Commonwealth of Massachusetts
Deferred Compensation Committee
Meeting Minutes

September 14, 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; Laura Rooney, Director of Operations, Defined Contribution Plans; Giuseppe Caruso, Operations Associate, Defined Contribution Plans; Emily Robbins, Defined Contribution Plans Counsel; 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.; Eric Green, CFA, Senior Managing Partner, Director of Research, Senior Portfolio Manager, PENN Capital Management; and Heather Nolan, Senior Client Service Director, PENN Capital Management.

I. Opening:

Call to order by Committee Chair Mr. Sheridan at 10:00 a.m. Mr. Curran was also present to make the quorum.

II. Approve Minutes:

Mr. Sheridan made a motion to approve the minutes of the June 1, 2017 meeting, subject to the correction of two minor grammatical typos as noted by Mr. Curran. The motion was seconded by Mr. Curran.

Prior to the Executive Director's Quarterly Update, Mr. Sheridan and Mr. Curran congratulated the SMART Plan staff on their recent award recognitions. Mr. Lynch thanked the Committee members. Mr. Lynch confirmed that the SMART Plan Active Choice Enrollment Form had won the National Association of Government Defined Contribution Administrators (NAGDCA) 2017 Leadership Recognition Award, and that the SMART Plan Re-Start Campaign had been chosen as the recipient of the 2017 Gold Hermes Integrated Marketing Award.

- Mr. Sheridan asked how the Plan became aware of these awards. Mr. Lynch replied that the NAGDCA Leadership Recognition Award had been announced publicly and that the Plan had submitted an application detailing the SMART Plan Active Choice Enrollment Form. Mr. Lynch noted that the Treasury subsequently submitted a press release recognizing this award by NAGDCA.

- Mr. Vandolder lauded the recognition for the SMART Plan. Mr. Vandolder also confirmed that the Defined Contribution Plans department, which administers the SMART Plan, has been recognized for an award from *Pension & Investments* magazine on its upcoming Massachusetts 401(k) CORE Plan as well. Mr. Sheridan congratulated the staff for all their recognition.

III. Executive Director's Quarterly Update:

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 informed the Committee that Plan assets rose to just under $8.5 billion. Mr. Lynch continued with new enrollments, which totaled just over 2,700 through the first two quarters of the year.

    - ❖ Mr. Lynch cited the SMART Plan Active Choice Enrollment Form as a significant factor in the strong new enrollment numbers. Mr. Lynch also cited the recent communications campaigns as having a positive impact on participant contribution amounts.

    - ❖ Mr. Curran appreciated the positive statistics and complemented the Plan staff on their work. Mr. Curran requested if it would be possible to include previous quarter statistics on future SMART Plan Key Statistical Data Charts, for the purposes of comparison. Mr. Sheridan supported the idea as well. Mr. Lynch commented that this was no issue and that prior statistical data would also be included in the Committee's materials in the future.

- <u>Real Estate "REIT" Fund</u>: Mr. Lynch updated the Committee that, as had previously been discussed, the Plan had transitioned to an 80% active management / 20% passive management asset allocation of the Real Estate "REIT" Fund. Mr. Lynch reminded the Committee that the REIT Fund now has an 80% asset allocation to the active Brookfield

Asset Management US Real Estate Securities Value Income Strategy and a 20% asset allocation to the passive State Street Global Real Estate Securities Index Fund. Mr. Lynch confirmed that this transition took place on August 31, 2017. Previously, the Real Estate "REIT" Fund had a 100% allocation to the Brookfield strategy.

- H29 – An Act Relative to the SMART Plan: Mr. Lynch informed Committee members that House Bill 29 (H29) would allow for auto-enrollment of all new state employees, while municipalities would have the option to elect to implement auto-enrollment. Mr. Lynch stated that H29 had been referred to Joint Committee on Public Service and written testimony was submitted in support of the legislation by the Treasury on April 14, 2017. Additionally, Mr. Lynch noted that the signed letter of support from the Deferred Compensation Committee was submitted to the Joint Committee on Public Service on July 10, 2017. Mr. Lynch then commented that the Joint Committee on Public Service has seen some turnover since the Bill was assigned, including the departures of former Co-Chairs Senator Jennifer Flanagan and Senator James Timilty. Mr. Lynch added that Senator Cindy Freidman now serves as Chairperson and then confirmed there have been no recent updates on the status of the Bill.

At 10:05, Committee Member Tom Magno arrived.

- Glide-Path Services RFR: Mr. Lynch stated that on March 24, 2017 an RFR has been posted to procure a glide-path services provider for the SMARTPath custom target date funds. Per Mr. Lynch, the Plan currently uses AllianceBernstein ("AB") for its glide-path services and that the existing contract had been set to expire, having reached its ten-year limit. Mr. Lynch confirmed that following the procurement process, the PMT had recommended to the Treasurer that AB be awarded the contract to provide glidepath services to the Plan. Mr. Lynch noted that AB would also provide additional enhanced services, which include the rebalance of target date funds and creation of custom fund fact sheets, both of which were previously provided by Empower Retirement. Mr. Lynch also noted that AB would develop a custom microsite to link directly the SMART Plan site, which would allow SMARTPath participants to find more information on the underlying funds in their SMARTPath portfolio. Lastly, Mr. Lynch noted that as permitted by the RFR, two other bidders, Aon Hewitt and Manulife, had been added as pre-qualified glidepath services providers, and so may be used should the need arise over the course of AB's contract term.

    - Mr. Sheridan asked both Mr. Lynch and Mr. Vandolder as to whether AB had stabilized, specifically with regards to recent executive changes. Mr. Lynch confirmed it had. Mr. Vandolder confirmed as well, but noted that this has been monitored by Aon Hewitt. Mr. Vandolder noted that Aon Hewitt would review backup providers should any new developments occur.

    - Mr. Curran asked Mr. Lynch if SMARTPath fees decreased with the new AB contract. Mr. Lynch confirmed they would decrease.

- Mr. Curran asked if recent Manulife reorganizations would affect their pre-qualification for glidepath services. Mr. Behrns noted that the changes at Manulife were limited to upper level management and had come after the recent suggestions of a potential IPO of John Hancock, a Manulife company. Mr. Behrns confirmed that there were no changes with the investment teams that handle daily operations, and stated that Mr. Lynch had been notified of the situation. Mr. Vandolder then commented that Aon Hewitt continues to monitor Manulife. Mr. Vandolder added that despite the recent changes, CEO Paul Lorenz is a long-time and well-liked Manulife employee.

- International Equity Fund – Expense ratio reduction: Mr. Lynch informed the Committee that the MFS Institutional International Equity mutual fund would transition to a lower cost separate account vehicle on or about October 1, 2017. Mr. Lynch noted that the level of assets reached in the International Equity Fund had facilitated this move to a separate account vehicle with MFS. Mr. Lynch stated that the fee reduction for the underlying MFS International Equity account would be reduced from 71 basis points (bps) to 53 bps and the fund overall, including the allocation to Harding Loevner, would see a reduction from 75 bps to 62 bps. Mr. Lynch voiced his appreciation of the tremendous amount of work put forth by Ms. Robbins and Ms. Rooney, specifically the process to open foreign markets for the separate account.

  - Mr. Behrns continued on that point and stated that this transition would save the Plan approximately $160,000 a year in fees. Mr. Sheridan voiced his appreciation of the savings for the Plan.

- Key change in Empower executive management team for SMART Plan: Mr. Lynch informed the Committee about the recent change in the Empower Retirement management team assigned to the SMART Plan; specifically, he announced that Karl Kroner, Client Relationship Director, had been informed that he would be terminated from employment with Empower Retirement and replaced in mid-October. Mr. Lynch noted that this came as a surprise to the Plan staff.

  - Mr. Sheridan asked Mr. Lynch what had happened to cause the termination. In response, Mr. Lynch commented on the 20-year tenure that Mr. Kroner has had with the SMART Plan, which also spanned three separate recordkeepers. Mr. Lynch noted that Mr. Kroner had been an essential part of the establishment of numerous relationships on behalf of the Plan throughout the Commonwealth and of overall Plan growth. Mr. Lynch voiced his support of Mr. Kroner and stated that this decision was not based on performance. Mr. Lynch noted that Mr. Kroner had always been responsive to questions, prompt to follow up on Plan issues, and overall a very strong resource for institutional knowledge. Mr. Lynch once again informed the Committee that this was a surprise and that the Plan had communicated their concern to Daniel Morrison, Senior Vice President at

Empower Retirement. Mr. Lynch stated that Mr. Morrison took the feedback and was receptive of the concerns on the abruptness of the change and cited Mr. Kroner's development and ongoing maintenance of strong relationships across participating municipalities and state agencies. Separately, Mr. Lynch noted that Empower was considering retaining Mr. Kroner outside of his current position in another capacity.

❖ Mr. Magno asked Mr. Lynch to confirm whether Mr. Kroner's departure was initiated by Empower or Mr. Kroner himself. Mr. Lynch confirmed that Mr. Kroner had been let go by Empower and, thus, from his role with the SMART Plan as well.

❖ Mr. Vandolder stated that he had met briefly with Mr. Kroner and noted that Mr. Kroner referred to his and other departures at Empower as, "A replacement of people with technology." Mr. Vandolder confirmed that this change in culture at Empower was a concern for Aon Hewitt. Mr. Vandolder confirmed that Aon Hewitt would comment on this with Empower as well as continue to monitor the situation. Mr. Vandolder also stated that Empower was the sole respondent to the most recent RFR for recordkeeper services.

❖ Mr. Sheridan asked if there are good competitors for Empower as pertains to a future RFR for recordkeeper services. Mr. Vandolder confirmed that there are, but noted difficulty to attract companies to a public-sector retirement plan as compared to a private sector retirement plan.

❖ Mr. Sheridan asked if Mr. Lynch has been satisfied with the performance of Mr. Kroner. Mr. Lynch confirmed and noted the integral role of Mr. Kroner in Plan operations.

❖ Mr. Magno asked Mr. Lynch for details on the replacement for Mr. Kroner. Mr. Lynch responded that the Plan has been informed about Mr. Kroner's replacement and that the new staff member would be based in Philadelphia, PA.

❖ Mr. Magno asked Mr. Lynch what these types of transitions mean for Empower as a company. Mr. Lynch referenced Empower's recent acquisition of JP Morgan's recordkeeping services and noted some of these changes might suggest that Empower grew too quickly, which was cause for close monitoring. Mr. Lynch also cited Empower's philosophical change to a more streamlined operational mindset focused on technology. Mr. Lynch stated that despite the size of the Plan, this transition would also affect other plans as well, as Mr. Kroner served in a similar capacity for the New Hampshire Public Employees Deferred Compensation Plan.

- ❖ Mr. Magno asked Mr. Lynch when the current recordkeeper contract concludes. Mr. Lynch stated that the initial term would end in October 2019.

- ❖ Mr. Sheridan asked whether there are stipulations in the current contract that would allow for the possibility to cancel the contract, should additional concerns arise. Mr. Lynch noted that while this language does exist in the contract, cancellation has not been considered yet. Mr. Lynch noted that Empower's overall performance and service delivery has been strong. Mr. Lynch noted that the Plan and Aon Hewitt would monitor new developments.

- ❖ Mr. Sheridan asked for the price of the Empower recordkeeping services. Mr. Lynch noted it was seven basis points on Plan assets and therefore over $7 million in total.

- ❖ Mr. Vandolder asked whether it would be useful to bring Empower in for the next Committee meeting. Mr. Lynch and Mr. Sheridan voiced support for the idea.

- ❖ Mr. Magno noted his disappointment in the departure of Mr. Kroner. Mr. Magno stated that Mr. Kroner had been a strong representative of the Plan.

- ❖ Mr. Curran also voiced his concern, and reminded the Committee and Plan staff that the Plan participants are the priority. Mr. Curran agreed that no action should be taken yet, but to continue to monitor future development. Mr. Sheridan once again voiced support for Empower to attend the next Committee meeting.

- ▪ <u>Award Recognitions: SMART Plan Active Choice Enrollment Form</u>: Mr. Lynch revisited the topic of the national recognition of the SMART Plan Active Choice Enrollment Form. With the full Committee present, he again informed the Committee that the Plan was the recipient of the 2017 Leadership Recognition Award from the National Association of Government Defined Contribution Administrators (NAGDCA) based on its submission of the SMART Plan Active Choice Enrollment Form. Mr. Lynch stated that this has been a very effective program which has had a positive impact on Plan enrollments. Mr. Lynch reiterated that full-time Commonwealth employees do not contribute to Social Security and would require a ten-year vesting period with the State Board of Retirement in order to receive a pension benefit. Mr. Lynch referenced the SMART Plan Active Choice Enrollment Form as a way to address this shortfall in retiree benefits. Mr. Sheridan, Mr. Curran and Mr. Magno congratulated the Plan staff on their achievement.

  - ❖ Mr. Magno asked Mr. Lynch if either the award or the Active Choice Enrollment Form had received any recognition beyond the Commonwealth. Mr. Lynch noted significant interest by other public plans to potentially adopt a similar program.

- Mr. Curran suggested that perhaps news of this award should be included in the next SMART Plan Quarterly Newsletter. Separately, in regard to previous requests for additional Plan communication pieces, Mr. Curran confirmed that he has received email communications from the Plan and thanked the Plan staff their response. Ms. Robbins noted the importance and relevancy of certain communication pieces. Ms. Robbins specifically cited participants that fail to update beneficiary information, which can result in numerous challenges and legal fees for beneficiaries in order to claim inheritance of a participant's Plan assets.

- Award Recognitions: SMART Re-Start Campaign: Mr. Lynch announced that the Plan has been awarded the 2017 Gold Hermes Integrated Marketing Award based on Plan staff's submission of the SMART Re-Start Campaign. Mr. Lynch noted that the campaign targeted actively employed participants with an account balance that had stopped contributions. Mr. Lynch cited communications tactics which included a website banner, an email, a newsletter article, and a direct mail postcard. Mr. Lynch stated that the campaign had resulted in 578 participants resuming contributions. Mr. Sheridan and Mr. Curran voiced their approval and support for similar campaigns in the future.

- SMART Plan NextGen Website: Mr. Lynch directed the Committee's attention to a variety of screenshots for the upcoming SMART Plan website update. Mr. Lynch stated that at the end of the month the Plan will be moving to a new website experience that provides for a more intuitive participant experience. Mr. Lynch noted the similarities between the pre-login landing page of the current website and the new website. However, Mr. Lynch stated that the new post-login experience would be more customized to the individual, as it would demonstrate how current account balance, contribution rates, and outside savings and retirement accounts can affect a participants Retirement Score as pertains to the individual's projected income replacement goal. Mr. Lynch also cited a slider feature which would allow participants to see how small changes can impact their retirement score and replacement income in the future. Mr. Lynch continued and stated that participants can accept these contribution changes directly from the slider feature with one click if they so choose.

    - Mr. Sheridan asked Mr. Lynch about who creates the website. Mr. Lynch responded that Empower Retirement creates and hosts the website.

    - Mr. Magno asked Mr. Lynch whether the functionalities previously mentioned were already featured in the current website. Mr. Lynch confirmed that some features were available, but additional features would be available with the new website as well. Ms. Halberstadt noted that this type of "retirement picture" for participants has become preferred as a result of its one-click feature. Ms. Halberstadt stated that this streamlined approach would make this an actionable screen, which would significantly reduce the number of clicks a participant must currently make to complete an account change. Mr. Magno noted that these features were similar to those used previously in the managed accounts service, but would now be available to all Plan participants.

- ❖ Mr. Sheridan asked Mr. Lynch for his thoughts on the current measures Empower has taken in terms of cybersecurity. Mr. Lynch stated that he had recently visited the Empower site in Denver, CO. and had been impressed with the significant investment Empower has made in cybersecurity. Mr. Curran voiced concern over the simplicity of the current four-digit pin number for online account login. Ms. Rooney responded that the new site would have a two-step authentication process, which would prompt participants for a unique pin number as well as an additional piece of information provided by the participant.

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

- On the topic of market review, Mr. Behrns began speaking on capital markets. Mr. Behrns stated that the overall outlook has remained positive with demonstrated strong earnings in the markets. Mr. Behrns cited that large cap U.S. equities were up 3.1% while small cap U.S. equities were up 2.5%. Mr. Behrns also noted current high P/E ratios.

- Mr. Behrns stated that international equities have rebounded well recently and were doing even better that U.S. equities. Per Mr. Behrns, international equities were up 6.1% in the previous quarter, as well as Emerging Markets which returned 6.3%. Mr. Behrns cited increased economic expansion in Europe and the Emerging Markets as a significant impact on the returns. Mr. Behrns also noted strong currency appreciation versus the U.S. Dollar. As reason therefore, Mr. Behrns mentioned a strong U.S. Dollar in 2014 and 2015, that has since fallen. Mr. Behrns stated that non-U.S. equities have had more room to grow, which resulted in the current currency trends. Mr. Behrns cited ten-year returns on U.S. equities were 7%, while non-U.S. equities were 1%.

    - ❖ Mr. Sheridan asked Mr. Behrns how currency adjustments works. Mr. Behrns responded that U.S. currency has appreciated significantly over last two years, while Europe and Japan lagged behind. Mr. Behrns confirmed that U.S. yields had risen while non-U.S. had fallen. Mr. Behrns cited Germany as an example, as it had a negative interest rate as recently as two years ago. Mr. Behrns noted that during this time, money would be moved to markets that had higher yields, namely the U.S. Currently, Mr. Behrns stated that there was renewed economic expansion in Europe with an increased stimulus package, and that the European Central Bank may soon also raise interest rates.

- Mr. Vandolder continued on the topic of the current U.S. Dollar weakness. Mr. Vandolder stated that the market was fully valued, and that federal tax reform would be key in the upcoming month, but that there appeared to be no movement on the issue currently in Congress. In addition to tax reform being critical to capital markets, Mr. Vandolder commented that geo-political risks (such as the ongoing situation with North Korea) could derail capital markets.

- Mr. Vandolder continued with recent trends in equity markets. Mr. Vandolder cited a divergence in value and growth investments, and noted a rise in growth investments, specifically large cap growth. Mr. Vandolder stated that the Plan's Large Cap Growth investment managers have all performed well in the current market. However, Mr. Vandolder also commented that small cap managers have fallen behind, and he cited the Plan's small cap managers, such as NWQ and Dimensional Fund Advisors, who have underperformed recently.

- Mr. Behrns stated that credit spreads had tightened and that this has been advantageous for corporate bonds. Mr. Behrns cited the positive performance by both underlying managers for the Plan's Diversified Bond Fund.

- Mr. Behrns turned the Committee's attention to the Fund Monitoring Summary. Mr. Behrns noted no concerns with any SMARTPath Target Date Funds. Mr. Behrns stated that the Plan's Large Cap Blend Stock Fund was currently on watch, primarily as a result of the Vanguard Dividend Growth mutual fund, which has a 55% allocation for the Large Cap Blend Stock Fund. Mr. Behrns noted that the mutual fund had a dividend focus, which has become out of favor in the past year. Per Mr. Behrns, this is largely a driver of market environment and not about the underlying manager's skill. Mr. Behrns added that prior to July 2016, the mutual fund was outperforming benchmark by 510 bps and retains a "BUY" rating from Aon Hewitt. Mr. Behrns stated that no other funds were currently on watch.

- Mr. Behrns confirmed that Empower Retirement would now be closely monitored due to the recent removal of Mr. Kroner and the potential adverse effect this may have on the Empower management team. Mr. Behrns echoed the earlier statements by Mr. Lynch and noted that Aon Hewitt was also concerned with the change.

    - Mr. Magno, asked whether this type of monitoring was in place when Mr. Brett Neese left Empower. Mr. Lynch replied that the checklist of factors to watch for in regard to the recordkeeper was put in place when Mr. Neese left, in part as a result of his departure and other changes to the Empower executive team assigned to the Plan.

- Mr. Behrns noted that the SMARTPath Target Date Funds have now risen to 16% of Plan assets, which he attributed to its current status as the Qualified Default Investment Alternative (QDIA). Mr. Behrns once again cited strong performance across all SMARTPath Funds, with returns ranging from 5% to 17%.

- Mr. Behrns continued with a discussion of peer rankings of investments. Mr. Behrns stated that the SMARTPath Funds showed strong performance compared to similar target date fund year vintages. Mr. Behrns noted that the only performance laggard was the SMARTPath Retirement Allocation Fund. Mr. Behrns stated that these vintages are the most conservative and vary significantly between managers based on individual investment philosophies. Despite the performance, Mr. Behrns confirmed that Aon Hewitt was not concerned with the SMARTPath Retirement Allocation Fund, as its intention was to be a conservative option with the objective of capital preservation.

    - Mr. Magno asked what the fundamental difference between various target date fund vintages would be, aside from their intended timeline. Mr. Behrns replied that vintages may have different methodologies for moving the assets from one portfolio weighting to another, meaning different slopes or allocations may be used at different times for the same vintage. Mr. Behrns cited strong performance by AllianceBernstein over the years as the glidepath provider, and attributed this to their philosophy of strong equity investments.

- Mr. Behrns stated that index funds comprised 20% of all Plan assets. Mr. Behrns cited generally positive performance overall, but noted that when index funds showed strong performance, it could signal underperformance by active managers. Mr. Behrns stated that only the Small Company Stock Index Fund showed underperformance relative to benchmark, but commented that this was not something Aon Hewitt was concerned over.

- Mr. Behrns concluded on investment manager performance with some additional highlights. Mr. Behrns stated that the International Equity Fund was up 220 bps, and that the GMO Benchmark-Free Allocation has shown strong performance since its inception in the first quarter, up 310 bps. Mr. Behrns noted that the Small Company Stock Fund was one of the few detractors, down 180 bps.

- Mr. Behrns turned the attention to manager research items that he said could be found behind Tab 3 of the Committee's materials. Per Mr. Behrns, two of the research items were related Plan managers. Mr. Behrns began with the imminent departure of Vanguard CEO F. William "Bill" McNabb at year end. Mr. Behrns stated that this was not a cause for concern, as Vanguard had implemented a succession plan for the position, with current CIO Mortimer J. "Tim" Buckley to fulfill the duties of CEO in 2018. Mr. Behrns added that Mr. Buckley had been a long-time Vanguard employee, having started at the firm as an intern to the founder and moved up. Mr. Behrns stated that Gregory Davis, Global Head of Vanguard's Fixed Income Group, would replace Mr. Buckley as CIO. Mr. Behrns also noted that Dimensional Fund Advisors (DFA) Co-CEO and Co-CIO, Eduardo Repetto, would leave the company in September. Mr. Behrns stated that replacements for both Co-CEO and Co-CIO have been selected and that Aon Hewitt would monitor new developments, but confirmed there were no concerns with these transitions.

- Mr. Sheridan asked what was entailed by the “Co-” titles prevalent with DFA, such as “Co-CEO.” Mr. Vandolder responded that this was an established practice with DFA and common of their management style. Mr. Vandolder stated that this practice allowed for shared responsibilities amongst duties as well as constant coverage at these positions should there be an unexpected departure.

- Mr. Vandolder provided brief comment on the included research paper that, while written years ago, speaks to a continued trend of working to implement the strengths of defined benefit plans in defined contribution plans and noted a continued challenge with respect to some asset classes and the ability to provide sufficient liquidity to meet the demands of the defined contribution plans.

  - Mr. Vandolder concluded by stating that of the four points of advice for plan sponsors to offer participants, the SMART Plan has accomplished three, which include automatic escalation of contribution rate, account rebalancing, and low-cost managed accounts.

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

V. PENN Capital portfolio review

At the invitation of the Plan, representatives from PENN Capital Management, who oversee the PENN Capital Small Cap Equity separate account strategy for the Plan, were invited to present before the Committee.

Present on behalf of PENN Capital Management were Eric Green, CFA, Senior Managing Partner, Director of Research, Senior Portfolio Manager, PENN Capital Management; and Heather Nolan, Senior Client Service Director, PENN Capital Management.

Mr. Sheridan welcomed both Mr. Green and Ms. Nolan.

- Mr. Green stated he was excited to come in and speak about PENN Capital and the portfolio. Mr. Green said that he wanted to give an overview of the PENN Capital investment strategy, their investments and their outlook. Mr. Green commented that he also wished to highlight the uniqueness of the strategy as well as the performance.

- Ms. Nolan began with an introduction of Mr. Green. Ms. Nolan stated that Mr. Green has been with PENN Capital for 20 years and was the current Director of Research and Senior Portfolio Manager. Ms. Nolan also noted Mr. Green’s strong involvement with the Anti-Defamation League Philadelphia outside of the office. Ms. Nolan moved on to a brief introduction of herself. Ms. Green stated that she had joined PENN Capital one year ago and fulfilled a similar role with a Philadelphia based real estate investment firm prior to that. Ms. Nolan stated that she was an ardent supporter of local community arts and ballet.

- Ms. Nolan continued with a firm overview for PENN Capital Management. Ms. Nolan stated that PENN Capital was founded in 1987 and has been independent and employee owned throughout its existence. Ms. Nolan noted that there were 66 employees, 20 partners, and 25 members of the investment team. Per Ms. Nolan, PENN Capital currently manages $4.6 billion in assets, with $3 billion of that in high yield credit strategies. Ms. Nolan noted that most clients were institutional and non-discretionary, with $800 million managed for institutional clients. Ms. Nolan once again reiterated that the discussion would be focused on the PENN Capital Small Cap Equity separate account strategy.

    - ❖ Mr. Vandolder asked how the current investment strategy would fair for capacity. Mr. Green responded that he was comfortable with the strategy and that, like every strategy at PENN Capital, it was capacity constrained.

    - ❖ Mr. Sheridan asked who was on the 25-member investment team. Ms. Nolan responded that the team included nine portfolio managers, five traders and one research analyst. Mr. Sheridan asked if there was equality across the entire investment team. Mr. Green confirmed and noted that it is a collaborative effort on the investment team.

- Mr. Green continued and noted that the founder served as CIO and mentor to many of the PENN Capital staff. Mr. Green stated that he was the Director of Research and the largest partner in firm that was not a member of the founding family. Mr. Green stated that more equity would be given away by the founding family in the future, with their intended reduction to be down to roughly 50% of the firm.

- Ms. Nolan stated that the PENN Capital management team was thoughtful and conservative. Ms. Nolan continued that the firm has no debt on balance sheet, and has never had outstanding debt since its founding. Lastly, Ms. Nolan stated that PENN Capital maintained three to five years of operating expenses in cash equivalent on its balance sheet.

- Mr. Green noted that when he had started at the firm, PENN Capital only had $200 million in assets under management. Mr. Green attributed the continued growth of the business to the roughly 70 people who have worked or were currently employed with PENN Capital. Mr. Green stated that PENN Capital has been committed to growth, adding staff and expanding business even during less positive years. Mr. Green cited PENN Capital's move from suburban Cherry Hill, NJ to Philadelphia, PA during the 2008 recession as an example of PENN Capital's commitment to future growth. Mr. Green noted that this example was indicative of PENN Capital's ability to find opportunities for success in difficult moments. Mr. Green stated that PENN Capital did not reduce staff or salaries during this period, but rather chose to add people and expand operations.

- Ms. Nolan returned the discussion to the investment team and investment strategies. Ms. Nolan stated that PENN Capital used investment strategies from across the risk spectrum in order to identify relative value opportunities. Ms. Nolan noted that PENN Capital array of investment strategies were primarily with high yield credit and micro, small, and mid cap equities. Ms. Nolan stated that the PENN Capital investment managers are experts in the equity and credit issues in the companies they manage. Ms. Nolan also noted that portfolio managers are organized by responsibility for asset class, with some focused on equities, others on credit, and one or two managers focused on both. Mr. Green continued and noted that some large investment firms often divide investment strategy groups, while PENN Capital has all groups work together. Mr. Green noted that all PENN Capital credit managers were also equity managers, and vice versa.

- Mr. Green stated that PENN Capital had a stable team with minimal turnover. Mr. Green noted that this was partially due to the limited investment firm options in Philadelphia, but also stated that PENN Capital has allowed investment managers to have several options in terms of what sectors they focus in, which have attracted and helped retain managers. Mr. Green also cited significant incentives for strong investment performance. Mr. Green cited the firm's location near Philadelphia International Airport as a vital resource, as it has attracted regular visitors from a variety of companies.

- Ms. Nolan stated that PENN Capital recently added a quantitative research analyst, focused on risk management and quantitative research on investment.

- Ms. Nolan then articulated the key characteristics that set PENN Capital apart from its peers. Ms. Nolan cited the following: PENN Capital's integrated equity / capital approach (complete capital structure analysis); that they provide a liquidity advantage; and that they believe the investment structure is very client focused.

- Mr. Green then dived into the firm's investment philosophy and process, which balances credit and equity. Mr. Green cited the current disconnect in energy sector, and noted that bonds have gone up while stocks have fallen. Mr. Green stated that there was an opportunity here in the credit markets, and that PENN Capital believes that credit markets were indicative of future equity market trends. Mr. Green stated that when credit markets rise, equity markets would return strong performances in the future as well. Mr. Green noted that credit market analysis was a key component in the determination of PENN Capital's investments. Mr. Green also cited his regular attendance to high yield bond conference as an indicator of how important all different components are to the PENN Capital investment philosophy and process.

    - Mr. Vandolder asked Mr. Green for comment on the current overweight to energy and the current underweight to financials in the strategy. Mr. Green confirmed the current overweight investment in energy and noted that it had contributed to the recent fund underperformance. However, Mr. Green reaffirmed his belief in the energy positions and that the price would continue to rise and noted that there has been a long period where energy has stagnated. Mr. Green reiterated that PENN Capital looked for company specific catalysts to invest in. Mr. Green stated that energy was extremely valuable in the market currently, similar to telecommunications. Mr. Green acknowledged that they were underweight in REIT exposure, currently none, and also underweight in insurance. With respect to financials, Mr. Green indicated that he and his colleagues did not like many of the sub-sector categories, with the exception being regional banks, where they did see value.

- Mr. Green began a discussion of the PENN Capital economic outlook and noted that financials are a positive currently. Mr. Green also referenced that small business confidence was at a 20-year high while consumer confidence was at a 10 year high. Mr. Green continued and stated that he believed that there would be a tax bill approved in the near future. Mr. Green noted his belief that Congressional Republicans would not delay a tax bill for fear of potential backlash, particularly in regard to upcoming midterm elections in 2018. Mr. Green stated that small business confidence was positive for the economy overall.

- Mr. Green outlined the overall investment philosophy as the identification of companies as they move, by leveraging or de-leveraging, towards the Optimal Capital Structure. Mr. Green noted that the Optimal Capital Structure was not 100% equity, but rather a strategy where companies with suboptimal capital structure traded with those that have optimal capital structure. For this, Mr. Green noted that PENN Capital sought not only companies that lack leverage, but companies that had leverage as well. Mr. Green cited Wendy's Restaurant as an example, and noted that Wendy's had moved from a company with 85% franchises to 99% franchises. Mr. Green stated that Wendy's shift to increased franchises allowed it to carry more debt that it had previously. Mr. Green noted that Wendy's de-leveraged and later repurchased over $1 billion in company shares at $12 a share.

- On the topic of new idea generation, Mr. Green stated that everyone on the PENN Capital team looked for 30% to 50% appreciation in investments. Mr. Green noted that two to three members of the investment team must support an idea, and then the ideas are brought to the portfolio manager.

- According to Mr. Green, if you believe rates are going to go higher, it is a great time for PENN Capital, despite not having performed well since the inception of the Plan's investment with the firm.

- Mr. Green continued the discussion with the PENN Capital Five Factor Analysis for investment return profile. Mr. Green stated that the five factors: increase gross domestic product, declining or stable high yield spreads, rising Treasury rates, cyclical stocks leading defensive stocks, and a declining market correlation. Mr. Green noted that these are used to ensure a positive return for their portfolio. Mr. Green turned the Committee's attention to the PENN Capital Small Cap Equity Strategy Review handout, which showed additional graphs and numeric analysis of each of the Five Factors. Per Mr. Green, PENN Capital has historically performed well when all Five Factors have been in evidence. Based on this, he said they expect to outperform over the next five years.

- Mr. Green concluded the discussion with an overview of the year to date performance, which he acknowledged has been difficult for PENN Capital as a result of their investment philosophy and strategy. Mr. Green noted that cyclicals have underperformed relative to defensives and that the portfolio overweight to energy has also hindered performance. Mr. Green commented that if they took energy out of the portfolio, the portfolio would actually be outperforming YTD. Regardless, Mr. Green reaffirmed his commitment to the energy stock selections that have been made and noted that the energy market showed positive signs recently. Mr. Green stated his belief that this overweight to energy will help over time, and further if energy stock were excluded from the portfolio, PENN Capital would have outperformed benchmark.

- Mr. Green stated that healthcare and biotech have both shown strong performance in the year to date, and that consumer and financials continued to be a positive. Mr. Green also noted that acquisitions within the portfolio have helped PENN Capital performance as well.

- Mr. Green returned to the PENN Capital Small Cap Equity Strategy Review handout. Mr. Green noted a graph comparison of the PENN Capital Small Cap Equity Strategy performance against the Credit Suisse Leverage Equity Index. Mr. Green stated that the performances mirrored each other; when the Credit Suisse Index underperformed, the PENN Capital portfolio underperformed. However, Mr. Green noted that PENN Capital has consistently outperformed the benchmark in times of market growth. Mr. Green stated that there have been times when the markets have been in favor of the PENN Capital strategy as well as times when it has been out of favor, and that these periods may last two to three years Mr. Green reaffirmed that their performance would return. Mr. Green noted that PENN Capital was excited for the future and that their strategy of long term investment sought long term value. Mr. Green stated that he did not wish to be a manager that overreacts to market changes, but one that looked for at a long-term market view. Mr. Green thanked the Committee for the invitation to speak and stated his hope to be a strong resource for the Plan in the future.

    - ❖ Mr. Curran asked what the investment turnover for the portfolio was. Mr. Green answered that it was roughly 60% to 70% turnover, with the average timeframe of about 18 months the period they keep a company in the portfolio. Mr. Green noted that this amount of time allowed the investment team to see if the investment was a proper fit for the portfolio. Mr. Curran followed up and asked whether turnover was automatically triggered. Mr. Green responded that turnover was not automatically triggered, but that each company would be reassessed should there be a change in company philosophy, an acquisition, or other type of corporate events.

    - ❖ Mr. Magno referenced Mr. Green's earlier comment about PENN Capital's strategy differences compared to other managers and asked whether PENN Capital ever reevaluates its strategy based on highs and lows. Mr. Magno noted that PENN Capital overperformed when markets were favorable, but underperformed more than other managers when markets were unfavorable. Mr. Green responded that PENN Capital has tightened their risk management procedures since 2008 to manage through market highs and lows and that there are regular meetings with their risk management team every Friday. Mr. Green also noted that these weekly meetings are attended by an outside industry strategist as well. Mr. Green also informed the Committee that PENN Capital has also implemented a Red Flag List, where the five investments with the largest underperformance are identified. Mr. Green stated that in these instances, their analysts must have a discussion and explain why they should keep in the portfolio or subtract the investment. Mr. Green stated that PENN Capital does not want to force the sale of companies, but wants to have a discussion with analysts first to understand the investment. Mr. Green noted that this policy has benefited PENN Capital in the past and allowed them to hold companies which would soon be purchased and show positive performance. Mr. Green noted again that recent underperformance has been due to their investment style being out of favor in current markets, but that PENN capital had also had a spectacular 2013 for their investments. Mr. Green affirmed that when things can be tweaked from a risk management perspective, it was done. Lastly, Mr. Green noted the benefit of the SMART Plan's multi-manager approach. Mr. Green noted that while PENN Capital may be out of favor currently compared to other managers, their strategy would outperform in markets where others may underperform.

- ❖ Mr. Sheridan asked Mr. Green about PENN Capital's vote for or against SeaWorld Entertainment Inc. Chairman David D'Alessandro. Mr. Green responded that they had voted against Mr. D'Alessandro's re-election. With regard to the investment in SeaWorld Entertainment Inc., Mr. Green noted that it was currently at a very cheap price compared to its competitors, such as Six Flags. Mr. Green stated that this was a result of bad public relations after recent backlash against SeaWorld. Mr. Green stated that he believed it remained a good investment and noted that SeaWorld did amazing things for their animals. Mr. Green also cited that orca shows have ceased in favor of orca observations.

Mr. Sheridan thanked both Mr. Green and Ms. Nolan for their presentation. Mr. Green and Ms. Nolan thanked the Committee once again for having them.

12: 05 pm. With no further questions, the representatives from PENN Capital Management departed the meeting.

VI. Communications updates

- Mr. Lynch noted that the communications updates were covered in Executive Summary. Mr. Sheridan agreed and noted no further questions from the Committee.

VII. Misc.

- Mr. Magno asked Mr. Vandolder for his thoughts on the private equity strategy utilized by PENN Capital. Mr. Vandolder responded that Aon Hewitt supported the strategy and were in favor of managers that position themselves as private equity oriented while in a public market. Mr. Vandolder stated that he found this to be an impressive strategy, but noted its high volatility. Mr. Vandolder stated that the higher volatility was the rationale for its 20% allocation in the Small Cap Stock Fund portfolio, as opposed to a larger allocation. Mr. Vandolder stated that these styles have been some of the most successful for investment and that PENN Capital was a dynamic organization. Mr. Vandolder noted some skepticism with regards to the $2 billion overall portfolio for PENN Capital, which he regarded as small. Mr. Sheridan noted the unique culture of PENN Capital. Mr. Vandolder agreed.

- Mr. Sheridan asked Mr. Lynch about the status of the Committee's request to the Treasurer for representation at the Deferred Compensation Plan Audit Advisory Board. Mr. Magno articulated his interest in this matter as well. Mr. Lynch replied that this had been communicated to executive staff but that to-date there was no update to provide.

- Mr. Sheridan next announced that he had recently spoken with Governor Charlie Baker in regards to the Governor joining the SMART Plan video. Mr. Sheridan noted that Governor Baker would review the request with his advisors.

- Finally, Mr. Sheridan asked Mr. Lynch about the Massachusetts 401(k) CORE Plan, its current outreach to nonprofits, and how it would affect the SMART Plan. Mr. Lynch responded that the CORE Plan would be entirely separate from the SMART Plan. Mr. Sheridan asked how close the CORE Plan was to release. Mr. Lynch responded that the documents were almost finalized and that it should be launched at the beginning of the month.

VIII. 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 early December prior to the holidays. Mr. Lynch and Ms. Rooney agreed. Ms. Rooney stated that staff would look to schedule a meeting in early December and would distribute possible dates.

IX. Close of Meeting

12:12 p.m. Close of Meeting.

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

Mr. Magno departs the meeting.

12:15 p.m. Meeting Reopened.

Mr. Curran referred back to a discussion at the previous Committee Meeting in regard to when a quorum is established outside the Committee Meeting setting, and asked Ms. Robbins for additional details on the matter. Ms. Robbins explained that any discussion between two of the current Committee Members outside of the Committee Meeting on Plan matters and/or matters that are the subject of quarterly meetings would constitute a quorum, as a majority of the three-member Committee would be present. Ms. Robbins noted that, as an example, Mr. Curran and Mr. Sheridan could meet outside of the Committee Meeting setting, but were not allowed to discuss issues which pertained to the matters before the Committee without there being compliance with open meeting law notice rules, etc.

Mr. Vandolder asked why the Committee was solely comprised of three members. Ms. Robbins responded that the statute, Massachusetts General Laws Chapter 29, Section 38B, has the Committee formed by three members, with one member each selected the Governor, the Treasurer, and the Commissioner of Insurance.

Mr. Curran thanked Ms. Robbins for her responses.

12:21 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 September 14, 2017

- Meeting materials including Updates, Highlights, Research Report;
- Executive Director's Quarterly Update dated September 7, 2017;
- Minutes of June 1, 2017 Deferred Compensation Committee Meeting;
- Draft of the Commonwealth of Massachusetts Deferred Compensation SMART Plan NextGen Website; and
- DC Committee Meeting: September 14, 2017, PENN Capital Small Cap Equity Strategy Review Handout.