

AMENDED

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

SEPTEMBER 23, 2014

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

Trustees present: Ms. Pilialoa Lee Loy, Chair
Mr. Vincent Barfield, Vice Chair
Mr. Patrick Frane
Mr. Colbert Matsumoto
Mr. Emmit Kane
Mr. Jerome Rauckhorst
Mr. Kalbert Young

Trustee excused: Ms. Jackie Ferguson-Miyamoto

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 Wetzel, 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

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. Guy Holappa) The Bank of New York Mellon
Ms. Linda McAtee

Mr. Neil Rue) Pension Consulting Alliance, Inc.

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 11:03 a.m.

PRESENTATION BY BNY MELLON ON AN UPDATE AND REVIEW OF THEIR CUSTODIAL BANK SERVICES FOR THE EMPLOYEES' RETIREMENT SYSTEM

Ms. Linda McAtee and Mr. Guy Holappa of The Bank of New York Mellon (BNY Mellon) gave a presentation to the Board regarding BNY Mellon, and the nature of custodial bank services that BNY Mellon has been providing to the ERS for the past year.

There being no further discussion, the representatives from BNY Mellon left the meeting.

RECESS

Chair Lee Loy called a recess for lunch at 11:40 a.m. and announced that the meeting would reconvene as soon as the trustees had picked up their lunch.

RECONVENE

A quorum being present (Trustee Young was absent), Chair Lee Loy reconvened the meeting at 12:08 p.m.

ENTER EXECUTIVE SESSION

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

- Pursuant to HRS § 92-5(a)(4) and (8), to consider, 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, member, retirant, and beneficiary requests for waiver of overpayment under HRS § 88-106; appropriate action;
- 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 regarding possible participation in litigation with respect to Greek sovereign debt; appropriate action;
- 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 regarding possible participation in litigation against Espirito Santo Group; appropriate action;
- 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 regarding the draft report with respect to sharing of investment information and services by the Employer-Union Health Benefits Trust Fund and the ERS; appropriate action; and
- Approval of May 13, 2014 executive session minutes.

(Trustee Young returned to the meeting.)

(Mr. Rue left the meeting.)

EXECUTIVE SESSION TO
CONSIDER, AND TO CONSULT
WITH THE BOARD'S
ATTORNEYS ON QUESTIONS
AND ISSUES PERTAINING TO
THE BOARD OF TRUSTEES
POWERS, DUTIES, PRIVILEGES,
IMMUNITIES, AND LIABLILITES
WITH RESPECT TO, MEMBER,
RETIRANT, AND BENEFICIARY
REQUESTS FOR WAIVER OF
OVERPAYMENT UNDER HRS §
88-106.

EXECUTIVE SESSION TO
CONSULT WITH THE BOARD'S
ATTORNEYS ON QUESTIONS
AND ISSUES PERTAINING TO
THE BOARD'S POWERS,
DUTIES, PRIVILEGES,
IMMUNITIES, AND LIABILITIES
REGARDING POSSIBLE
PARTICIPATION IN LITIGATION
WITH RESPECT TO GREEK
SOVEREIGN DEBT

EXECUTIVE SESSION TO
CONSULT WITH THE BOARD'S
ATTORNEYS ON QUESTIONS
AND ISSUES PERTAINING TO
THE BOARD OF TRUSTEES
POWERS, DUTIES, PRIVILEGES,
IMMUNITIES, AND LIABILITIES
REGARDING POSSIBLE
LITIGATION AGAINST
ESPIRITO SANTO GROUP

EXECUTIVE SESSION TO
CONSULT WITH THE BOARD'S
ATTORNEYS ON QUESTIONS
AND ISSUES PERTAINING TO
THE BOARD OF TRUSTEES
POWERS, DUTIES, PRIVILEGES,
IMMUNITIES, AND LIABILITIES
REGARDING THE DRAFT
REPORT WITH RESPECT TO
SHARING OF INVESTMENT
INFORMATION AND SERVICES
BY THE EMPLOYER-UNION

HEALTH BENEFITS TRUST
FUND AND THE EMPLOYEES'
RETIREMENT SYSTEM

APPROVAL OF EXECUTIVE
SESSION MINUTES
– MAY 13, 2014

EXIT EXECUTIVE SESSION

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

(Mr. Rue returned to the meeting.)

BREACH OF INVESTMENT
GUIDELINES – FIXED INCOME
MANAGERS

Investment Officers Aaron Au and Anthony Goo reported that Western Asset Management Company (WAMCO), one of ERS's fixed income managers, reported to the ERS, WAMCO's non-compliance with the ERS's *Investment Policy Guidelines & Procedures* involving 25 securities that were rated below AAA requirement at the time of purchase. ERS's general investment consultant, Pension Consulting Alliance, Inc. (PCA), agreed that the breach was material and needed corrective action. Upon notification from ERS staff that corrective action was required, WAMCO liquidated the securities on July 11, 2014. Throughout the process of resolving this matter, it was also discovered that other similar securities did not meet the AAA requirement and that there was a misinterpretation of the ERS's *Investment Policy Guidelines & Procedures* relating to securities. The AAA rating requirement had been interpreted to mean that securities that were rated AAA at the time of purchase, but were thereafter downgraded, did not have to be sold. As a result of additional findings, the investment managers were informed of the compliance breach and were advised to comply going forward, with some investment managers providing written justification for continuing to hold the lower rated securities.

In closing, Mr. Vijoy Chattergy, Chief Investment Officer (CIO), noted that improved coding of the compliance monitoring system has been implemented and that the misinterpretation has been clarified with the investment managers. ERS investment staff will continue to monitor the ERS's portfolios as the fixed income managers prepare to transition to newly clarified mandates.

APPOINTMENT OF TRUSTEES,
PURSUANT TO HRS 92-2.5(b)(1),
TO PRESENT, ON AN ‘ŌLELO
BROADCAST, THE VIEWS OF
THE TRUSTEES WITH RESPECT
TO THE MISSION, VISION, AND
DIRECTION OF THE
EMPLOYEES’ RETIREMENT
SYSTEM

Mr. Wesley Machida, Executive Director, reported that, as part of the objectives and strategic initiatives of the ERS’s Strategic Plan to provide excellent service and educational communications with the members, the ERS will be developing a monthly pre-recorded series of programs for broadcast on ‘Ōlelo to educate ERS members and the public on the ERS. Planned topics include: benefits; investments; the Board; funding; and the ERS website. Recorded programs could also be made available on DVD for distribution to members and for presentation purposes. The Executive Director asked trustees to volunteer for the first program of the series to discuss the mission, vision, and direction of and for the ERS.

Chair Lee Loy appointed herself and Vice Chair Vince Barfield to present on an ‘Ōlelo broadcast, the views of the trustees with respect to the mission, vision, and direction of the ERS.

EMPLOYEES’ RETIREMENT
SYSTEM’S ACTUARIAL
ASSUMPTIONS

The Executive Director presented a report from Gabriel, Roeder, Smith & Company (GRS), ERS’s actuary, on the potential impact of a change in the investment return rate on the pension liabilities and the amortization period to pay down the ERS unfunded actuarial accrued liability (UAAL). The report was requested by the Board for the Board’s consideration in evaluating the adequacy of the current investment return rate assumption of 7.75%. The report included the estimated impact that a 0.5 percentage point and 0.25 percentage point reduction to the investment return rate would have on the ERS’s UAAL and UAAL amortization period. The report also included 3- and 5- year scenarios for phase-in of a reduction in the investment return rate. The Executive Director reminded the Board that the Board has the option to keep the current investment return rate assumption, lower it, or raise it, and that GRS needs the Board’s decision before December 2014, for inclusion in the 2014 Annual Actuarial Valuation Report.

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%

LEGISLATIVE PROPOSALS
AFFECTING THE EMPLOYEES'
RETIREMENT SYSTEM

The Executive Director presented a summary of the ERS's possible legislative proposals for the 2015 Legislative Session. The Board's Administrative and Legislative Committee discussed the following proposals at its September 9, 2014 meeting and recommended that the Board authorize the proposals:

New Proposals

1. Qualified Domestic Relations Orders (QDRO) Implementation. ERS could introduce a proposal for the implementation of QDRO's that would be administratively practical and feasible for the ERS.

Re-introduction Proposals

2. Benefit Forfeiture. Forfeiture of ERS benefits for members convicted of work-related felonies.
3. Change in Formula for Crediting Unused Sick Leave. Crediting 50% of unused sick leave credit towards retirement benefits for new employees.

Housekeeping Proposals

4. Chapter 88 Housekeeping. Amend section 88-341(c) to require 10 years of service as a condition for payment a deceased former Hybrid plan member's hypothetical account balance to the former member's beneficiary, if the member joined the ERS after the effective date of Act 163/2011.
5. Judges' Parity. Re-introduce legislation to correct sections 88-73(b) and 88-74(c) and (d) to restore age and service requirements for contributory ERS plan members who become judges after June 30, 2012.

ERS staff also proposed the following legislation for the Board's consideration:

Revision Proposals

6. Revise § 88-59: Acquisition of Membership Service. Change the following for current and/or future members:
 - a. Purchase cost for service credit is currently based on the member's current salary and contribution rate. The proposed formula would be based on an actuarial calculation to include the present value cost of this additional service credit.
 - b. Currently members may request to acquire services that was previously not eligible for membership (i.e., hourly, per-diem, short-term, emergency hire, etc.). Propose to limit service credit acquisition to previous "membership" service, if eligible.

- c. Allow for lump sum purchase of service only and eliminate purchase of service by payroll deduction.
 - d. Review the Administrative Directive allowing the purchase cost of professional improvement leaves to be based on the salary during the period of leave.
7. Calculation of Average Final Compensation (AFC).
- a. Revise the method of calculating service credit and AFC for teachers (9-month, 10-month and 11-month employees). In contrast to salaries paid to members by other departments, the Department of Education (DOE) pays teachers according to a daily rate schedule paid over the number of duty days worked during the school year. ERS proposes to differentiate the calculation of service credit and AFC for this group based on their method of pay. Proposed method would be to calculate service credit and monthly salaries based on the percentage of the school year worked, and distribute the total school year salaries over the months of earned service. (Subject to legal review.)
 - b. Revise § 88-81: AFC. Propose to change the calculation of a member's AFC from the "highest 3 or 5 years" to the highest consecutive 3 or 5 years (12-month periods) during the 10 years of credited service prior to retirement/termination.
8. Revise § 88-87: Adjustment for deficiency in accumulated contributions. Re-consider the application of interest on deficiency payments which was excluded after 5/31/2000.

Certain trustees expressed concerns regarding the employer and employee payments that would be required under the legislative proposal regarding the acquisition of membership service credit. The trustees directed staff to obtain more information from the ERS's actuary on the acquisition costs to the employer and employee.

On a motion made by Trustee Matsumoto, seconded by Trustee Rauckhorst, and unanimously carried, the Board authorized the following legislative proposals for the 2015 Legislative Session:

1. QDRO Implementation. ERS could introduce a proposal for the implementation of QDRO's that would be administratively practical and feasible for the ERS.
2. Benefit Forfeiture. Forfeiture of ERS benefits for members convicted of work-related felonies.
3. Change in Formula for Crediting Unused Sick Leave. Crediting 50% of unused sick leave credit towards retirement benefits for new employees.

4. Chapter 88 Housekeeping. Amend section 88-341(c) to require 10 years of service as a condition for payment a deceased former Hybrid plan member's hypothetical account balance to the former member's beneficiary, if the member joined the ERS after the effective date of Act 163/2011.
5. Judges' Parity. Re-introduce legislation to correct sections 88-73(b) and 88-74(c) and (d) to restore age and service requirements for contributory ERS plan members who become judges after June 30, 2012.
6. Revise § 88-59: Acquisition of Membership Service. Change the following for current and/or future members:
 - a. Purchase cost for service credit is currently based on the member's current salary and contribution rate. The proposed formula would be based on an actuarial calculation to include the present value cost of this additional service credit.
 - b. Currently members may request to acquire services that were previously not eligible for membership (i.e., hourly, per-diem, short-term, emergency hire, etc.). Propose to limit service credit acquisition to previous "membership" service, if eligible.
 - c. Allow for lump sum purchase of service only and eliminate purchase of service by payroll deduction.
 - d. Review the Administrative Directive allowing the purchase cost of professional improvement leaves to be based on the salary during the period of leave.
7. Calculation of AFC.
 - a. Revise the method of calculating service credit and AFC for teachers (9-month, 10-month and 11-month employees). In contrast to salaries paid to members by other departments, the DOE pays teachers according to a daily rate schedule paid over the number of duty days worked during the school year. ERS proposes to differentiate the calculation of service credit and AFC for this group based on their method of pay. Proposed method would be to calculate service credit and monthly salaries based on the percentage of the school year worked, and distribute the total school year salaries over the months of earned service. (Subject to legal review.)
 - b. Revise § 88-81: AFC. Propose to change the calculation of a member's AFC from the "highest 3 or 5 years" to the highest consecutive 3 or 5 years (12-month periods) during the 10 years of credited service prior to retirement/termination.

8. Revise § 88-87: Adjustment for deficiency in accumulated contributions. Re-consider the application of interest on deficiency payments which was excluded after 5/31/2000.

The Executive Director commented that the legislative proposals are subject to legal review and that ERS staff will continue to work with the Administrative and Legislative Committee to provide formalized 2015 legislative proposals and recommendations at future Board meetings.

OPERATIONS REPORT
– AUGUST 2014.

Ms. Kanoë Margol, Deputy Executive Director, presented a report on the ERS's operations and website statistics (top 10 viewed pages) for August 2014. Highlights included:

- Conducted first “Brown Bag” informational session specific to the Noncontributory and Contributory plans members. Previous Brown Bag sessions included members of all three plans.
- Met with the State Departmental Personnel Officers (DPOs) to discuss ERS retiree return to work issues, distribution of “Holomua” newsletter, and enrollment retirement class code accuracy. Briefings have been offered to the City & County of Honolulu, Judiciary Personnel, as well as the County (Maui, Hawaii, and Kauai) Personnel.
- Completed site visit of the ERS's Maui office to evaluate the staff's counseling activities, as recommended by the ERS' internal auditor, to ensure that the Maui staff is providing current and consistent information.
- Fiscal Year (FY) 2012 Audit Reported, dated July 29, 2014 was issued. The 2012 Comprehensive Annual Financial Report (CAFR) is available on ERS website. FY 2013 audit is currently underway and is expected to be completed late fall of 2014. FY 2014 Audit is expected to be completed in January 2015.
- Preliminary bill to the State for Act 153 was sent out June 2014 for approximately \$4.1 million for finalized cases with excess pension costs. Total estimated billing is \$12 million for the State and Counties. Payment is due by June 30, 2015.
- Internal audit is progressing; auditors began their review of unclaimed member benefits and accounts.
- Status of ERS's operating expense budget as of July 31, 2014.
- Top ten viewed web pages of the ERS' website included the benefits calculator still holding at number one.

ADJOURNMENT

On a motion made by Trustee Matsumoto, seconded by Trustee Barfield, and unanimously carried, Chair Lee Loy adjourned the meeting at 2:26 p.m.

**REDACTED
SIGNATURE**

Kanoe Margol
Interim Executive Director

KM: jh