Commonwealth of Massachusetts
Deferred Compensation Committee
Meeting Minutes

Wednesday, March 6, 2019

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; Henry Clay, Treasury Director of Investments; Laura Rooney, Director of Operations, Defined Contribution Plans; Emily Robbins, Counsel, Defined Contribution Plans; Giuseppe Caruso, Operations Associate, Defined Contribution Plans; Kevin Vandolder, Principal, Aon Hewitt Investment Consulting, Inc.; Chris Behrns, Senior Consultant, Aon Hewitt Investment Consulting, Inc; and Thomas Stork, Equity Manager Research, Aon Hewitt Investment Consulting, Inc. (via remote participation).

I. Opening:

With all committee members present, Committee Chair Mr. Sheridan called the meeting to order at 10:00 a.m.

II. Approve Minutes:

Mr. Sheridan cited no errors on the minutes of the December 4, 2018 meeting.

Mr. Sheridan made a motion to approve the minutes of the December 4, 2018 meeting. Mr. Curran seconded the motion to approve the minutes. Mr. Magno rounded out unanimous approval.

III. Executive Director's Quarterly Update:

- <u>SMART Plan Key Statistical Data</u>: Mr. Lynch directed the Committee's attention to the Key SMART Plan Statistics chart that was included in his memorandum. Mr. Lynch reported overall plan assets down to $8.519 billion at fourth quarter end but noted a recovery up to $9.275 billion as of February 26, 2019. Referring to the data included in his summary, Mr. Lynch highlighted details on increases in contributions and participant numbers over Q4 of 2017. Mr. Lynch cited a reduction in average full-time participant account balance, down to $73,862, but attributed this to market environment. Lastly, Mr. Lynch stated that the number of Roth accounts had increased 34.11% from the year prior, in part attributable to popularity amongst the younger participant population.

  On the topic of participation trends, Ms. Rooney noted the continued rise in participants contributing on the percentage basis, currently at 17%. Mr. Lynch agreed and noted that over 95% of participants were contributing on a dollar basis a decade earlier.

  - Mr. Sheridan asked whether most full-time participants elect to retain assets in the Plan or take a full withdrawal at retirement. Mr. Lynch responded that participants vary between maintaining their assets in the Plan, taking partial withdrawals, or taking full-withdrawals. Mr. Lynch noted that the addition of Empower's Retirement Solutions Group (RSG) service would seek to actively engage participants at retirement and communicate options, including option to and the potential benefits of remaining in the Plan.

- <u>High Yield Bond Fund Allocation Change</u>: In follow-up to the prior quarter's meeting, Mr. Lynch informed the Committee that the High Yield Bond Fund underlying allocation was adjusted from a 50% / 50% between the two managers to an allocation of 60% Nomura Asset Management and 40% Eaton Vance.

- <u>RFR Emerging Markets Debt – TDFs</u>: Mr. Lynch stated that the procurement process for an Active Emerging Market Debt Investment Services was complete and that Ashmore Investment Management Limited (Ashmore) has been selected. Mr. Lynch also noted that Goldman Sachs and PGIM (Prudential Financial) had been selected as pre-qualified managers for Active Emerging Debt Investment Services. Mr. Lynch stated that contracting with Ashmore is ongoing.

  - In response to a question from Mr. Curran, Mr. Lynch stated that both managers responded positively and immediately to the request to be on the pre-qualified list.

- <u>Statement of Work (SOW) for Audit Services</u>: Mr. Lynch informed the Committee that Clifton Larson Allen LLP ("CLA") had been selected to provide audit services for the 457(b) SMART Plan audit years 2018 through 2020 and that contracting is ongoing. In response to Committee member questions, Mr. Lynch and Ms. Rooney provided some background information about the firm, including the partner assigned to the Plan.

- Mr. Curran asked whether the auditor would need approval on an annual basis or if they were to remain for the length of the three-year contract. Ms. Robbins responded that she would review the contract but that the statewide contract should allow for termination of contract in cases of unsatisfactory work. However, Ms. Robbins noted continuity as one of the benefits of a multi-year contract, especially given the complexity of the Plan.

- 2016 and 2017 Financial Statements Audit Update: Mr. Lynch stated that the 2016 and 2017 Financial Statements are nearing finalization and that the 2016 audit report is expected to be issued shortly, with an Audit Committee Meeting to be scheduled. Mr. Lynch attributed the delay to the extensive work done on the 2016 financial statements which included the addition of a new, detailed fair-value table. However, Mr. Lynch noted that this work would allow for a rapid conclusion to the 2017 report.

- Automatic Enrollment for SMART Plan: Mr. Lynch informed the Committee that new legislation (H35) has been filed for the 2019-2020 legislative cycle in support of automatic enrollment for state employees as well as an optional adoption of auto-enrollment for participating municipalities.

    - Mr. Sheridan asked the Committee members if they would be comfortable submitting a letter of support on behalf of the Committee. Mr. Magno and Mr. Curran both responded in the affirmative. Ms. Rooney stated that she would notify the Committee members regarding the timeline for hearings on the legislation.

- Empower Retirement Organizational Changes: Mr. Lynch summarized recent organization changes to Empower Retirement's executive leadership. Mr. Lynch stated that these changes would have no direct effect on Plan activities, but noted that Dan Morrison, Head of Government Markets at Empower Retirement, would now report to Mr. Linton rather than Mr. Murphy.

- New Fee Structure: Mr. Lynch stated that the Plan has moved to the new hybrid fee structure as discussed in our previous meeting. Mr. Lynch stated that a communication was sent to participants regarding the new fee structure and that only a handful of calls had been received thus far regarding the change.

- E-Delivery: Mr. Lynch stated that the Plan has moved to e-delivery for participant statements effective March 1, 2019, and that all participants with a valid email on file would begin receiving quarterly statements via e-delivery if they do not opt-out of the service. Mr. Lynch stated that a communication was sent to participant, in conjunction with the new fee structure, regarding e-delivery and ability to opt-out.

- Paperless Distribution Processing: Mr. Lynch stated that in an effort to address concerns regarding fraudulent activity observed across Empower Retirement's client base, including fraudulent reproduction of paper distribution forms, the Plan will look to move to a paperless distribution process by the end of second quarter 2019. Mr. Lynch noted that the paperless distribution process would subject participants to additional authentication measures and would provide a more streamlined and better overall experience for participants.

- ❖ In response to an inquiry from Mr. Curran, Mr. Lynch stated that once any necessary documentation is complete, a targeted communication campaign strategy would be developed.

- ❖ Mr. Magno asked about the notarization requirement for forms and whether it should be required. Mr. Lynch responded that this was standard procedure for all Empower Retirement clients. Ms. Robbins continued and noted that the Plan would not want to move away from the standardized procedures instituted by Empower Retirement, which may lessen security.

- ▪ <u>MSRB Intent to Retire Data Integration</u>: Ms. Rooney stated that Plan staff are collaborating with State Retirement Board to collect "intent to retire" data on monthly basis, which would allow the Plan to have targeted conversations with participants prior to retirement about the benefits of remaining in the Plan and their distribution options. Ms. Rooney noted that currently the Plan would only be notified when a term date arrives on a participant file.

  - ❖ In response to a question from Mr. Curran Mr. Lynch explained that RSG will play a role in discussing with participants their retirement options as relates to the Plan, as would the regional representatives. Ms. Rooney added that this information would be included in the Retirement & Beyond Seminar presentation, which are a collaborative effort between the State Retirement Board and the Plan aimed at pre-retirees. Ms. Rooney stated that Plan staff were working to update the seminar and online webinar.

  - ❖ Mr. Sheridan asked if the State Retirement Board publicized events such as the Retirement & Beyond Seminar. Ms. Rooney responded in the affirmative.

- ▪ <u>Account Retention / Retirement Solutions Group (RSG)</u>: Mr. Lynch stated that the Retirement Solutions Group (RSG) service, offered through Empower Retirement, was designed to engage participants from enrollment through retirement. Mr. Lynch noted that initial results have shown a demonstrated effectiveness in asset retention. Referring to his memo, Mr. Lynch highlighted some statistics. Mr. Behrns commented on the potential benefits of asset retention, stating that this increased purchasing power of the investment managers within the Plan. In response to an inquiry from Mr. Magno, Mr. Lynch explained that total retained assets are calculated based on participants that have called to take a distribution but have not done so following the conversation. Finally, in reply to Mr. Sheridan, Mr. Lynch identified Thomas Farias, Head of Strategic Partnerships for RSG as the Plan's relationship manager for RSG.

Mr. Sheridan asked the Committee 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, page 92 of the Plan Quarterly Highlights Report, Mr. Behrns began with a review of capital markets, noting the significantly poor performance due to volatility across the capital markets in the fourth quarter of 2018. Mr. Behrns attributed this to a collection of factors including concerns over peak market conditions, the potential for rising interest rates, and geopolitics concerns such as talks of a U.S.-China trade war and continued concerns over Brexit developments.

  - Mr. Curran asked what attributed to the recent turnaround in the year-to-date. Mr. Behrns responded that the Federal Reserve's announcement of a pause on an interest rate rise has eased some concerns for investors. Mr. Behrns stated that current market conditions were indicative of a market transition period.

  - Mr. Curran next questioned what the market environment means for the Plan. Mr. Behrns responded that the Plan was participant driven and, as such, it was important for them to have an effective, diversified portfolio. Mr. Behrns added that the Plan does this by allowing participants to have a range of investment options, including growth, fixed income, and stable value investments, to construct an effective portfolio. Mr. Behrns also highlighted the SMARTPath Target Date Funds and a managed account option which both allow for a diversified portfolio based on retirement timelines. Mr. Lynch added that over 70% of Plan participants were utilizing some account management feature.

  - Mr. Magno asked what the net gain, excluding contributions and distributions, of the Plan was for 2018. Mr. Vandolder responded that they would request the data and include it for the next Committee Meeting.

- Moving on to Project Updates and Highlights, Mr. Behrns directed the Committee to Tab 1, page 2 of the Plan Quarterly Highlights Report. Mr. Behrns noted the recent request for response (RFR) posting for the Large Company Value Stock Fund, Large Company Blend Stock Fund, and Small Company Stock Fund investment management services.

  - Mr. Curran asked if the contract for investment management services were binding for the duration of the contract, and what the standard contract duration was. In response to a question from Mr. Curran, Mr. Lynch stated that the initial contract term is typically five years, with the option to extend for additional periods up to a maximum contract term of ten years. He added that a RFR can be issued for management services at any time.

- Mr. Behrns next informed the Committee that nine investment manager due diligence meetings have occurred thus far in 2019, both on location and via phone. Mr. Behrns stated that these meetings discuss the investment process and any changes to strategy or personnel. In reply to an inquiry from Mr. Sheridan, Mr. Vandolder responded that he and/or Mr. Behrns regularly attend on behalf of Aon Hewitt, while Mr. Lynch and/or Ms. Rooney attend on behalf of the Treasury.

- ❖ Mr. Curran asked if it would be possible to see comparative performance data between current and legacy managers, and whether this may prove useful for future manager selections. Mr. Vandolder responded that the data could be gathered.

- Moving on to the Fund Monitoring Summary, Mr. Behrns referred to page 4 of the Plan Quarterly Highlights and identified the funds on watch. Mr. Behrns commented on the relative performance of the SMARTPath Funds, noting the vintages either matched their respective benchmarks or underperformed by up to 50 basis points over the past five years. Mr. Lynch noted that although the SMARTPath Fund performance was in some cases below the respective custom benchmark, the peer ranking performance was quite strong.

  Mr. Behrns also noted that the Large Company Blend Fund, Small Company Blend Fund, and Real Return Fund were on watch status given the funds' underperformance over the short and medium-term time period.

With no further questions on market review, Mr. Sheridan thanked Mr. Vandolder and Mr. Behrns and complimented Aon Hewitt for their continued work on the quarterly market updates.

V. Target Date Funds – Defensive Equity Strategies Review/Discussion – Aon Hewitt

At this time, Thomas Stork, Equity Research Manager, of Aon Hewitt Investment Consulting, based in London, per request of Mr. Behrns and Mr. Vandolder participated via phone.

Mr. Stork briefly introduced himself and noted experience in manager research and research on quantitative equity strategies, primarily for low volatility investments.

- Mr. Behrns, recalling the most recent Committee Meeting where Alliance Bernstein (AB) recommended the potential addition of a defensive equity sleeve for the SMARTPath Target Date Fund vintages, began with a brief overview. Mr. Behrns stated that defensive equities typically only capture 80% of market upside, but only 60% of market downside. Mr. Behrns noted that traits of defensive equities can include low volatility and dividend-orientation.

  - ❖ Mr. Sheridan asked about the pros and cons of defensive equities. Mr. Behrns responded that the main pro for defensive equities was downside protection. However, Mr. Behrns noted that equity, typically a driver of investment growth, would lag in performance with defensive equities in bull markets.

  Mr. Behrns next added that the Plan already has numerous investment diversifiers available which could be utilized to achieve similar portfolio objectives across the SMARTPath vintages as defensive equities. Mr. Behrns stated that the Vanguard Dividend Growth Fund has similar characteristics to a defensive equity fund which could be utilized currently.

  - ❖ Mr. Sheridan asked what costs could be expected for a defensive equity fund management. Mr. Stork responded that the expense ratio typical ranges between

30 to 60 basis points. Mr. Vandolder confirmed that adding a defensive equity fund would increase costs due to active management.

Directing the Committee to page 60 of the Plan Quarterly Highlights Report, Mr. Behrns referred to historical performances of three typical defensive equity funds and noted that only one fund outperformed its respective benchmark, the MSCI AC World Index, over a five-year period.

- ❖ When solicited for his thoughts on this matter by Mr. Sheridan, Mr. Lynch responded that he agreed with Mr. Behrns and Mr. Vandolder regarding the comments on utilizing diversification.

- ❖ In reply to a question by Mr. Curran, Mr. Vandolder responded that if used, a defensive equity fund could be used across the vintages as determined by AB.

- ❖ Ms. Rooney asked about AB's rationale for a defensive equity option, given the numerous Plan diversifiers available to construct a portfolio. Mr. Vandolder responded that AB's research has shown the ability of defensive equity to provide downside protection in a difficult market environment and the potential positive effect that may have on long-term time periods.

- ❖ Mr. Magno asked if similar results to a defensive equity could be achieved by simply shifting away from equities to more conservative funds. Mr. Vandolder responded in the affirmative.

- ❖ Ms. Robbins asked whether they believed it to be worthwhile to pursue the procurement process for a defensive equity manager. Mr. Behrns responded that AB has not pushed significantly for it. Mr. Vandolder concluded that Aon Hewitt did not believe it necessary.

Mr. Sheridan asked for a motion regarding pursuing a defensive equity fund. Upon a motion by Mr. Curran, seconded by Mr. Magno and also supported by Mr. Sheridan, the Committee stated that it had considered AB's request and declined to support adding such a low volatility manager.

VI. Miscellaneous

Mr. Lynch proposed that the responsibility for future notation of Meeting Minutes be transferred to Aon Hewitt. Mr. Lynch noted that this service is currently provided by Aon Hewitt for the CORE Plan Investment Committee and that Aon Hewitt provides this service to several clients. Mr. Vandolder continued and stated that Aon Hewitt would provide minutes that more closely align with standard methods for other clients.

Mr. Curran stated that moving towards a more standardized approach may be beneficial. Ms. Robbins continued and noted that the meeting minutes are also an extensive process for Plan staff.

The Committee members unanimously articulated their support for Aon Hewitt to assume responsibility for Committee Meeting minutes going forward.

VII. Future Meeting Dates

Mr. Sheridan noted that he would be unable to attend the upcoming first quarter Committee Meeting as currently scheduled for June 3, 2019 and asked the Committee members and attendees regarding potential dates in early June that would be most convenient. The Committee Members and attendees agreed upon a tentative date of June 14, 2019. Ms. Rooney stated that she would circulate the invitation to the Committee members via email.

VIII. Close of Meeting

11:47 a.m. Close of Meeting.

- Motion to adjourn by Mr. Sheridan. Motion to approve by Mr. Magno. Seconded by Mr. Curran.

<u>Documents Used at the Deferred Compensation Committee Meeting of March 6, 2019</u>

- Agenda for the March 6, 2019 Deferred Compensation Committee Meeting;
- Executive Director's Quarterly Update dated March 6, 2019;
- Minutes of the December 4, 2018 Deferred Compensation Committee Meeting;
- Target Date Funds – Defensive Equity Strategies Review, March 6, 2019, Aon Hewitt;
- Plan Quarterly Highlights Report, Fourth Quarter 2018; and
- Quarterly Investment Report, Fourth Quarter 2018;