

MINUTES OF THE REGULAR MEETING OF THE
BOARD OF TRUSTEES OF THE EMPLOYEES' RETIREMENT SYSTEM
OF THE STATE OF HAWAII

FEBRUARY 9, 2015

CITY FINANCIAL TOWER
201 MERCHANT STREET, SUITE 1200
HONOLULU, HAWAII 96813

Trustees present:

Ms. Pilialoa Lee Loy, Chair
Mr. Vincent Barfield, Vice Chair
Ms. Jackie Ferguson-Miyamoto
Mr. Patrick Frane
Mr. Wesley Machida
Mr. Colbert Matsumoto
Mr. Emmit Kane
Mr. Jerome Rauckhorst

Staff present:

Ms. Kanoë Margol, Interim Executive Director
Mr. Karl Kaneshiro, Interim Deputy Executive Director
Mr. Vijoy Chattergy, Chief Investment Officer
Mr. Aaron Au, Investment Officer
Mr. Anthony Goo, Investment Officer
Mr. Howard Hodel, Investment Officer
Mr. Andrew Chen, Investment Specialist
Mr. Ian Wetzel, Investment Specialist
Ms. Donna Curry, Program Specialist
Ms. Jaime Hirata, Recording Secretary
Ms. Wanda Kugiya, Secretary

Attorneys present:

Mr. Brian Aburano, Deputy Attorney General (Counsel for the Board)
Ms. Diane Kishimoto, Deputy Attorney General (Counsel for the Board)
Ms. Elmira Tsang, Deputy Attorney General (Counsel for ERS Staff)

Guests present:

Mr. Michael Humphrey) Courtland Partners, Ltd.
Mr. Paul Yett) Hamilton Lane Advisors, LLC
Mr. Colin Bebee) Pension Consulting Alliance, Inc.
Mr. Neil Rue
Mr. Andy Betz) Stafford Capital Partners
Mr. Rick Fratus

Member of public present:

Ms. Nancy Lauer

QUORUM/CALL TO ORDER	A quorum being present, Chair Lee Loy called the regular meeting of the Board of Trustees (Board) of the Employees' Retirement System (ERS) to order at 9:00 a.m.
PUBLIC COMMENT	No testimony was offered by members of the public.
RECESS	Chair Lee Loy called a recess and announced that the meeting would reconvene following the Investment Committee meeting.
RECONVENE	A quorum being present, Chair Lee Loy reconvened the meeting at 10:57 a.m.
PRESENTATION BY PENSION CONSULTING ALLIANCE, INC. ON THE PERFORMANCE OF THE EMPLOYEES' RETIREMENT SYSTEM'S INVESTMENT PORTFOLIO FOR 4 TH QUARTER 2014	<p data-bbox="581 533 1531 653">Mr. Neil Rue of Pension Consulting Alliance, Inc. (PCA), ERS's general investment consultant, presented PCA's reports on the performance of the ERS's investment portfolio and risk management for the fourth quarter of 2014. Highlights included:</p> <ul data-bbox="630 695 1531 1942" style="list-style-type: none"> <li data-bbox="630 695 1531 722">• Aggregate portfolio value of \$14.1 billion as of December 31, 2014. <li data-bbox="630 764 1531 827">• During the fourth quarter, the portfolio increased by \$0.2 billion; the portfolio's value increased by \$0.5 billion over the latest year. <li data-bbox="630 869 1531 968">• Portfolio outperformed the Policy Benchmark by 50 basis points and exceeded the Median Public Fund by 20 basis points for the fourth quarter. <li data-bbox="630 1010 1531 1199">• Over the 1-year period, the portfolio trailed the Policy Benchmark with a 6.6% return and underperformed the Median Public Fund by 10 basis points. Performance attributed to active domestic large cap equity manager's performance and differences in strategic allocations. Longer term performance gaps have begun to narrow as a result of the near-term outperformance. <li data-bbox="630 1241 1531 1430">• Portfolio ended the fourth quarter overweight to Broad Growth by 1.8% and Other Assets by 1.7%, while underweight Principal Protection by 2.0% and Real Estate by 1.0%. , due to policy changes and portfolio adjustments to existing fixed income mandates under the realignment of the portfolio to a new risk-based framework from asset-based framework. <li data-bbox="630 1472 1531 1598">• Five of eleven Domestic Equity managers matched their respective benchmarks over the fourth quarter, and four of the eleven managers matched or outperformed their respective benchmarks over the 1-year period. <li data-bbox="630 1640 1531 1808">• Restructuring of the International Equity portfolio reduced the number of International Equity managers and increased the level of passive management since 2011. All six International Equity managers matched or outperformed their respective benchmarks over the fourth quarter, and five outperformed over the 1-year period. <li data-bbox="630 1850 1531 1942">• Four of six Fixed Income managers matched or outperformed their respective benchmarks over the fourth quarter, and 5 outperformed over the 1-year period.

- Real Estate strategic class exceeded its policy benchmark over the fourth quarter and 1-year, and matched the benchmark over the 3-year period.
- Private Equity strategic class outperformed its policy benchmark over the fourth quarter, while trailing over the extended time periods.
- Total and Policy Portfolios are less exposed to growth risk than in prior periods (pre-2014); more exposed to interest rate risk and inflation risk than in prior periods.
- Portfolio's beta (on a 12-month basis relative to the Policy Portfolio) is above 1.0, indicating that the Total Portfolio is more susceptible to broad market risks than the Policy Portfolio.

PRESENTATION BY
COURTLAND PARTNERS,
LTD. ON THE PERFORMANCE
OF THE EMPLOYEES'
RETIREMENT SYSTEM'S
REAL ESTATE INVESTMENT
PORTFOLIO FOR 3RD
QUARTER 2014

Mr. Michael Humphrey of Courtland Partners, Ltd. (Courtland Partners), ERS's real estate investment consultant, presented Courtland Partners' report on the performance of the ERS's real estate investment portfolio for the third quarter of 2014. Highlights included:

- Portfolio market value of \$908,070,337 for the period ended September 30, 2014.
- Total number of current investments: 16 (16 last quarter).
- Total net return was 2.7% for the quarter; 9.8% year-to-date.
- Total portfolio internal rate of return inception to date was 7.4%.
- Portfolio is 6.5% of total plan assets (versus 7.0% target allocation).
- Portfolio income was 1.8%, 5.6%, 7.3%, 7.7%, 7.3%, 7.2%, and 7.4% for the current quarter, year-to-date, 1-, 2-, 3-, and 5-year periods, respectively.
- Portfolio measured by market value is 80.5% to core, 13.7% to value, and 5.8% opportunistic investments; gradual moderation from the current exposure in core investments to an allocation is 70% core, 20% value, and 10% opportunistic is in process.
- Portfolio outperformed the National Council of Real Estate Investment Fiduciaries (NCREIF) property index (NPI) by 0.5%, 2.6%, 1.3%, 4.3%, 4.6%, and 3.8% for the current-quarter, year-to-date, 1-, 2-, 3-, and 5-year periods, respectively.
- Portfolio underperformed the NPI by 3.7% for the inception-to-date period.
- Overview of market trends, and possible investment opportunities in U.S., European, Latin America, and Asia.

Mr. Humphrey also provided an update on the ERS's investments in KKR Global Infrastructure Investors Fund II, L.P., the Royal Ka'anapali Golf Courses, and BlackSand Capital Opportunity Fund I, L.P.

(All ERS staff, investment consultants, and members of the public left the room, except Mr. Vijoy Chattergy, Ms. Jaime Hirata, and Ms. Wanda Kugiya.)

RECRUITMENT AND SEARCH FOR A NEW EXECUTIVE DIRECTOR

Deputy Attorney General Brian Aburano reported that in working with ERS staff a Request for Quotations (RFQ) was issued to secure an executive search firm to assist with the recruitment of a new Executive Director for the ERS. The deadline for the submittal of quotations is 12:00 p.m. on February 18, 2015. Mr. Aburano circulated a list of questions from potential bidders that would be discussed in executive session.

Mr. Aburano also reported that he and ERS staff have been working with the personnel office of the Department of Budget and Finance (B&F) to draft an updated position description for the Executive Director position, and that B&F had asked if the Board would like to have the Executive Director position become an "appointive position" under current State procedures and collective bargaining agreements. If such a change was made, a person currently in a civil service position could take the Executive Director position without having to terminate from the civil service. Mr. Aburano discussed information he had received regarding the applicable State procedures and collective bargaining agreements. A few members of the Board indicated that they did not favor making the Executive Director position into an "appointive position" and no motion was made to that effect.

(Ms. Tsang and all ERS staff except Ms. Hirata were excused from the room.)

ENTER EXECUTIVE SESSION

On a motion made by Trustee Kane, seconded by Trustee Ferguson-Miyamoto, and unanimously carried, the Board entered executive session:

- Pursuant to HRS § 92-5(a)(4), to consult with the Board's attorneys on questions and issues pertaining to the Board's powers, duties, privileges, immunities, and liabilities with respect to the recruitment and search for a new executive director; and
- Pursuant to HRS § 92-5(a)(4), to consult with the Board's attorneys on questions and issues pertaining to the Board's powers, duties, privileges, immunities, and liabilities with respect to investment policies and procedures.

EXECUTIVE SESSION TO
CONSULT WITH THE
BOARD'S ATTORNEYS ON
QUESTIONS AND ISSUES
PERTAINING TO THE
BOARD'S POWERS, DUTIES,
PRIVILEGES, IMMUNITIES,
AND LIABILITIES WITH
RESPECT TO THE
RECRUITMENT AND SEARCH
FOR A NEW EXECUTIVE
DIRECTOR

(The Interim Executive Director, the Interim Deputy Executive Director, and Ms. Tsang returned to the meeting.)

EXECUTIVE SESSION TO
CONSULT WITH THE
BOARD'S ATTORNEYS ON
QUESTIONS AND ISSUES
PERTAINING TO THE
BOARD'S POWERS, DUTIES,
PRIVILEGES, IMMUNITIES,
AND LIABILITIES WITH
RESPECT TO INVESTMENT
POLICIES AND PROCEDURES

EXIT EXECUTIVE SESSION

On a motion made by Trustee Kane, seconded by Trustee Ferguson-Miyamoto, and unanimously carried, the Board exited from executive session.

RECESS

Chair Lee Loy called a recess for lunch and announced that the meeting would reconvene following the Board's Chapter 91 proceedings.

RECONVENE

A quorum being present, Chair Lee Loy reconvened the meeting at 1:00 p.m. (Trustee Machida did not return from the recess.)

PRESENTATION BY
HAMILTON LANE ADVISORS,
LLC ON AN UPDATE OF THE
EMPLOYEES' RETIREMENT
SYSTEM'S PRIVATE EQUITY
PROGRAM

Mr. Paul Yett of Hamilton Lane Advisors, LLC (Hamilton Lane), ERS's private equity consultant, reported on the status of the ERS's private equity portfolio. Highlights included:

- Strong performance over the quarter ended September 30, 2014, with a point-to-point internal rate of return (IRR) of 1.52% for the quarter (15.98% for the year) and \$9.2 million in value generated during the quarter (\$80.9 million for the year).
- Since inception IRR increased 47 basis points over the past year to from 9.07% to 9.28%.
- Portfolio market value increased from \$592.6 million to \$617.2 million as of September 30, 2014.

- Since inception return of 9.28% as of September 30, 2014 follows nine consecutive quarters of positive performance.
- Portfolio created \$9.2 million in value during the third quarter ending September 30, 2014.
- To-date in 2014, closed on 8 investments, \$240 million in committed capital:
 - \$35 million each to:
 1. Waterton Precious Metals Fund II, L.P. (small buyout)
 2. American Securities Opportunities Fund III, L.P. (distressed debt control)
 3. Providence Debt Opportunity Fund III, L.P. (distressed debt non-control)
 4. Veritas Capital Fund V, L.P. (mid buyout)
 5. Hellman & Friedman Capital Partners VIII, L.P. (mega buyout)
 6. Blackstone Energy II, L.P. (large buyout)
 - \$15 million each to:
 7. Polaris Partners VII, L.P. (venture capital)
 8. JMI Equity Fund VIII, L.P. (growth equity)
- Compared to September 30, 2013, exposure increased to Distressed Debt (+6%), Mid Buyout (+4%), and Small Buyout (+3%), while exposure declined to Large Buyout (-4%), VC (-3%), and Growth Equity (-2%).

Mr. Yett also highlighted the following initiatives under the 2015 Tactical Plan for the ERS's private equity portfolio:

- Increase commitment pacing to \$350 million per year.
- Maintain existing relationships with strong-performing general partners by focusing on constructing a more concentrated portfolio with largest commitments to existing managers that demonstrated strong track records.
- Increase average commitment size.
- Focus on Buyout investments with tactical exposure to specific investment strategies such as Energy and Credit.
- Diversify the portfolio geographically with a goal of increasing exposure to international and emerging markets.
- Consider investments in secondary opportunities that would allow access to top-performing general partners.

In closing, Mr. Yett noted that to-date in 2015, investment of \$35 million to American Securities Partners VII, L.P. (corporate finance buyout large) has

closed, and that Hamilton Lane is currently considering four investment opportunities for the ERS (\$35 million each to growth equity and 2 corporate finance buyout mid, and \$40 million to corporate finance buyout large).

PRESENTATION BY
STAFFORD CAPITAL
PARTNERS ON THE HAWAII
TARGETED INVESTMENT
PROGRAM (HiTIP) UPDATE

Mr. Andy Betz and Mr. Rick Fratus of Stafford Capital Partners (Stafford), managers for the ERS's Hawaii Targeted Investment Program (HiTIP) reported on the status of the Stafford HiTIP Fund I, L.P. (HiTIP Fund) managed by Stafford for the ERS. Highlights included:

- As of September 30, 2014, \$25.25 million (100% of capital) committed to seven funds with investments across 103 companies and one co-investment.
- 521 Hawaii-based investment opportunities reviewed by the HiTIP Fund.
- Two investments completed in Hawaii-based companies; 1 investment in a company with technology developed on Maui.
- HiTIP's value increased by \$802,000 in third quarter 2014; annualized a 19% return.
- \$148,000 distributed in third quarter 2014; \$2.4 million total distributions since inception in 2008.
- Arsenal Venture Partners and Azure Capital Partners made new investments, totaling \$3 million and \$0.5 million, respectively.
- Polaris Partners sold a portion of its position in Receptos, as well as proceeds from the sale of SpaceMonkey.
- Hu Honua of TEM Capital reported that agreement terms were reached in December 2014.
- Volta Industries, an Epic Ventures Fund IV investment, completed fundraising in December 2014.

Mr. Betz also reported that now that the HiTIP Fund is fully (100%) committed, if there is extra capital, Stafford would like to propose commitment to Startup Capital Ventures II.

There being no further discussion, Mr. Betz and Mr. Fratus left the meeting.

INVESTMENT MANAGER
WATCH STATUS (BRADFORD
& MARZEC, LLC)

Mr. Vijoy Chattergy, Chief Investment Officer (CIO), reported that he and PCA recommended that the existing "Watch Status" of Bradford & Marzec, LLC, a fixed income manager, should be extended through the first quarter of 2016, due to additional changes in the organizational structure from the departure of senior level investment professionals.

On a motion made by Trustee Barfield, seconded by Trustee Ferguson-Miyamoto, and unanimously carried, the Board approved extension of the Watch Status for Bradford & Marzec, LLC through the first quarter of 2016.

(All ERS investment staff and investment consultants except the CIO, Ms. Kugiya, and the representatives from PCA left the room.)

LEGISLATIVE PROPOSALS
RELATING TO THE
EMPLOYEES' RETIREMENT
SYSTEM

Ms. Donna Curry, Program Specialist, reported that the following legislative proposals relating to the ERS that were previously authorized by the Board and the Department of Budget and Finance have been introduced as part of the Governor's administrative package:

1. **House Bill (H.B.) 917 and Senate Bill (S.B.) 1086.** Forfeiture of ERS benefits for members convicted of work-related felonies.
2. **H.B. 918 and S.B. 1087.** Hybrid Plan death benefits and refunds.
3. **H.B. 919 and S.B. 1088.** Relating to retirement credit for sick leave.
4. **H.B. 920 and S.B. 1089.** Relating to the ERS service credit and workers' compensation benefit contributions.
5. **H.B. 291 and S.B. 1090.** Relating to the ERS employer reporting with penalty for non-compliance.

Ms. Curry also reported that the following proposals related to the ERS have been introduced by other parties, which includes proposals originally initiated by the ERS and proposals related to qualified domestic relations orders (QDRO):

6. **H.B. 790 and S.B. 1208.** Relating to the ERS Board of Trustees meetings held in executive session.
7. **H.B. 791 and S.B. 1209.** Relating to the retirement of judges.
8. **H.B. 85.** Relating to disability retirement.
9. **H.B. 256.** Establishment of a Special Task Force to study death certificates.
10. **H.B. 382.** Relating to the ERS division of pension pursuant to a QDRO.
11. **H.B. 521.** Relating to the ERS pensioners' bonus (technical amendments).
12. **H.B. 602.** Establishment of a Special Task Force to address the State and County unfunded liabilities.
13. **H.B. 680.** Forfeiture of ERS benefits for members convicted of work-related felonies.
14. **H.B. 1075.** Relating to Health (transition the Maui Regional System Facilities to a new public-private collaboration).
15. **H.B. 1137.** Require certain taxes collected by the State to be applied to unfunded liabilities.

16. **H.B. 1370.** Relating to divorce (direct payment to a former spouse pursuant to a QDRO).
17. **H.B. 1511.** Divestiture of ERS's investments in fossil fuels.
18. **S.B. 133.** Forfeiture of ERS benefits for members convicted of work-related felonies.
19. **S.B. 311.** Transition the Hawaii Health Systems Corporation to a new healthcare management system.
20. **S.B. 693.** Require employers (State and County) to furnish to ERS, payroll and personnel transaction information.
21. **S.B. 827.** Require the ERS to require employers to provide accurate payroll and personnel information to the ERS.
22. **S.B. 1324.** Provide authority for the ERS to direct payment to former spouse (divorce) pursuant to a QDRO.

The Board's Administrative and Legislative Committee's recommendations with respect to the foregoing bills was as follows:

Support: H.B. 790; S.B. 1208, H.B. 791; S.B. 1209.

Support Intent: H.B. 680; S.B. 133; S.B. 693; S.B. 827.

Oppose: H.B. 85; H.B. 382; H.B. 602; H.B. 1370; H.B. 1511; S.B. 1324.

The Trustees discussed, their concerns that H.B. 85 would provide a benefit enhancement that would violate the moratorium on benefit enhancements until the ERS is fully funded, and that H.B. 382 would require extensive administrative and operational costs to the ERS to implement this proposal because, among other things, the current version of the proposal does not provide for an appropriation out of the general fund.

On a motion made by Trustee Ferguson-Miyamoto, seconded by Trustee Matsumoto, and unanimously carried, the Board adopted the following positions:

Support: H.B. 790; S.B. 1208, H.B. 791; S.B. 1209; H.B. 1137;

Support Intent: H.B. 680; S.B. 133; S.B. 693; S.B. 827; and

Oppose: H.B. 85; H.B. 382; H.B. 602; H.B. 1370; H.B. 1511; S.B. 1324;

and authorized the individual ERS trustees, ERS Interim Executive Director, and other ERS staff to take all necessary and appropriate measures in furtherance of the Board's positions, including the preparation and presentation of testimony to legislative committees and authorized ERS staff to provide technical and operational comments to the legislature with respect to the bills relating to qualified domestic relations orders.

JUNE 30, 2014 ANNUAL
ACTUARIAL VALUATION OF
THE EMPLOYEES'
RETIREMENT SYSTEM

The Interim Executive Director presented the draft report on the annual actuarial valuation of the ERS for the year ending June 30, 2014, as prepared by the ERS's actuary Gabriel Roeder Smith & Company (GRS). Highlights included:

- Unfunded actuarial accrued liability (UAAL) increased to \$8.578 billion from \$8.495 billion.
- Funding period to pay off the ERS's unfunded liability decreased to 26 years from 28 years.
- Funded ratio improved to 61.4% from 60% for 2013 based on the 4-year smoothing methodology adopted by the Board for determining the valuation numbers.
- 2014 investment performance was favorable (17.8% return on market value of assets; investment return assumption is 7.75%); deferred \$561 million in investment gains (compared with \$391 million deferred losses in 2013) still to be recognized in the actuarial value of assets.
- The ERS's largest risks to funding going forward include payroll growth, investment performance, and mortality rates. The ERS has the longest living mortality assumption in the nation, with life expectancy rates of retirees and beneficiaries increasing faster than actuaries can adequately incorporate into their provisions and calculations for mortality tables.

REPORT ON FINANCIAL
REPORTING FOR PENSION
PLANS (GOVERNMENTAL
ACCOUNTING STANDARDS
BOARD (GASB) STATEMENT
NO. 67)

The Interim Executive Director presented the report on financial reporting for pension plans for the year ending June 30, 2014, in compliance with the Governmental Accounting Standards Board (GASB) Statement No. 67 that requires the notes of financial statements to include additional disclosure information. Highlights of the report prepared by the ERS actuary, GRS, included required supplementary information, and the calculation of the single discount rate.

On a motion made by Trustee Ferguson-Miyamoto, seconded by Trustee Kane, and unanimously carried, the Board accepted the 89th Annual Actuarial Valuation of the ERS for the year ending June 30, 2014, and the report on financial reporting for pension plans for the year ending June 30, 2014, both as presented.

APPOINTMENT OF TRUSTEES
TO GOVERNANCE POLICY AD
HOC COMMITTEE

In response to the Trustees' questions and concerns regarding their fiduciary duties in connection with governance, including investment policies and guidelines related to the implementation of the ERS's risk-based functional framework for the strategic allocation of the ERS's investments, Chair Lee Loy assigned the following trustees, pursuant to HRS § 92-2.5 (b)(1), to investigate best practices with respect to governance and fulfillment of fiduciary duties, and to provide their findings and recommendations to the Board:

- Patrick Frane (Chair)
- Vince Barfield

- Emmitt Kane
- Pilialoa Lee Loy

**OPERATIONS REPORT –
JANUARY 2015**

Mr. Karl Kaneshiro, Interim Deputy Executive Director, presented the monthly report on the ERS’s operations and website statistics for January 2015.

**CORRECTION OF MINUTES
– SEPTEMBER 23, 2014**

Proposed amended public minutes of the September 23, 2014 Board meeting were circulated for the Board’s consideration. The amendment of the minutes is necessary to correctly reflect the motion amending the investment return assumption as follows (corrections are underscored):

On a motion made by Trustee Matsumoto, seconded by Trustee Young, and unanimously carried, the Board approved to lowering the investment return rate to 7.50% from 7.75%, to be phased in over three years as follows:

Valuation Date	Investment Return Assumption
6/30/2014	7.75%
6/30/2015	<u>7.65%</u>
6/30/2016	<u>7.55%</u>
6/30/2017	7.50%

On a motion made by Trustee Kane, seconded by Trustee Ferguson-Miyamoto, and unanimously carried, the Board approved the amended minutes of the September 23, 2014 meeting, as circulated.

**APPROVAL OF MINUTES
– DECEMBER 8, 2014
(DEFERRED)**

Chair Lee Loy announced that consideration of the minutes of the December 8, 2014 meeting (including the executive session minutes) was deferred to a future meeting.

**NEXT MEETING
– MARCH 9, 2015**

Chair Lee Loy announced that the next Board meeting is scheduled for March 9, 2015.

ADJOURNMENT

On a motion made by Trustee Ferguson-Miyamoto, seconded by Trustee Kane, and unanimously carried, the Board adjourned the meeting at 2:43 p.m.

**REDACTED
SIGNATURE**

Kanoe Margol
Interim Executive Director

KM: jh