,806 contribution increases
        - 343 GoalMaker enrollments
        - $6.4 million rollovers into the Plan
        - 3,634 individual counseling sessions
        - 483 group meetings

There were no questions from the Board.

Agenda
Item # 5: Performance Evaluation Performance Report for the Second Quarter 2023 by Segal Marco Advisors

Mr. Nipp presented Segal's Performance Report for the Second Quarter 2023.

- Market Environment
  - U.S. stocks made robust gains in June 2023. Mid Caps were the leaders in the month. Consumer discretionary stocks increased the most though industrials were not far behind.
  - The S&P stock rose 16.9% and the Russell 2000 rose 8.1%
  - The Federal Reserve paused its interest rate hiking cycle as data showed inflation to be easing.
  - Non-U.S. developed markets equity also made gains, though not as much as U.S. stocks.
  - Bonds did well in the First Quarter 2023, however performance fell in the Second Quarter 2023 due to rising interest rates.
- Total Fund Allocation and Performance
  - Stable Value Fund performance is 0.7%.
  - BlackRock U.S. Bond Index performance is -0.8%.
  - BlackRock Total Return Bond Fund outperformed the Bond Index is -0.7%.
  - Both the BlackRock U.S. Large Cap Index and American Funds AMCAP matched its respective benchmarks at 8.7%.
  - Mainstay Large Cap Growth outperformed its benchmark at 12.9%.
  - Wellington Research Value matched its benchmark. The fund is outperforming the benchmark based on its year-to-date performance.
  - BlackRock Small/Mid Cap Index matched its benchmark at 6.4%.
  - Harbor Small Cap Value performed under its benchmark; however, the fund is outperforming the benchmark based on its year-to-date performance.
  - William Blair Small/Mid Cap Growth matched its benchmark at 6.4%.
  - BlackRock Non-U.S. Equity Index outperformed its benchmark at 2.6%.
  - MFS International Intrinsic Value outperformed its benchmark at 3.2%.
  - Schroder Emerging Markets outperformed its benchmark at 1.9%.
  - American Funds EuroPacific Growth outperformed its benchmark at 2.2%.

- The Vanguard Wellington Admiral underperformed its benchmark; however, the performance is in line with expectations for a fund that includes value equities.
- SSGA Real Asset Strategy outperformed its benchmark at 1.9%
- All the funds in the Vanguard Target Date Series matched its benchmark except for the Vanguard Target Retirement 2020 Trust II which performed slightly under the benchmark at 2.1%.

- Fee Schedule
  - The Investment Option Fees of the funds in the plan are below the median.

There were no questions from the Board.

Agenda
Item # 6: Panel Presentation #1: Inflation and Currency by Capital Group and BlackRock

Mr. Nipp explained there are two educational panel presentations on the agenda. Two Fund Providers worked on each presentation and the first presentation was by Capital Group and BlackRock. The panels are designed to explain the options in the Plan and how the investments are managed.

a. International Investing in Challenging Times by Capital Group

Mr. Ortega commented on the relationship between the Plan and Capital Group. He also introduced Ms. Walton who presented Capital Group's portion of the first panel presentation.

- Strong Labor Market May Keep Economy Out of Recession
  - There is likely to be a mild recession, however Ms. Walton is optimistic that the longer it takes to hit a recession, the less likely there will be a recession or if there is a recession, the effects will not be as severe as expected.
- Recoveries Have Been Much Longer and Stronger than Downturns
  - The one thing known about recessions is they always end.
  - Historically, the strong markets we have seen overshadow in terms of length and strength to the short recessions there have been.
  - In the context of international investing, the changes in interest rates and inflation will have an impact on currencies. Currencies may drive purchasing power of international investing and the strength of the dollar in investments will be impacted by interest rates and inflation. Pulling back inflation and stabilizing interest rates are a strong indication of the

opportunities that exist moving forward will be stronger and will impact the ability to invest internationally.

- Evolution of the Investable World: The Era of Home Country Bias
    - Investable World in 1970
        - From a market capitalization perspective, $512 billion invested in the investable universe, however only 18 countries were available for investments with the share of total market capital from five largest countries making up 88% of the investable universe.
- Evolution of the Investable World: Global Investing Today
    - Investable World in 2022
        - The investable universe is significantly larger than it was in 1970.
        - $66,266 billion invested in the investable universe with 48 countries available for investments and 77% of the share of total market capital from five largest countries making up the total market capital.
        - A lot of opportunities to invest outside of the U.S.
- Dividends have Staged a Comeback and Abound Outside the U.S.
    - After a decline, companies are paying dividends again.
    - There are 148 companies in the U.S., 413 companies in international, and 558 companies in emerging markets with dividend yields higher than 3%.
    - In challenging markets, dividend paying stocks can help minimize volatility when markets are down and create opportunities outside of the U.S.
- Reglobalization: Geopolitical, Supply-Chain Disruptions Underscore Need for Redundancies
    - In anticipation of a recession, there may have been mini recessions in different sectors across the globe.
    - For example, in the industrial sector, despite rising costs and falling margins, there are opportunities for growth.
- A New Geography
    - When managing the EuroPacific Growth Fund, Capital Group considers where companies are based and where they are making their revenue.

There were no questions from the Board.

b. The New Regime: What to Expect? by BlackRock

Ms. Kim presented BlackRock's portion of the first panel presentation.

- Environment Moving Forward

  - The Bond market has changed. The current market environment is comprised of rising interest rates, higher inflation, and quantitative tightening.
  - 2022 was a difficult environment for the Bond portfolios. As interest rates rise, Bond portfolios tend to provide a negative return.
  - From 2000 to 2008, Bond portfolios provided high yields and healthy income. From 2010 to 2021, it was difficult for Bond portfolios to generate income. From 2022, Bond portfolios yields have increased and reaching levels not seen in a decade.
- Fastest Rate Hike Since 1980
  - Rapid policy tightening has exposed financial cracks in the system.
  - The Fed is likely done raising interest rates or there is only one more rate hike.
  - Inflation and full employment will drive the decision on another interest hike.
- What Happens with Inflation?
  - Economists' inflation forecasts are settling into a higher landing point. Expect inflation to cool, but to stay above 2%.
  - Generally, inflation fluctuates between 1-2%. However, in recent years, inflation has been as high as 7%.
  - Predicting by year, inflation will moderate down to 3%, which is slightly higher than the 1-2% the economy fluctuates at.
- A New Regime Sets a Strong Backdrop for Fixed Income
  - Higher rates and increased dispersion create ample opportunity while requiring prudent active management to navigate tail risks.
  - Rates are likely to stabilize or decrease, which is highly conducive to a Bond portfolio.
  - The market in general will become attractive for a Bond portfolio manager to optimize yield income levels.
- What About Correlations?
  - The specific role for Fixed Income is to diversify equities and we want a negative correlation between Bond portfolio and Equity portfolio.
  - In 2022, both Bond markets and Equity markets were down at the same time creating a difficult environment for Fixed Income.
  - When The Fed started hiking interest rates, the correlation between bonds and equities was a positive 26% on average, but when The Fed is finished hiking rates, the correlation falls to negative 16%.
- BlackRock Total Return
  - Seeks to generate attractive risk adjusted returns that exceed the benchmark Bloomberg U.S. Aggregate Index.

  - Seeks to implement an unbiased, multi-sector approach built to navigate all market cycles.
- Results Delivered Without Undue Risk
  - Competitive returns are important, but not at the opportunity costs of what the role of the portfolio should be.
  - Diversification: offering portfolio ballast in times of market volatility.
  - Stability: operating within a reasonable range of risk, allowing risk budgets to be spent elsewhere.
  - Consistency: reliable, attractive risk adjusted returns.

There were no questions from the Board.

Mr. Nipp asked if the current yield is a good estimate of what kind of returns to expect. Ms. Kim answered returns are often dependent upon the backdrop of the situation.

There were no further questions.

Agenda Item #7: Panel Presentation #2: Hawai‘i Stable Value Fund Overview by Invesco and Jennison

Mr. Egger presented Invesco's portion of the second panel presentation. He gave a brief introduction and reminded the Board that Invesco only manages half of the Stable Value Fund. The other half is managed by Empower, formerly Prudential Retirement, and Mr. Grove from Empower can provide comments as needed.

- Introduction to Stable Value
  - What is a stable value fund?
    - Low risk investment option available in tax-qualified defined contribution and select education savings programs.
    - Designed to couple capital preservation and income generation.
    - In the Plan, it's the safest investment option.
  - Stable value objectives
    - Principal preservation.
    - Daily liquidity.
    - Returns comparable to high quality bond funds over full market cycles.
    - Crediting rates that move in the direction of market interest rates.
- Stable Value Investments

- The investment is comprised of two components. The Wrap Contract provides Stable Value pricing and the underlying investments.
- Each component seeks to deliver specific investment characteristics.
- About 33% of Plan assets are held in the Stable Value Fund.

Mr. Kaplan presented Jennison's portion of the second panel presentation. He focused on the underlying investments component.

- Stable Value History – As of June 30, 2023
  - Entered Stable Value business with the Plan in 1991.
  - The current total assets held in Stable Value Fund are $14.2 billion.
- Fixed Income Investment Philosophy
  - Active management seek top quartile returns over a full market.
  - Portfolio managers construct high-quality, diversified, high conviction, duration neutral portfolios. Portfolio managers construct the portfolios daily, there is not a team of research analysts behind the scenes.
  - Identify the best risk and reward opportunities with a focus on lowering downside volatility.
  - Portfolio managers perform rigorous credit analysis to seek to keep portfolios ahead of negative credit developments.
- Potential Sources of Added Value
  - Corporates - asset allocation across treasuries, corporates, and securitized products like mortgages and asset backed securities.
  - Securitized – individual bond selections across Agency MBS, ABS, and CMBS sectors.
  - Yield Curve – portfolio managers decide where on the yield curve to invest.
- Key Positioning: Intermediate Government/Credit Strategy
  - Current positioning in the portfolio.
  - The Yield Curve is skewing towards shorter bonds with higher yield.
  - Underweight credit position with a high-quality bias. The portfolio is mostly underweight in the non-corporate sector, which are bonds that are not issued by companies.
  - Assets are allocated into high-quality securitized products like AAA rated ABS, AAA rated CMBS, and mortgages.
- Characteristics
  - The Plan portfolio as of June 30, 2023, is under yielding the and out spreading the benchmark.

  - The Yield Curve shows concentration of higher yielding investments at the front of the curve at the expense of investments being underweight at the 10-year part of the curve.
- Latest Spreads
  - AAA rated ABS and MBS are the shortest asset class, but its trading at historically wide spreads. One of the largest buyers of these two asset classes are banks, however in March 2023, there was a regional banking scare where a few banks failed. As a result, the securitized portfolios were sold to other investors and other banks are nervous to buy these asset classes.
  - As spread widens to historically wide levels, portfolio managers can take advantage of buying these high-quality bonds.
- U.S. Treasury Yield Curves: A Wild Ride
  - Over time, the Yield Curve can be reversed, go back and forth between being inverted, flat, and extremely steep. This makes Yield Curves difficult to forecast.

Mr. Nipp asked if there are restrictions to operate under when managing a portfolio that is part of a Stable Value Fund. Mr. Kaplan confirmed that usually the Wrap provider has standard guidelines for the portfolios. Mr. Grove commented that Empower is the Wrap provider for half the fund and they have measurements on how the portfolio is managed. As the Wrap manager, they are adding a guarantee on top of the fund to ensure participants make transactions at Book Value.

Mr. Egger continued with Invesco’s portion of the presentation.

- How Wrap Contracts Work
  - Wrap contracts provide for the pricing stability of the Stable Value Fund.
  - Wrap contracts have a 0.0% crediting rate floor and reset every quarter, but they do not reset below 0.0%.
  - The Plan has a quarterly fixed communicated rate that provides the positive daily returns.
- The Role of Crediting Rates
  - As rates fall, market value bonds rise and vice versa.
  - Book Values grow at a consistently positive interest rate, regardless of changes in market rates.
  - Differences between Market Value and Book Value are amortized through the crediting rate.
  - When Book Value exceeds Market Value, it’s considered a Wrap Liability. The Fund is in a Wrap Liability.
- Wrap Contracts Diversification and Quality

- Empower covers half of the Wrap Contract for the Stable Value Fund. There are four other Wrap providers.
- The Wrap providers cover the full Book Value for participant withdrawals.
- All providers are rated A+ or better.

- How the Crediting Rate is Set
  - Each Wrap Contract uses a formula that is designed to converge Book Value and Market Value over time.
  - Three primary components of the crediting rate formula are: Yield to Maturity of underlying bond portfolio, Portfolio Duration, and Ratio of Market Value of underlying assets to Book Value of account.
  - The Plan also has a Declared Rate. The Wrap Contracts are reset quarterly, but there's also a cash component in the Fund to provide liquidity.
  - Even though the contract crediting rates are set for three months, there's cash flow in and out of the Fund.
  - The declared rate is designed to provide for a known rate of income each quarter that tracks prevailing market interest rates, while limiting the divergence of Fund and participant values over time.

Trustee Larsen asked if the amount Invesco manages is about $14 billion. Mr. Egger explained that is the amount Jennison manages, Invesco manages about $52 billion. Trustee Larsen asked of the amount Invesco and Jennison manage, about $1 billion is the Stable Value Fund in the Plan to which Mr. Egger confirmed. Trustee Larsen questioned if there would be any large-scale impact if there were significant changes to the $1 billion investments from the Plan. Mr. Egger answered that the investments are most likely divided equally between Invesco and Jennison at $500 million, however there are contract provisions that map out transition periods, so the impact will be less significant.

Chairperson Rapoza asked Trustee Larsen to clarify what significant changes he was referring to. Trustee Larsen explained if participants started changing their allocations from Stable Value to more diversified funds. Mr. Egger commented that if there are changes in participants' outflows, then the issuers would cover the flows. Mr. Grove added the crediting rate formula looks at the difference between Market Value and Book Value of the Fund. Increased participant outflows from the Fund would affect the Market to Book Value and would become a component in setting future crediting rates.

There were no further questions from the Board.

Agenda Item #8: Discussion on Offering a Money Market Option in the Plan by Segal Marco Advisors

Ms. Tokuda read the two testimonies submitted for Agenda Item #8 for the Board.

Mr. Egger led the discussion on how Stable Value is different from a Money Market Fund. Mr. Nipp reminded the Board that Stable Value Funds are only available for Defined Contribution Plans.

- Both Stable Value and Money Market are Bond Funds. Money Market Funds are usually shorter and more liquid while Stable Value Funds are longer, diversified portfolio bonds with an added benefit of a Wrap to provide stable pricing.
- Stable Value is designed to produce returns comparable to short or intermediate bonds over full market cycles, with less volatility.
- Stable Value is designed to outperform Money Markets over a full cycle. Money Market Funds are currently outpacing Stable Value, however during this time the Yield Curve is steeply inverted.
- The Plan allows participants to create Self-Directed Brokerage Accounts (SDBA), so participants might have access to Money Market Funds through this SDBA.
- Over full-market cycles, the Stable Value Fund produced returns comparable to short or intermediate high-quality bonds, but with volatility like Money Market Funds.
- Since July 2013, the Stable Value Fund has generated more wealth for participants than Money Market Funds. Over the same period, Money Market Funds have failed to keep pace with inflation.

Mr. Grove commented that the Stable Value Fund is not meant to have the highest rate, but to have performance over time to outperform Money Markets.

Chairperson Rapoza asked how long it takes interest rates to reset to the norm. Mr. Grove commented that typically inverted Yield Curves are seen during an 18–24-month range. Mr. Egger agreed that it's usually a short period where Money Markets outperform Stable Value. Mr. Grove added that Money Market options are available in the Plan's SDBA.

Trustee Larsen asked Empower if there have been participants inquiring about the SDBA and investing in Money Markets. Mr. Malmud answered that there has not been an influx of participant inquiries about Money Market options. Mr. Kaplan added that Jennison does manage a couple other accounts similar to the Plan that allows for daily cash flows. He has noticed that there has been a steady outflow from the Stable Value Funds, however he has not confirmed the funds have been moved into Money Market options. Mr. Nipp added that the SDBA allows participants to invest in Money Markets if they want to, however he has not seen both Stable Value and Money Market Funds available in other plans.

Chairperson Rapoza commented that this is not an action item, it is just for Board discussion to examine this issue and assess what would be best for the Plan. He views the Plan as a way for participants to protect their assets and plan for retirement.

There were no further questions from the Board.

Agenda Item #9: Discussion of the Part-time, Temporary, Seasonal/Casual Plan (PTS Plan) Reports, including:

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

Ms. Tokuda reported the New Interest Rate for the PTS Plan for Third Quarter 2023 is 2.39%. This is up from the Second Quarter 2023 rate of 2.24%.

There were no questions from the Board.

Chairperson Rapoza thanked everyone for their participation in today's meeting. Special thanks were given to Capital Group, BlackRock, Invesco, and Jennison for their presentations and to Segal for coordinating the panels. He also thanked Empower, BlackRock, William Blair, and Vanguard for sponsoring part of the meeting.

He adjourned the meeting at 11:28 a.m.

(NOTE: Signed copy on file.)