

MINUTES OF THE REGULAR BOARD MEETING OF THE
BOARD OF TRUSTEES OF THE EMPLOYEES' RETIREMENT SYSTEM (ERS)
FEBRUARY 11, 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. Piliialoha Lee Loy
Mr. Jerome Rauckhorst
Mr. Wayne Yamasaki
Mr. Kalbert Young

Trustee excused: Ms. Jackie Ferguson-Miyamoto

Attorney present: Ms. Diane Kishimoto, Deputy Attorney General

Staff present: Mr. Wesley Machida, Administrator
Ms. Kanoë Margol, Assistant Administrator
Mr. Vijoy Chattergy, Chief Investment Officer (via conference call)
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: Ms. Patty Glazier) Arsenal Venture Partners

Mr. Michael Humphrey) Courtland Partners, Ltd.

Ms. Tara Blackburn) Hamilton Lane Advisors, LLC
Ms. Jenna Greer
Mr. Paul Yelt

Mr. Andrew Betz) Macquarie Funds Group
Ms. Erica Bushner

Mr. John Linder) Pension Consulting Alliance, Inc.
Mr. Neil Rue

Mr. Monte Bren) StepStone Group LLC
Mr. Scott Hart
Ms. Aiyu Yuan

Mr. Mark Friedberg) Wilshire Associates Incorporated
Mr. Kevin Nee

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 8:10 a.m.

Chair Matsumoto announced that he has resigned as Chair effective February 11, 2013 and that Trustee Kane, as Vice Chair, will be serving as Acting Chair until a new Chair is elected.

AMENDMENT OF THE AGENDA

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

- Executive Session, pursuant to HRS § 92-5(a)(8), to consider an update on discussions with Bruce Graham, ERS counsel in the Kaho'ohanohano vs. State of Hawaii case; appropriate action.

ENTER 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 meet with and evaluate priority-listed finalists for the ERS's Request for Proposals (RFP) for private equity consultant services.

EXECUTIVE SESSION TO MEET WITH AND EVALUATE PRIORITY-LISTED FINALISTS FOR THE ERS'S REQUEST FOR PROPOSALS FOR PRIVATE EQUITY CONSULTANT SERVICES

(Trustee Matsumoto left the meeting at 8:39 a.m.)

(The Administrator left the meeting at 9:00 a.m.)

(Trustee Young arrived at the meeting at 9:10 a.m.)

(Trustee Matsumoto returned to the meeting at 9:42 a.m.)

(Trustee Young left the meeting at 10:00 a.m.)

EXIT EXECUTIVE SESSION

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

RECESS

Acting Chair Kane called a recess at 12:10 p.m. for lunch and the Investment Committee meeting and announced that the Board meeting would reconvene after the Investment Committee meeting.

(The Administrator returned to the meeting during the recess.)

RECONVENE

Acting Chair Kane reconvened the meeting at 12:26 p.m.

APPROVAL OF BOARD MEETING MINUTES

- SEPTEMBER 10, 2012
- OCTOBER 11, 2012
- OCTOBER 12, 2012
- NOVEMBER 13, 2012

On a motion made by Trustee Lee Loy, seconded by Trustee Rauckhorst, and unanimously carried, the Board approved the minutes of the Board meetings of September 10, 2012, October 11, 2012, October 12, 2012, and November 13, 2012, as presented.

2013 LEGISLATIVE PROPOSALS
AFFECTING THE EMPLOYEES'
RETIREMENT SYSTEM

The Administrator reported on the status of the ERS's 2013 legislative proposals:

- H.B. 805 and S.B. 1035 – Relating to the federal tax qualification of the ERS
 - Heard by LAB; recommended that the measure be passed unamended.
- H.B. 806 and S.B. 1036 – Relating to ERS personnel
 - Heard by LAB; recommended that the measure be passed unamended.
- H.B. 807 and S.B. 1037 – Relating to retirement benefits for judges
 - Heard by LAB; recommended that the measure be passed unamended.
- H.B. 808 and S.B. 1038 – Relating to the federal tax qualification of the ERS; civil unions
 - Heard by LAB; recommended that the measure be passed unamended.

The Administrator also reported on the status of the Legislative Committee's recommendations regarding other legislative proposals that may affect the ERS.

On a motion made by Trustee Rauckhorst, seconded by Trustee Lee Loy, and unanimously carried, the Board decided to support the ERS's 2013 legislative proposals.

On a motion made by Trustee Lee Loy, seconded by Trustee Rauckhorst, and unanimously carried, the Board adopted the Legislative Committee's recommendations for positions on the following House bills:

- Oppose: H.B. 212; H.B. 275; H.B. 638; H.B. 1179; H.B. 1182; and H.B. 1484, H.D. 1 (to the extent that the bill affects the ERS).
- Support: H.B. 271; H.B. 1040; and H.B. 1462.

On a motion made by Trustee Matsumoto, seconded by Trustee Rauckhorst, and unanimously carried, the Board adopted positions on the Senate bills reported on as follows:

- Oppose: S.B. 73; S.B. 346; S.B. 557; S.B. 1312; S.B. 1331; and S.B. 1354.
- Support Intent: S.B. 335 (intended to reduce unfunded liability); and S.B. 604 (would reduce unfunded liability).
- Provide information only: S.B. 34; S.B. 798; and S.B. 886.

- Recommend deferral to provide more time to study feasibility: S.B. 946.

ENTER 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 a report on the status of the Royal Ka'anapali Golf Courses; and
- 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.

(Acting Chair Kane recused himself and asked Trustee Matsumoto to preside while the Acting Chair was out of the meeting room.)

EXECUTIVE SESSION TO
CONSIDER A REPORT ON THE
STATUS OF THE ROYAL
KA'ANAPALI GOLF COURSES

(Acting Chair Kane returned to the meeting.)

EXECUTIVE SESSION TO
CONSIDER AND, IF APPROPRIATE,
TO MAKE A DECISION
REGARDING COURTLAND
PARTNERS PRELIMINARY
RECOMMENDATIONS REGARDING
STRUCTURE OF THE ERS'S REAL
ESTATE PORTFOLIO

(Trustee Young returned to the meeting at 1:42 p.m.)

(Trustee Matsumoto left the meeting at 1:57 p.m. and did not return for the remainder of the meeting.)

EXIT EXECUTIVE SESSION

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

PRESENTATION BY COURTLAND
PARTNERS ON THE
PERFORMANCE OF THE ERS'S
REAL ESTATE PORTFOLIO
PERFORMANCE

Mr. Michael Humphrey presented the report by Courtland Partners, Ltd. (Courtland) of the performance of the ERS's real estate portfolio for the period ending September 30, 2012 (third quarter of 2012). Highlights included:

- \$ 979,799,074 portfolio market value
- 8.3% of total plan assets (vs. 7.0% target)
- \$157,411,555 unfunded investment commitments
- 1.7% total net return
- 6.7% internal rate of return

- 26.7% core leverage
- 54.0% value leverage
- 56.1% opportunistic leverage

Mr. Humphrey observed that the total return for the real estate portfolio is good and that the ERS is getting the returns that are expected from the value funds at this stage of the market cycle.

COURTLAND PARTNERS REPORT ON PLACEMENT AGENTS

Mr. Humphrey presented Courtland's report on the use of a placement agent in connection with the ERS's investment in Lone Star Fund VII (U.S.), L.P. and Lone Star Real Estate Fund II (U.S.), L.P. (Lone Star Funds). The Lone Star Funds paid a placement agent in connection with the ERS's investment in the funds; however, the ERS did not pay or receive any portion of the placement agent fee. At the time the investment in the Lone Star Funds was approved, the ERS did not have a policy regarding the use of placement agents; the Board adopted a policy for the use of placement agents at its January 2013 meeting. Courtland was not aware that the Lone Star Funds were using a placement agent; Courtland's recommendation that the ERS invest in the Lone Star Funds was not impacted or influenced by the Lone Star Funds' use of a placement agent.

ENTER EXECUTIVE SESSION

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

- To approve executive session minutes of the Board meetings of September 10, 2012, October 11, 2012, October 12, 2012, and November 13, 2012;
- Pursuant to HRS § 92-5(a)(8), to hear a status report from Macquarie Funds Group (USA) Inc. on the Hawaii Targeted Investment Program (HiTIP);
- Pursuant to HRS § 92-5(a)(8), to hear a status report on HiTIP fund manager, Arsenal Venture Partners;
- Pursuant to HRS § 92-5(a)(8), to consider an update on discussions with Bruce Graham, ERS counsel in the Kaho'ohanohano vs. State of Hawaii case; and
- Pursuant to HRS § 92-5(a)(8), to evaluate priority-listed finalists for the ERS's Request for Proposals for private equity consultant services.

APPROVAL OF EXECUTIVE
SESSION BOARD MEETING
MINUTES

- SEPTEMBER 10, 2012
- OCTOBER 11, 2012
- OCTOBER 12, 2012
- NOVEMBER 13, 2012

EXECUTIVE SESSION TO HEAR A
STATUS REPORT FROM
MACQUARIE FUNDS GROUP (USA)
ON HiTIP

EXECUTIVE SESSION TO HEAR A
STATUS REPORT ON HiTIP FUND
MANAGER, ARSENAL VENTURE
PARTNERS

EXECUTIVE SESSION TO HEAR A
STATUS REPORT ON
KAHO‘OHANO HANO VS. STATE OF
HAWAII

EXECUTIVE SESSION TO
EVALUATE PRIORITY-LISTED
FINALISTS FOR THE ERS'S
REQUEST FOR PROPOSALS FOR
PRIVATE EQUITY CONSULTANT
SERVICES

EXIT EXECUTIVE SESSION

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

PRESENTATION BY PENSION
CONSULTING ALLIANCE ON THE
PERFORMANCE OF THE ERS'S
INVESTMENT PORTFOLIO AND
RISK MANAGEMENT FOR 4TH
QUARTER 2012

Mr. John Linder and Mr. Neil Rue of Pension Consulting Alliance, Inc. (PCA), ERS's general investment consultant, presented PCA's report on the performance of the ERS's investment portfolio and risk management for the period ending December 31, 2012, 4th quarter of 2012. Highlights included:

- \$11.9 billion aggregate portfolio value.
- During the 4th quarter and over the latest year, the portfolio increased by \$164.6 million and \$1,178.2 million, respectively.
- Portfolio returned 2.1%, outperforming the policy benchmark return of 2.0% and slightly underperforming the Median Public Fund return of 2.2%., lagging by 10 basis points.

- Domestic equity strategic class trailed the policy benchmark's return for the quarter by 40 basis points. Over longer periods, the majority of the current domestic equity managers matched or exceeded applicable benchmarks; underperformance was primarily due to managers no longer retained by the ERS.
- International equity strategic class exceeded its policy benchmark during the quarter by 60 basis points.
- Total fixed income strategic class outperformed its policy benchmark during the quarter and 1- and 3-year trailing periods (this strategic class was restructured in 2008).
- Real Estate strategic class outperformed its policy benchmark over the 1- and 3-year periods, but underperformed over the quarter and 5-year period.
- Private Equity strategic class outperformed its policy benchmark over the quarter, but lagged all other reported periods.
- Real Return and Covered Calls strategic classes outperformed their respective benchmarks across all reported periods.

The Board and ERS staff also discussed policy targets, the economic impact of Hurricane Sandy and the allocation of total portfolio risk:

- Policy risk is dominating overall portfolio risk.
- Class weightings versus targets have marginally reduced overall risk.
- Active management is increasing overall risk.

OPERATIONS REPORT
– JANUARY 2013

The Administrator reported on the status of ERS operations for January 2013:

- ERS received a favorable decision from the Intermediate Court of Appeals in the Fratinaro case.
- The internal audit being conducted the ERS's internal audit consultant, KMH LLP is moving along.
- Board meeting minutes will be posted on the ERS's website.
- Mailed approximately 800 postcards to ERS members regarding login information for the ERS's Self-Service system available on the ERS website.

2013 EMPLOYEES' RETIREMENT
SYSTEM'S INVESTMENT SUMMIT

The CIO presented a report on the tentative budget for and the due diligence site inspections of properties that are being considered by the ERS to host its 2013 Investment Summit scheduled for July 16-18, 2013 on Maui.

NEXT BOARD MEETING
– MARCH 11, 2013

Acting Chair Kane announced that the next Board meeting is scheduled for March 11, 2013.

ADJOURNMENT

On a motion made by Trustee Barfield, seconded by Trustee Rauckhorst, and unanimously carried, the meeting was adjourned at 4:17 p.m.

**REDACTED
SIGNATURE**

Wesley K. Machida
Administrator

WKM: jh