

MINUTES OF THE REGULAR BOARD MEETING OF THE
BOARD OF TRUSTEES OF THE EMPLOYEES' RETIREMENT SYSTEM (ERS)
JANUARY 14, 2013
CITY FINANCIAL TOWER, 201 MERCHANT STREET, SUITE 1935
HONOLULU, HAWAII

Trustees present: Mr. Colbert Matsumoto, Chair
Mr. Emmitt Kane, Vice Chair
Mr. Vincent Barfield
Ms. Jackie Ferguson-Miyamoto
Ms. Piliialoha Lee Loy
Mr. Jerome Rauckhorst
Mr. Wayne Yamasaki
Mr. Kalbert Young

Attorney present: Mr. Brian Aburano, Deputy Attorney General
Ms. Diane Kishimoto, Deputy Attorney General

Staff present: Mr. Wesley Machida, Administrator
Ms. Kanoe Margol, Assistant Administrator
Mr. Vijoy Chattergy, Chief Investment Officer
Mr. Ajay Umanikar, Investment Specialist
Ms. Donna Curry, Program Specialist
Ms. Gerri Konishi, Member Home Loan Assistant
Ms. Jaime Hirata, Recording Secretary
Ms. Wanda Kugiya, Secretary

Guests present: Mr. Cory Martin) Barrow, Hanley, Mewhinney &
Strauss, LLC
Mr. Mike Donnelly) C.S. McKee, Inc.
Mr. Gene Natali
Mr. Michael Humphrey) Courtland Partners, Ltd.
Mr. Dan Moore
Mr. Joe Newton) Gabriel Roeder Smith & Company
Mr. Lewis Ward
Mr. Nelson Lau) KPMG LLP
Ms. Kimberly Miyoshi
Mr. Jeff Freidman) Mesa West Capital, LLC
Ms. Kay Ceserani) Pension Consulting Alliance, Inc.
Mr. Neil Rue
Mr. Eoin Middaugh) Systematic Financial Management,
Mr. Kevin McCrush L.P.

CALL TO ORDER/QUORUM

A quorum being present, Mr. Colbert Matsumoto, Chair of the Board of Trustees of the Employees' Retirement System (ERS), called the regular meeting of the Board of Trustees of the ERS (the Board) to order at 9:02 a.m.

AMENDMENT OF THE AGENDA

On a motion made by Trustee Kane, seconded by Trustee Lee Loy, and unanimously carried, the Board amended the agenda to include the following item:

- Award of special deputy attorney general contract for tax counsel services to J. Thomas Mahoney, Esq.

ENTRY INTO EXECUTIVE SESSION

On a motion made by Trustee Lee Loy, seconded by Trustee Barfield, and unanimously carried, the Board entered into executive session:

- Pursuant to HRS § 92-5(a)(8), to consider, evaluation, and, if appropriate, to make decision on the draft of the June 30, 2012 Actuarial Valuation; appropriate action.

(Trustee Young arrived at the meeting.)

EXECUTIVE SESSION TO
CONSIDER, EVALUATE, AND
MAKE DECISIONS ON THE DRAFT
OF THE 87TH ANNUAL ACTUARIAL
VALUATION OF THE EMPLOYEES'
RETIREMENT SYSTEM FOR THE
YEAR ENDING JUNE 30, 2012

(Trustee Barfield exited the meeting.)

(Trustee Rauckhorst exited the meeting.)

EXIT EXECUTIVE SESSION

On a motion made by Trustee Lee Loy, seconded by Trustee Yamasaki, and unanimously carried, the Board exited from executive session.

UPDATED ACTUARIAL OPTION
FACTORS

The Administrator announced that representatives of Gabriel Roeder Smith & Company (GRS), the ERS's actuaries, will be meeting with State and county employers and members of the legislature. The Administrator also announced that GRS's Annual Actuarial Valuation of the Employees' Retirement System for the Year Ending June 30, 2012 was accepted by the Board in Executive Session that was just concluded.

Mr. Joseph Newton and Mr. Lewis Ward of GRS presented GRS's recommendations for new factor tables to be used in converting the maximum retirement allowance to other optional forms of payment for ERS members with membership dates prior to July 1, 2012. The recommendations are based on the actuarial assumptions approved by the Board at its September 2012 meeting. GRS will provide its recommendations for factor tables for ERS members with membership dates after June 30, 2012 later this year.

On a motion made by Trustee Lee Loy, seconded by Trustee Yamasaki, and unanimously carried, the Board adopted the factors in Tables 1 through 6, attached hereto, for converting the maximum retirement allowance to other optional forms of benefit payment for ERS members with membership dates prior to July 1, 2012 who retire after December 31, 2013.

ENTRY INTO EXECUTIVE SESSION

On a motion made by Trustee Lee Loy, seconded by Trustee Young, and unanimously carried, the Board entered executive session:

- Pursuant to HRS § 92-5(a)(4) and (8), to discuss, and to consult with the Board's attorneys on questions and issues pertaining to the Board's powers, duties, privileges, immunities, and liabilities regarding the audit and draft financial statements of the ERS and to take appropriate action thereon; and
- Pursuant to HRS § 92-5(a)(8), to consider, evaluate, and make decisions on the responses to the ERS's Request for Proposals for internal audit consultant services.

EXECUTIVE SESSION TO DISCUSS,
AND TO CONSULT WITH THE
BOARD'S ATTORNEYS ON
QUESTIONS AND ISSUES
PERTAINING TO THE BOARD'S
POWERS, DUTIES, PRIVILEGES,
IMMUNITIES, AND LIABILITIES
REGARDING THE AUDIT AND
DRAFT FINANCIAL STATEMENTS
OF THE ERS

EXECUTIVE SESSION TO
CONSIDER, EVALUATE, AND
MAKE DECISIONS ON THE
RESPONSES TO THE ERS'S
REQUEST FOR PROPOSALS FOR
INTERNAL AUDIT CONSULTANT
SERVICES

EXIT EXECUTIVE SESSION

On a motion made by Trustee Lee Loy, seconded by Trustee Kane, and unanimously carried, the Board exited from executive session.

RECESS

Chair Matsumoto called a recess and announced that the meeting would reconvene after Chapter 91 deliberations.

RECONVENE

Chair Matsumoto reconvened the meeting.

SEPTEMBER 10, 2012 BOARD
MEETING MINUTES - DEFERRED

The Chair announced that consideration of the Minutes of the September 10, 2012 meeting (including the Executive Session Minutes) would be deferred until the next meeting.

2013 EMPLOYEES' RETIREMENT
SYSTEM LEGISLATIVE
PROPOSALS

The Administrator reported on the ERS's proposals for the 2013 legislative session that were submitted to the Governor's Policy Office to be included in the Administration Package. Proposed bills and justifications are for the following:

- BUF-05(13) Related to Federal Tax Qualification for the ERS
 - Intent section regarding favorable determination letter
 - Re-ordered amended sections numerically
 - Corrected formatting and style
- BUF-06(13) Related to ERS Personnel
 - Corrected formatting and style
- BUF-07(13) Relating to Benefits for Judges
 - Corrected formatting and style
- BUF-08(13) Relating to ERS; Civil Unions
 - Clarified intent
 - Added a new section to chapter 88 to include civil union partners under spousal terms unless there is a conflict with the ERS' tax-qualified requirements
 - Replaced amendments for section 88-93 regarding beneficiary designations with amendments to section 88-74.7 regarding the commencement of benefits – deleting reference to civil union partners

The Administrator also noted that the Legislature will create a special committee on unfunded liabilities.

RECESS

Chair Matsumoto called a recess and announced that the meeting would reconvene after the Investment Committee meeting.

(Trustees Barfield and Rauckhorst returned during the recess.)

RECONVENE

Chair Matsumoto reconvened the meeting at 12:09 p.m.

PRESENTATION BY BARROW,
HANLEY, MEWHINNEY AND
STRAUSS, LLC ON THE
PERFORMANCE OF THE ERS'S
LARGE CAP VALUE PORTFOLIO

Mr. Cory Martin of Barrow, Hanley, Mewhinney and Strauss, Inc. (Barron Hanley) presented Barrow Hanley's review of the performance of investments in the large cap value portfolio managed by Barrow Hanley for the ERS.

(Trustee Young exited the meeting.)

PRESENTATION BY C.S. MCKEE,
L.P. ON THE PERFORMANCE OF
THE ERS'S LARGE CAP VALUE
PORTFOLIO

Mr. Mike Donnelly and Mr. Gene Natali of the C.S. McKee, L.P. (C.S. McKee) presented C.S. McKee's review of the performance of investments in the large cap value portfolio managed by C.S. McKee for the ERS.

(Trustee Young returned to the meeting.)

PRESENTATION BY SYSTEMATIC
FINANCIAL MANAGEMENT, L.P.
ON THE PERFORMANCE OF THE
ERS'S LARGE CAP VALUE
PORTFOLIO

Mr. Kevin McCrush and Mr. Eoin Middaugh of Systematic Financial Management (Systematic) presented Systematic's review of the performance of investments in the large cap value portfolio managed by Systematic for the ERS.

ENTRY INTO EXECUTIVE SESSION

On a motion made by Trustee Lee Loy, seconded by Trustee Kane, and unanimously carried, the Board entered executive session:

- Pursuant to HRS § 92-5(a)(8), to consider and, if appropriate, make a decision regarding domestic equity mandates;
- Pursuant to HRS § 92-5(a)(8), to consider, evaluate, and make decisions on the responses to the ERS's Request for Proposals for private equity consultant services;
- Pursuant to HRS § 92-5(a)(8), to consider and, if appropriate, to make a decision regarding an investment in the Mesa West Real Estate Income Fund III, L.P.; and
- Pursuant to HRS § 92-5(a)(8), to consider and, if appropriate, to make a decision regarding sales of properties in the Heitman Capital Management and LaSalle Investment Management, Inc. core real estate portfolios.

EXECUTIVE SESSION TO
CONSIDER AND, IF APPROPRIATE,
MAKE A DECISION REGARDING
DOMESTIC EQUITY MANDATES

EXECUTIVE SESSION TO
CONSIDER, EVALUATE, AND
MAKE DECISION ON THE
RESPONSES TO THE ERS'S
REQUEST FOR PROPOSALS FOR
PRIVATE EQUITY CONSULTANT
SERVICES

EXECUTIVE SESSION TO
CONSIDER AND, IF APPROPRIATE,
TO MAKE A DECISION
REGARDING AN INVESTMENT IN
THE MESA WEST REAL ESTATE
INCOME FUND III, L.P.

EXECUTIVE SESSION TO
CONSIDER AND, IF APPROPRIATE,
TO MAKE A DECISION
REGARDING SALES OF
PROPERTIES IN THE HEITMAN
CAPITAL MANAGEMENT AND
LASALLE INVESTMENT
MANAGEMENT, INC. CORE REAL
ESTATE PORTFOLIO

(Trustee Rauckhorst exited the meeting and did not return for the remainder of the meeting.)

EXIT EXECUTIVE SESSION

On a motion made by Trustee Lee Loy, seconded by Trustee Barfield, seconded by Trustee Kane, and unanimously carried, the Board exited from executive session.

HEITMAN CAPITAL
MANAGEMENT LEVERAGE
POLICY SUMMARY OF PAST
WAIVER AND REQUEST FOR NEW
WAIVER

The CIO reported on the status of the leverage policy waiver granted to Heitman through December 31, 2012. The waiver was granted to allow Heitman to obtain, refinance, or eliminate certain debt obligations. As of December 31, 2012, was in technical compliance with the leverage policy.

Heitman has been actively pursuing the sale of the Royal Kaanapali Golf Courses and University Park Village. If these sales go through, the loan-to-value of the portfolio exceeded the 30% target set by the existing leverage policy and Heitman would be in breach of the leverage policy. Heitman has therefore requested a new waiver of the leverage policy for either a maximum of up to 24 months or until December 31, 2014. The CIO and Courtland recommended that Heitman be granted the waiver until December 31, 2014.

On a motion made by Trustee Barfield, seconded by Trustee Lee Loy, and unanimously carried, the Board granted Heitman a waiver of the leverage policy until December 31, 2014, on the condition that Heitman present prospective acquisitions to the ERS Board (through ERS staff and Courtland) for approval.

2013 ELECTION OF OFFICERS,
COMMITTEE ASSIGNMENT, AND
ADOPTION OF BOARD POLICIES

Chair Matsumoto proposed to the Board that there be no change in the Board's officers and recommended the following changes to the Board's committee assignments for 2013:

- Add Trustee Young to the Legislative Committee

- Create a new committee called the “Compensation Review Committee” that would be responsible for recommending to the full Board the compensation for the Administrator, CIO, the investment officer positions, as well as for other “exempt” positions.

On a motion made by Trustee Yamasaki, seconded by Trustee Kane, and unanimously carried, the Board confirmed Trustee Matsumoto as Board Chair and Trustee Kane as Vice Chair and approved the following changes to the Board’s committee assignments for 2013:

- Add Trustee Young to the Legislative Committee;
- Create a new committee called the “Compensation Review Committee,” consisting of Chair Matsumoto as Chair, and Trustees Barfield, Rauckhorst, and Young, as members, that will be responsible for recommending to the full Board the compensation for the Administrator, Chief Investment Officer, investment officer positions and other exempt positions.

(Trustee Kane exited the meeting and did not return for the remainder of the meeting.)

ALLOCATION BETWEEN
GATEWAY INVESTMENT
ADVISERS, LLC’S REPLICATION
AND NON-REPLICATION
MANDATES/AFFIRMATION

The CIO and PCA recommended that the Board affirm the decision, made by the Board at its December meeting, to change the allocation of the covered calls portfolio managed by Gateway Investment Advisers, LLC (Gateway) to 50 % replication and 50 % non-replication. The CIO also recommended that the ERS not hire a transition manager to implement the rebalancing.

On a motion made by Trustee Lee Loy, seconded by Trustee Barfield, and unanimously carried, the Board affirmed its decision to allow Gateway to implement a 50% - 50% allocation between the full replication and non-replication strategies.

PLACEMENT AGENT POLICY

The CIO presented the draft of a policy regarding the potential role of placement agents in the ERS investment process for inclusion the ERS *Investment Policy, Guidelines, & Procedures* manual. PCA concurs with the proposed placement agent policy.

On a motion made by Trustee Lee Loy, seconded by Trustee Barfield, and unanimously carried, the Board approved the proposed “Policy for the Use of Placement Agents” as presented.

WATCH LIST POLICY REVISIONS

The CIO presented a draft of changes to the policy for “Guidelines for Manager Watch List or Termination” in section C.4 of the ERS *Investment Policy, Guidelines, & Procedures* manual.

ERS staff and PCA recommended the following changes:

- Incorporate ERS’s four recently funded mandates (passive US large-cap growth, passive US large-cap value, active covered calls, and passive-replication covered calls); and
- Provide for the reduction by up to 50% of the manager’s assets in the portfolio for a fund manager operating in “watch status” to lower exposure and to create an added incentive for the fund manager to improve performance.

On a motion made by Trustee Barfield, seconded by Trustee Lee Loy, and unanimously carried, the Board approved the proposed changes to the “Guidelines for Manager Watch List or Termination” as presented.

COMMISSION RECAPTURE BROKER REQUEST FOR INFORMATION

Ms. Ceserani reported on the Request for Information (RFI) for commission recapture broker services for the ERS, managed by PCA. The purpose of the search, which began in October 2012, was to expand the list of the participating brokers in ERS’ Commission Recapture Program in an effort to increase manager participation. Four responses were received.

Based on ranking according to PCA’s scoring results, PCA recommended that the ERS retain ConvergeX Execution Solutions LLC, Russell Implementation Services, Inc., and Capital Institutional Services Inc. for commission recapture program services, pending final due diligence. PCA also recommended that ERS’s pool of providers be limited to a minimum of three and a maximum of five firms.

On a motion made by Trustee Lee Loy, seconded by Trustee Barfield, and unanimously carried, the Board approved to the retention of ConvergeX Execution Solutions LLC, Russell Implementation Services, Inc., and Capital Institutional Services Inc. to provide commission recapture program services for the ERS.

OPERATIONS REPORT – DECEMBER 2012

The Administrator presented the monthly operations report. Highlights included:

- December 2012 quarterly issue of the ERS’s newsletter, the Holomua, was completed December 17, 2012 and mailed to retirees and active members
- The audits for the ERS’s 2010 and 2011 financial statements are currently underway
- ERS’s Request for Proposals (RFP) for a private equity consultant and internal auditor were completed and released. Only one proposal was received in response to the RFP for internal audit services.

2013 BOARD MEETING DATES

ERS staff and the Board reviewed Board meeting schedule for 2013. Scheduled meeting dates are:

- January 14
- February 11
- March 11
- April 8
- May 14
- June 10
- July 16
- August 12
- September 9
- October 17
- November 12
- December 9

The Administrator noted that the June Board meeting date may change due to the June 11 State holiday for King Kamehameha Day. Other meeting dates are also subject to change. There were no other comments.

ENTRY INTO EXECUTIVE SESSION

On a motion made by Trustee Lee Loy, seconded by Trustee Barfield, and unanimously carried, the Board entered executive session:

- Pursuant to HRS § 92-5(a)(8), to consider and, if appropriate, to make a decision regarding Courtland Partners, Ltd.'s preliminary recommendations regarding structure of the ERS's real estate portfolio.

(Trustee Young exited the meeting and did not return for the remainder of the meeting.)

EXECUTIVE SESSION MAKE A
DECISION REGARDING
COURTLAND PARTNERS
PRELIMINARY
RECOMMENDATIONS REGARDING
STRUCTURE OF THE ERS'S REAL
ESTATE PORTFOLIO

EXIT EXECUTIVE SESSION

On a motion made by Trustee Lee Loy, seconded by Trustee Barfield, and unanimously carried, the Board exited from executive session.

TAX COUNSEL

The Administrator reported that J. Thomas Maloney of D'Amato & Maloney, LLP had been selected through a chapter 103D professional services procurement process to serve as the ERS's tax counsel for a term commencing January 1, 2013. Mr. Maloney has served as the ERS's tax counsel for over five years. The Administrator requested the Board's approval of the proposed terms of the contract: three years, with a two-year extension at the ERS's option, at a \$300.00 hourly rate.

On a motion made by Trustee Lee Loy, seconded by Trustee Barfield, and unanimously carried, the Board approved the retention of J. Thomas Maloney and the D'Amato & Maloney, LLP law firm as the ERS's tax counsel for three years, at a \$300.00 hourly rate, with the option of a 2-year contract extension.

NEXT BOARD MEETING –
FEBRUARY 11, 2013

Chair Matsumoto announced that the next Board meeting is scheduled for February 11, 2013.

ADJOURNMENT

On a motion made by Trustee Lee Loy, seconded by Trustee Barfield, and unanimously carried, the Board adjourned the meeting at 3:53 p.m.

**REDACTED
SIGNATURE**

Wesley K. Machida
Administrator

WKM: jh