

MINUTES OF THE REGULAR MEETING
OF THE BOARD OF TRUSTEES OF THE EMPLOYEES' RETIREMENT SYSTEM
HELD ON MONDAY, FEBRUARY 14, 2011
CITY FINANCIAL TOWER, 201 MERCHANT STREET, SUITE 1935
HONOLULU, HAWAII

ROLL CALL

Trustees present: Mr. Colbert Matsumoto, Chair
Ms. Jackie Ferguson-Miyamoto
Mr. Emmit Kane
Mr. Alton Kuioka
Ms. Pili'alo'ha Lee Loy
Mr. Jerome Rauckhorst
Mr. Wayne J. Yamasaki
Mr. Kalbert K. Young

Attorney: Ms. Diane Kishimoto, Deputy Attorney General

Staff: Mr. Wesley K. Machida, Administrator
Mr. Rodney June, Chief Investment Officer
Ms. Betty Tachibana, Recording Secretary

Guests: Mr. Neil Rue) Pension Consulting Alliance, Inc.
Mr. David Sancewich)

Ms. Julie Gonsch) The Northern Trust Company
Ms. Laurie Neu)

Mr. Andrew Betz) Macquarie Funds Management (USA) Inc.

Ms. Odetta Fujimori) Hawaii State Teachers Association - Retired
Ms. Donna Higashi)

Mr. Andrew Pereira) KHON2 News

Mr. Neil J. Tremblay) State Street Global Advisors
Ms. Lynn S. Blake)

Mr. Richard Clark) Northern Trust Global Investments
Mr. Chad Rakvin)

Mr. Charles J. Jacklin) Mellon Capital Management
Ms. Karen Q. Wong)
Mr. Greg B. Lindsey)

QUORUM

A quorum being present, Chair Colbert Matsumoto called the meeting to order at 10:57 a.m.

AMENDMENT OF AGENDA

On a motion by Mr. Kuioka, seconded by Mr. Yamasaki, and unanimously approved, the Agenda was amended to add:

- Executive Session, pursuant to HRS § 92-5(a)(8), to consider a

report of Heitman Capital Management regarding the Ka'anapali Golf Resort; and

- Executive Session, pursuant to HRS § 92-5(a)(8), to consider, deliberate, and act on BlackSand Capital Opportunity Fund I, L.P. real estate investment opportunity.

(Ms. Lee Loy left the meeting at 10:58 a.m.)

APPROVAL OF MINUTES –
REGULAR MEETING, NOVEMBER 9,
2010
SPECIAL MEETING, JANUARY 26, 2011

On a motion made by Ms. Ferguson-Miyamoto, seconded by Mr. Kuioka, and unanimously carried, the Board approved the Minutes of the meeting held on November 9, 2010, as circulated. On a motion made by Ms. Ferguson-Miyamoto, seconded by Mr. Rauckhorst, and unanimously carried, the Board approved the Minutes of the meeting held on January 26, 2011, as circulated.

(Ms. Lee Loy returned to the meeting at 11:00 a.m.)

PRESENTATIONS

HAWAII STATE TEACHERS
ASSOCIATION - RETIRED REGARDING
COST OF LIVING ADJUSTMENT

Chair Matsumoto welcomed to the meeting Odetta Fujimori and Donna Higashi of the Hawaii State Teachers Association - Retired (HSTA-R) to present HSTA-R's "COLA Fairness Proposal." The proposal, which HSTA-R believes has a stronger correlation to inflation than the current 2.5% non-compounded "COLA", provides for a compounded "COLA" that rises from 2.0 % for recent retirees, to 2.5% for retirees who have been retired for more than 10 years, and to 3.0% for retirees who have been retired for more than 20 years. HSTA-R asked the Board to consider a study on the HSTA-R proposal. If the Board does not conduct the study, HSTA-R will ask the Legislature for a resolution directing the ERS to conduct the study.

After their presentation, the Chair thanked Mses. Fujimori and Higashi and they left the meeting.

NORTHERN TRUST COMPANY –
CUSTODIAL RELATIONSHIP

The Chair welcomed Julie Gonsch and Laurie Neu of The Northern Trust Company to update the Board on its custodial relationship.

After their presentation, the Chair thanked Mses. Gonsch and Neu and they left the meeting.

PENSION CONSULTING ALLIANCE,
INC. – INVESTMENT PORTFOLIO
PERFORMANCE REPORT FOR 4TH
QUARTER 2010

Neil Rue and David Sancewich of Pension Consulting Alliance, Inc. (PCA) presented PCA's investment portfolio performance report for the 4th quarter of 2010. Highlights for the quarter were:

- As of December 31, 2010, the ERS portfolio had an aggregate value of \$11.2 billion. Over the latest quarter, the portfolio increased by \$596.3 million. Over the latest year, the portfolio increased by \$971.4 million.
- The portfolio generated a return of 6.2% during the quarter, outperforming the policy benchmark for the quarter by 20 basis

points. The portfolio ended the quarter generally in-line with the policy target allocations.

- Seven of ERS's ten domestic equity managers matched or outperformed their respective benchmarks over the quarter and all ten managers posted positive absolute returns: C.S. McKee, L.P.; Systematic Financial Management, L.P.; Bank of Hawaii; CM Bidwell & Associates; Mellon Capital Management; T.Rowe Price Associates; and Jennison Associates, LLC.
- Five of ERS's six international equity portfolio managers outperformed their respective benchmarks during the latest quarter: JP Morgan Asset Management, Philadelphia International Advisors, State Street Global Advisors, Acadian Capital Management, and Rexiter Asset Management LLC.
- Five of ERS's six active core managers outperformed their respective benchmarks for the quarter: Bishop Street Capital Management; Pacific Income Advisers; Bradford & Marzec, Inc.; Western Asset Management, Co.; and Oechsle International Advisors LLC.

MACQUARIE FUNDS GROUP (USA)
INC. – HITIP UPDATE

The Chair welcomed Andrew Betz of Macquarie Funds Group (USA) Inc. to present an update on HiTIP.

Mr. Betz reported that:

- Three regional funds and one national fund are actively reviewing Hawaii-based companies for investment potential.
- Regional allocation filled and one slot remaining in national allocation. The pipeline for additional HiTIP fund investments remains strong, especially for regional funds.
- To provide optimal coverage of investment opportunities of Hawaii-based companies, additional funds with Healthcare and Cleantech investment foci likely to be added to HiTIP portfolio.

AMENDMENT OF AGENDA

On a motion made by Ms. Lee Loy, seconded by Ms. Ferguson-Miyamoto, and unanimously carried, the Board amended the Agenda to include an Executive Session, pursuant to HRS § 92-5(a)(8), to hear the report on the status of specific potential HiTIP investments.

EXECUTIVE SESSION

On a motion made by Ms. Lee Loy seconded by Ms. Ferguson-Miyamoto, and unanimously carried, the Board entered into Executive Session, pursuant to HRS § 92-5(a)(8), to hear the report on the status of specific potential HiTIP investments.

REPORT ON THE STATUS OF SPECIFIC
POTENTIAL HITIP INVESTMENTS

On a motion made by Ms. Lee Loy, seconded by Mr. Kuioka, and unanimously carried, the Board emerged from Executive Session.

The Chair thanked Mr. Betz for his report and Mr. Betz left the meeting.

(Mr. Young was excused and left the meeting at 12:41 p.m.)

LEGISLATIVE COMMITTEE
RECOMMENDATIONS ON 2011 BILLS
AFFECTING THE ERS; APPROPRIATE
ACTION

The Administrator presented the Legislative Committee's recommendations on the 2011 bills that affect the ERS and reported on the status of the bills that were introduced at the ERS's request. The Administrator also reported that Senator Hee asked what the Board's position is on S.B. 1104 and S.B. 1269.

On a motion by Ms. Lee Loy, seconded by Mr. Kuioka, and unanimously approved, the Agenda was amended to add an Executive Session, pursuant to HRS § 92-5(a)(4), to consult with the Board's attorney on the Board's powers, duties, privileges and immunities, and liabilities regarding S.B. 1269.

EXECUTIVE SESSION

On a motion made by Ms. Lee Loy, seconded by Mr. Kuioka, and unanimously approved, the Board entered into Executive Session, pursuant to HRS § 92-5(a)(4), to consult with the Board's attorney on the Board's powers, duties, privileges and immunities, and liabilities regarding S.B. 1269.

EXECUTIVE SESSION, PURSUANT TO
HRS § 92-5(a)(4), TO CONSULT WITH
THE BOARD'S ATTORNEY ON THE
BOARD'S POWERS, DUTIES,
PRIVILEGES AND IMMUNITIES, AND
LIABILITIES REGARDING S.B. 1269

On a motion made by Ms. Ferguson-Miyamoto, seconded by Mr. Kuioka, and unanimously carried, the Board emerged from Executive Session.

After discussion, on a motion made by Ms. Ferguson-Miyamoto, seconded by Mr. Yamasaki, and unanimously carried, the Board adopted the following positions on bills affecting the ERS:

Bill No.	Description	Remarks/Comments	Board's Position
HB 174 SB 1029	Increases the members on the ERS board of trustees from eight to ten. Establishes county representation on the ERS board of directors.	County appointee shouldn't be appointed to represent the counties, but he or she should represent all members. There has always been a representative on the Board from the City over the past 20 or more years. If the trustee is from the county, then added travel costs of about \$5,000 per year and materials and other costs of about \$800 per year.	Oppose

Bill No.	Description	Remarks/Comments	Board's Position
HB 517	Provides annual lump sum payments for retirees at least seventy-five years old who have been in retirement for at least twenty years as of June 30, 2011; makes appropriation. (\$)	There are about 4,000 retirees who have been retired for at least 25 years and about 4,000 who are 75 years old and older.	Oppose
HB 589	Segregates teachers from all other employees for determination of employer normal cost, accrued liability contributions, and annual contributions by the State and counties to the employees' retirement system.	Would increase the employer-teacher contribution rate from 15% to 18% and decrease the employer-general employee contribution rate from 15% to 13%. May also encourage other groups to be separated out such as professors, judges, elected officials, etc.	No position
HB 673	Removes overtime and sick leave as part of the compensation upon which public employees retirement benefits is based for public employees who have less than five years of credited service as of 1/1/12.	The elimination of overtime would result in an approximate savings of \$3 million in FY2012 and the change in unused sick leave would also result in about a \$3.7 million reduction to the employer contribution funding costs for FY2012.	No position but support intent to reduce the ERS unfunded liability
HB 674	Changes the base for the average final compensation from the 3 highest to the 5 highest paid years of credited service for public employees hired after 01/01/2012.	This is one of the requirements in our administrative bill for pension reform for new hires after 6/30/2012. This should smooth out the AFC and spiking of salaries.	Support
HB 779	Requires state contributions to the employees' retirement system to be paid from the general fund on a quarterly basis. Requires payments to be made before the end of the fiscal quarter. Requires departments and agencies whose employees are paid from state non-general funds to reimburse the state general fund for advance contributions. Requires the departments and agencies to pay monthly interest at 0.25% on the reimbursements. Takes effect on 07/01/2011 and is repealed on 06/30/2015.	Currently, we receive the employer contribution payments monthly (one month after the due date). If it were to change to quarterly and be due one month after the end of the quarter, then this change would result in the ERS not being able to earn about \$3 - \$4 million in the first year and compounded thereafter.	Oppose
HB 816	Provides that, for a public employee who first enters service after 6/30/11, "compensation" for the purpose of calculating retirement allowances does not include overtime payments, differentials, supplementary payments, bonuses, and lump sum salary supplements. States expressly that the provision does not apply to a public employee who first entered service before 7/1/11.	This change in the definition of compensation would result in an approximate reduction to the FY2012 employer contributions of about \$1 million. See comments re SB 1269.	Oppose
HB 817	Establishes the percentage of "regular interest" credited to the retirement account of a public employee who first enters service after 06/30/11 at 2% as opposed to a public employee who first entered service prior to 07/01/11, whose regular interest percentage is 4 and 1/2%.	This change to the regular interest to 2% credited to the employee contributions would result in a \$2.5 million reduction to the employer contribution funding costs for FY2012.	Support the intent to reduce the ERS unfunded liability
HB 818	Provides, for a new public employee hired after 06/30/11, retirement service credit for unused sick leave that is half of the credit applicable to an existing public employee. Does not change the unused sick leave credit provisions for an existing public employee.	This reduction in the unused sick leave credit for benefit calculation purposes would result in about a \$1.5 million reduction to the employer contribution funding costs for FY2012.	No position but support the intent to reduce the ERS unfunded liability
HB 824	Requires the set aside from the general excise tax revenues of an amount equivalent to the unfunded accrued liability contribution by the State for state employees. Takes effect on 07/01/11.	Any monies set aside to pay down the unfunded liability will improve the funded status of the ERS.	Support
HB 835	Proposes a constitutional amendment to article VII, section 6 of the state constitution to authorize the legislature to deposit excess general fund revenues into a fund to fund pension benefits and other post-employment benefits for State employees. (ConAm)	Any monies set aside to fund the ERS would improve the funded status of the ERS.	Support

Bill No.	Description	Remarks/Comments	Board's Position
HB 1035 SB 1262 [BUF-17(11)]	Institutes a moratorium on the enhancement of Employees' Retirement System benefits until the system's funded ratio is at least eighty percent.	Administrative bill to prevent further decreases in the ERS funded ratio.	Support
HB 1036 SB 1263 [BUF-18(11)]	Adopts language, regarding death benefits for Employees' Retirement System member on qualified military service, required to maintain the tax-qualified status of the Employees' Retirement System and adopts provisions, for the commencement of benefits, required to maintain the tax qualified status of the Employees' Retirement System.	Administrative tax compliance needed to maintain the tax exempt status of the ERS. Also, would require the ERS to pay out minimum distributions to those over 70 ½ years of age. Currently, estimated payouts would amount to approximately \$360,000.	Support
HB 1037 SB 1264 [BUF-19(11)]	Sets the rates for employer contributions to the Employees' Retirement System.	Administrative bill that sets the employer contribution rates based on the pension reform for new hires in HB 1038 and SB 1265. Should some or all of the pension reforms for new hires not pass, then the employer contribution rates would require increases.	Support
HB 1038 SB 1265 [BUF-20(11)]	Provides for retirement benefits for State and county employees who become members of the Employees' Retirement System after June 30, 2012.	Administrative bill that changes benefit requirements for new hires. Does not include the change to increase the retirement age.	Oppose but replace with SB 1341
HB 1042 SB 1269	Amends the definition of "compensation" for the purpose of calculating retirement benefits.	This change in the definition of compensation would result in an approximate reduction to the FY2012 employer contributions of about \$1 million. Would cause current active members to retire sooner (negative impact on unfunded liability); may be subject to legal challenge.	Oppose
HB 1092 SB 1319	Makes various amendments to the tax laws including indexing income tax amounts for inflation; excluding pension income from income tax only for certain persons; eliminating the deduction for state income taxes paid; eliminating the income tax exclusion for certain persons involved in copyrights; and modifying the tax rate on timeshare occupants and modifying the tax base upon which these persons are taxed.		No position
HB 1142	Provides for the retirement age for state and county employees who become members of the ERS after 6/30/12.	Includes change to increase the retirement age as well as other pension reforms described in HB 1038 and SB 1265.	Support with amendments consistent with SB 1341
HB 1143	Reduces the investment return yield rate assumption for ERS for the fiscal year ending 06/30/11, to 7 3/4%. Authorizes the ERS board of trustees to set the investment return yield rate assumption after 06/30/11, based on recommendations of the actuary.	Sets the investment return rate assumption as recommended by the ERS Actuary and approved by the ERS Board of Trustees.	Support
HB 1208	Amends the Hawaii Revised Statutes relating to employees' retirement system.	Short form	---
HB 1448	Temporarily allows members of the ERS with 10 or more years of service and are at least 55 years of age to retire without penalty.	Would substantially increase the cost of the ERS and require increased employer contributions.	Oppose
HB 1479	Establishes qualified domestic relations orders by which the employees' retirement system is required to make payments to an alternate payee of benefits payable to a retiree or member.	Would require a change to the ERS computer system and operations that may increase its operating costs for FY2012 by \$200,000.	Oppose

Bill No.	Description	Remarks/Comments	Board's Position
SB 64	Proposes a constitutional amendment to article XVI, section 2, of the Hawaii State Constitution to require the forfeiture or reduction of benefits of any member of the employees' retirement system who is convicted of a felony related to the member's employment with the State or any political subdivision thereof. (ConAm)	Would decrease the ERS's total accrued liability.	No position
SB 74	Proposes a constitutional amendment to article XVI, section 2 of the Hawaii State Constitution to authorize the legislature to allow the judiciary to reduce the pension benefits of any member of the employees' retirement system who is convicted of a felony related to the member's employment with the State or any political subdivision thereof. (ConAm)	Would decrease the ERS's total accrued liability.	No position
SB 75	Requires a court that sentences a public employee for a felony for conduct related to the public employee's duties to order that all or a portion of the public employee's benefits be forfeited to the credit of the pension accumulation fund.	Would decrease the ERS's total accrued liability.	No position
SB 183	Allows the surviving spouse or surviving reciprocal beneficiary of a police officer, firefighter, deputy sheriff, or public safety officer in the employees' retirement system who died in the line of duty to remarry, marry, or enter into a new reciprocal beneficiary relationship and to continue to receive pension and other retirement benefits arising from their former spouse's employment. Allows for the reinstatement of benefits.	Would increase the ERS's total accrued liability.	Oppose
SB 450	Short form bill		---
SB 463	Short form bill		---
SB 649	Provides annual lump sum payments for retirees at least seventy-five years old who have been in retirement for at least twenty years as of June 30, 2011; makes appropriation. (\$)	There are about 4,000 retirees who have been retired for at least 25 years and about 4,000 who are 75 years old and older.	Oppose
SB 1104	Segregates teachers from all other employees for determination of employer normal cost, accrued liability contributions, and annual contributions by the State and counties to the employees' retirement system.	Would increase the employer-teacher contribution rate from 15% to 18% and decrease the employer-general employee contribution rate from 15% to 13%. May also encourage other groups to be separated out such as professors, judges, elected officials, etc.	No position
SB 1216	Reduces the investment return yield rate assumption for the employees' retirement system for the fiscal year ending June 30, 2011, to seven and three-quarters percent and authorizes the board of trustees of the employees' retirement system to set the investment return yield rate assumption after June 30, 2011, based on recommendations of the actuary.	Sets the investment return rate assumption as recommended by the ERS Actuary and approved by the ERS Board of Trustees.	Support
SB 1341	Amends retirement benefits for state and county employees who become members of the employees' retirement system after June 30, 2012.	Includes change to increase the retirement age as well as other pension reforms described in HB 1038 and SB 1265.	Support
SB 1445	Deducts the period of time between the earliest instance of criminal conduct by a public employee and criminal conviction for the conduct from the calculation of credited service for purposes of pension benefits calculation.	Would decrease the ERS's total accrued liability.	No position

Bill No.	Description	Remarks/Comments	Board's Position
SB 232	Extends the same rights, benefits, protections, and responsibilities of spouses in a marriage to partners in a civil union. Takes effect 1/1/2012.		No position. However, inform committee chairs that the Bill needs technical amendments to be consistent with ERS statutes.

(Mr. Machida and Mr. Rauckhorst left the meeting at 2:00 p.m.)

NEW BUSINESS

INVESTMENT MANAGER WATCH STATUS

The Chief Investment Officer (CIO) reported that due to recent performance results of Goldman Sachs Asset Management (GSAM), PCA recommends that GSAM be placed on watch status to be closely monitored over the next 9- to 15-months. GSAM's short-term performance reflects underperformance on a rolling 12-month basis for three consecutive months.

The CIO reported that during the 28-month watch period ending December 31, 2010, Western Asset Management Co.'s (WAMCO) performance has improved and outperformed its benchmark. PCA is recommending that WAMCO be removed from watch status.

On a motion made by Mr. Kane, seconded by Mr. Kuioka, and unanimously carried, the Board placed GSAM on watch status due to short-term underperformance and removed WAMCO from watch status as a result of improved performance.

(Mr. Rauckhorst returned to the meeting at 2:03 p.m.)

(Ms. Lee Loy left the meeting at 2:03 p.m.)

GLOBAL INFLATION-LINKED SECURITIES INVESTMENT POLICY

The CIO presented proposed language for the Investment Policy addressing the Global Inflation-Linked Securities (GILS) strategy. The language has been reviewed by the finalist GILS manager selected by the Board to run the GILS mandate and ERS legal counsel.

On a motion by Mr. Kane, seconded Mr. Kuioka, and unanimously carried, the Board adopted the proposed GILS policy changes as presented.

EXECUTIVE SESSION

On a motion made by Ms. Ferguson-Miyamoto, seconded by Mr. Rauckhorst, and unanimously carried, the Board entered into Executive Session to:

- consider a report of Heitman Capital Management regarding the

Ka'anapali Golf Resort;

- consider, deliberate, and act on BlackSand Capital Opportunity Fund I, L.P. real estate investment opportunity;
- meet with and evaluate priority-listed finalists for passive global equity manager and, if appropriate, to select a passive global equity manager; and
- approve the Executive Session minutes of the meetings held on November 9, 2010, and January 26, 2011.

(Ms. Lee Loy returned to the meeting.)

BLACKSAND CAPITAL OPPORTUNITY
FUND I, L.P. REAL ESTATE
INVESTMENT OPPORTUNITY

REPORT OF HEITMAN CAPITAL
MANAGEMENT REGARDING THE
KA'ANAPALI GOLF RESORT

(Ms. Kishimoto was excused from the meeting.)

APPROVAL OF EXECUTIVE SESSION
MINUTES –
SPECIAL MEETING, JANUARY 26, 2011

MEET WITH AND EVALUATE
PRIORITY-LISTED FINALISTS FOR
PASSIVE GLOBAL EQUITY MANAGER
AND, IF APPROPRIATE, TO SELECT A
PASSIVE GLOBAL EQUITY MANAGER

APPROVAL OF EXECUTIVE SESSION
MINUTES –
REGULAR MEETING, NOVEMBER 9,
2010

On a motion made by Ms. Lee Loy, seconded by Mr. Yamasaki, and unanimously carried, the Board emerged from Executive Session.

ADJOURNMENT

On a motion made by Ms. Lee Loy, seconded by Mr. Yamasaki, and unanimously carried, the Chair adjourned the meeting at 4:32 p.m.

REDACTED

Wesley K. Machida
Administrator

WKM:bmt