

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

JANUARY 11, 2016

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

- Trustees present: Mr. Vince Barfield, Chair  
Mr. Emmit Kane, Vice Chair  
Dr. Catherine Chan  
Ms. Jackie Ferguson-Miyamoto  
Mr. Patrick Frane  
Mr. Wesley Machida  
Mr. Colbert Matsumoto  
Mr. Jerome Rauckhorst
- Staff present: Mr. Thomas Williams, Executive Director  
Ms. Kanoe Margol, 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. Wanda Kugiya, Secretary  
Ms. Dale Kanae, Secretary  
Ms. Traci Toguchi, Recording 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. Neil Rue, Pension Consulting Alliance, LLC  
Mr. John Linder, Pension Consulting Alliance, LLC  
Mr. Michael Humphrey, Courtland Partners, Ltd.  
Ms. Janeane O'Dell, Lowe Enterprises, Inc.  
Mr. Bleecker Seaman, Lowe Enterprises, Inc.  
Mr. Russell Munn, Lowe Enterprises, Inc.
- Public present: Mr. Benjamin Sadoski, UNITE HERE Local 5

## QUORUM/CALL TO ORDER

A quorum being present (Vice Chair Barfield, and Trustees Chan, Ferguson-Miyamoto, Frane, Kane, Matsumoto and Rauckhorst), then-Vice Chair Barfield called the regular meeting of the Board of Trustees (Board) of the Employees' Retirement System of the State of Hawaii (ERS) to order at 9:02 a.m.

Vice Chair Barfield introduced new Trustee Catherine Chan, providing highlights of Trustee Chan's academic accomplishments and her service to the University of Hawaii as professor and chair of the Agricultural Marketing, Economic Development and Environmental Management Department.

## PUBLIC COMMENT

Vice Chair Barfield called for public comment. Mr. Benjamin Sadoski of UNITE HERE Local 5 (Local 5) was present to provide comment regarding one of the ERS's investment managers. Vice Chair Barfield noted that the matter was not on the agenda and that the Board's policy for public testimony limits public comment to specific to agenda items; however, the Board would allow an exception in this instance, as a courtesy to the union. Vice Chair Barfield asked Mr. Sadoski to adhere to the three minute time limit.

Mr. Sadoski stated that Local 5 is part of the national UNITE HERE organization of the hospitality workers' union. He provided the Board with an oral and written report on issues related to Leonard Green & Partners, noting that the ERS is a limited partner with Leonard Green. Mr. Sadoski reported that Local 5 is pleased with an agreement that the union came to with Lowe Enterprises, Inc. (Lowe) after an ERS Board meeting, several months ago, at which he presented concerns to Board regarding Lowe.

## ELECTION OF OFFICERS AND COMMITTEE ASSIGNMENTS

Executive Director Williams assisted the Board in facilitating the election of its officers. Nominations for the ERS Board Chair and Vice Chair positions were entertained.

On a motion made by Trustee Matsumoto and seconded by Trustee Rauckhorst, Trustee Barfield was nominated as Chair of the Board of Trustees for a term of one year or until a successor is elected. Trustee Barfield was unanimously elected as Chair of the Board of Trustees for a term of one year or until a successor is elected.

On a motion made by Trustee Matsumoto and seconded by Trustee Rauckhorst, Trustee Kane was nominated as Vice Chair of the Board for a term of one year or until a successor is elected. Trustee Kane was unanimously elected as Vice Chair of the Board of Trustees for a term of one year or until a successor is elected.

(Trustee Machida joined the meeting at this time.)

Chair Barfield presented a proposal for Board Officers and Committee assignments. He states that respective backgrounds of the Trustees were taken into consideration and that he held separate discussions with individual Trustees regarding the proposed assignments. Chair Barfield opened the matter for discussion. There was no discussion.

On a motion made by Trustee Matsumoto, seconded by Trustee Kane, and unanimously carried, the Board adopted the Officers and Committee

Assignments set forth in Attachment A to these minutes.

RECESS

Chair Barfield called for a recess at 9:12 a.m. for the Investment Committee Meeting. Chair Barfield announced the meeting would reconvene upon conclusion of the Investment Committee meeting.

RECONVENE

A quorum being present, Chair Barfield reconvened the meeting at 10:05 a.m.

(All trustees in attendance at the meeting were present at this time, with the exception of Trustee Rauckhorst.)

(Trustee Rauckhorst returned to the meeting at 10:07 a.m.)

PENSION CONSULTING  
ALLIANCE, LLC – CRISIS RISK  
OFFSET CLASS  
IMPLEMENTATION REVIEW

Chief Investment Officer Chattergy opened the discussion of the Crisis Risk Offset Class by reviewing the reasons why the class was created. When the individual members of the Board were surveyed by ERS's general consultant, Pension Consulting Alliance, LLC (PCA) in 2015, the key priorities of the Trustees were:

- Maintain ERS funding path progress
- Avoid deterioration of ERS funding ratio
  - (Seek to never be below 55% funding ratio)
- Avoid seeking higher %-of-ay contribution levels
  - (Avoid exceeding the UAAL 30-year amortization schedule)

The ERS therefore switched from an Asset Class Framework as the basis for structuring its portfolio to a Risk Class Framework. The goal of the Crisis Risk Offset Class is to reduce risk in the portfolio.

Mr. Neil Rue and Mr. John Linder of Pension Consulting Alliance, LLC (PCA) presented an oral and written report of PCA's recommendations for implementation of the Crisis Risk Offset (CRO) class. In order to maintain continuous exposure to CRO strategies, without transfer gaps, PCA analyzed the following implementation options:

1. Staff monitors and rebalances CRO components/managers using standard managed-account framework;
2. Enter into Prime Broker (PB) relationship where the PB owns all the manager accounts and enters into a Total Return Swap with ERS (the PB commits to providing the CRO return to ERS);
3. Establish a manager-of-managers (MoM) platform to monitor and manage CRO class portfolio, but maintain custody at the custodian bank; MoM given discretion-in-a-box platform to appropriately monitor and manage CRO class;
4. Same as 3, with the platform provided by one of the CRO managers; and
5. Engage a single investment manager to run all CRO Class sub-strategies and provide platform capabilities.

PCA believes that: options 1 and 2 are not realistic at this time; option 3 is high-cost; and options 4 and 5 are most attractive and would be pursued via requests for proposals.

Mr. Linder, Mr. Rue, Chief Investment Officer Chattergy, and the Trustees discussed the pros and cons of each option, the elements of the CRO class, communication with, and education of, managers and stakeholders regarding the class and risk management, and the requirements for managing the CRO class, including: liquidity; trend following strategies; leverage; counterparty risks; derivatives; volatility; resources required to rebalance within the subclasses, classes and the overall portfolio; implementation timeline; and cost.

Chair Barfield stated that this matter warrants further discussion before any decision is made by the Board.

#### EXTENSION OF KMH, LLP INTERNAL AUDIT CONTRACT

Executive Director Williams presented staff's request for the Board's approval to extend the internal audit contract with KMH LLP (KMH) and to increase the contract amount by \$548,000. The current term of the contract expires on January 31, 2016.

In response to a question from Chair Barfield, Executive Director Williams confirmed that staff is satisfied with the quality of KMH's work and noted that KMH's findings and recommendations have been valuable.

The Trustees asked about the amounts that have been expended under the contract. Further consideration of the matter was deferred until the information could be provided.

#### ANNUAL SECTION 88-103.7(f) REPORT

Executive Director Williams presented the ERS's status report to the Legislature, required by Act 87, Session Laws of Hawaii 2015, on the progress by State and county departments and agencies in complying with the requirements of section 88-103.7(f), Hawaii Revised Statutes, as amended by Act 87, with respect to the reporting of personnel and payroll information to the ERS. The status report was sent to the Legislature through the Director of Finance. Annual status reports are required through the 2020 legislative session. The reporting requirements of section 88-103.7, as amended by Act 87, will become effective July 1, 2020.

In response to questions from the Trustees, Executive Director William and Program Specialist Donna Curry explained that "no" on the written report meant that there has been no movement from the agency and that "pending" meant that the agency is working with the ERS to achieve compliance with the requirements of section 88-103.7, but is not compliant yet; for most agencies that are not in compliance, the problem is reporting retroactive data.

#### HAWAII TARGETED INVESTMENT PROGRAM (HiTIP) ANNUAL REPORT (ACT 260/2007)

Chief Investment Officer Chattergy presented the ERS's Innovation Economy 2015 report (referencing the Hawaii Targeted Investment Program (HiTIP)) that was transmitted to the Legislature as required by Act 260, Session Laws of Hawaii 2007.

Chief Investment Officer Chattergy reported that the HiTIP program is fully committed at this point, and that the Investment Staff is monitoring the

performance of the HiTIP investments.

In response to questions from the Trustees, Chief Investment Officer Chattergy reported that the HiTIP program has performed reasonably well, but that Hawaii impact was limited. Executive Director Williams added that he and Chief Investment Officer Chattergy will be reviewing the investments in the HiTIP program in light of the planned increase in commitments to private markets.

#### SUDAN ANNUAL REPORT (ACT 192/2007)

Chief Investment Officer Chattergy presented the ERS's Direct Holdings in Sudan Scrutinized Companies 2015 report that was transmitted to the Legislature as required by Act 192, Session Laws of Hawaii 2007. The report summarizes activities related to the Sudan holdings and violations over the past year.

In response to Chair Barfield's inquiry about significant issues or outstanding items with respect to Act 192, Chief Investment Officer cited the use of staff resources to monitor and maintain compliance with the Sudan policy.

#### COMMISSION RECAPTURE ANNUAL REVIEW REPORT

Chief Investment Officer Chattergy presented the 2014 Commission Recapture Program Activity Report prepared by PCA. Chief Investment Officer Chattergy noted that the trend in the marketplace is decreasing commission recapture credits; managers are focusing on best execution. The next time a review of the program is made, continued participation in the program may be re-considered.

#### OPPORTUNISTIC RISK CLASS DRAFT POLICY GUIDELINES

Chief Investment Officer Chattergy and Mr. Neil Rue of Pension Consulting Alliance, LLC presented draft Opportunistic Risk Class. Chief Investment Officer Chattergy explained that the creation of an Opportunistic Risk Class was approved by the Board at the Board's September 14, 2015, meeting as part of the new long-term strategic allocation policy resulting from the 2015 Asset-Liability Project. Chief Investment Officer Chattergy noted that the Opportunistic Risk Class has a zero asset allocation target due to the nature of the investment.

Mr. Rue explained that the Opportunistic Risk Class is intended for investment opportunities that are transitory in nature -- 3-5 years for a specific investment. No action on the guidelines is required at this time. The guidelines will be presented to the Board for approval in a few months.

In response to questions from the Trustees, Mr. Neil stated that the typical investment size for this class would be \$25 million to \$50 million, but possibility up to \$250 million if funds are available for the investment. Investment recommendations for this class would be made by Investment staff and a consultant.

#### ANALYSIS OF THE 2016 ERS INVESTMENT EDUCATION SUMMIT

Chief Investment Officer Chattergy presented an analysis for the 2016 ERS Investment Education Summit. He reported that the summit is currently planned for the last week in July, for 2-1/2 days; however, the start date for the summit has not been set. Staff is considering sites on Maui for the summit. Based on a budget analysis, the estimated budget for the summit is \$40,830. This is an increase over the cost of the summit held last year on Oahu due to interisland air travel expenses.

EXTENSION OF KMH, LLP  
INTERNAL AUDIT CONTRACT

Deputy Executive Director Margol provided the Board with the requested information about the amounts expended under the original contract with KMH. The original amount expended and the additional amounts requested are as follows:

Phase I (February 1, 2013 to January 31, 2016): \$687,000;

Phase II (February 1, 2016 to January 31, 2017): \$395,000 additional request. This amount is for changes to the scope of work resulting from the re-assessment of risks and changes in project priorities; and

Phase III (February 1, 2017 to June 30, 2017): \$153,000 additional request.

Total Cost: \$1,235,000.

On a motion made by Trustee Matsumoto, seconded by Vice Chair Kane, and unanimously carried, the Board approved:

- (1) Extension of the term of the contract with KMH LLP for internal audit services for one year to January 31, 2017; and
- (2) Subject to availability of funds and any necessary procurement approvals:
  - (a) Further extension of the term of the contract to June 30, 2017; and
  - (b) Increase in the contract amount by up to an additional \$548,000 (\$385,000 for Phase II and \$153,000 for phase 3).

APPROVAL OF MINUTES  
– SEPTEMBER 14, 2015  
– NOVEMBER 9, 2015

On a motion made by Trustee Ferguson-Miyamoto, seconded by Trustee Frane, and unanimously carried, the Board approved the minutes of the September 14, 2015, and November 9, 2015, meetings, as presented.

EXECUTIVE DIRECTOR'S  
REPORT

Executive Director Williams provided the Board with an oral report. Highlights included the following:

- Will provide Trustee Chan with a trustee orientation manual and introduce her to the ERS staff;
- Participated in a budget hearing with Trustee Machida, and Senate and House Finance Committee Chairs, with an additional meeting scheduled with the House Finance Committee staff regarding budgets;
- Meetings scheduled with labor committee chairs Senator Gilbert Keith-Agaran, and Representative Mark Nakashima;
- Working very closely with Chief Investment Officer Chattergy and the Investment Staff regarding the Request for Proposal (RFP) and implementation process, with timeframes and responsibilities identified;
- A bill drafted by the Department of the Attorney General, at the ERS's request, to shift the Investment Specialists' positions from civil service to an exempt classification was sent to Trustee Machida, and Executive Director Randy Perreira of the Hawaii Government Employees Association (HGEA) for review and hopeful support;

- Continued challenges regarding secretarial support roles relating to the short term nature of the assignment and pay;
- The ERS staff's draft relating to Qualified Domestic Relations Orders was sent to Senator Maile Shimabukuro and Representative San Buenaventura, who have strong interest in this matter;
- The ERS management sponsored a new year's eve lunch for the staff that was well received;
- (Executive Director Williams') family has fully relocated to Hawaii as of December 30, 2015;
- Close to a resolution regarding County of Kauai Police Chief Darryl Perry's request for reinstatement of his pension;
- Working with Mr. Mike Hirai of First Hawaiian Bank on a gathering in honor of prior ERS Board Chair Pilialoha Lee Loy on January 22, 2016;
- Working closely with Information Technology Manager Keith Miyamoto and the Office of Enterprise Technology Services (ETS) regarding cybersecurity challenges, including the ETS's provision to the ERS of a penetration test in January, which is delayed due to being out of the scope of the contract the ETS has with the provider;
- Concluded and approved an extension of an internal audit contract; acknowledged Chief Investment Officer Chattergy and Deputy Executive Director Margol for their hard work during the process of shaping Operations and the Investment Staff;
- In the process of refining the trustee education policy, including trustee educational opportunities in relation to the Investment Staff;
- The Board may have already received invitations and/or a request for dialogue from 350 Hawaii (via the ERS); 350 Hawaii requested Board contact information from the ERS; and
- Spoke of needing a larger discussion with the ERS's actuarial firm regarding recent research stating that, while investment returns to play a big role in determining the level of unfunded liability that pension funds face, changing assumptions actuarially relating to areas including mortality and salary increases, thus looking not only at investments but at actuarial assumptions, which can have significant impact as well.

Executive Director Williams responded to an inquiry by Trustee Matsumoto regarding the former's prior mention of contracting an independent fiduciary services consultant.

OPERATIONS REPORT  
- DECEMBER 2015

Deputy Executive Director Margol provided an oral and written Operations Report for December 2015, highlighting the Finals Report, where she noted that December is the heaviest month for retirements. She stated there were 1,400 benchmark pending status cases within 6 months, and that staff was able to keep the backlog to less than 3%.

RECESS

At 12:37, Chair Barfield called for a ten minute recess for lunch.

RECONVENE

A quorum being presented, Chair Barfield reconvened the meeting at 12:53 p.m.

ENTER EXECUTIVE SESSION

On a motion made by Trustee Ferguson-Miyamoto, seconded by Trustee Machida, and unanimously carried, the Board entered executive session at 12:53 p.m.:

- Pursuant to HRS § 88-27.5(a)(1) and HRS § 92-5(a)(4), to consider the system's investment in, and 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 Royal Ka'anapali Golf Courses property; appropriate action;
- Pursuant to HRS § 88-27.5(a)(1), to conduct discussions and deliberations and to make decisions relating to the Equity-Oriented Options-Based Managers Search;
- 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 legislation to authorize the ERS to make direct payment to the former spouse of an ERS member or retirant when the former spouse has been awarded a portion of the member's or retirant's retirement benefits as part of a property division adjudicated, ordered or decreed by a court in a domestic relations proceeding;
- Pursuant to HRS § 92-5(a)(2) and (4), to consider personnel matters relating to, and 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 roles, responsibilities and direction of, the Investment Office; appropriate action; and
- To approve the minutes of the July 13, 2015, July 21, 2015, August 10, 2015, and November 9, 2015, meetings.

EXECUTIVE SESSION TO CONSIDER THE SYSTEM'S INVESTMENT IN, AND 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 ROYAL KA'ANAPALI GOLF COURSES PROPERTY; APPROPRIATE ACTION

(Mr. Bleecker Seaman and Mr. Russell Munn of Lowe Enterprises, Inc. joined the meeting by telephone.)

(Ms. O'Dell, Mr. Seaman and Mr. Munn left the meeting at 1:45 p.m.).

(Mr. Humphrey left the meeting at 1:47 p.m.)

EXECUTIVE SESSION TO CONDUCT DISCUSSIONS AND DELIBERATIONS AND TO



MAKE DECISIONS RELATING  
TO THE EQUITY-ORIENTED  
OPTIONS-BASED MANAGERS  
SEARCH

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 LEGISLATION  
TO AUTHORIZE THE ERS TO  
MAKE DIRECT PAYMENT TO  
THE FORMER SPOUSE OF AN  
ERS MEMBER OR RETIRANT  
WHEN THE FORMER SPOUSE  
HAS BEEN AWARDED A  
PORTION OF THE MEMBER'S  
OR RETIRANT'S RETIREMENT  
BENEFITS AS PART OF A  
PROPERTY DIVISION  
ADJUDICATED, ORDERED OR  
DECREED BY A COURT IN A  
DOMESTIC RELATIONS  
PROCEEDING

(Investment Staff and the PCA representatives left the meeting at 1:59  
p.m.)

APPROVAL OF EXECUTIVE  
SESSION MINUTES  
– JULY 13, 2015  
– JULY 21, 2015  
– AUGUST 10, 2015  
– NOVEMBER 9, 2015

EXECUTIVE SESSION TO  
CONSIDER PERSONNEL  
MATTERS RELATING TO,  
AND 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 ROLES,  
RESPONSIBILITIES AND  
DIRECTION OF, THE  
INVESTMENT OFFICE;  
APPROPRIATE ACTION

EXIT EXECUTIVE SESSION

On a motion made by Trustee Ferguson-Miyamoto, seconded by Trustee Frane, and unanimously carried, the Board exited executive session at 3:00 p.m.

ADJOURNMENT

On a motion made by Trustee Ferguson-Miyamoto, seconded by Trustee Frane, and unanimously carried, Chair Barfield adjourned the meeting at 3:00 p.m.

**REDACTED  
SIGNATURE**

Thomas Williams  
Executive Director

TW:tt

**BOARD OF TRUSTEES OF THE  
EMPLOYEES' RETIREMENT SYSTEM  
OF THE STATE OF HAWAII**

**OFFICERS & COMMITTEE ASSIGNMENTS**

**Effective 1/11/16**

**BOARD MEMBERS**

**Vince Barfield, Chair**  
**Emmit Kane, Vice Chair**  
Catherine Chan  
Jackie Ferguson-Miyamoto  
Patrick Frane  
Wesley Machida  
Colbert Matsumoto  
Jerry Rauckhorst

**INVESTMENT COMMITTEE**

**Emmit Kane, Chair**  
**Jerry Rauckhorst, Vice Chair**  
Vincent Barfield  
Catherine Chan  
Jackie Ferguson-Miyamoto  
Patrick Frane  
Wesley Machida  
Colbert Matsumoto

**ADMINISTRATIVE & LEGISLATIVE COMMITTEE**

**Jackie Ferguson-Miyamoto, Chair**  
Catherine Chan  
Wesley Machida  
Jerry Rauckhorst (Alternate)

**AUDIT COMMITTEE**

**Patrick Frane, Chair**  
Jackie Ferguson-Miyamoto  
Catherine Chan

**COMPENSATION REVIEW COMMITTEE**

**Jerry Rauckhorst, Chair**  
Colbert Matsumoto  
Vince Barfield  
Emmit Kane

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**GOVERNANCE POLICY (ad-hoc)**

**Colbert Matsumoto, Chair**  
Vince Barfield  
Emmit Kane

**KA'ANAPALI COMMITTEE (ad-hoc)**

**Colbert Matsumoto, Chair**  
Vince Barfield  
Wesley Machida