

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

**OPEN SESSION MINUTES
MEETING # 398**

Date: December 21, 2015

Place: Plaza Club
Honolulu Pacific Conference Room, 20th Floor
900 Fort Street Mall
Honolulu, HI 96813

Present: Michael Okumoto, Employee Member
Roderick Becker, Employee Member
Wesley Machida, Ex-Officio Member (arrived at 10:43 a.m.)
Kanoë Margol, Employee Member
Brian Moto, Employee Member
Kenneth Villabrille, Employee Member

Others: Rodney J. Tam, Deputy Attorney General
Cynthia Akiyoshi, DHRD Staff
Kevin Malmud, Jeanne Kanai, Grace Baracao, Al Lee, Peter Eddy,
Kapena Kim, Prudential Honolulu Office
Glenn Ezard, Segal Rogerscasey
Julie Klassen and Carol Blumenthal, Prudential Retirement – via
conference call
Wendy Young Carter, Segal Rogerscasey - via conference call
Todd Egger, INVESCO – via conference call
Michael Chandra, Taylor Alan-Lee, and David Fisher, PIMCO – via
conference call

Absent: James Nishimoto, Ex-Officio Member

Call to Order: There being a quorum present, Interim Chairperson Michael Okumoto called the meeting to order at 9:03 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.

Interim Chairperson Okumoto stated that all trustees are present with the exception of Trustee Nishimoto who is excused due to a meeting conflict, and Trustee Machida who will be joining the meeting a little later. He opened the meeting with introductions of Board members, staff, and guests in attendance, followed by attendees participating via conference line.

Before starting with the agenda items, Interim Chairperson Okumoto covered some housekeeping items.

Agenda

Item # 1:

New Business

- a. Approval of Minutes No. 397

The Board took a few minutes to review Minutes No. 397.

A motion was made by Trustee Moto and seconded by Trustee Villabrille to approve Minutes No. 397. The motion passed unanimously.

- b. Approval of List of Annuity Providers for the Annuity Shopping Service for the Plan and Its Participants

Interim Chairperson Okumoto called on Ms. Klassen to review the list of annuity providers that Prudential Retirement is proposing to use for the Plan.

Ms. Klassen summarized that under the current contract, Prudential is responsible for providing an annuity shopping service for Plan participants who are interested in purchasing an annuity option. She presented the following points:

- List of proposed annuity providers are those who meet the ratings criteria, with the exception of American National which may not currently meet the ratings criteria.
- List of annuity providers are subject to change.
- A fixed annuity can be offered within Prudential and by companies outside of the Plan. Immediate annuity options are purchased with rollover monies from outside the Plan and considered out-of-Plan options.
- The Plan's options will remain within the Plan.
- The focus is on providing withdrawal strategies to Plan participants and help participants manage the draw down to provide a guaranteed income stream based on the needs of the participant.
- The other components of the overall income are their pension from the Employees' Retirement System and social security income benefits.
- There are managed payout options available within the Managed by Morningstar.
- The purpose is to provide annuity to be distributed to participants by Pruco representatives.

Ms. Carter added that it is a good option to have available to evaluate options at the time of distribution. Historical usage has been low. However, you may see an increase as having a guaranteed retirement income stream option are growing in popularity.

DAG Tam noted that the review of the list is to make sure the proposed companies are highly rated; that the list provides for a neutral group of companies (i.e., Prudential representatives are not focusing only on mentioning Prudential annuity products to participants – the goal is to ensure that all companies on the list are neutrally discussed with participants); and that there is an array of companies that are “A” rated companies.

A motion was made by Trustee Moto and seconded by Trustee Margol to adopt the recommendations proposed by Prudential and approve the list of annuity providers that will be used by the service representatives who receive inquiries and requests from Plan participants. The motion passed unanimously.

Agenda

Item # 2:

Ongoing Business

- a. Performance Evaluation Report by Segal Rogerscasey for 3rd Quarter 2015, Period Ending September 30, 2015
- i. Performance Overview on Funds Currently on the Watch List: MainStay Large Cap, Victory Institutional Diversified Stock Fund, and PIMCO Total Return Fund

Mr. Ezard presented an overview of the 3rd Quarter 2015, along with some updates on the performance of the investment options within the Plan:

- Equities were down as of September 30, 2015.
- Emerging markets were down quite a bit; currently down about ½%. Global equities were weak.
- Commodities were a big driver of poor performance.
- Investors saw deflationary trends globally.
- Energy and materials sectors fell during the 3rd quarter.
- Non-U.S. equities and Emerging markets saw significant drops.
- Hi-yield bonds weakened due to the energy sector.
- The funds on the watch list:
 - Performance of the Victory Institutional Diversified Stock Fund worsened during the current 4th Quarter 2015.

- MainStay's performance has been improving during the 4th Quarter 2015.
- PIMCO's performance has been improving during the 4th Quarter 2015.
- INVESCO received a notice from the Department of Labor related to the handling of their STIF fund.
- PIMCO continues with its organizational and regulatory concerns.
- Other investment funds within the Plan are not having concerns with performance.
- JP Morgan Diversified Real Return fund saw a slightly weak performance and is being monitored closely.
- Emerging markets are still performing well despite a difficult market.
- The Lifecycle Income Portfolio is performing satisfactory.
- The Lifecycle portfolios with allocations towards equities are seeing a weaker performance; but otherwise no concerns.

Mr. Ezard asked to take the agenda item related to INVESCO's report at this time. There were no objections.

ii. INVESCO Report on the Short-Term Investment Fund

Mr. Egger reported that in 2013, the Department of Labor (DoL) raised some concerns and then in September 2015, INVESCO received a letter with charges related to dealings by the Trust company. The dealings relate to the INVESCO STIF (Short Term Investment Fund) which is used internally for collective trust funds and is a stand-alone fund. Mr. Egger provided the following comments:

- INVESCO believes that the charges are based on inaccurate information.
- INVESCO has been providing updates to the DoL, but have not heard back. They anticipate a response sometime in January 2016.
- INVESCO does have a support agreement, and will make sure that the fund is made whole.
- The STIF fund is used as a cash sweep for collective trusts. The Hawaii Stable Value fund does not invest directly into it, except for a small exposure and underlying funds.
- There are no issues with the strength of the Fund.

iii. Status Update Report from PIMCO and Review and Consideration

of and Possible Actions on Recommendations from the Plan's
Investment Consultant Segal Rogerscasey

Mr. Chandra opened with introductions of Mr. Taylor Alan-Lee and Mr. David Fisher who is the head product manager for the PIMCO Total Return Fund:

- PIMCO did see significant outflows when Bill Gross resigned.
- Since Mr. Gross' departure, there were other departures.
- Three (3) portfolio managers were put in place, and there have been no changes since that time. All 3 have vast experience with PIMCO and they are not new to the Total Return Fund.
- PIMCO's assets were at \$1.47 trillion, but dropped about 20% over last year. However, PIMCO is still one of the largest asset managers.
- PIMCO received a Wells notice (from the SEC) related to the launch of its BOND ETF in early 2012 and looks at only the period within a time span of four (4) months. The SEC is looking at PIMCO's odd lot mortgage positions. There is no overlap between the BOND ETF and the Total Return Fund. PIMCO is providing information to the SEC on how they are pricing their securities.
- Mr. Bill Gross filed a lawsuit in August 2015 and PIMCO has filed a motion to dismiss in the courts. If there is a finding against PIMCO, PIMCO will fight the finding in court, as they feel the lawsuit has no merit.
- Fund flows have reduced with a small negative as a reaction to the Feds tightening the rates. Overall, they may continue to see outflows.

Mr. Fisher presented an overview on performance of the Fund, and explained the relationship of PIMCO with its parent company Allianz:

- Historically, the performance return of the fund was in the top quartile of similar funds 90% of the time.
- During the calendar year, performance has been consistent relative to the benchmark.
- Longer term track record shows the Fund has outperformed the benchmark.
- In comparison relative to peers in past 15 months, the Fund has performed 85% of the time of similar funds.
- PIMCO is owned by Allianz, which is one of the largest companies in the world, and is able to stand behind PIMCO in

the event of any findings against PIMCO.

In response to Trustee Okumoto's question on the areas that PIMCO has over competitors when managing the fund, Mr. Fisher noted that within the fixed income market, PIMCO has good coverage across the board relative to fixed income and have numerous support staff, including portfolio managers throughout the world. The investment committee makes portfolio decisions by determining the best opportunities and an optimal mix to represent those investments in the Fund.

Interim Chairperson thanked PIMCO and INVESCO for joining the meeting and presenting their respective reports.

Interim Chairperson Okumoto stated that the Board will need to confer with the Plan's legal counsel before making any decisions relative to PIMCO.

A motion was made by Trustee Becker and seconded by Trustee Villabrille to move into Executive Session at 10:22 a.m. to confer with legal counsel on the Board's powers, duties, privileges, immunities, and liabilities with respect to any possible actions on PIMCO. The motion passed unanimously.

All guests were excused, with the exception of Mr. Ezard.

EXECUTIVE SESSION

Meeting

Reconvened: A motion was made by Trustee Villabrille and seconded by Trustee Becker to move out of Executive Session at 10:36 a.m. The motion passed unanimously.

All guests rejoined the meeting.

Interim Chairperson Okumoto stated that the Board discussed the information and options presented in the memo dated December 14, 2015, provided by Segal Rogerscasey.

A motion was made by Trustee Moto and seconded by Trustee Villabrille to adopt option # 4, as recommended by Segal, to maintain PIMCO on the watch list and start the RFP (Request For Proposals) search process for an active core fixed income investment option, and allow PIMCO to submit a bid.

Discussion: DAG Tam summarized that the Board would keep PIMCO on the watch list, and noted that the Board would be able to cancel the RFP process at any time in the best interest of the State. And, if the Board moves ahead with the RFP and the Board selects another fund manager, then the contract with PIMCO can be terminated at that time.

The motion passed unanimously.

Trustee Moto thanked Segal Rogerscasey for preparing the summary and consideration of options.

Trustee Becker was excused from the meeting at 10:41 a.m.

b. Plan Administrator's Report

- i. Plan Highlights
- ii. Report on the Fall 2015 Benefits Fair
- iii. Plan Communication Strategy Initiatives for 2016

Ms. Klassen reported and provided highlights of the Plan and Expense Report, and some Plan commentary:

- Plan assets totaled \$2,019,369,196 with a total of 27,490 participants and 18,206 active participants through November 30, 2015. Based on the total number of active participants, the participation rate for the Plan is at 31%.
- Review of the Plan expense account shows a Plan account reserve of approximately \$982,000.
- The Benefits Fair on Maui was well attended. Communications were designed for participants to see themselves in the future and recognize where they want to be in retirement. Mr. Malmud added that approximately 30% of the attendees made account changes. The workshops were well attended and standing room only.
- Communication initiatives for the Plan in 2016 include a Plan website redesign which is in progress. In addition, development of videos are underway with DHRD and DOE. Mr. Malmud added that the development of the videos would increase exposure of the Plan. Discussions were held with former Board member Barbara Krieg on a DOE video for onboarding of DOE employees, and with DHRD staff for short videos for benefits orientations. Ms. Klassen noted that there is also a video in development that would tie to the Hawaiian culture.
- Mr. Malmud reviewed the contractual meeting goals of the

local office staff and reported that the team has already exceeded its goals for the current Plan year. The local office representatives have also accomplished getting their certifications and those representatives have been reaching top level numbers in their accomplishments nationally. They have also been involved in meetings with internal partners to discuss the development of an administrative processing manual to improve the administration of the Plan, documentation, and training of representatives.

c. Staff Administrative Report

Ms. Akiyoshi provided summary highlights and overview of the ongoing administrative activities, including oversight of (1) the Vacation Pay Deferral Program in which the 2016 Post Separation Vacation Pay Schedules have been updated and posted on the DHRD website; (2) the activities involving the ERS Refund Rollovers in which a follow-up meeting is being planned between ERS and Prudential to review rollover information/data since 2009; (3) the list of annuity providers that was discussed with Prudential which was raised as an agenda item for today's meeting; and (4) the meeting with Morningstar in October to discuss improvements in servicing of participants whereby Morningstar, as reported at the November Semi-Annual meeting, and plan to initiate some improvement strategies to increase their visibility.

In addition, (1) Ms. Akiyoshi reported that assistance was provided to N&K CPAs for their examination and reporting of the Plan audit that is being conducted for the Plan Year July 1, 2013 to June 30, 2014; (2) the status of the vacation payout deferral issues within one of the department whereby a memo to DLIR was prepared to seek reimbursement that resulted in a loss to a participant. Staff consulted with DAG Tam and is on the radar to prepare a follow-up memo on the status of the reimbursement; and (3) a draft Summary Plan Document that is being drafted to complement Prudential's Plan Document. Ms. Akiyoshi reported working on investment manager contract amendments, in particular the Prudential contract that amends the language related to Jennision's request to allow single ratings by agencies, and on the monitoring of the INVESCO wrap providers' ratings; monitoring latest announcements by PIMCO, Victory, and William Blair; the review of the PTS Plan monthly distribution reports for September, October, and November 2015; and the preparation of the Memorandum of Understanding with the County of Kauai and the draft amendments to the Hawaii Administrative Rules to reflect the inclusion of county participation in the Plan.

- d. PTS Plan
- i. Approval of Report on Funds Not Deposited in the State/County Treasuries for the Period Ending September 30, 2015
 - ii. Quarterly Management Report for the Period Ending September 30, 2015

Ms. Akiyoshi reported that the Report on Funds is ready for the Board's review and action, and the Quarterly Management Report is provided for information.

A motion was made by Trustee Villabrilie and seconded by Trustee Machida to accept the Report on Funds Not Deposited in the State/County Treasuries for the period ending September 30, 2015. The motion passed unanimously.

Agenda

Item # 3:

New Business for PTS Plan

- a. Action on the Memorandum of Understanding between the State and the County of Kauai

Interim Chairperson remarked that as Board members may be aware, staff has been working on a draft Memorandum of Understanding (MOU) that would allow the County of Kauai to join the PTS Plan.

DAG Tam reviewed and explained the terms in the MOU. The Hawaii Administrative Rules are also being amended at this time to change references to include the counties.

A motion was made by Trustee Moto and seconded by Trustee Margol to accept the Memorandum of Understanding, as drafted, with noted edits on the appropriate point of contact within the County of Kauai. The motion passed unanimously.

- b. Amendments to the Hawaii Administrative Rules Related to the State of Hawaii PTS Deferred Compensation Plan

This item was discussed and covered by DAG Tam.

Interim Chairperson Okumoto called for a lunch break at 11:09 a.m., if there are no objections, and take the last remaining items when the meeting is resumed. There were no objections.

The meeting resumed at 11:52 a.m.

Agenda

Item # 4: Other Business/Announcements

a. Election of Board Chairperson/Vice Chairperson for 2016

Interim Chairperson Okumoto stated that since the Board will be entering a new year, it is a good time to discuss elections of a Chairperson/Vice-Chairperson. He asked for indications from Board members who are interested in serving in the role of either Chairperson or Vice-Chairperson. He added that his term will expire on June 30, 2016, and announced his plans to retire next year on April 1, 2016. He indicated that therefore, he will not be around for another term. He asked that any interested persons contact the Board's staff.

With the upcoming vacancy and expiration of Trustee Okumoto's term on June 30, 2016, Ms. Akiyoshi raised whether the Board would want to make recommendations to the Governor's office before the Legislature convenes. The Board discussed qualified candidates and are aware that former Board member Kalbert Young remains interested in serving on the Board.

A motion was made by Trustee Moto and seconded by Trustee Margol to submit the nomination of Mr. Kalbert Young's name to the Governor's Office for the upcoming vacancy. The motion passed unanimously.

b. Scheduling of Meetings for 2016

Ms. Akiyoshi confirmed the dates of the 2016 meetings based on the trustees' availability. The first meeting scheduled for 2016 will be on February 12, 2016; and the date of the Semi-Annual meeting will be on May 13, 2016.

There being no other business, Interim Chairperson Okumoto adjourned the meeting at 11:59 a.m.

(NOTE: Signed copy on file.)