

DRAFT
STATE OF HAWAII
DEFERRED COMPENSATION PLAN
BOARD OF TRUSTEES

OPEN SESSION MINUTES
MEETING # 445

Date: July 22, 2022

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

Present: Kalei Rapoza, Chairperson
Roderick Becker, Ex-Officio Member
Kalbert Young, Employee Member
Lance Larsen Jr., Employee Member
Reiko Matsuyama, Employee Member
Ken Kitamura, Employee Member
Randall Nishiyama, Deputy Attorney General
Cynthia Akiyoshi, DHRD Staff
LiAnn Tokuda, DHRD Staff
Doreen Kuroda, DHRD Staff
David Greengard, Segal Marco Advisors
Kevin Malmud, Plan Administrator Staff (Empower)/Honolulu Office
Julie Klassen, Empower

Present via

Teams Link: Ryker Wada, Ex-Officio Member
Wendy Carter, Segal Marco Advisors
Melanie Walker, Segal Marco Advisors
Carol Blumenthal, Empower
Deborah Baran, Empower
Jeanne Kanai, Empower
Barton Jefferys, Empower
Rob Luciani, Empower

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

Agenda

Item # 1: Welcome and Introduction of Incoming Board Member(s)

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

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Item # 2: Public Testimony Period

There was no one from the public in attendance to offer testimony.

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Item # 3: Approval of Minutes No. 444 for the May 20, 2022 Meeting

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

A motion was made by Trustee Matsuyama and seconded by Trustee Young to approve Minutes No. 444, as presented. The motion passed unanimously.

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Item # 4: Plan Administrator's Updates, including but not limited to:

- a. Status on the Vanguard Target Retirement 2015 Fund merger with the Vanguard Target Retirement Income Fund

Ms. Klassen presented the Plan Administrator's Updates to the Board. She started with the status on the Vanguard Target Retirement 2015 Fund merger with the Vanguard Target Retirement Income Fund.

- The merge was effective July 8, 2022, and was available July 11, 2022. Four hundred and twenty participant accounts were impacted with about \$19 million mapped to the Income Fund.

Trustee Young asked about the Vanguard Target Retirement 2020 Fund and when this fund is expected to merge with the Vanguard Target Retirement Income Fund. Ms. Klassen clarified the 2020 Fund will be merged at a later date. Mr. Greengard confirmed this and explained the glidepath for these funds is seven years; meaning seven years after the fund has reached its target date, it will merge into the Income Fund.

There were no further questions from the Board.

- b. Update on the Addition of the Vanguard Target Retirement Trust II 2070 Fund

Ms. Klassen continued with her updates for the Board.

- The Vanguard Target Retirement Trust II 2070 Fund will be effective on July 27, 2022, and will be available on July 28, 2022. Communication about both the Vanguard 2015 and 2070 Fund has been shared with participants in June 2022. Ms. Klassen explained the take up and utilization of the 2070 Fund would impact participants born after 2005.

There were no questions from the Board.

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Item # 5: Discussion on Handling Gains and Losses in the Plan

Ms. Akiyoshi discussed the updated Board policy on handling gains and losses in the Plan.

- The policy was adopted in 2017 to address the handling of gains and losses in the Plan due to erroneous payroll postings. The policy has been reviewed, updated, and accepted in 2022 by the Standing Committee on Operations.
- The Board first discussed this policy during the February and March 2017 Board Meetings. The Board wanted to have a procedure for handling gains and losses in the Plan that resulted from corrective action to participants accounts. The policy was finalized in 2017 but was not distributed to the appropriate State and County agencies due to several unexpected events at the time.
- The updated policy outlines the procedures when an error is caused by the Third Party Administrator (TPA) or by a State or County agency and how to handle any adjustments in the Plan.
- The difference between the 2005 policy and the updated policy is the \$250 threshold in the updated policy. If losses incurred is greater than \$250 as a result of an error caused by a State or County agency, the TPA will request the responsible State or County agency to reimburse the Plan for the amount lost.
- The policy also includes a procedure for the TPA to set aside the gains that have incurred from payroll errors into a separate “Mr. Gains” account. The Standing Committee on Operations agreed to use the conversion money from the prior record keeper as seed money for the “Mr. Gains” account. This “Mr. Gains” account will be used for losses incurred from payroll errors equaling less than \$250.

Ms. Klassen further commented on the establishment of the “Mr. Gains” account, history on past payroll adjustments, and plans to provide reports to the Board for payroll adjustments relating to this policy.

- Empower can implement the Board’s policy and she will memorialize the policy with her operations team. A memorialization document will be presented to Board Staff shortly.

- The “Mr. Gains” account can be established with the seed money that was inherited from the prior record keeper. The seed money, which is approximately \$32,000, is being held in the Plan Expense Account. This amount, and any earnings from this amount, would be transferred into a separate “Mr. Gains” account where it will be used to make appropriate adjustments in the Plan according to the updated policy.
- The “Mr. Gains” account could be transferred into an Allocated Plan Account and the name of the account can be changed upon further discussion with the Board.

Trustee Becker asked for clarification on where the approximated \$32,000 originated from and Ms. Klassen explained it is the gains that was inherited from the previous record keeper which was converted and is being held in the Plan Expense Account. She further explained that if this amount is to be used per the updated policy, the amount should be moved into its own Plan Managed Account or Plan Allocation Account.

Trustee Becker was unsure why this account would be used to rectify TPA errors and Ms. Klassen clarified that the account would be used for State and County agency errors up to the \$250 threshold. Chairperson Rapoza confirmed that if a State or County agency caused an error equaling less than \$250, the “Mr. Gains” account would be used to make the adjustments for the error, but for any amount greater than \$250, Empower as the Plan’s TPA would seek the payroll adjustment from the responsible State or County agency.

Ms. Klassen and Mr. Malmud continued with historical figures on past payroll adjustments.

- There have been about ten payroll errors a month on average. In the fiscal year ending June 30, 2022, the Counties had a total of ten payroll errors for an estimated total amount of \$26,000. For the State payroll errors, an estimated total amount of \$21,000 for calendar year 2021.
- Mr. Malmud explained that most of these errors occur due to ineligible contributions into the Plan and many ineligible contributions result from a participant’s change in status. An employee could change their status from full-time to part-time back to full-time which could lead to ineligible contributions for the participant.
- In recent meetings between DAGS and Empower, DAGS has confirmed they have improved programming to help solve issues related to ineligible contributions. This new programming should reduce the amount of payroll errors.

Ms. Blumenthal commented that there are various reasons for payroll errors and the errors are usually a de minimis amount, so the \$250 threshold is reasonable.

Trustee Young questioned how these payroll errors have been handled since 2017. Ms. Klassen explained the errors were recalled and there was no calculation of gains or losses. Trustee Matsuyama asked if the losses could exceed the gains and what would happen if it did. Ms. Klassen answered that there is a possibility for loss, but the “Mr. Gains” account would help restore these losses. Trustee Becker asked what the distribution of errors is among the employers. Ms. Klassen responded that the Counties have fewer errors compared to the State, however the State has a greater percentage of participants in the Plan. So, the errors are proportionate to participant population.

Chairperson Rapoza confirmed with Ms. Klassen that the Board will be receiving quarterly reports on erroneous payroll postings and the separate accounting of the “Mr. Gains” account.

Trustee Young asked if the “Mr. Gains” account was to move to an allocated account from the Plan Expense Account, if there would be a problem transferring funds from the Plan Expense Account to the “Mr. Gains” account in the event the funds in the “Mr. Gains” account needed to be replenished. Ms. Klassen replied that there should not be a problem using the Plan Expense Account to replenish the “Mr. Gains” account but deferred to Mr. Nishiyama for further commentary. Mr. Nishiyama confirmed it is the Board’s discretion if they chose to replenish the “Mr. Gains” account using the Plan Expense Account.

Trustee Becker questioned what would happen if a State or County agency disagrees that they were responsible for a payroll error. Ms. Klassen explained if the error was under the \$250 threshold, the “Mr. Gains” account would be used to cover the loss. If the error was greater than \$250, Empower would request the responsible State or County agency to correct the error, however if they refuse, Empower would need guidance from the Board on how to proceed. Mr. Malmud did reassure that if an error occurred, despite who the responsible party is, the participant will be made whole and will not be impacted by the error.

The policy will be distributed to State and County agencies appropriately.

There were no further questions from the Board.

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Item # 6: Segal Marco Advisors Investment Fund Updates and Announcements, including but not limited to:

- a. Investment Management Fee Changes and Other Updates on the Wellington Management Research Value Fund

Mr. Greengard reviewed the Market Updates and Plan Highlights for the Board.

- Annual inflation unexpectedly accelerated to 8.6% in May 2022 which is the highest it has been since December 1981.

- The Central Bank has increased interest rates to combat the rise in inflation.
- The raised interest rates are supposed to help slow down inflation and the economy.
- All liquid asset classes fell in June.
- Plan assets have decreased to \$2.86 billion as of May 31, 2022. The Hawaii Stable Value Fund remains the largest holding with \$986 million and 34.5% of Plan assets.
- All investment expenses remain competitive with their respective peer groups.

Mr. Greengard presented the Investment Management Fee changes and other updates on the Wellington Management Research Value Fund.

- Effective June 1, 2022, the management fee for the portfolio will be reduced to a flat fee of 45 basis points (bps).
- Wellington reduced the fee because there was an outflow from the portfolio. There used to be two plans invested in the Wellington vehicle, however the other plan left leaving the Island Savings Plan as the sole participant. The fee was lowered to ensure the Plan's effective fee does not increase because of the outflow. After the outflow and fee reductions, the Plan's effective fee is 47.6 bps, a 2 bps reduction from the previous 49.6 bps.
- The objective on this fund is to consistently outperform the Russell 1000 Value Index over 3–5-year periods.
- The fund is exceeding or matching the benchmark, so it is performing as it should.

Trustee Becker questioned if the objective of the Wellington Fund is to meet the benchmark set by the Russell 1000 Value Index, and since the Russell 1000 Value Index was included in the Plan, why should we keep the Wellington Fund in the Plan. Mr. Greengard answered the Russell 1000 Value Index is not in the Plan, but the objective of the Wellington Fund is to exceed this index. Mr. Greengard said he will elaborate more on what the options are for the Wellington Fund after his review on the AMCAP Fund.

There were no further questions from the Board.

b. Investment Management Update on the American Funds AMCAP

Mr. Greengard provided an update on the American Funds AMCAP to the Board.

- The objective of the AMCAP Fund is to outperform the Standard & Poor's 500 Composite Index.
- In terms of performance, the strategy has not beaten the benchmark and has lagged the median fund.

- As the AMCAP Fund has been underperforming, Mr. Greengard provided options to the Board on replacing this fund.
 - He explained that the AMCAP Fund and the Mainstay Large Cap Growth Fund are similar funds in the Plan. So, the AMCAP Fund could be mapped to the Mainstay Fund, or a fund search can be conducted for a new fund.
 - However, he wants to compare these funds together and present to the Board his findings.

Mr. Greengard returned the topic back to the Wellington Fund and addressed Trustee Becker's previous question. He explained that although the Wellington Fund is not continuously exceeding the benchmark, it is still matching it and doing so with lower volatility than the benchmark. However, the operational aspect of the Plan being the only plan in the Trust for the Wellington Fund, is a bit concerning. Mr. Greengard will research more on these questions and concerns with Wellington and will present the findings with the Board.

Trustee Young asked if the AMCAP Fund is on a Watch List or on probation due to its underperformance. Mr. Greengard answered the fund is not on a formal Watch List, but it is being monitored. If the Board decides to add the AMCAP Fund to a formal Watch List, he can do that.

Chairperson Rapoza questioned if the Board has a Watch List Policy and Ms. Klassen confirmed there is an Investment Policy Statement (IPS). She explained that an IPS may have a provision for keeping or discontinuing a fund and gives that discretion to the governing body. Trustee Becker recalled that for past funds that were underperforming, the Board placed the funds on watch and Chairperson Rapoza confirmed the Board has done this a couple times in the past. Chairperson Rapoza would like Mr. Greengard to report his research on the Wellington and AMCAP Funds reported back to the Board at the next Board meeting. Mr. Greengard agreed to put both funds on a Watch List, and he will present his findings to the Board at the next Board Meeting.

There were no further questions from the Board.

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Item # 7: Updates on the Proposed Amendments to Title 14, Chapters 41-44, Hawaii Administrative Rules

Ms. Akiyoshi presented the updates on the proposed amendments to the Administrative Rules.

- The proposed Rule Amendments were sent to the State and County Payroll Departments on June 6, 2022, for advanced review and comments.
- Staff received comments back from County of Kauai Finance Department and questions from Hawaii County Department of Water Supply.

However, there were no comments raised that there would be any issues, or the payroll departments would not be able to accommodate the Roth deferrals into the Plan.

- Ms. Akiyoshi will be proceeding forward with the Rule Amendments and is currently working on the Justification Sheet.

Chairperson Rapoza asked when the rules are expected to be implemented and if the Board is still on track for this timeline. Ms. Akiyoshi confirmed the target date for the rules to be implemented is January 2024, and the Board is on track with this timeline.

There were no further questions from the Board.

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Item # 8:

PTS Deferred Compensation Retirement Plan for Part-Time, Temporary, Seasonal/Casual Employees (PTS Plan)

- a. Notification of New Interest Rate for the PTS Plan, Effective July 1, 2022

Ms. Akiyoshi reported that the new interest rate for the PTS Plan effective July 1, 2022, for the Third Quarter is 2.01%. This rate is slightly up from the second quarter rate of 2.00%.

There were no questions from the Board.

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Item #9:

Other Business/Announcements

- a. National Association of Government Defined Contribution Administrators Annual 2022 Virtual Conference

Ms. Akiyoshi reminded the Board that the upcoming NAGDCA Conference is in September and the Trustees can attend in-person or virtually. She asked the Trustees to inform her of their decision to attend the conference so she can complete the early registration.

There were no questions from the Board.

Chairperson Rapoza announced that this will be Ms. Akiyoshi's last Board Meeting as she will be retiring soon. On behalf of the Board, he read a letter from former Chairperson Moto addressed to Ms. Akiyoshi recognizing her service to the Board and the Plan and her well-earned retirement. Chairperson Rapoza also presented a Letter of Appreciation from the Board to Ms. Akiyoshi thanking her for her over twenty years of service to the Plan. Members of the Board, Empower, and Segal also provided comments on their working relationships with her over the years and offered their congratulations to Ms. Akiyoshi on her retirement.

Chairperson Rapoza thanked everyone for their participation in today's meeting. He adjourned the meeting at 10:14 a.m.

Taken and recorded by:

Reviewed and approved by:

LiAnn Tokuda
Board Staff

Kalei P. Rapoza
Chairperson

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