

AMENDED

MINUTES OF THE REGULAR BOARD MEETING OF THE  
BOARD OF TRUSTEES OF THE EMPLOYEES' RETIREMENT SYSTEM (ERS)

MAY 13, 2014

CITY FINANCIAL TOWER  
201 MERCHANT STREET, SUITE 1935  
HONOLULU, HAWAII 96813

Trustees present: Ms. Pilialoa Lee Loy, Chair  
Ms. Jackie Ferguson-Miyamoto  
Mr. Patrick Frane  
Mr. Emmit Kane  
Mr. Colbert Matsumoto  
Mr. Jerome Rauckhorst  
Mr. Kalbert Young

Trustees excused: Mr. Vince Barfield, Vice Chair

Attorneys present: Ms. Diane Kishimoto, Deputy Attorney General (Counsel for the Board)  
Ms. Elmira Tsang, Deputy Attorney General (Counsel for ERS staff)

Staff present: Mr. Wesley Machida, 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 Wetzal, Investment Specialist  
Ms. Donna Curry, Program Specialist  
Ms. Gerri Konishi, Member Home Loan Assistant  
Ms. Jaime Hirata, Recording Secretary  
Ms. Raechele Joyo, Secretary  
Ms. Wanda Kugiya, Secretary

Guests present: Mr. Michael Humphrey ) Courtland Partners, Ltd.  
Mr. Paul Yett ) Hamilton Lane Advisors, LLC  
Mr. Andy Betz ) Macquarie Funds Management (USA) Inc.  
Mr. John Linder ) Pension Consulting Alliance, Inc.  
Mr. Neil Rue

QUORUM/CALL TO ORDER

A quorum being present, Chair Lee Loy, called the regular meeting of the Board of Trustees of the Employees' Retirement System (the Board), to order at 9:37 a.m.

AMENDMENT OF THE AGENDA

On a motion made by Trustee Ferguson-Miyamoto, seconded by Trustee Kane, and unanimously carried, the Board amended the agenda to add:

- Report by the members of the Board appointed pursuant to HRS § 92.2.5(b) to meet with representatives of Macquarie Funds Management (USA) Inc. to investigate organizational changes affecting Macquarie Funds Management (USA) Inc.
- Executive Session, pursuant to HRS § 92-5(a)(8), to consider staff comments with respect to a preliminary review of the Employees' Retirement System's (ERS) actuarial assumptions.

TRUSTEE JERRY RAUCKHORST  
REAPPOINTMENT TO THE BOARD  
OF TRUSTEES OF THE EMPLOYEES'  
RETIREMENT SYSTEM

Chair Lee Loy congratulated Trustee Rauckhorst on his reappointment to the Board and presented him with a lei.

RECESS

Chair Lee Loy called a recess at 9:38 a.m. and announced that the meeting would reconvene following the Investment Committee meeting.

RECONVENE

A quorum being present, (Trustees Lee Loy, Frane, Ferguson-Miyamoto, Kane and Matsumoto) Chair Lee Loy reconvened the meeting at 10:20 a.m.

PRESENTATION BY PENSION  
CONSULTING ALLIANCE, INC. ON  
THE PERFORMANCE OF THE  
EMPLOYEES' RETIREMENT  
SYSTEM'S INVESTMENT  
PORTFOLIO AND RISK  
MANAGEMENT REPORTS FOR 1<sup>ST</sup>  
QUARTER 2014

Mr. John Linder and Mr. Neil Rue of Pension Consulting Alliance, Inc. (PCA), general investment consultant, presented PCA's Portfolio Performance and Risk Management Reports of the ERS's investments for the 1<sup>st</sup> quarter of 2014. Highlights included:

- Aggregate portfolio value was \$13.7 billion as of March 31, 2013.
- Portfolio increased by \$0.2 billion during the first quarter and by \$1.4 billion over the latest year.
- Portfolio underperformed the Policy Benchmark return of 2.2% and the Median Public Fund return of 2.1% for the 1<sup>st</sup> quarter.

(Trustee Rauckhorst joined the meeting. Trustee Kane left the meeting.)

- Over the 1-year period, the portfolio exceeded the Policy Benchmark and the Median Public Fund by 30 and 90 basis points, respectively. Relative outperformance over the 1-year period was largely attributed to the ERS's active domestic equity and fixed Income managers' combined performance exceeding their respective benchmarks, as well as an overweight to domestic equity and underweight to fixed income versus the policy target. Longer-term performance gaps have begun to narrow as a result of the near-term outperformance.

- Eight of eleven domestic equity managers matched or outperformed their respective benchmarks and all eleven managers outperformed their respective benchmarks over the 1-year period.
- Restructuring of the international equity portfolio reduced the number of international equity managers and increased the level of passive management in 2011.
- Five of six fixed income managers exceeded their respective benchmarks during the 1<sup>st</sup> quarter and over the 1-year period.

(Trustee Kane returned to the meeting.)

- Risk allocation is currently consistent with asset allocation.
- Growth risk is 45% of the policy portfolio's explainable risk.

(Trustee Rauckhorst left the meeting.)

PRESENTATION BY COURTLAND PARTNERS, LTD. ON THE EMPLOYEES' RETIREMENT SYSTEM'S REAL ESTATE PORTFOLIO MANAGEMENT REPORT FOR 4<sup>TH</sup> QUARTER 2013

Mr. Michael Humphrey of Courtland Partners, Ltd. (Courtland Partners), real estate investment consultant, presented Courtland's Real Estate Portfolio Performance Measurement Report for 4<sup>th</sup> quarter 2013. Highlights included:

- Portfolio market value was \$890,229,656 for the period ended December 31, 2013.
- Total number of current investments: 18.
- Total net return was 0.8% for the quarter; 12.6% year-to-date.
- 7.3% internal rate of return (IRR).
- Portfolio is 6.6% of total plan assets (versus 7.0% target allocation).
- Portfolio outperformed the National Council of Real Estate Investment Fiduciaries (NCREIF) property index (NPI) by 3.5%, 3.5%, 4.7%, 5.0%, and 3.1% for the year-to-date, 1-, 2-, 3-, and 5-year periods, respectively.
- Portfolio underperformed the NPI by 1.2% and 4.0% for the quarter and inception to date periods, respectively.
- Quarterly losses due to the transfer of assets to Heitman Capital Management and Invesco Real Estate from LaSalle Asset Management, and the restructuring of BlackSand Capital's portfolio.

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

Mr. Humphrey noted that Courtland plans to be more involved with the appraisals of the properties to improve its management and coordination of the evaluations and tracking of the properties and transactions. In closing, Mr. Humphrey presented an overview of the current real estate market conditions and a preview of the European and Latin America real estate markets and possible future investment opportunities.

Mr. Paul Yett of Hamilton Lane Advisors, LLC (Hamilton Lane), private equity investment consultant, reported on the progress of Hamilton Lane's strategic plan and 2014 tactical plan for the ERS's private equity program, as approved by the Board at its January 13, 2014 meeting. Highlights included:

- Hamilton Lane's review of the ERS' private equity investment portfolio reported a strong performance over the year ended December 31, 2013, with a point-to-point IRR of 19.5% and nearly \$88 million of net value generated.
- Portfolio market value increased 13% over the past year, to \$518.1 million as of December 31, 2013 and continues to grow with total exposure increasing by over \$175 million during the past year.
- Venture capital of 3.11% is low relative to the rest of the portfolio; buyout had an 11.65% IRR, but also 53% above cost.
- To-date in 2014, closed on three investments, \$105 million in committed capital (\$35 million each to American Securities Opportunities Fund III, L.P., Providence Debt Opportunity Fund III, L.P., and Waterton Precious Metals Fund II, L.P.).
- Portfolio recommendations:
  - Establish "foundation managers" who will be expected to outperform peers and benchmarks.
  - Increase exposure to growth equity and to Asia.
  - Increase average commitment size with the goal of committing more capital to fewer managers with the largest commitments to be allocated to core managers.
  - Commit approximately \$250 million during 2014 to approximately 10 partnerships.
  - Decrease exposure to venture capital.
- Tactical Plan
  - Commit approximately \$250 million during 2014 to approximately 10 partnerships.
  - Focus on a more concentrated portfolio with largest commitments to foundation managers.
  - Maintain existing relationships with strong-performing general partners.
  - Target exposure to buyouts, credit and energy investments
  - Identify small and middle-market managers with specialized expertise in unique opportunity sets.

- Diversify the portfolio geographically with a goal of prudently increasing exposure to internal and emerging markets exhibiting strong economic fundamentals.

In closing, Mr. Yett described four possible investment opportunities that Hamilton Lane is currently researching:

- \$15 million to JMI Equity Fund VIII, L.P. (growth equity).
- \$35 million to Kelso Investment Associates IX, L.P. (corporate finance buyout-mid).
- \$15 million to Polaris Partners VII, L.P. (venture capital).
- \$35 million to Vista Equity Partners V, L.P. (corporate finance buyout-large).

REPORT BY MEMBERS OF THE BOARD APPOINTED PURSUANT TO HRS § 92.2.5(b), TO MEET WITH REPRESENTATIVES OF MACQUARIE FUNDS MANAGEMENT (USA) INC. TO INVESTIGATE ORGANIZATIONAL CHANGES AFFECTING MACQUARIE FUNDS MANAGEMENT (USA) INC.

Mr. Vijoy Chattergy, Chief Investment Officer (CIO), reported on the meeting with representatives of Macquarie Funds Management (USA) Inc. (Macquarie). Macquarie oversees the Hawaii Targeted Investment Program Fund I, LP (HiTIP) for the ERS. The trustees and ERS staff present discussed Macquarie's pending ownership changes and prospects for additional Hawaii investments.

(Trustee Young joined the meeting.)

RECESS

Chair Lee Loy called a recess at 11:44 a.m.

RECONVENE

Chair Lee Loy reconvened the meeting.

AMENDMENT OF THE AGENDA

On a motion made by Trustee Frane, seconded by Trustee Kane, and unanimously carried, the Board amended the agenda to add:

- Acquisition of Oracle Software Licenses and Support Services.

Trustee Matsumoto disclosed to the Board that a subsidiary of the company of which he is president is an Oracle end user license reseller. He therefore recused himself from consideration of this matter and left the room.

ACQUISITION OF ORACLE  
SOFTWARE LICENSES AND  
SUPPORT SERVICES

Mr. Wesley Machida, Executive Director (Executive Director), reported that it was recently discovered that the ERS does not have sufficient licenses for the use of Oracle software for the ERS's pension administration system and accounting system. The cost of acquiring the additional licenses is approximately \$1,400,000.00. Acquisition of computer software by State agencies is subject to approval by the Governor. The Governor approved the software acquisition, on the understanding that the Board's approval would also be obtained.

On a motion made by Trustee Frane, seconded by Trustee Kane, and unanimously carried, the Board authorized the Executive Director to procure additional Oracle software licenses and support services for the pension administration system and accounting system.

(Trustee Matsumoto returned to the meeting.)

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)(8), to hear a status report from Maquarie Funds Management (USA) Inc. on the Hawaii Targeted Investment Program;
- Pursuant to HRS § 92-5(a)(8), to consider a report from Pension Consulting Alliance, Inc. on a review of the Hawaii Targeted Investment Program;
- To approve March 10, 2014 and March 17, 2014 executive session minutes;
- Pursuant to HRS § 92-5(a)(8), to consider a status report from Courtland Partners, Ltd. regarding investment in McMorgan Infrastructure Fund I, L.P.;
- Pursuant to HRS § 92-5(a)(8), to consider a status report from Courtland Partners, Ltd. Regarding the Royal Ka'anapali Golf Courses property;
- Pursuant to HRS § 92-5(a)(4) and (8), to consult with the ERS's attorneys on questions and issues pertaining to the ERS's powers, duties, privileges, immunities and liabilities with respect to, and to consider preliminary staff proposals for future legislative initiatives; and
- Pursuant to HRS § 92-5(a)(8), to consider staff comments with respect to a preliminary review of the ERS's actuarial assumptions.

EXECUTIVE SESSION TO HEAR A  
STATUS REPORT FROM  
MACQUARIE FUNDS  
MANAGEMENT (USA) INC. ON THE  
HAWAII TARGETED INVESTMENT  
PROGRAM (HiTIP)

(The Executive Director left the meeting.)

EXECUTIVE SESSION TO CONSIDER  
A REPORT FROM PENSION  
CONSULTING ALLIANCE, INC. ON A  
REVIEW OF THE HAWAII  
TARGETED INVESTMENT  
PROGRAM (HiTIP)

(Ms. Tsang joined the meeting.)

(The Executive Director returned to meeting.)

(Trustee Rauckhorst returned to the meeting.)

APPROVAL OF EXECUTIVE SESSION  
MINUTES  
– MARCH 10, 2014  
– MARCH 17, 2014

EXECUTIVE SESSION TO CONSIDER  
A REPORT FROM COURTLAND  
PARTNERS, LTD. REGARDING  
INVESTMENT IN MCMORGAN  
INFRASTRUCTURE FUND I, L.P.

EXECUTIVE SESSION TO CONSIDER  
A STATUS REPORT FROM  
COURTLAND PARTNERS, LTD.  
REGARDING THE ROYAL  
KA'ANPALI GOLF COURSESES  
PROPERTY

EXECUTIVE SESSION TO CONSULT  
WITH THE EMPLOYEES'  
RETIREMENT SYSTEM'S  
ATTORNEYS ON QUESTIONS AND  
ISSUES PERTAINING TO THE  
EMPLOYEES' RETIRMENT  
SYSTEM'S POWERS, DUTIES,  
PRIVILEGES, IMMUNITIES AND  
LIABILITIES WITH RESPECT TO,  
AND TO CONSIDER PRELIMINARY  
STAFF PROPOSALS FOR FUTURE  
LEGISLATIVE INITIATIVES

EXECUTIVE SESSION TO CONSIDER  
STAFF COMMENTS WITH RESPECT  
TO A PRELIMINARY REVIEW OF  
THE EMPLOYEES' RETIREMENT  
SYSTEM'S ACTUARIAL  
ASSUMPTIONS

EXIT EXECUTIVE SESSION

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

2014 – 2015 PRELIMINARY  
STRATEGIC INVESTMENT AGENDA

The CIO and PCA presented the Preliminary Strategic Investment Agenda for fiscal year 2015. The agenda included a list of projects that the Investment Office expects to work on and complete over the next twelve plus months. Projects included an Asset/Liability Study, and the introduction of new risk classes the end of calendar year 2014. In closing, Mr. Rue noted that PCA's draft of the proposed changes to the *ERS Investment Policy, Guidelines, and Procedures* "manual" will be presented to ERS staff for review prior to presentation to the trustees at the July 2014 Board meeting.

LEGISLATIVE PROPOSALS  
AFFECTING THE EMPLOYEES'  
RETIREMENT SYSTEM

The Executive Director presented a summary of the legislative changes related to the ERS from 2011 to 2014. During the 2014 legislative session, one of the ERS's two administrative proposals was enacted. This was House Bill (H.B.) 2264 relating to the investment authority of the ERS. This measure, designated as Act 35, and approved without amendments, allows the ERS to retain or dispose of real estate acquired by the ERS by foreclosure, in the enforcement of security, or in satisfaction of debts in the same manner as the ERS's other investments in interest in real property. H.B. 2263 relating to changing the formula for crediting unused sick leave toward retirement benefits for new employees after June 30, 2014 crossed-over to the Senate, but was not heard. Other proposals, which were not part the ERS's administrative package but which were supported by the Board: Senate Bill (S.B.) 1038 regarding the forfeiture of retirement benefits for members convicted of work-related felonies and S.B. 2916 requiring standard employer reporting to the ERS with penalties for non-compliance, were deferred in conference committee.

The Executive Director also announced that the Governor's appointment of Jerry Rauckhorst to the Board (G.M. 533), for a term to expire on January 1, 2020, was unanimously confirmed by the Senate.

The Executive Director shared his preliminary goals for the 2015 legislative session, which included networking and meeting with the legislators, State and County officials, unions, etc. earlier than last year.

APPROVAL OF MINUTES  
– MARCH 10, 2014  
– MARCH 17, 2014

On a motion made by Trustee Ferguson-Miyamoto, seconded by Trustee Kane, and unanimously carried, the Board approved the minutes of the March 10, 2014 and March 17, 2014 meetings, as circulated.

OPERATIONS REPORT  
– APRIL 2014

The Executive Director presented a report on ERS operations and ERS website statistics (top 10 viewed pages) for April 2014. Highlights included:

- ERS quarterly newsletter, “Holomua”, was distributed to active members and retirees on April 18, 2014.
- As part of the on-going effort to educate active employees on their retirement benefits, ERS staff conducted two lunch hour “Brown Bag Information Sessions” at the University of Hawaii of Manoa (UH), which were broadcast live to the UH Community Colleges; approximately 40 attendees.
- The number of retirants who are still on estimated pensions is increasing; staff is working with its “finalization” contractors to get the numbers back down.
- Status of the ERS’s operating expense budget as of March 31, 2014.
- Top ten viewed web pages of the ERS’ website included the benefits calculator still holding at number one since October 2013.
- The Ombudsman contacted the Executive Director regarding several complaints regarding the length of time it takes to process disability retirement claims. When ERS staff investigated the cases, it appeared that the cases are outliers; on average, disability retirement claims are processed by the Medical Board in two to five months. Future monthly operations reports will include the status of the disability retirement benefit cases.

NEXT MEETING  
- JUNE 9, 2014

Chair Lee Loy announced that the next Board meeting is scheduled for June 9, 2014.

ADJOURMENT

On a motion made by Trustee Rauckhorst, seconded by Trustee Ferguson-Miyamoto, and unanimously carried, Chair Lee Loy adjourned the meeting at 2:28 p.m.

**REDACTED  
SIGNATURE**

Wesley K. Machida  
Executive Director

WKM: jh