Commonwealth of Massachusetts
Deferred Compensation Committee
Meeting Minutes

June 1, 2017

One Ashburton Place, 12th Floor
Boston, MA 02108

Committee Members Present:

- Robert Sheridan, Committee Chair
- John Curran, Committee Member
- Tom Magno, Committee Member

Also present for all or part of the meeting were: David Lynch, Executive Director, Defined Contribution Plans; Nicola Favorito, Deputy Treasurer / Executive Director, State Retirement Board; Laura Rooney, Director of Operations, Defined Contribution Plans; Giuseppe Caruso, Operations Associate, Defined Contribution Plans; Emily Robbins, Defined Contribution Plans Counsel; Henry Clay, Treasury Director of Investments; Kevin Vandolder, Principal, Aon Hewitt Investment Consulting, Inc.; Chris Behrns, Senior Consultant, Aon Hewitt Investment Consulting, Inc.; Beth Halberstadt, Partner – U.S. Delegated DC Solutions Product Manager, Aon Hewitt Investment Consulting, Inc.; Steve Mortimer, Portfolio Manager, Wellington Management; Eileen Leary, Investment Director, Wellington Management; and Jed Petty, Managing Director, Wellington Management.

I. Opening:

Call to order by Committee Chair Mr. Sheridan at 10:55 a.m.

Mr. Lynch noted for the record that the scheduled start of the meeting was delayed as a result of a full building evacuation of One Ashburton Place.

II. Approve Minutes:

Mr. Curran noted a single typo, but nothing to affect substance. Mr. Sheridan made a motion to approve the minutes with the typo corrected. The motion was seconded by Mr. Curran.

III. Executive Director's Quarterly Update:

Prior to the Quarterly Update, Mr. Lynch updated the Committee that he had informed Wellington Management of the need to delay their presentation to the Committee meeting due to the building evacuation. He then asked that, in the interest of time, the Committee confirm that Wellington Management's presentation be pushed back to 11:45 a.m. Mr. Sheridan, Mr. Magno, and Mr. Curran all agreed.

With that, Mr. Lynch turned the Committee's attention to the key points included in the SMART Plan Key Statistical Data Chart:

- <u>SMART Plan Key Statistical Data</u>: Mr. Lynch noted a rise to over $8.2 billion in Plan assets. Mr. Lynch continued with new enrollments, which totaled 1,157 through the first quarter.

  - ❖ Mr. Lynch noted the Active Choice spreadsheet, which showed a breakdown of enrollment via the Active Choice Enrollment Form since its inception in April 2016. Mr. Lynch noted the Active Choice enrollment, when combined with enrollments of municipal employees, yielded just over 19% of new SMART Plan enrollments. Mr. Lynch reminded the Committee that as the Active Choice Enrollment Form is a supplement to State Retirement Board enrollment forms, municipal employees do not have the opportunity to enroll via Active Choice. Mr. Lynch next pointed to the April 2017 Active Choice Enrollment numbers, which showed that as a percentage of new state employee enrollments only, the SMART Plan saw over 34% enrollment via Active Choice. Lastly, Mr. Lynch noted the success of the program and that most participants contributions are at least three percent or more of their salary. Mr. Sheridan concurred.

  - ❖ Mr. Lynch next informed the Committee that three new public entities have elected to join the SMART Plan – the Lancaster Sewer District, Plymouth County, and Plymouth County Retirement. Mr. Curran commented that the Lancaster Sewer District had only one participant and asked whether this incurred additional costs. Mr. Lynch confirmed that this is all included in the current SMART Plan cost structure.

  - ❖ Mr. Sheridan asked how the SMART Plan is marketed. Mr. Lynch explained that the regional representatives market the Plan through individual and group meetings, communications programs such as targeted e-mail campaigns and various other informational materials on a regular basis. Mr. Sheridan asked to what entity did the regional representatives report; Mr. Lynch replied that the regional representatives of the Plan are employees of Empower Retirement but are accountable to the Treasury. Mr. Lynch further replied that the representatives report to Robert Young, Manager, Retirement Plan Counseling, Empower Retirement, who is also accountable to Treasury. With regards to communication pieces, Mr. Lynch updated the Committee, informing them that the SMART Plan had added 7,500 state e-mail addresses to the SMART Plan e-mail database for enhanced communication capabilities via e-mail distribution of materials.

- ❖ Mr. Lynch stated the average account balance for full-time SMART Plan participants was over $74,000 and that the average salary contribution for those participants contributing on a percentage basis is over nine percent. Mr. Lynch noted, however, that most participants contribute on a dollar basis, not a percent basis. Mr. Lynch next commented that auto-escalation enrollment was being utilized by just under 5,000 participants and that the average investment cost as a percentage of assets was 35 basis points (bps). Mr. Lynch also confirmed administrative costs to be 8 bps of assets, with a breakdown of 7 bps allocated for the recordkeeper and 1 bp allocated for administrative expenses.

- <u>SMART Plan Administrative Expense Fund</u>: Mr. Lynch notified the Committee that the accrual on Plan assets set for day-to-day expenses of the Plan is 1 bp, established and set in 2009. Per Mr. Lynch, it is noteworthy that since 2009, the Plan assets have doubled. As a result, Mr. Lynch suggested an accrual reduction from 1 bp to ¾ bps. Mr. Lynch referred the Committee to the Administrative Expense Account Estimated Profit & Loss 2018 spreadsheet included with their materials to demonstrate how the expense account accrual can be reduced, which would result in even lower costs for Plan participants. Mr. Lynch directed the Committee to the two examples, one for a ¾ bp accrual and one for a ½ bp accrual. Mr. Lynch explained that a ½ bp accrual would result in a potential expense shortfall, but that a ¾ bp accrual would cover anticipated expenses. Mr. Lynch also noted that should it ever become applicable, the ¾ bp accrual would also cover the salaries of Treasury employees for their work on the Plan.

  - ❖ Mr. Sheridan asked if this approach to payment of Plan expenses, with regards to salaries, is common of other states. Mr. Lynch confirmed that it was and that was currently done similarly by MSRB. Mr. Curran asked who the SMART Plan employee staff consisted of. Ms. Rooney confirmed it to be the four staff in the Treasury's Defined Contribution Plans department. Ms. Robbins noted that the Defined Contribution Plans department was also covering the new 401(k) CORE Plan to be launched in the upcoming months and that any percentage of time spent by the department staff for the CORE Plan could not be paid by the SMART Plan and so would not be included in this expense. Mr. Lynch confirmed this. Mr. Curran asked if this was all under the Treasury as well. Mr. Lynch confirmed. Mr. Sheridan asked regarding the 401k CORE Plan generally, the target audience, and the current CORE Plan balance. Mr. Lynch responded that non-profit organizations in the Commonwealth and their employees are the targeted audience and that currently there are no assets in the CORE Plan, as it has yet to be launched.

- ❖ Returning to the topic of the SMART Plan Administrative Expense Fund, Mr. Lynch noted a $1 million refund of the administrative expense fund to participants in conjunction with the adjustment from 1 bp accrual to ¾ bp. Ms. Rooney noted that the target surplus, sufficient to cover three years' worth of expenses, would also be maintained to cover costs during any period of potential losses, should they occur.

Mr. Curran asked if this would require a vote to confirm support for the adjustment to a ¾ bp accrual and whether later changes can be made to the accrual amount, should the adjustment be insufficient. Mr. Lynch responded in the affirmative. Mr. Magno asked what brought about the idea to lower the accrual and whether it was audit related. Mr. Lynch responded that due diligence on this issue has been ongoing for some time to lower costs for participants while simultaneously making sure the Plan retained the appropriate assets to cover administrative expenses. Mr. Lynch stated that it has been tracked and recommended the adjustment as a result of the expense account surplus.

- Mr. Curran made motion to vote in support of lowering the accrual to ¾ bps. Mr. Mango seconded the motion. The motion passed by unanimous vote of the Committee.

- <u>Real Estate "REIT" Fund</u>: Mr. Lynch confirmed that as negotiations with State Street Global Advisors (SSGA) have concluded, and as the Committee is already aware, a 20% passive strategy via investment in the State Street Global Real Estate Securities Index Fund will be included in the Real Estate "REIT" Fund. Mr. Lynch reminded the Committee that the current 100% allocation to the Brookfield Asset Management US Real Estate Securities Value Income Strategy is actively managed and has experienced high volatility and short-term underperformance, which brought about the suggestion of diversification of the Real Estate "REIT" Fund with a passive strategy. Mr. Lynch stated that an 80/20 asset allocation split between Brookfield and SSGA would result in reduced anticipated volatility and lower costs for participants.

- <u>H29 – An Act Relative to the SMART Plan</u>: Mr. Lynch informed Committee members that H29 would allow for auto-enrollment of all new state employees, while municipalities would have the option to elect to implement auto-enrollment. For municipalities, this would be accomplished via a new or amended Joinder Agreement. Mr. Lynch noted the importance of auto-enrollment in the Plan given that state employees require a ten-year creditable service vesting period to receive pension benefits. Mr. Lynch also noted that vested state employees with spouses that contribute to Social Security could see a reduction in their Social Security benefits by two-thirds as a result of the government pension offset (GPO) program. Therefore, participation in Plan would provide public employees with some protection from the potential reduction in Social Security benefits resulting from a government pension offset.

- Mr. Sheridan asked how the Joint Committee on Public Service hearing had gone and if the Treasurer had testified. Mr. Lynch noted that Treasury had submitted written testimony.

- Mr. Sheridan asked Mr. Vandolder and Mr. Behrns as to their thoughts on auto-enrollment. Mr. Vandolder voiced support of the idea and noted that Aon Hewitt was one of the first firms to suggest the auto-enrollment option.

- Mr. Magno asked what the procedure would be for new employees should auto-enrollment be established. Mr. Lynch responded that if auto-enrollment is implemented, new employees would need to actively opt-out of the program. Mr. Magno asked if Mr. Lynch remembered the percentage of public plans currently using auto-enrollment cited in the NAGDCA benchmarking survey. Mr. Lynch stated that he believed it to be around 33% of public plans. Mr. Vandolder confirmed the estimate, but noted that while 33% of public plans utilize auto-enrollment, over 75% of corporate plans have an auto-enrollment program. Ms. Robbins noted that the lower percentage of public plans involved in auto-enrollment was a result of anti-garnishment laws to which public employers are subject.

- Mr. Magno, Mr. Sheridan, and Mr. Curran all voiced support for auto-enrollment. Mr. Sheridan then articulated that he was "enthusiastically" in favor of it.

- Mr. Curran then added as an aside that while he hopes for continued growth of the Plan, he urged the Defined Contribution Plan staff to exercise caution with regards to over-expansion of staff as the Plan continues to grow, should the legislation allow for the funding of staff salaries from the SMART Plan administrative expense account. Mr. Curran stated that he appreciated the dedication of the current staff.

- Mr. Sheridan asked about the status of the bill, specifically with regards to which committee it was assigned to. Mr. Lynch noted that the bill had been assigned to the Joint Committee on Public Service, and from there would be referred to the Ways and Means Committee, if approved.

- <u>Glide-Path Services RFR</u>: Mr. Lynch advised the Committee that AllianceBernstein, which currently provides glide-path services for SMARTPath Target Date Funds, has a contract that is set to expire in July 2017 after a ten-year term. Mr. Lynch noted that the Treasury, on behalf of the Plan, had posted an RFR on March 24, 2017 to re-procure custom glidepath services for the Plan.

- Enhanced Services for Plan Field Representatives: Mr. Lynch stated that all SMART Plan regional representatives have become Series 65 accredited and can now provide individual account recommendations for participants.

    - Mr. Sheridan asked whether they would be considered fiduciaries. Mr. Lynch confirmed. Mr. Sheridan asked about any potential risk for the SMART Plan given the new accreditations for regional plan representatives. Mr. Lynch confirmed he would refer the question to Empower Retirement. Mr. Vandolder noted that any potential risk would fall under Empower Retirement and not the SMART Plan. Ms. Robbins commented that this will be addressed with Empower and will be reflected in an amended contract.

- Update: Targeted Communication Campaigns: Before Mr. Lynch introduced the discussion, Mr. Curran noted that he had not yet received any electronic communications for the SMART Plan and does not receive any communication pieces beyond the quarterly newsletter. Mr. Curran stated that this needed to be addressed. Mr. Lynch replied that an increase in electronic communication materials to come, as they have been in development. Mr. Lynch also noted that the SMART Plan e-mail database for full-time participants has now reached 68,000. Mr. Lynch advised the Committee that several targeted email strategies were upcoming and would reach a wider audience as a result of the increased database size.

- 2016 Re-Start Campaign (summary of NAGDCA Award submission): Mr. Lynch informed the Committee that the 2016 Re-Start Campaign targeted participants with a balance in the SMART Plan, but have ceased contributions. Mr. Lynch explained that this strategy targeted two separate groups of participants, those over age 50 and those under age 50, with tailored messages. Mr. Lynch provided the results of the campaign as follows: 6.9% of the under age 50 audience and 2.4% of the over 50 audience resumed contributions, for a total of 578 participants who have resumed contributions.

- 2017 Beneficiary Campaign: Mr. Lynch noted that this campaign would be sent later in the year to participants that had not updated their beneficiaries or have no beneficiary on file with the Plan.

    - Mr. Curran asked who would fall under the audience of participants without an updated beneficiary. Ms. Rooney responded that the previous Beneficiary Campaign in 2016 targeted only those participants with no beneficiary on file. Mr. Curran noted that he had not received this communication. Ms. Rooney then continued that this year's targeted campaign would contact both participants that do have a beneficiary on file and those with no beneficiary on file. Mr. Curran stated that he looked forward to receiving this communication. Ms. Rooney confirmed that he would receive an e-mail. Mr. Curran reiterated his interest in the SMART Plan's engagement with participants through various communication pieces and that he hopes to see an increase. Mr. Curran noted that various companies send communications constantly through the mail and via e-mail, but he has not received anything from the SMART Plan for an extended period. Mr. Curran then commented that he appreciates the consideration for additional communication materials by the staff.

- 2017 Stay Campaign: Mr. Lynch noted that the Stay Campaign would target those participants in retirement or nearing retirement. Mr. Lynch stated that there are roughly 28,000 participants that are either approaching retirement and have an employment termination date on file. Mr. Lynch explained that the Stay Campaign would target all such participants to inform them that once a participant separates from service or retires, they can choose to leave their money in the SMART Plan.

    - ❖ Mr. Curran noted that he admired this strategy and that he hopes to see this communication relayed to him as well. Mr. Curran and Mr. Sheridan both stated an appreciation of these communication programs overall and that they hope to see the programs succeed in their intended objectives.

IV. Market Review, Recommendations, Highlights and Performance Update: Aon Hewitt

Mr. Behrns, noting the delayed start of the Deferred Compensation Committee Meeting, in the interest of time suggested a quick overview of the materials prepared by Aon Hewitt as it relates to the market review, watch list, managers and a liquidity analysis. Mr. Sheridan appreciated the suggestion and noted that this would also accommodate the guests from Wellington Management more appropriately as well.

- On the topic of market review, Mr. Behrns commented that only the Large Cap Blend Fund had been on the watch since the previous quarter, due mainly to the Vanguard Dividend Growth Fund performance. Mr. Behrns noted that this was partly a result of a market environment issue, which resulted in an overall downturn, but cited overall underperformance by the Vanguard Dividend Growth Fund over the past three quarters. Mr. Behrns explained that the Vanguard Dividend Growth Fund looks for companies with capable dividend growth in place and was focused on quality investments. He commented that the previous 9 months had been a challenging market environment for this philosophy. Mr. Behrns clearly stated that there was nothing deficient with the manager, the results this far have been just a feature of the market. Mr. Behrns also noted a reversal in the market of late, which should improve performance of the fund. Finally, Mr. Behrns stated that this fund is still "Buy" rated by Aon Hewitt.

- Mr. Behrns yielded for questions from the Committee. The Committee stated no further questions.

V. AB / Eaton Vance / Reams / Wellington Updates

Mr. Vandolder began the discussion to overview various manager updates.

- Mr. Vandolder stated that Eaton Vance, an underlying manager for the Plan's High Yield Bond Fund, was currently under investigation related to securities fraud perpetrated by a trader within Eaton Vance. Mr. Vandolder confirmed that this was a concern of Aon Hewitt but that they are comfortable with the SEC investigation and further that Aon Hewitt has and will continue to monitor the investigation and would provide any pertinent updates in the future. Mr. Vandolder described the case and stated that the trader in question had not made Eaton Vance aware of a personal portfolio. Mr. Behrns stated that this case also brought about potential concerns with Eaton Vance's overall due diligence and compliance process, which Aon Hewitt has also monitored, but also noted this concern is a concern of Aon Hewitt's in the industry, generally, and may apply more broadly across investment managers.

  - Mr. Magno asked how Aon Hewitt monitored due diligence processes. Mr. Vandolder noted that these were reviewed by manager research teams for compliance.

  - Mr. Sheridan asked whether the SEC must make a criminal referral, and asked what the process for that was. Mr. Behrns noted that the liability was strictly with the individual.

  Mr. Vandolder then stated that Aon Hewitt had confirmed that the incident related to securities fraud did not affect the High Yield fund in which the Plan is invested, and that this is true going back to the date of the Plan's initial investment in the fund in 2012.

- Mr. Vandolder continued with a discussion on AllianceBernstein, specifically related to organizational changes. Mr. Vandolder noted a "shake-up" in the board of directors, specifically with the parent company of AllianceBernstein, AXA, as well as the removal of the CEO of AllianceBernstein. Mr. Vandolder also stated that AXA soon planned to go public with its US operations. Mr. Vandolder noted that this would have some effect on AllianceBernstein and that Aon Hewitt would continue to monitor the situation.

  - Mr. Sheridan asked if this change had been foreseen. Mr. Vandolder confirmed that this was expected as AllianceBernstein has long been struggling organizationally to decide what is next for them in the DC space. Mr. Vandolder stated that Aon Hewitt would monitor new developments.

- Mr. Vandolder then turned the subject to a discussion on Reams Asset Management, which he noted had a ten percent asset allocation within the current Diversified Bond Fund. Mr. Vandolder updated the Committee that Reams was owned by Scout Investments Inc. and that Scout Investments Inc. had recently had a change of ownership as a result of an agreement between their parent company, UMB Financial Corporation, and Carillon Tower Advisers, a wholly owned subsidiary under Raymond James. Mr. Vandolder stated that Reams would remain autonomous, and that the current employment contracts, which would last through 2022, would remain in place. Additionally, Mr. Vandolder noted that Reams employees have a one year non-compete clause as part of their current contracts. Further, Mr. Vandolder stated that Reams had a high level of stability in the views of Aon Hewitt. Mr. Vandolder stated that Reams was the premier investment firm in Indiana and that it was an attractive job for workers with good compensation. As a result, Mr. Vandolder concluded that Reams would remain stable despite the change in ownership, but that Aon Hewitt would continue to monitor the situation.

- Lastly, Mr. Vandolder began a brief discussion of Wellington Management. Mr. Vandolder informed the Committee that the SEC is opening an investigation into private equity investments at Wellington. Mr. Vandolder commented that Aon Hewitt sees this type of SEC action frequently and he assured the Committee that this would not impact the Wellington Dynamic Growth Fund (an underlying investment strategy in the Large Company Growth Stock Fund), as the fund does not invest in private equity. Mr. Vandolder stated that it would also have no effect on the underlying managerial work Wellington Management does for the Vanguard Dividend Growth Fund.

    - Mr. Favorito asked if there were any people working on with private equity as well as with the Wellington Dynamic Growth Fund within the SMART Plan. Mr. Behrns suggested this would be a very appropriate question to raise directly with Wellington. Mr. Behrns also stated that as soon as news was received about SEC investigations into Wellington, conversations were begun by Aon Hewitt with Wellington to discuss the situation.

VI. Liquidity Pool Review

- Mr. Vandolder noted that public and private plans often ask whether they have appropriate liquidity sleeves for their investments. Mr. Vandolder stated that the SMART Plan's liquidity sleeves are currently set to rebalance to five percent of the investment, with a three percent liquidity floor and ten percent liquidity ceiling. Mr. Vandolder noted that while a ten percent liquidity ceiling was not inappropriate, Aon Hewitt recommended a reduction to an eight percent ceiling. Mr. Behrns then commented that had an eight percent liquidity ceiling already been in place, only two additional rebalances would have occurred when compared with the current ten percent ceiling.

  Mr. Vandolder reiterated that there are no issues with regards to individual investment managers that brought about this recommendation, and that Aon Hewitt simply recommended a reduction of the liquidity ceiling to eight percent. He then summarized Aon Hewitt's recommendations as to the Plan's liquidity structure as follows:
    - Retain the 5% strategic allocation to liquidity;
    - Tighten to a 3% liquidity floor and an 8% liquidity ceiling; and
    - Retain all managers.

- Mr. Sheridan called for a vote to approve the liquidity ceiling from ten percent to eight percent based on the recommendation from Aon Hewitt. Mr. Curran made a motion to approve. Mr. Sheridan seconded the motion. The motion passed by unanimous vote of the Committee.

VII. Wellington Management Dynamic Growth portfolio review

At the invitation of the Plan, representatives from Wellington Management, who oversee the Wellington Dynamic Growth Fund separate account strategy for the Plan, were invited to present before the Committee. Prior to Wellington Management representatives joining the meeting, Mr. Behrns advised the Committee that the fund managed by Wellington Management had experienced a recent underperformance but has since rebounded.

Present on behalf of Wellington Management were Steve Mortimer, Portfolio Manager, Wellington Management; Eileen Leary, Investment Director, Wellington Management; and Jed Petty, Managing Director, Wellington Management.

- Mr. Petty began by introducing himself as the Relationship Manager for Wellington Management on this account. Mr. Petty described his duties as the lead for the team that provides the investment service. Ms. Leary introduced herself as the Investment Director and stated that she works with the portfolio managers, provided analytic support, assessed investment risk, and supported the business with client meetings. Lastly, Mr. Mortimer introduced himself as the lead manager for the Dynamic Growth Fund portfolio. Mr. Mortimer stated that he was a senior portfolio manager with ownership in the firm, and has had a long career with Wellington Management.

- Mr. Petty called attention to Wellington Management Dynamic Growth Fund booklet. Mr. Vandolder noted that the slides were impressive and informative.

- Mr. Petty stated that the private partnership model was important to both Wellington and to its clients. Mr. Petty noted that this used to be a more common feature, but was less so now. Mr. Petty stated that he still believed it to be the most enduring ownership model, as it was focused on a long-term view. Mr. Petty also noted that this feature allowed Wellington to retain talented staff and stressed the importance of talent in the investment industry. Mr. Petty cited the low turnover rate at Wellington, which stood at five percent. Mr. Petty stated that he believed turnover rates in the industry to be around ten to twelve percent in the investment industry. Mr. Vandolder confirmed the estimate. Mr. Petty also noted that Wellington was attractive to potential workers as it provided a real possibility for ownership in the firm. Mr. Petty cited Mr. Mortimer as an example.

- Mr. Mortimer began discussion of the Wellington Dynamic Growth Fund booklet. Mr. Mortimer started with the investment philosophy of the Dynamic Growth Fund. He described the four tenants of the investment philosophy:

- ❖ Expectation of Earnings: Mr. Mortimer described this tenant as Wellington's realization of inefficiencies in market consensus beliefs. Mr. Mortimer stated that differentiated views on the forecast of companies and their growth is where Wellington finds opportunities for growth.

- ❖ Expectation of Change: Mr. Mortimer described this tenant as the ability to make adjustments as situations develop. Mr. Mortimer noted that investors were often anchored into old beliefs, which delayed adjustments in investment decisions. Mr. Mortimer stated that his strategy was open to investment adjustments. Mr. Mortimer pointed to investors' initial belief that Facebook had been a failed IPO when its stock dropped to $25. Mr. Mortimer noted that in that situation, Wellington saw an opportunity to adjust and bought at that moment, which would later result in a benefit due to a 40% rise in stock price. Mr. Mortimer noted that Wellington continued to buy and Facebook stock prices continued to rise on a multi-year run.

- ❖ Flexibility: Mr. Mortimer described this as an ability to seek growth in unexpected places. Mr. Mortimer cited cardboard boxes as a great spot of growth, as well as paper industries in general. Mr. Mortimer noted that while these examples were not necessarily stocks with huge appeal, they had a huge potential for growth.

- ❖ Risk Management: Mr. Mortimer described Wellington investors as "growth investors with a conscience." Mr. Mortimer noted that the Dynamic Growth team tries to quantitatively balance upside potential with risk.

- ▪ Mr. Mortimer next noted new additions to the Wellington Dynamic Growth team, which included two new Equity Research Analysts. Mr. Mortimer stated that John Schneider has joined the team as an expert in small cap investments, as well as Joe Chung for his experience in international investments.

  - ❖ Mr. Sheridan asked Mr. Mortimer about the reason for the new hires, and if it was potentially "addition by subtraction." Mr. Mortimer replied that Mr. Schneider replaced someone who had departed the Dynamic Growth team, while Mr. Chung was a new hire for Wellington.

- ▪ Mr. Mortimer turned the attention of the Committee to the Dynamic Growth market cap spectrum, which demonstrated a breakdown of the individual team member areas of expertise. Mr. Mortimer specifically cited Steven Angeli for his knowledge of small cap growth and Michael Carmen for his expertise in mid- and large cap growth investments. Mr. Mortimer noted that the entire Dynamic Growth team achieved better results through an analysis of the whole life cycle of a company, through which they can better understand future investment opportunities.

- ▪ Mr. Mortimer proceeded to describe the investment process, specifically which companies would fall under the Dynamic Growth investment market. Mr. Mortimer noted that these were companies with a market cap over $2 billion, typically innovative companies or "next generation growth" companies such as Tesla and Ulta Beauty, and companies which have a demonstrated model for sustainable growth, such as Facebook via advertisements. Mr. Mortimer stated that any such companies must also fit Wellington thematically as well. Mr. Mortimer stated that companies must have an accelerating or high rate of revenue. Mr. Mortimer also noted that Wellington was very conscious to look closely at balance sheets to confirm or deny a company's income statement. Mr. Mortimer commented that while some companies understate their statement, some stretch their balance sheet. In these instances, Mr. Mortimer stated that Wellington has often decided to sell.

- Mr. Mortimer next articulated that when choosing companies in which to invest, proprietary surveys were used by Wellington in their investment determination process. Lastly, with regards to portfolio construction, Mr. Mortimer stated that the Dynamic Growth portfolio was constructed with 60 to 100 stocks, typically.

    - Mr. Vandolder asked Mr. Mortimer what the P/E ratio for Amazon was and noted that he believed it to be almost 200. Mr. Mortimer confirmed, but noted that Wellington valued Amazon as effectively three distinct businesses; US, International and Internet, with the value of each calculated separately. Mr. Mortimer stated that the high Amazon valuation was in part a result of expansion of international operations and investment in India, which would have an outsized impact on the P/E ratio. Mr. Mortimer added that Netflix also had a high P/E, but noted that they continue to expand internationally as well.

    - Mr. Sheridan asked Mr. Mortimer about Amazon's cloud operations and what percentage of the overall market share Amazon controlled. Mr. Mortimer stated that the percentage of cloud services to Amazon's overall business would be very small, perhaps $8 billion. Mr. Sheridan asked generally, for Mr. Mortimer's thoughts on Google Cloud versus Amazon Drive cloud services. Mr. Mortimer noted that Amazon had invested in the cloud platform far prior to everyone.

- Mr. Mortimer continued with a discussion on the Dynamic Growth investment process. Mr. Mortimer noted that the Dynamic Growth team relied on each manager's areas of expertise, as each field requires a huge depth of knowledge. Mr. Mortimer stated that technology was a common area of expertise for growth investors. Mr. Mortimer also noted that good ideas could come from all areas and fields, and that the genesis of ideas and analysis came from conversations between Dynamic Growth managers and Mr. Mortimer.

- Mr. Mortimer discussed the formula used in the determination in upside and downside price targets, which help exploit opportunities and minimize risk. Mr. Mortimer explained that earnings expectations helped determine upside price targets. For downside price targets, Mr. Mortimer stated that this was based on more negative earnings cases. Mr. Mortimer stated that new investments were given a 2-to-1 ratio. Mr. Mortimer then commented that sometimes the consensus opinion was to be adhered to with regards to valuation, but that there remained an opportunity to earn from low valuation stock. Mr. Mortimer noted that the Dynamic Growth team would determine if there was something the market was missing, and if so, seek to exploit that opportunity.

- Ms. Leary began with a discussion on portfolio construction. Ms. Leary explained that from a portfolio style perspective, Dynamic Growth placed consistent overweight to growth and underweight to market cap size, with mid-cap companies as a common feature of the portfolio. Ms. Leary noted that the markets have been in a fairly volatile period since September as a result of the presidential election. Specifically, technology was a particularly volatile area as investors questioned President Trump's support for technology. Regardless, Ms. Leary confirmed growth in technology markets since then. Ms. Leary stated that while elections were commonly volatile times for markets, investments were currently back to cycle. She cited growth in the technology, healthcare, and energy markets most recently, but noted that technology and energy were some of the biggest detractors since the inception of the Plan's investment in the Dynamic Growth fund through April. Ms. Leary specifically cited Panera Bread and Netflix as the largest contributors from Dynamic Growth inception through April.

    - Mr. Sheridan asked Ms. Leary and Mr. Petty how Wellington monitors Mr. Mortimer with regards to his investment decisions. Ms. Leary confirmed regular collaboration with Mr. Mortimer to discuss investment decisions and monitor risk, including regular manager meetings, as examples of how Mr. Mortimer and his team are monitored. Ms. Leary then commented that Mr. Mortimer's team has shifted into investment in more cyclical names in industrials and the financials market. Ms. Leary noted that while volatility was up a bit recently, investments were still within the five-year band of where Mr. Mortimer has been historically investing.

    - Mr. Sheridan stated his past attendance on Wellington Management global conference calls and that he has been impressed with the discussions featured on them. Ms. Leary responded and noted that she had worked elsewhere in financial services previously, and that she remained impressed by the quality of the Wellington Management Global Call conversations. Mr. Petty cited the open source research platform at Wellington and noted that all work that was done by Mr. Mortimer or by anyone at Wellington was available to all other team members, which makes for interesting collaborative dynamic as other managers can question and collaborate on investment selection.

    - Mr. Favorito noted that as public officials, all those involved with the State Retirement Board, Defined Contribution Plans, and the DC Committee, are constrained to ask about the SEC investigation into Wellington and what potential overlap there would be with the Dynamic Growth Fund. Mr. Petty responded that the SEC investigation relates to private securities and Wellington's methodology for valuing such securities. Mr. Petty noted that Wellington was fully cooperating with the SEC and that Wellington's practices were common across the market. Mr. Petty then stated that private securities were usually used in hedge funds and that the Dynamic Growth fund in which the SMART Plan invests does not and will not invest in private securities. Mr. Petty noted that the valuation process at Wellington was in line with industry standards nevertheless.

- ❖ Mr. Favorito asked whether personnel or data was shared between Dynamic Growth investors and private securities investors at Wellington. Mr. Mortimer noted that he does have private investments for other clients, but that he does not set valuations. Mr. Mortimer then commented that there is a benefit in being familiar with private companies before they go public. Mr. Favorito acknowledged the response and asked that Wellington keep Mr. Lynch informed of the entire process and investigation updates. Mr. Mortimer confirmed.

- ❖ Mr. Clay asked specifically about Under Armour and Dick's Sporting Goods and the correlation of certain portfolio holdings. Mr. Clay noted that they had been big detractors. Mr. Mortimer stated that Under Armour had become too expensive and its growth experienced a slowdown. Mr. Mortimer commented that, in hindsight, Under Armour had been hit driven by sales item releases such as the new Steph Curry sneaker. Mr. Mortimer noted that overall growth by Under Armour was slow. Mr. Mortimer also cited the philosophy behind investment in Dick's Sporting Goods – specifically, that his analysts anticipated greater sales and traffic at Dick's Sporting Good's following the Sports Authority bankruptcy. Mr. Mortimer pointed to past examples of "sales shifts" and cited Bed, Bath & Beyond and Best Buy as models of growth after their respective competitors had fallen. Mr. Mortimer noted that, unfortunately, growth was not as positive with Dick's Sporting Goods as expected and that there had been leakage to other areas of the market.

- ❖ Mr. Sheridan asked for Mr. Mortimer's thoughts on investment in Nike. Mr. Mortimer stated that Nike did not have a very differentiated view from the market and that he did not believe Nike could provide the same high, sustainable growth that other companies would, as it is already established. Ms. Leary did however note that global industry analysis did have high opinion of Nike.

12: 15 pm. With no further questions, the representatives from Wellington Management departed the meeting.

- Mr. Sheridan noted the appropriateness of all the questions put forward to the Wellington Management representatives and voiced his appreciation of it.

VIII. Misc.

- Mr. Sheridan asked Mr. Lynch about the date and time of the upcoming Audit Committee Meeting. Mr. Lynch replied that the Audit Committee was in the process of finalizing a date. Ms. Rooney responded that it was tentatively being scheduled for late June. Mr. Sheridan thanked Mr. Lynch and Ms. Rooney for the update and stated that he wished to be informed once the final date was confirmed.

- Mr. Sheridan announced that he had reached out to Governor Charlie Baker with regards to an appearance in the SMART Plan Video and noted that Governor Baker was receptive to the idea. Mr. Sheridan stated that Governor Baker had a few logistics questions, but was otherwise considering participation.

IX. Future Meeting Dates

Mr. Sheridan asked for future meeting dates to be determined based on what would be most convenient for attendees, but stated a preference for August or September. After some small discussion, Mr. Lynch stated that staff would look to schedule a meeting for September and would distribute possible dates.

X. Close of Meeting

12:26 p.m. Close of Meeting.

- Motion to adjourn by Mr. Sheridan and seconded by Mr. Curran.

Documents Used at the Deferred Compensation Committee Meeting of June 1, 2017

- Meeting materials including Updates, Highlights, Research Report;
- Executive Director's Quarterly Update dated May 23, 2017;
- Minutes of March 21, 2017 Deferred Compensation Committee Meeting;
- Draft of the Commonwealth of Massachusetts Deferred Compensation SMART Plan "Stay Campaign" Flyer;
- Commonwealth of Massachusetts Deferred Compensation SMART Plan 2016-2017 Active Choice Enrollment Table;
- Commonwealth of Massachusetts Deferred Compensation SMART Plan Administrative Expense Account Estimated Profit & Loss Table; and
- DC Committee Meeting: June 1, 2017, Wellington Management Dynamic Growth Review Handout.