Commonwealth of Massachusetts
Deferred Compensation Committee
Meeting Minutes

June 13, 2018

One Ashburton Place, 12th Floor
Boston, MA 02108

Committee Members Present:

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

Also present for all or part of the meeting were: David Lynch, Executive Director, Defined Contribution Plans; Laura Rooney, Director of Operations, Defined Contribution Plans; Giuseppe Caruso, Operations Associate, Defined Contribution Plans; Emily Robbins, Counsel, Defined Contribution Plans; Kevin Vandolder, Principal, Aon Hewitt Investment Consulting, Inc.; Chris Behrns, Senior Consultant, Aon Hewitt Investment Consulting, Inc.; James Cia, CFA, Head of Relationship Management, Loomis Sayles; and Rick Raczkowski, Portfolio Manager, Loomis Sayles.

I. Opening:

With Mr. Magno present to establish quorum, Committee Chair Mr. Sheridan called the meeting to order at 10:12 a.m.

Before beginning with the agenda for the Committee Meeting, Mr. Sheridan expressed his congratulations to Ms. Rooney on her recent marriage.

II. Approve Minutes:

Mr. Sheridan cited no errors on the minutes. Mr. Magno agreed.

Mr. Sheridan asked for a motion to approve the minutes of the March 6, 2018 meeting. Mr. Magno made the motion to approve the minutes. Mr. Sheridan seconded the motion.

III. Executive Director's Quarterly Update:

- SMART Plan Key Statistical Data: Mr. Lynch directed the Committee's attention to the key points included in the SMART Plan Key Statistical Data Chart that was included in his memorandum. Mr. Lynch noted total assets were up at end of first quarter to $8.74 billion, a 7.5% increase from the previous year, and that assets had continued to rise to $9.18 billion as of May 21, 2018. Mr. Lynch noted that total contributions for the first quarter were $100 million, up 2.9% compared to first quarter the previous year. Mr. Lynch stated that total full withdrawals for first quarter of 2018 had risen $17 million when compared to the same timeframe last year. Mr. Lynch explained that these withdrawals from the Plan primarily represented withdrawals of high value accounts, and that Mr. Caruso would follow up with further withdrawal statistics for Plan Year 2016 and 2017 during the NAGDCA Benchmark Review. Mr. Lynch then noted that the number of total full-time Plan participants had a net gain of over 2,500 from the prior year, representing a 2.5% increase. Mr. Lynch remarked that this was a positive statistic and hopefully a reflection of increased retention efforts. Mr. Lynch also noted that Roth account numbers had risen to over 6,300 total Roth accounts, a 30.33% increase from the previous year. Lastly, Mr. Lynch advised that average full-time participant account balance increased to just over $78,000, a 5.1% increase from the prior year.

    - Mr. Sheridan asked Mr. Lynch for any recommendations moving forward. Mr. Lynch noted that they would like to see distributions, particularly full withdrawals, decrease. Mr. Lynch remarked that the Plan wants to ensure participants understand that they have the option to keep their assets in the SMART Plan even after severance from employment, including retirement, and that they have the correct information to make informed decisions and are not unknowingly moving their assets to potentially costlier brokerage accounts.

- Target Date Fund Re-balance: Mr. Lynch noted that Plan staff, Aon Hewitt and Empower Retirement were currently evaluating an overweight within the target date funds glidepath. Mr. Lynch noted that Alliance Bernstein (AB) had identified that overweight when they took over rebalance process from Empower Retirement at the beginning of the year.

- H29 – An Act Relative to the SMART Plan: Mr. Lynch informed the Committee members that House Bill 29 (H29), which would create an automatic enrollment feature for the SMART Plan for all future state employees and give an option for the same to participating municipalities, was not referred to the House Ways and Means Committee from the Joint Committee on Public Service before the May 31st deadline. Mr. Lynch expressed his disappointment in the decision and remarked that the Plan would need to begin the process again at the start of the new session. Nevertheless, Mr. Lynch thanked Ms. Rooney and Mr. Caruso for gathering statistics in support of H29, such as case studies from states that have adopted auto-enrollment for public sector employees. Ms. Robbins added that auto-enrollment remained a hot topic of conversation on the NAGDCA listserv. Ms. Robbins stated that as more data continues to come in about other states that have adopted auto-enrollment plans, this would assist the Treasury's efforts towards getting auto-enrollment legislation enacted for the Plan. Mr. Lynch informed the Committee that Matt Peterson, Executive Advisor for NAGDCA, was heading efforts in support of auto-enrollment as well.

- ❖ Mr. Lynch noted that a letter of opposition submitted by the National Tax-Deferred Savings Association (NTSA) to the Joint Committee on Public Service likely prevented the referral out of Committee on Public Service. Mr. Lynch voiced his disappointment over the development. Mr. Lynch also noted that the letter of opposition was penned by Mr. Brent Neese, Executive Director of NTSA, the former Head of Government Markets for Empower Retirement, who had previously been assigned to the Plan relationship. Mr. Lynch stated that he had penned a draft letter to the Joint Committee on Public Service in response to the NTSA letter. Mr. Sheridan asked Mr. Lynch if he could share the letter of rebuttal with the Committee. Mr. Lynch confirmed that he would.

- ❖ Mr. Lynch noted that the letter of opposition from NTSA states that H29 would create a monopoly in the deferred compensation space for public sector workers in Massachusetts and could potentially limit additional options for those with 403(b) plans also available to them, such as teachers. Mr. Lynch noted for the Committee that these individuals currently have the option to contribute to both the 457 and 403(b) plans simultaneously. Mr. Lynch also noted that the letter of opposition from NTSA cites bias in the legislation towards pre-tax deferrals. Mr. Lynch remarked that currently only 1% of Plan participants have an after-tax Roth account, and that employees can switch to Roth contributions during the enrollment process and at any time during their participation with the Plan. Mr. Lynch cited that, on a national basis (per 2017 Vanguard: How America Saves Report), 87% of retirement plans default to pre-tax deferrals unless an affirmative election is made by the participant to do otherwise, and thus the decision for auto-enrollment with pre-tax deferrals remains consistent with industry practice in both the public and private sector. Mr. Sheridan asked if Roth accounts were more cumbersome to administer. Mr. Lynch noted that they were not, but do have some additional restrictions on rollovers.

- ❖ In addition to Mr. Lynch's letter of rebuttal, Mr. Sheridan asked if Aon Hewitt could also send a letter supporting the H29 legislation. Mr. Vandolder confirmed that Aon Hewitt could submit a letter which would also include relevant survey data and statistics as well. Ms. Rooney suggested that perhaps NAGDCA could also potentially submit a letter of support. Mr. Lynch and Mr. Sheridan agreed that this was a great suggestion.

- ❖ Mr. Magno asked if the lack of support from the Joint Committee on Public Service was related to the substance of the legislation or rather the timing of the legislation having to be decided upon. Mr. Lynch confirmed that time was a factor, considering the shortened legislative session. Mr. Lynch speculated that once some resistance arose for the legislation, it halted movement from the Joint

Committee on Public Service. Mr. Magno asked about the argument of a pre-tax bias in the legislation, as stated by NTSA. Ms. Rooney noted that, for the reason Mr. Lynch had previously identified, this was not a strong argument against the legislation, and that the primary concern for prospective participants should be beginning to save for retirement in any form. Mr. Lynch agreed, noting again that participants could easily elect to contribute on either a pre-tax and/or Roth basis at any time upon or after enrollment. Mr. Vandolder then added that there are also some arguments against Roth, primarily related to concerns over future tax policy, as no one fully knows what tax policy will be at retirement. Mr. Vandolder referenced recent tax policy discussions on the topic of a potential surtax on Roth distributions.

- ❖ Mr. Magno noted that the current list of states that have adopted auto-enrollment did not appear impressive to him. Ms. Rooney questioned why Mr. Magno felt this way. Mr. Magno responded that the current list only included 13 states, and so he wondered if there may be concerns from legislators that it is still too early to make an informed decision until there is more data available. Mr. Sheridan asked what the total asset share of these 13 auto-enrollment states was compared to the entire public sector deferred compensation space. Mr. Vandolder noted that this was a good question and that he would research this.

- ❖ Mr. Lynch continued by highlighting the lack of Social Security benefits for Massachusetts public sector employees as another key in the push for auto-enrollment legislation. Mr. Lynch also cited that the Windfall Elimination Provision (WEP) can reduce social security benefits for public sector employees, even if they have served in private sector, and the Government Pension Offset (GPO) can reduce Social Security benefits by two-thirds for spouses, widows, or widowers collecting Social Security. Mr. Magno asked whether there was concern that auto-enrollment legislation could be viewed as a form of government intervention. Ms. Rooney responded that context was important for this discussion, and that this should not be viewed as government in a government role, but government in an employer role. Ms. Rooney noted that private sector firms such as Aon Hewitt automatically enroll employees into their retirement plans. Ms. Robbins added that Aon Hewitt employees also pay into Social Security as opposed to a pension system.

- ❖ Mr. Magno asked who NTSA represents. Ms. Rooney responded that NTSA is an independent organization that primarily represents 403(b) plans and plan brokers.

- ❖ Mr. Sheridan thanked Mr. Lynch for the updates and asked that he keep the Committee informed on any new developments.

- ▪ <u>Account Retention Initiatives</u>: Touching on a subject from earlier in the meeting, Mr. Lynch informed the Committee that there are a number of new initiatives planned to increase retention of assets in the Plan and promote best practices. Specifically, Mr. Lynch highlighted the following:

- Retiree Readiness Meetings: Mr. Lynch stated a goal of 3,600 Retirement Readiness Reviews for 2018, with roughly 1,200 reviews having been completed in first quarter. Mr. Lynch stated that the Retirement Readiness Review were individualized meetings designed to more fully serve participants with distinct goals of providing better support and creating a positive affiliation between the participant and the Plan.

- Retiree Advocate Seminars: Mr. Lynch next noted the reintroduction of Retiree Advocate Seminars, which are larger group meetings designed to promote access to support for participants nearing retirement. According to Mr. Lynch, retirement plan advisor Sean Brennan from Empower Retirement would conduct 15 Retiree Advocate Seminars in 2018, and these events would be promoted at quarterly payroll user group meetings.

- STAY Campaign: Mr. Lynch stated that, as was done in the prior year, STAY Campaign communications were set to be distributed in the Fall. Mr. Lynch reminded the Committee members that the campaign seeks to encourage participants to stay in Plan by educating them on numerous Plan features, including access to local advisors, potentially lower fees, and the ability to consolidate other retirement accounts, amongst other benefits.

- Retirement Solutions Group (RSG): Mr. Lynch stated that the Retirement Solutions Group (RSG) service, offered through Empower Retirement, is designed to engage participants from enrollment to retirement. Mr. Lynch noted that the RSG program identifies touchpoints in a participant's lifecycle, beginning at enrollment, to identify goals to work towards for a successful retirement. At retirement, Mr. Lynch noted that participants would also be made aware of their options at retirement, which would hopefully also assist in asset retention efforts. Mr. Lynch noted that Plan staff continues to work with Empower Retirement to amend the services contract prior to rollout, but stated that the provision of RSG services would be at no additional cost to participants. Mr. Lynch remarked that his only concern was that Empower Retirement not market their own products.

    - Mr. Magno asked how RSG services compare to meetings scheduled with local advisors. Mr. Lynch responded that this was an additional service which, in part, established touchpoints with participants throughout their retirement planning lifecycle. Ms. Rooney continued on that point and noted that, currently, a participant could enroll in the Plan and potentially have no further contact with the Plan until retirement, unless the participant takes action to call a representative or request a meeting. Ms. Rooney stated that through the RSG program, Empower Retirement would proactively reach out to participants via an outbound call or written communication at various stages, beginning with a welcome call upon enrollment, to engage participants. Ms. Rooney also cited similar engagement efforts once a participant reaches retirement age.

- Mr. Magno asked whether there would be engagement from RSG to participants between enrollment and retirement. Ms. Rooney confirmed there would be. Mr. Lynch added that this would also include tailored emails and videos to further educate participants.

- Mr. Sheridan asked if this service was used by other clients. Mr. Lynch confirmed that it was and that he could gather of list of clients utilizing Empower's RSG service. Ms. Robbins, continuing on the topic of touchpoints, noted that this could also assist participants over the age of 50 by alerting them of the opportunity for catch up contributions.

- Mr. Magno asked if the touchpoints were milestone driven. Ms. Rooney confirmed that they were a combination of the age and goal milestones. Mr. Sheridan asked if the service was very interactive. Ms. Rooney confirmed it was, particularly for participants who would otherwise be less engaged.

- Human Resources Outreach Campaign: Mr. Lynch next informed the Committee that Ms. Rooney had developed a human resources outreach campaign to thank the departments which had hosted a SMART Plan seminar during the first quarter. Mr. Lynch noted that feedback had been positive.

  - Ms. Rooney added that, aside from the local Plan representatives, human resources managers are the primary advocates for the Plan to their agency employees. Ms. Rooney thanked Mr. Caruso and the Empower Retirement Operations Team for their efforts in the process as well. Ms. Rooney noted that Plan staff had received a very positive message and email from the Director of Recruitment at the Suffolk County Sheriff's Department. Ms. Rooney continued and noted that another outreach campaign targeting departments with high Plan participation rates would be rolled out soon, in addition to other potential recognitions. Mr. Sheridan voiced his appreciation of this campaign, acknowledging it as a great marketing effort for the Plan to recognize these managers.

- Electronic Remittance for Political Subdivisions: Mr. Lynch stated that Plan staff were working with Empower Retirement to improve payroll data among the political subdivisions outside of the HR/CMS state payroll system. Mr. Lynch noted that the project would promote payroll submission via a single format file, allowing for a more timely and accurate data submission process. Mr. Lynch stated that Ms. Rooney, Mr. Caruso, and the Empower Retirement Operations Team have worked with Harpers Payroll Services to develop a Brainshark webinar that would guide employers through the transition process. Mr. Lynch praised the success of these efforts to-date, with five of the 15 employers in the pilot group engaging with the Brainshark and transitioning to electronic submission. Ms. Rooney also noted that the electronic submission process would allow for automatic updated salary information details, improving the accuracy of lifetime income scores, as well as the addition of participant emails for Plan communications.

- Award Recognitions: Mr. Lynch next informed the Committee members that the STAY Campaign as first rolled out last year had received an Honorable mention at the HERMES Creative Awards in the category of Public Relations/ Communications Strategic Programs: Communication/Marketing Campaign. Mr. Lynch also noted that the Brainshark series received a HERMES Platinum award in the category of Electronic Media/Social Media/Interactive Media – Website Element: E-Learning. Mr. Lynch stated that these short, education videos were available on the SMART Plan website pre-login via the Learning Center link. Ms. Rooney continued and noted that additional Brainsharks would continue to be added to the Plan's website.

- Summary 2017 SMART Plan vs. 2016 NAGDCA Benchmark Report Data: Mr. Lynch directed the Committee's attention to the Summary of the 2017 SMART Plan vs. 2016 NAGDCA Benchmark Data chart. Mr. Lynch stated that Mr. Caruso would be elaborating on the statistics in the discussion later in the meeting as well.

In the interest of time, Mr. Sheridan asked Mr. Magno for any additional questions on the Executive Summary. With no further questions, Mr. Sheridan suggested moving on to the Market Review.

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

- Directing the Committee to Tab 6 of the meeting materials, Mr. Vandolder began speaking on Market Highlights. Mr. Vandolder began with a discussion on capital markets. Mr. Vandolder noted that the rate of return for the first quarter of 2018 was modestly negative across the board as a result of increased discussions surrounding trade tariffs. Mr. Vandolder stated that earnings remain strong. Mr. Vandolder cited that over a one-year period, small cap markets were up over 10%, while long-dated bonds returned around 6%. In closing, Mr. Vandolder noted the bond returns reflected the first negatives since 1984, and that he would let Looms Sayles further expound on the market conditions.

- Mr. Behrns then directed the Committee members to Tab 1, Page 2 of the materials. Mr. Behrns stated that Plan staff were currently developing Request for Responses (RFR) for a number of investment mandates. Noting that Plan contacts typically have an initial five-year term and cannot exceed a maximum ten-year term, Mr. Behrns added that investment management services have typically been procured either as needed, or otherwise every five to ten years, as applicable, and that a number of contracts were reaching the end of their initial contract term. Mr. Behrns commented that per his discussions with Plan staff, the RFRs are expected to be posted in June or July. Mr. Behrns remarked that the bidding process presents an opportunity to gain better fees. Mr. Behrns stated that it would also be beneficial to see other potential investment manager options, to add additional bench managers, should their services be needed in the future. Mr. Behrns noted that the availability of bench managers helps to avoid the potential for a 12 to 18-month RFR process, should there ever be a need for an immediate shift in managers. Mr. Lynch agreed with Mr. Behrns and confirmed that creating a bench of eligible managers was consistent with PRIM's practices. Mr. Lynch reiterated the importance of bench managers in the event a current investment manager loses key talent.

- Mr. Sheridan asked if the RFR process was time consuming. Mr. Lynch confirmed that it was. Mr. Lynch noted that RFRs must be posted for 45 days before bids can be submitted, followed by a review whether each bid met the specified minimum requirements. Per Mr. Lynch, each bid that is found to have met the minimum requirements will be evaluated by the procurement management team ("PMT") on the substance of the response, followed by scheduling and then holding in-person interviews with potential investment managers. Mr. Lynch thanked Ms. Robbins for her efforts to improve the efficiency of the process in recent years. Ms. Robbins then remarked that in terms of efficiency of the procurement process, there has been efforts to set a schedule for the PMT in advance. On the contract side of things, per Ms. Robbins, a bidder is notified that it has been selected to provide services to the Plan, she has worked to pre-schedule meetings, ultimately improving the efficiency of the contracting process. However, Ms. Robbins noted this also depends on the responsiveness of the investment managers.

- Mr. Magno asked if the RFRs were staggered between asset classes. Mr. Lynch responded that they typically were, but that the Plan was primarily looking to identify potential bench managers. However, Mr. Lynch noted that if a manager comes forward with a bid far superior to a current manager, they could be awarded a contract.

- Mr. Sheridan asked if the Plan uses referrals from other states to identify investment managers. Mr. Lynch responded that investment managers would be reviewed along with assistance from Aon Hewitt.

- Mr. Behrns stated that Aon Hewitt would be conducting due diligence meetings with several managers in the upcoming months. Mr. Behrns noted an upcoming meeting with Loomis Sayles on July 17th, and future meetings with Brookfield Asset Management, Income Research + Management, and Manulife Asset Management to be scheduled as well. Mr. Behrns also directed the Committee to the current list of bench managers for the Plan in various strategies.

- Turning the Committee's attention to the Fund Monitoring Summary, Mr. Behrns began by noting that all SMARTPath Target Date Funds are currently performing well and no action was required. Mr. Behrns continued with the core investment managers, and noted that the Large Company Blend Fund and Real Estate "REIT" Fund were each on watch due to short term underperformance. Mr. Behrns informed the Committee members that the Large Company Blend Fund was 1.2% below benchmark, a result of the majority allocation to the Vanguard Dividend Growth Fund, which has been out of favor for 18 months. Mr. Behrns then stated that the Real Estate "REIT" Fund also continues to underperform, primarily due to the active Brookfield Asset Management US Real Estate Securities Value Income Strategy, which had its share of fund assets reduced from 100% to 80% in July 2017. Mr. Behrns noted that the investment had recently rebounded in April and May, and that a due diligence meeting with Brookfield would be scheduled for

September. Mr. Behrns reiterated that long-term performance had been disappointing the past three-year period.

- Mr. Lynch asked if Mr. Behrns still suggested patience with the investment. Mr. Behrns confirmed and stated that Brookfield remains "Buy" rated by Aon Hewitt. Mr. Behrns then commented that the addition of the 20% passive State Street Global Real Estate Securities Index Fund to REIT allocation provided flexibility as well. Mr. Lynch noted the timing of the Plan's entrance into the Brookfield strategy was poor and reminded the Committee that it was Brookfield's decision to pass on storage unit investments that seemed to lead to this underperformance. Mr. Lynch asked Mr. Behrns if the investment remained 250 basis points (bps) below benchmark since inception in the Plan. Mr. Behrns responded that it was down 350 bps compared to benchmark for that timeframe. Mr. Vandolder stated that it normally takes between three to five years to see if an investment was a success. Mr. Vandolder acknowledged that the Brookfield investment continued to perform below benchmark over the past year, but that Aon Hewitt would still recommend staying the course. Mr. Sheridan asked if the investment management team at Brookfield had remained the same. Mr. Behrns confirmed.

- Continuing with a discussion on the Fund Monitoring Summary, Mr. Vandolder identified for the Committee three managers currently on watch. Mr. Vandolder reiterated the underperformance of the Vanguard Dividend Growth Fund. Mr. Vandolder then noted short-term underperformance from the Reams Asset Management Unconstrained Bond Fund, although he commented on a general downturn across the fixed income market likely having an effect. Finally, Mr. Vandolder cited the PIMCO Emerging Local Bond for its short-term underperformance, yet noted that long-term underperformance was only 20 bps.

  - Mr. Magno asked if managers are informed when they are on watch. Mr. Vandolder responded that normally Aon Hewitt and the plans it advises do not notify managers of the rating status, as managers should continue to invest according to their strategy, regardless. Mr. Vandolder continued and noted strong performance for both the Large Company Growth Fund and Large Company Value Fund.

  - Mr. Magno asked if Aon Hewitt performs investment manager evaluations at year-end. Mr. Behrns responded that it is more of a continuous process, but he recalled for Mr. Magno that year-end reviews are normally presented at the annual third quarter Committee in and around December, primarily to provide analysis on whether allocations in multi-manager funds remain appropriate.

- Mr. Behrns, in the interest of time, directed the Committee to the Recordkeeper Vendor Monitoring Summary. Mr. Behrns noted that Empower Retirement staff was on watch, following the discovery of an overweight to the REIT allocation in the SMARTPath Fund as mentioned by Mr. Lynch earlier in the meeting. Mr. Behrns clarified this was primarily related to the Operations Team.

- Mr. Magno asked if Mr. Karl Kroner, the Plan's Client Relationship Manager from Empower Retirement, remained with the Plan. Mr. Lynch confirmed that Mr. Kroner was retained by Empower Retirement. Mr. Sheridan asked if this was due to input by Mr. Lynch to Empower Retirement. Mr. Lynch confirmed, noting that he voiced his recommendation to retain Mr. Kroner, given Mr. Kroner's strong relationship with municipalities.

- Mr. Sheridan asked if there are there other recordkeepers that could be considered. Mr. Behrns confirmed that there were, but noted that transitioning recordkeeper services is often a difficult task. Mr. Vandolder continued by explaining that there has been a great deal of consolidation in the recordkeeper space in the last several years, and only a few firms would have the capability to recordkeep a plan of the Commonwealth's size and complexity. Mr. Vandolder then stated that there is often little competition during the bidding process, and that options were more limited in the public government sphere compared with the private sector. Mr. Magno asked about Fidelity recordkeeper services. Mr. Vandolder responded that Fidelity works primarily in the private sector.

- Mr. Vandolder continued noting that seven out of ten active managers in the Plan outperformed the benchmark in the past year. Mr. Vandolder cited a slight underperformance by the SMARTPath Target Date Funds, yet noted good performance over the past three-year period. Mr. Vandolder also informed the Committee that the PIMCO All Asset Fund, a bench manager for the SMART Real Return Fund, had recently been upgraded to "Buy" rated.

- Mr. Behrns updated the Committee that Aon Hewitt had recently begun rating managed account providers, and directed the Committee to the Aon *InBrief* review of Morningstar. Mr. Behrns noted that Advised Assets Group (AAG) utilizes Morningstar to make their investment decisions. Mr. Behrns stated that Morningstar remains one of the best in the industry, and confirmed that Aon Hewitt has them as "Buy" rated.

  - Mr. Lynch asked what Morningstar has as a typical fee. Mr. Behrns responded that Morningstar's fee was normally six to nine bps. Mr. Magno asked if managed account providers had always been rated by Aon Hewitt. Mr. Behrns responded that this was a new feature, and noted that this will continue to be an ongoing process. Mr. Lynch asked if Aon Hewitt also reviewed Financial Engines. Mr. Behrns confirmed and cited that they were rated as "Qualified." Mr. Behrns noted that only two of the five managed account providers were considered "Buy" rated.

- Finally, Mr. Vandolder directed the Committee members to Tab 5, noting that there the inaugural Aon Hewitt *Pathways* Newsletter could be found. Mr. Sheridan thanked Mr. Vandolder and noted that the newsletter was very well done.

Mr. Sheridan asked Mr. Magno if he had any additional questions on the Market Review. Mr. Magno responded in the negative. With no further questions, Mr. Sheridan suggested moving on to the Loomis Sayles Diversified Bond Fund Review.

V. Loomis Sayles – Diversified Bond Fund

At the invitation of the Plan, representatives from Loomis Sayles, who oversee the Loomis Sayles Core Plus Fixed Income separate account strategy for the Plan, were invited to present before the Committee.

Present on behalf of Loomis Sayles was: James Sia, CFA, Head of Relationship Management, Loomis Sayles; and Rick Raczkowski, Portfolio Manager, Loomis Sayles.

Mr. Sheridan welcomed the representatives from Loomis Sayles, and asked for comment about the impact of the current political climate on markets.

- Mr. Rick Raczkowski replied that President Trump has been very conventional with the Federal Reserve since assuming office then turned to Mr. James Sia to begin their presentation.

- Mr. Sia thanked the Committee for inviting Loomis Sayles in to present and introduced Mr. Raczkowski, Portfolio Manager for the Core Plus Fixed Income strategy. Mr. Sia referenced his previous experience as Portfolio Manager for Loomis Sayles and his working relationship with the Plan for the past five years. Mr. Sia also cited his experience at Wellington Management prior to joining Loomis Sayles.

- Mr. Sia stated that the firm had recently appointed former fixed income analyst Kathleen Bochman as Director of ESG at Loomis Sayles. Mr. Sia noted that Large Cap Core and Large Cap Value investments comprised only about 5% of Loomis Sayles's value. Mr. Sia also stated that Loomis Sayles would be closing a few of its equity strategies but would be launching Emerging Market Equity strategies. Mr. Sia noted that Loomis Sayles was structured as a series of boutique investment firms. Mr. Sia then commented that for the last three and five years, Loomis Sayles beat the benchmark by 87% and 89%, respectively. Mr. Sia proceeded to turn the discussion over to Mr. Raczkowski.

- Mr. Raczkowski began with a discussion on bond market environment. Mr. Raczkowski noted a significant backup in 10-Year Treasury yields this year, rising from 2,400 up to 2,900 early this year. Mr. Raczkowski cited synchronized global growth and recent tax cuts as positive trends going into 2018. Directing the Committee to page 15 of the Loomis Sayles handout, Mr. Raczkowski remarked that the shape of yield curve has been of significant interest lately, as demonstrated in the 2-Year to 10-Year yield spread. Mr. Raczkowski stated that this development has affected the portfolio positively, as Loomis Sayles retains a high allocation in maturities. Mr. Raczkowski stated that the yield curve flattens when the Federal Reserve raises rates.

- Mr. Raczkowski next noted that oil prices have risen recently following an OPEC cut in production, thereby pushing demand and oil prices up.

- Mr. Raczkowski then discussed TIPS. He explained that TIPS comprises a big position in the Plan's portfolio, at approximately 10%, adding however, the bulk of that allocation was long duration. Mr. Raczkowski added that TIPS are designed to be driven by CPI and noted that when TIPS break even and move up, it means TIPS are doing well and performing as designed, as reflected in the increase from 2% at the start the year to 2.19% by mid-April. He added that when U.S. yields go up, Emerging Markets goes down.

- Directing the Committee to page 17 of the Loomis Sayles handout, Mr. Raczkowski stated that investment grade corporate bonds had performed poorly, however, the high yield bond market had been steady, with spreads showing little movement.

- Moving on to currency markets, found on page 18 of the handout, Mr. Raczkowski noted the decline in the US Dollar in 2017 following synchronized global growth. Mr. Raczkowski stated that a strong global economy weakens the U.S. Dollar, and vice versa. Mr. Raczkowski noted the position in the portfolio of the Mexican Peso. Mr. Raczkowski cited volatility for the Peso following uncertainties surrounding NAFTA discussions, as well as a large selloff since April 15th. Mr. Raczkowski reaffirmed his position in the Peso, noting that it remains a cheap investment. Mr. Raczkowski added the Peso should resurge once NAFTA discussions and the upcoming Mexican presidential election in July have settled. Mr. Raczkowski also noted that Mexican government bonds were up 7%.

- Mr. Raczkowski noted that the portfolio had outperformed benchmark by 169 bps over the past year. He attributed this to the nonparallel shift in the yield curve resulting in a 67 bps gain. Mr. Raczkowski also noted that U.S. Treasuries and Securitized Credit, Investment Grade Corporate Bonds, and High Yield Bonds had all performed positively. Mr. Raczkowski continued with a further breakdown of Investment Grade Corporate Bonds, noting strong performance from Industrials.

  - Mr. Behrns asked whether the widening of yield spreads would result in a reversal. Mr. Raczkowski noted the 6% portfolio weight to High Yield Corporate Bonds, while Investment Grade Corporate was reduced to an underweight compared to benchmark allocation. Mr. Raczkowski noted the reduction has occurred over the past two years.

- Mr. Raczkowski shifted to a discussion on performance during first quarter timeframe. Mr. Raczkowski cited continued strong performance from U.S. Treasuries and Investment Grade Corporates, while continuing to benefit from a non-parallel shift.

  - Mr. Sheridan asked about the lack of allocation to life insurance. Mr. Raczkowski responded that several of the allocations are based on "bottom up" decisions, such as specific investment ideas brought forward by analysts, as opposed to a "top down" industry selection.

- Ms. Rooney asked why Mr. Raczkowski sounded surprised by the High Yield performance. Mr. Raczkowski noted that as Investment Grade Corporate yields were up by 20 bps, High Yield should have been up by 60 bps, as it was three times more volatile. Mr. Raczkowski stated his belief that we are in a late cycle right now, citing low default rates. Mr. Raczkowski attributed this to the current pause in global economic growth, but added that synchronized global growth should return. Mr. Raczkowski also noted that Investment Grade Corporate Bonds continue to look like an interesting investment, as well as High Yield, despite the portfolio reduction from 17% to 6% currently. Mr. Raczkowski also cited strong performance from BB and B bonds as a reason.

- Mr. Behrns asked what the typical portfolio allocation of High Yield was. Mr. Raczkowski responded that Loomis Sayles wants to have the best risk adjusted returns depending on the cycle, referencing the 2009-2014 period where there were higher allocations to High Yield. Mr. Raczkowski stated that the High Yield allocation reduction was a result of a current turning into the cycle. Mr. Raczkowski stated that the current shift was towards protecting capital, and that the portfolio remains aware of benchmark allocations.

- Mr. Vandolder asked if there was concern about the level of bond yield in the US, potentially leading to a "bond bubble." Mr. Raczkowski stated that Loomis Sayles is not supply side focused and so did not see a concern, particularly in light of the continuing trend of increasing budget deficit, both nominally and as a percentage of GDP. Mr. Raczkowski next referenced the additional $1.5 trillion stimulus package as a consideration, despite acknowledging a current economy that was operating close to capacity. Mr. Raczkowski then added that is why Loomis Sayles uses TIPS in the strategy and so he was not overly worried. Mr. Raczkowski stated that Loomis Sayles believes that what drives Treasury prices is inflation.

- Mr. Vandolder asked if Mr. Raczkowski could elaborate on the Guideline Summary portion of the materials. Mr. Raczkowski responded that these included fairly standard guidelines and limitations as relates to investments. Mr. Raczkowski noted that Loomis Sayles does like allocating to bank loans – but he was not sure if Loomis Sayles allocates to bank loans for the Plan. Mr. Sia stated that he would check on this.

- Concluding the discussion, Mr. Raczkowski directed the Committee to the Sector Allocation breakdown to demonstrate how the portfolio has changed over the past year. Mr. Raczkowski reiterated the reduction in High Yield allocation, while noting an overweight allocation to Non-US Dollar and Securitized Agencies. Mr. Raczkowski stated that the Securitized Agencies allocation remained underweight compared to benchmark.

- Mr. Behrns asked if the current level of Cash Equivalents was due to lack of opportunity in the marketplace. Mr. Raczkowski replied that the higher position in cash was really more a result of an interest in keeping overall portfolio duration down in conjunction with a cash inflow from a TIPS position that had matured. Mr. Raczkowski further clarified that the position included treasury bills.

- Mr. Sheridan asked what Mr. Raczkowski believed the core strength of the firm was. Mr. Raczkowski responded that the firm believed in fundamental research. Mr. Raczkowski noted that Loomis Sayles was renowned for credit analysis, and that the firm was dedicated to bottom up research, complimented by macro, sovereign bond, and securitized investment teams. Mr. Raczkowski concluded by stating that the firm worked very well together and had a philosophy built on collaboration.

- Mr. Sia thanked the Committee for their time. Mr. Sia remarked that, as a Massachusetts based company, they appreciated the relationship with the Plan.

Mr. Sheridan thanked Mr. Sia and Mr. Raczkowski for their presentation and insight.

11:57 a.m. Loomis Sayles departs.

VI. NAGDCA Benchmark Review

- Directing the Committee to the NAGDCA Benchmarking 2016 Highlights, Mr. Caruso began the discussion on plan environment. Mr. Caruso noted that, for purposes of the benchmarking highlights, the peer group for comparison would be plans over $5 billion in assets under management. In addition to the NAGDCA Benchmarking 2016 statistics, Mr. Caruso noted that statistics for Plan Year 2017 were included as well.

- Mr. Caruso stated that Plan assets had risen 15.1% from 2016 to 2017, up to $8.5 billion. Mr. Caruso next informed the Committee that the Plan had added over 4,000 participants in 2017, but that the Plan continued to maintain a 60:40 ratio of contributing accounts to non-contributing accounts. Mr. Caruso then gave a breakdown of non-contributing accounts including both those of current employees as well as those of non-current employees, such as retirees, terminated employees, and beneficiary accounts. Mr. Caruso cited positive trends from 2016 to 2017, noting that non-contributing current employees had declined, while the non-current employees group had risen by over 3,000. Mr. Caruso cited the additional efforts towards retention as a key aspect of this trend. Mr. Caruso also noted that, in 2016, the average age of Plan participants was 2.5 years older than the peer universe, further emphasizing the importance of account retention.

- Mr. Caruso continued with contribution statistics. Mr. Caruso noted that contributions had risen by 8%, or about $26 million, from 2016 to 2017. Additionally, per Mr. Caruso the overall average and overall median of Plan participants in 2016 outperformed the peer universe by over $1,000. Mr. Caruso stated that the overall average and overall median also outperformed the benchmark for the NAGDCA peer universe of all 457 plans, noting that all 457 plans have the additional benefit of Special Three-Year Catch-Up Provision.

- Mr. Caruso next discussed investment statistics. Mr. Caruso noted that 47% of all Plan assets in 2016 were invested in Large Cap or Small Cap investments, a figure which had risen to 48% in 2017. Mr. Caruso commented that this statistic indicated a high equity share amongst participant assets, as well as a high share of active investments per the investment breakdown. Mr. Caruso stated that the active share of total assets in 2016 was 79%, when inclusive of the SMARTPath Target Date Funds as active investments, compared to a benchmark of 70%. Mr. Caruso continued that the share of total assets for target date funds and stable value investments were in line with the peer universe benchmark, but cited a steady rise in the target date fund share. Mr. Caruso stated that the target date fund share would continue to rise due to its position as the qualified default investment alternative (QDIA). Mr. Caruso cited the Plan's low asset share of mutual funds when compared to benchmark, 10.7% to 17.7%, and the further decline in 2017 to 6.7% of total assets. Mr. Caruso explained that most Plan assets were invested in collective investment trusts (CIT) and separate accounts, which provided a big cost-saving benefit to participants compared to mutual funds.

- On the topic of distributions, Mr. Caruso directed the Committee to the full lump sum distribution statistics. Mr. Caruso noted that despite only 3,658 Plan accounts withdrawn via full lump sum distribution, about one-third compared to the peer universe benchmark, the total dollars distributed exceeded that of the peer universe. Mr. Caruso reiterated the importance of account retention, particularly as relates to high balance accounts, and cited retention efforts including the STAY Campaign, educational seminars, and managed account services as ways to promote the benefits of remaining in the Plan. On the topic of account transfers, Mr. Caruso noted that the Plan had doubled the number of total accounts transferred into the Plan compared to benchmark, with a total dollar figure surpassing benchmark by over $20 million as well. Mr. Caruso noted that total account transfers and rollovers out of the Plan had decreased by 161 accounts from 2017 to 2016. Mr. Caruso also noted that while the total dollars transferred out of the Plan in 2017 surpassed that of 2016, it was partially attributed to strong market performance increasing balances.

- Finally, on the topic of fees, Mr. Caruso noted that the Plan net administrative fee was 1 basis point less than the peer universe benchmark, 8 bps to 9 bps. Mr. Caruso stated that the Plan had a net investment fee in 2016 of 29 bps, 8 bps above benchmark, and had seen a further reduction for Plan year 2017 to 26 bps. However, Mr. Caruso explained that the higher net investment fee was participant driven, primarily due to the high share of costlier active investments by participants, rather than a true reflection of costlier investments compared to peers.

    - Mr. Magno asked about a statistic listed for managed accounts. Mr. Caruso responded that the NAGDCA Benchmarking Survey results noted that 48.9% of all respondents did not offer managed accounts. Mr. Caruso stated that managed accounts were a significant benefit offered by the Plan, but that it is a benefit many other plans do not offer. Mr. Magno asked Mr. Vandolder if Aon Hewitt had seen similar levels of adoption amongst its clients. Mr. Vandolder confirmed that only half of retirement plans offer managed account services thus far.

- ❖ Mr. Magno asked if it were possible to see a comparison of investment performance, such as a return on investment (ROI), across the Plan overall compared to benchmark. Mr. Behrns responded that it would be difficult to obtain, as investments were participant driven. Mr. Vandolder agreed. Mr. Sheridan suggested that Aon Hewitt could shows statistics for an overall ROI across Plan years for comparison. Mr. Behrns agreed that this data could be gathered.

- ❖ Referencing the NAGDCA Benchmarking Survey, Mr. Sheridan asked about the possibility of revisiting the discussion of loans, citing data that two-thirds of plans offer loans. Mr. Sheridan asked whether lack of loans in the Plan could deter participation. Mr. Lynch responded that while it may encourage additional participation for those seeking a provision for loans, it would also require another layer of administrative complexities. Mr. Sheridan asked Mr. Vandolder if there were statistics showing participation rates of plans which offered loans compared to plans that do not. Mr. Vandolder responded that was no significant comparison data at the moment.

  - Ms. Rooney recalled that Empower Retirement had spoken on the topic a few years prior. Ms. Rooney added that Empower Retirement also lacked any qualitative data to show significant participation variations between plans that offered loans and those that did not. Ms. Rooney also noted that while there was the belief that participants in plans offering loans may be more willing to select a "reach contribution," no data backed that assumption either. Ms. Rooney stated that, most notably, many participants were not aware of the Plan's lack of a loan provision until after enrollment. Mr. Lynch remarked that while the Plan may be an outlier for not offering loans, the Plan's intended goal remains as a retirement savings account. Mr. Sheridan thanked everyone for their responses, but affirmed a desire to continue following industry trends.

  - Continuing on the topic of loans, Ms. Robbins noted that this would be a decision requiring final approval from the Treasurer. Ms. Robbins stated that, from a philosophical perspective, the biggest concern with offering loans has been its potential impact on saving. Ms. Robbins emphasized that the average Commonwealth worker only receives a yearly pension of approximately $30,000, and could also have their Social Security benefit significantly reduced or eliminated due to the WEP and the GPO. Ms. Robbins also noted the unforeseeable emergency provision as a potential option for participants to access retirement savings, should certain requirements be met. Mr. Sheridan thanked Ms. Robbins, but reaffirmed his desire to keep watch of industry trends. Mr. Vandolder responded that the discussion can be reopened again at a future meeting. However, Mr. Vandolder reiterated that retirement savings remained the primary concern. Mr. Vandolder also noted the additional costs to be borne by participants that would elect to take a loan.

VII. Future Meeting Dates

Mr. Sheridan asked for future meeting dates to be determined based on what would be most convenient for attendees. Ms. Rooney stated that she would gather all available dates and forward them to the Committee members.

VIII. Miscellaneous

Mr. Sheridan asked Mr. Lynch if the Committee members could attend the upcoming Audit Committee Meeting, similar to the previous year. Mr. Lynch responded that he would inform the Committee members once the date became available.

Mr. Sheridan asked Mr. Lynch if it would be possible for Committee members to receive ID badges for One Ashburton Place. Mr. Lynch responded that the original request had been denied as ID badges were only available to employees within the building, but that he would submit the request once again.

Mr. Sheridan, on behalf of the Committee, presented a gift to Ms. Rooney in honor of her recent marriage.

Mr. Sheridan asked Mr. Lynch if there were any additional items. Mr. Lynch just added for the Committee's information that total Plan assets have doubled over the ten-year period, beginning just prior to the financial crisis in 2008. Mr. Lynch noted that this is noteworthy since Plan assets had dropped to $3.6 billion following the stock market crash in 2008. Mr. Lynch then added that the average participant Plan account balance in 2008 was $45,000, while it currently stood at just over $78,000.

IX. Close of Meeting

12:24 p.m. Close of Meeting.

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

<u>Documents Used at the Deferred Compensation Committee Meeting of June 13, 2018</u>

- Agenda for the June 13, 2018 Deferred Compensation Committee Meeting;
- Executive Director's Quarterly Update dated June 13, 2018;
- Minutes of the March 6, 2018 Deferred Compensation Committee Meeting;
- NTSA Letter dated April 18, 2018;
- Plan Quarterly Highlights Report, First Quarter 2018;
- Quarterly Investment Report, First Quarter 2018;
- NAGDCA Plan Performance Report;
- NAGDCA Benchmarking 2016 Highlights; and
- Loomis Sayles Handout, June 13, 2018.