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STATE OF HAWAI'I
DEFERRED COMPENSATION PLAN
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July 15, 2016

ADDENDUM NO. 2

WRITTEN RESPONSES TO QUESTIONS RECEIVED ON THE REQUEST FOR PROPOSALS FOR AN ACTIVE CORE FIXED INCOME INVESTMENT OPTION FOR THE STATE OF HAWAII SECTION 457 DEFERRED COMPENSATION PLAN, RFP NO. DCP-16-1

This is to inform you that the Board of Trustees ("**Board**") of the State of Hawaii's ("**State**") Deferred Compensation Plan ("**Plan**") received the following written questions pertaining to the above-referenced RFP. After careful consideration, the Board hereby responds to these questions as follows:

Q1. *"Is the plan willing to accept a separate account vehicle?"*

A1. Yes.

Q2. With respect to item 'B.3. Performance' in the Scope of Work section, item c. refers to the "median Active Core Fixed Income manager universe" – *"would you mind confirming which universe the State of Hawaii uses to determine eligibility? Is the eVestment universe used for these purposes, or is a different universe preferred?"*

A2. Yes, the median Active Core Fixed Income manager return will be determined from the eVestment Active Core Fixed Income manager universe.

Q3. We noted that the General Conditions state that Hawaii State Law applies to the agreement. We would like to offer a collective trust vehicle; however, the trust provisions state that New Hampshire law applies (to the extent not pre-empted by ERISA). Investors in the collective trust vehicle sign a standard participation agreement that has the same governing law provision so that there is no conflict with the operation of the trust.

A3. (a) *"Will Hawaii consider a collective investment trust where the participation agreement specifies that a governing law other than Hawaii?"*

Please list this as a variance and the Board will consider it.

(b) *"As noted, the collective investment trust has a standardized participation agreement. The trust company may be able to satisfy some state requirements in a side letter (other than*

applicable law) but cannot include provisions that would change investor terms or the operation of the trust. Would Hawaii consider such investment option?"

Please list this as a variance and the Board will consider it.

Q4. In the State of Hawaii General Conditions, Clauses 2.c and 7: These provisions, relating to the CONTRACTOR'S assumption of liability and indemnification requirements, could be read to require the CONTRACTOR be liable to all investors for all losses; however we believe that is beyond the scope of what was intended. *"Please confirm that that the STATE is in accordance with such interpretation."*

A4. Yes. However, the provisions apply to any losses caused by the CONTRACTOR.

Q5. In the State of Hawaii General Conditions, Clause 6.a: *"Please confirm that this provision is not intended to prohibit the CONTRACTOR from engaging another investment advisory firm to subadvise some or all of the product's assets."*

A5. Yes, a CONTRACTOR is not prohibited from engaging another investment advisory firm.

Q6. In the State of Hawaii General Conditions, Clauses 24 and 42.b: We interpret these provisions to permit the CONTRACTOR to provide information, data and any other material to a government regulator of competent jurisdiction where required by law. *"Please confirm that the STATE is in accordance with such interpretation."*

A6. In general, yes (however, it depends on the information that is being requested to be provided and the other law's requirements).

Q7. In the State of Hawaii General Conditions, Clause 31 and 42.e: We interpret these provisions to permit the CONTRACTOR to comply with any and all record retention requirements to which it is subject under other federal or state law. *"Please confirm that the STATE is in accordance with such interpretation."*

A7. Yes, the CONTRACTOR is required to comply with all federal and state record retention provisions.

Q8. *"Does investment product requirement IIIB1b have any time period associated with it? In other words, is the firm unqualified if it has ever in its history been involved in any major litigation – say, even if the activities underlying the major litigation occurred 30 years ago? Five years ago?"*

A8. Yes, although there is no specific time period stated in the RFP, please describe all major litigation involving your firm or company.

Q9. *"Can you provide a definition of 'major litigation' as used in IIIB1b?"*

A9. There is no general definition of "major litigation". However, the State wants to ensure that the firm or company has not been involved in any major litigation that may have an adverse

impact to the Plan.

Q10. *"Does IIIB1b pertain to the entire firm or just the team managing the proposed investment vehicle?"*

A10. "Major litigation" would apply to the entire firm.

Q11. *"Are there any limits on allowable investments not represented by the Barclays US aggregate Index (i.e. Sectors, Credit ratings, etc.)?"*

A11. No.

Q12. *"Is there a target (or relative) return objective?"*

A12. No.

Q13. *"Can your administrator unitize a separate managed account allowing a separate managed account to be an acceptable vehicle proposal?"*

A13. Yes.

Q14. *"Can you provide additional information regarding appropriate investment guidelines? For instance, are there any limits for the mandate such as a maximum allowable below investment grade exposure?"*

A14. Please refer to the description of the investment option set forth in the RFP.

Q15. If we propose a separate account vehicle, *"Will the State of Hawaii unitize the vehicle?"*

A15. <u>See</u>, Q&A # 13.

Q16. Regarding the Scope of Work, Section C.1.A. Quarterly Reports on page 9, *"should we propose our 40-act mutual fund, we are able to provide all requested information with the exception of 5. Compensation paid to the Plan's TPA (in dollar amount). However, we believe this information will be provided by Prudential in the 408b2. From a reporting standpoint, will this meet the needs of Hawaii?"*

A16. No, the State wants the CONTRACTOR to independently confirm any compensation paid by the CONTRACTOR to the Plan's TPA.

Q17. Regarding the Scope of Work, Section C.2.B on page 10, *"the semiannual fund reports for our proposed 40-act mutual fund are dated April 30 and October 31. Are these time periods acceptable to Hawaii?"*

A17. Yes.

Q18. In addition to data as of December 31, 2015 (page 12), *"would it be helpful for us to also provide data as of March 31, 2016 and/or June 30, 2016?"*

A18. Yes, if they are presented as additional information.

Q19. Our offering is a registered 40 Act fund in which investors sign an account application rather than enter into an investment management agreement with the manager. As the fund manager, we act as fiduciary to the fund, and are not appointed as fiduciary by individual clients investing in the fund. *"In such instance, would the referenced Contract Execution referred to in the RFP (p. 34) not be applicable?"*

A19. The State enters into an "Agreement for Investment Product(s)" with every investment product provider in the Plan. However, the State may also complete and sign an account application, if necessary.

Q20. *"With reference to the Contract Execution (p.34 of the RFP), is a sample of the form contract available for review?"*

A20. No, each "Agreement for Investment Product(s)" is unique.

Q21. We note that Appendix D, State of Hawaii General Conditions (p. 41 of the RFP), simply states "see General Conditions" but these are not attached to the RFP. *"Is a copy of the General Conditions available for review?"*

A21. Yes, a copy of the State of Hawaii General Conditions is available on the Department of Human Resources' website at www.hawaii.gov/hrd.

Q22. *"What type of distribution vehicle (mutual fund, separate account, etc.) is used for the Plan's current investment in the PIMCO Total Return Bond Fund?"*

A22. The PIMCO Total Return Bond Fund is a mutual fund vehicle.

Q23. With regard to Appendix B (Standard Proposal Letter), *"what form of 'evidence' is required for an officer signing on behalf of an LLC? Would a certificate of incumbency stating that whoever signs is an authorized officer of the LLC be acceptable? Would this certificate also need to be notarized?"*

A23. The Board accepts corporate resolutions that identify the individuals who are authorized to bind the entity. If your certificate of incumbency is equivalent to a corporate resolution, the Board may accept it. The certificate of incumbency must be notarized.

Q24. Regarding Section III Scope of Work Group B General Information #3 Performance Requirements Sub-Section c. on page 9 of the RFP that states: Performance that has outperformed the median Active Core Fixed Income manager universe and the Barclays Aggregate Bond Index over a rolling three (3) and five (5) year period.

As of 3/31/2016, our proposed product has underperformed the Barclays U.S. Aggregate Bond Index over a rolling three (3) year period by .04% (gross returns). The three year

under-performance is largely due to the strategy having an effective duration of approximately 2.5 years shorter than the index listed above.

As of 31/2016, our proposed product has outperformed over the rolling five (5) year period.

"We ask that our strategy be provided an exemption to the rolling three year out-performance requirement in light of the narrow performance gap and meeting or exceeding all other requirements"

A24. The Board will evaluate each proposal under the Evaluation Criteria specified in the RFP.

Q25. We are looking for clarification under Section III, Scope of Work, Item B.2, Investment Strategy:

a. At least $500 million in assets under management (includes all investment vehicles for the proposed strategy), *"what is meant by this line?"*

A25. The State asks for confirmation that the investment product/option that the firm or company is proposing has at least $500 million in assets under management, that combined includes all investment vehicles such as mutual funds, separately managed accounts, collective trusts, etc.

Q26. *"Is Ms. Cynthia Akiyoshi the Issuing Officer who the RFP should be mailed to?"*

A26. Yes.

Q27. *"Is this mandate a part of a 457(b) plan sponsored by a government entity under the State of Hawaii?"*

A27. Yes.

Q28. Appendix D, Sections 7 & 8 – *"In the event that the company is not negligent, will the State of Hawaii consider carving out from the indemnity and cost of litigation obligations contained in Section 7 and 8, respectively, of the State of Hawaii General Conditions? Our proposed alterations to the language are below in italicized font."*

"7. Indemnification and Defense. The CONTRACTOR shall defend, indemnify, and hold harmless the State of Hawaii, the contracting agency, and their officers, employees, and agents from and against all liability, loss, damage, cost, and expense, including all attorneys' fees, and all claims, suits, and demands therefore, arising out of or resulting from the *negligent* acts or omissions of the CONTRACTOR or the CONTRACTOR'S employees, officers, agents, or subcontractors under this Contract. The provisions of this paragraph shall remain in full force and effect notwithstanding the expiration or early termination of this Contract.

8. Cost of Litigation. In case the STATE shall, without any fault on its part, be made a party to any litigation commenced by or against the CONTRACTOR in connection with this Contract *in which the Contractor is not negligent*, the CONTRACTOR shall pay all costs and expenses incurred by or imposed on the STATE, including attorneys' fees."

A28. Please list this as a variance and the Board will consider it.

Q29. Appendix D, Section 26 – In Section 26 of the State of Hawaii General Conditions, the State claims that they shall have complete ownership and the right to copyright the material sent to them. *"Is this negotiable?"*

A29. Yes.

Q30. RFP – VI. – Administrative Provisions, Section J – 1 Tax Clearance and Certifications, paragraph D - *"As a company incorporated in another state, we plan to submit the information required for the HCE portal. Must we complete the HBE portal (found when calling the DCCA) as well, including Form BB-1 (State of Hawaii Basic Business Application)?"*

A30. Yes, prior to contract award, companies must register with the DCCA to transact business in the State of Hawaii. Registration can be done through the HBE (Hawaii Business Express) "QuickFile". The QuickFile provides an online registration process. The business registration information is needed for the HCE portal which ensures vendor compliance under the State procurement regulations.

Q31. RFP – VI. – Administrative Provisions, Section K– Insurance - *"We have proposed amendments with the State's proposed Insurance provisions. Below in italics are our proposed changes. In bold are comments from our Legal department regarding our potential compliance with some of the provisions. Are these suggestions acceptable with the State?"*

"K. Insurance

1. The CONTRACTOR shall maintain insurance, *with carriers having A.M. Best rating of "A",* ~~*acceptable to the STATE*~~ in full force and effect throughout the term of the Contract as follows:

b. Professional liability insurance coverage – minimum of $5,000,000.00 per *claim and annual aggregate* ~~*occurrence*~~ provided that this policy shall contain the following clauses:

2. The State of Hawaii Deferred Compensation Plan is added as an additional insured with respect to operations and services performed for the State of Hawaii Deferred Compensation Plan. ***We cannot add the State's Plan as an additional insured to our Professional Liability policy. Our Professional Liability policy benefits the subsidiaries of our parent, which include _____LLC and we do not extend coverage to third parties. We can add the State of Hawaii Deferred Compensation Plan as an additional insurance to our General Liability policy. Our company maintains errors and omissions while performing professional services to the State of Hawaii Deferred Compensation Plan.***

2. The Contractor shall throughout the term of the Contract obtain and keep in force an ~~appropriate~~ errors and omissions liability insurance policy covering the CONTRACTOR against claims that may arise as a consequence of errors or omissions in providing services (including any such claims which may arise in connection with the services provided under the Contract). The provisions of this paragraph shall survive the expiration or earlier termination of the Contract.

3. The CONTRACTOR agrees to deposit with the STATE, on or before the effective date of the Contract, certificate(s) of insurance necessary to satisfy the STATE that the provisions of the Contract have been complied with, and to keep such insurance in effect and provide the certificate(s) of insurance to the STATE during the entire term of the Contract. Upon request by the STATE, the CONTRACTOR shall furnish a copy of the policy or policies." ***Our policy is proprietary and we do no give out copies.***

A31. Please list this as a variance and the Board will consider it.

Q32. Section III.B. states that the investment strategy shall have a strong adherence to an active core fixed income style mandate. The mutual fund that we would like to propose typically holds 60-80% of its assets in investment grade bonds across U.S. Government, Mortgage-Backed Securities, Emerging Markets, Investment Grade and High Yield Corporate, Bank Loan, and Collateralized Loan Obligation securities. *"Are there any sector constraints for this mandate?"*

A32. No.

Q33. *"If proposing a commingled fund vehicle, i.e., mutual fund or collective investment trust, for this mandate, is the investment manager required to enter into a Contract with the State of Hawaii, to adhere to the reporting requirements stated in Section III.C, to provide the certifications identified in Section VI.J, and to add the State of Hawaii as an additional insured as noted in Section VI.K.?"*

A33. The State enters into "Agreement for Investment Product(s)" with every investment product provider in the Plan, and the CONTRACTOR must comply with the requirements of sections III.C. ("Reports and Annual Meeting") and VI.J. ("Certifications Required Prior to Contract Award"). With respect to section VI.K. ("Insurance"), please list this as a variance and the Board will consider it.

Q34. Section IV.C., Question 3, states that the Board prefers to access the lowest cost investment vehicle. The lowest cost investment vehicle for our Core Plus Fixed Income strategy is our separate account vehicle. Our separate account vehicle, however, has a minimum account size of $100 million. *"Could this mandate at inception potentially be $100 million+? The RFP notes a mandate of $80 million for one manager or $40 million if split between two managers."*

A34. The State cannot forecast or guarantee the size of the Plan's assets that will actually be invested in the Active Core Fixed Income Investment Option that is selected. You may want to list investment options with different minimum investment amounts in your proposal.

Q35. *"Does this mandate fall under ERISA guidelines?"*

A35. No. However, the Plan does follow ERISA guidelines.

Q36. *"Standard Proposal Letter, requirement #1, are we able to include a response stating that while we agree with the specified requirements as listed, we respectively request to discuss certain sections for purposes of clarification and/or to determine mutually-agreeable terms, if needed."*

A36. Yes.

Q37. Scope of Work, Question #10.b., pg. 19, for this performance history question, the net returns that we provide are calculated using the highest stated fee schedule for the strategy that is being proposed, the Core Fixed Income Strategy. However, the Core Fixed Income Strategy has a tiered fee schedule. *"Is it acceptable to present the returns using the highest stated fee schedule, or would you prefer we provide the returns based on the tiered fee schedule?"*

A37. Fee proposals should be provided in the context of an estimated value of $80 million in assets. For clarification, it is best to include the fee schedule tiers.

Q38. *"We are proposing an institutional mutual fund for the Board's consideration. Since investment in a mutual fund is typically governed solely by the terms of the prospectus, would we need to enter into a contract and agree to the general conditions for an investment in said mutual fund?"*

A38. Yes, **the State enters into an "Agreement for Investment Product(s)" with every investment product provider in the Plan. <u>See also</u>, Q&A # 19.**

Q39. *"Does the STATE have a preference for a collective investment fund (CIF) vs. a mutual fund?"*

A39. No.

Q40. *"If investment in a CIF is feasible for the Active Core Fixe Income mandate, please note plans investing in the CIF enter into a standard Adoption Agreement with the trustee. The Adoption Agreement constitutes the contract between the plan and the trustee, on behalf of the CIF, and terms include representations and warranties necessary to confirm the eligibility of a plan to invest in the CIF, disclosure of CIF fees and expenses, conflicts disclosure and other matters. Generally terms of the Adoption Agreement are consistent across CIF investors. We would propose that the Adoption Agreement serve as the "contract" for the plan to invest in the CIF, rather than entering into a separate advisory contract. Is this an option that the Board would consider?"*

A40. No. <u>See</u>, Q&A # 19.

Q41. *"Can you provide further clarification of the meaning of Question 22 contained in Section C of the RFP: 'Describe how your company will guarantee to the STATE that said funds and investment shall never be diverted (through business failure or otherwise) by virtue of bonds furnished the STATE, escrow arrangements, securities pledged with the STATE, or otherwise'?"*

A41. Please provide policies and/or procedures that insure segregation of participant assets for purposes of safekeeping.

Q42. *"To address certain municipal advisor registration requirements, please confirm whether contributions to the plan currently or may represent either (1) proceeds of municipal securities or any other funds of a municipal entity that are deposited in an escrow account to pay the principal of, premium, if any, and interest on one or more issues of municipal securities, or (2) monies derived from the sale of municipal securities, investment income derived from the investment or reinvestment of such monies, or monies held in funds under legal documents for the municipal securities that are reasonably expected to be used as security or a source of payment for the payment of the debt service on the municipal securities, including reserves, sinking funds, and pledged funds created for such purpose, and the investment income derived from the investment or reinvestment of monies in such funds."*

A42. Only employee contributions, through payroll deductions or qualified rollovers into the Plan, are deposited into the Plan.

Q43. *"Can you please advise if the plan is a 457 or a 457(B) plan?"*

A43. The State of Hawaii Deferred Compensation Plan is a section 457(b) plan.

Q44. "To the extent that you are considering a collective investment fund, is the 'Firm' as referenced in the RFP, the trustee or the subadvisor?"

A44. That is up to each bidder.

Q45. *"How do you define the 'median Active Core Fixed Income manager universe'?"*

A45. See, Q&A #2.

Q46. *"Please provide a sample of what is required for Question A.19 which asks respondents to provide a statement of counsel that the service and products you intend to provide are legal and appropriate under relevant STATE and federal regulations, and that the company is licensed to do business in the State of Hawaii, or will be at the time of Contract commencement."*

A46. The State does not have a sample of this. Your counsel can draft an appropriate response.

Q47. Our insurance broker has informed us that insurance carriers of professional liability insurance for investment management services will not add clients as additional insureds. *"Accordingly, would the State consider removing the requirement in VI. Administrative Provisions, K.1.b.2 to name the State of Hawaii Deferred Compensation Plan from this RFP?"*

A47. Please list this as a variance and the Board will consider it.

Q48. *"If the State selects a separate advisory account bidder, will the State enter into a separate investment management agreement that complies with the Investment Advisers Act of 1940 that would be separately negotiated?"*

A48. See, Q&A # 19.

State. *"Please confirm whether the Contractor must obtain a General Excise Tax License in order to enter into a contract with the State even if the Contractor has no physical presence in the State and all services to be provided are performed outside the State."*

A49. The Board cannot give tax advice, and suggests that you consult your private tax attorney or expert on this.

Q50. We have identified two products that could be suitable. Although these offerings are pooled investment vehicles we believe that given the mandate size as well as your prior investment allocation in the space, these both present suitable potential strategies: (1) the first offering is a private commingled fund; (2) the second offering is a 40 Act Fund. The primary difference between the two funds is the liquidity profile (monthly for the commingled fund, daily for the mutual fund). *"We would appreciate any guidance you can provide on your preference of which investment offering you would prefer us to submit for proposal."*

A50. Please refer to Section II.B, Investment Option Being Sought.

BRIAN T. MOTO
Chairperson
Board of Trustees
State of Hawaii
Deferred Compensation Plan