

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

MAY 15, 2018

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

Trustees present: Dr. Catherine Chan
Ms. Jackie Ferguson-Miyamoto
Ms. Laurel Johnston
Dr. Genevieve Ley
Mr. Wesley Machida

Trustees excused: Mr. Emmit Kane, Chair
Mr. Jerome Rauckhorst, Vice Chair
Mr. Vincent Barfield

Staff present: Mr. Thomas Williams, Executive Director
Ms. Kanoë Margol, Deputy Executive Director
Ms. Donna Curry, Program Specialist
Mr. Karl Kaneshiro, Retirement Benefits Manager
Mr. Aaron Au, Investment Officer – Illiquid Markets
Mr. Andrew Chen, Investment Specialist
Mr. Anthony Goo, Investment Officer – Liquid Markets
Mr. Ian Wetzel, Investment Specialist
Ms. Dale Kehau Kanae, Recording Secretary
Ms. Lori Kim, Secretary
Ms. Geraldine Konishi, Member Home Loan Assistant
Ms. Wanda Kugiya, Secretary

Staff excused: Mr. Howard Hodel, Acting Chief Investment Officer

Attorneys present: Mr. Lyle Leonard, Deputy Attorney General
Ms. Elmira Tsang, Deputy Attorney General
Ms. Jodi Yi, Deputy Attorney General

Attorney excused: Ivan Torigoe, Deputy Attorney General

Guests present: Mr. Doug Doughty, Fortress Japan Opportunity Fund IV (via telephone)
Mr. Peter Hausmann, Fortress Japan Opportunity Fund IV (via telephone)
Mr. Paul Yett, Hamilton Lane Advisors, LLC
Mr. Raymond Iwamoto, Heitman Capital Management LLC
Mr. Paul Rezens, Heitman Capital Management LLC
Mr. Collin Bebee, Pension Consulting Alliance, LLC
Ms. Mary Bates, Pension Consulting Alliance, LLC
Mr. Chae Hong, Townsend Group, an Aon Company

Public present: Mr. Riley Fujisaki, House Finance Committee
Mr. Robert Nishimoto, Senate Ways & Means
Mr. Hovo Harutyunyan, Senator Donovan Dela Cruz's Office

QUORUM/CALL TO ORDER A quorum being present (Acting Chair Ferguson-Miyamoto, and Trustees Chan, Johnston, Ley, and Machida), Acting Chair Ferguson-Miyamoto called the regular meeting of the Board of Trustees (Board) of the Employees' Retirement System of the State of Hawaii (ERS) to order at 9:04 a.m.

PUBLIC COMMENT Acting Chair Ferguson-Miyamoto called for public comment. There were no comments from the public in attendance.

RECESS Acting Chair Ferguson-Miyamoto called for a recess at 9:04 a.m. and announced that the meeting would reconvene following the conclusion of the Chapter 91 Proceedings and the Investment Committee Meeting.

(All in attendance left the meeting except for the Board; Executive Director, Thomas Williams; Retirement Benefits Manager, Karl Kaneshiro; and Deputy Attorney General, Jodi Yi)

RECONVENE A quorum being present (Acting Chair Ferguson-Miyamoto, and Trustees Chan, Johnston, Ley, and Machida), Acting Chair Ferguson-Miyamoto reconvened the meeting at 10:13 a.m.

PENSION CONSULTING ALLIANCE, LLC Mr. Collin Bebee of Pension Consulting Alliance, LLC, (PCA), gave an oral and written presentation on the Quarterly Performance Report for the 1st Quarter of 2018 ending March 31, 2018:

INTRODUCTION

HIERS Portfolio Review

- Portfolio Valuation
- Performance vs. Policy Benchmark and Median Public Fund
- Takeaways:
 - Over the past 12 months, the ERS Total Portfolio modestly underperformed the Policy Benchmark. Results over the longer time periods tracked or exceeded the benchmark.
 - Over the recent quarter ending March 31, 2018, the Total Portfolio underperformed the Policy Benchmark. Each of the Plan's four primary strategic classes trailed their respective benchmarks over the period.
 - Relative to the Median Public Fund, the ERS Total Portfolio trailed the Median Fund over the quarter and 1-year periods. Lagging performance was due largely to differences in allocation. Results over the extended time periods tracked or outperformed the Median Fund.
 - With respect to the new interim evolving policy target that took effect January 1, 2018, the Total Portfolio ended the latest quarter overweight Broad Growth and Other Assets, while underweight Real Return. The Plan began shifting portfolio assets in the prior quarter to implement the current policy target.

ECONOMIC OVERVIEW

Economic & Market Overview – 1Q 2018

- Overview: Real U.S. GDP increased in the first quarter of 2018. GDP growth was driven by increases in business investment, consumer

spending, exports, and inventory investment. At quarter-end, the unemployment rate was unchanged at 4.1%. The seasonally adjusted Consumer Price Index for All Urban Consumers increased by 2.5% on an annualized basis during the quarter. Commodities decreased during the first quarter, but the 1-year return for a basket of commodities remains positive at 3.5%. Global equity returns were negative for the quarter. The U.S. Dollar depreciated against the Euro, Pound, and Yen by -2.7%, -3.7%, and -5.7%, respectively.

- Market Summary – Multi-term Performance

ERS PORTFOLIO RISK REVIEW

Macro Risk Analytics – Key Takeaways

- Late-cycle macro risks (e.g., Growth Risk, Leverage Risk, Interest Rate Risk, and Inflation Risk) are all relevant factors to the ERS's portfolio.
- While Growth Risk has been the dominant macro risk over the last several years, the influence of Interest Rate Risk and Leverage Risk has increased since 4Q 2016.
- The entrance of Leverage Risk as a relevant risk factor is noteworthy. This factor is interrelated with Growth Risk, as the credit cycle has a meaningful impact on economic growth across the globe. The rise of Leverage Risk reflects loosening lending standards and rising societal debt levels.
- The Market Liquidity Risk exposure reflects recent monetary policy changes and is thus related to Interest Rate Risk.
- Currently, broad market valuation indicators show that risks are reasonable-to-expensive (in aggregate).
- Despite a volatile first quarter, investor sentiment remained positive (tilted towards favoring risk).
- In light of the increased market volatility, the Actual Portfolio's beta (on a 12-month basis relative to the Policy Portfolio) materially increased to above 1.0. PCA and the ERS Staff will closely monitor the evolution of this metric over the next several months.

ERS PORTFOLIO REVIEW

ERS Portfolio Allocation

Strategic Class Performance

- The Broad Growth class underperformed the policy benchmark over the recent quarter, while outperforming over the longer time periods measured. For the quarter, the Traditional Growth segment posted results over its benchmark, however, these gains were negated by relative underperformance in Stabilized Growth and Private Growth.
- The Principal Protection class trailed its policy benchmark over the quarter and tracked or exceeded the benchmark over the extended time periods reported. Over the 1-year period, the class bested the benchmark by 1.0% as both the Plan's reporting Principal Protection managers outperformed their respective benchmarks.
- The Crisis Risk Offset class reached its 1-year mark since its initial funding in March 2017. Over the quarter and 1-year period, the class underperformed its policy benchmark. For the quarter, two of the class's segments, Alternative Return Capture and Systematic Trend Following, trailed their respective benchmarks, while the third segment, Treasury Duration Capture, performed in-line with its benchmark.
- The Real Return class underperformed its CPI + 3% benchmark over

PENSION CONSULTING
ALLIANCE, LLC (CONT'D)

each period measured. While the class's global inflation-linked securities (GILS) mandate, the class's largest segment, has tracked or outperformed its benchmark, results have trailed the strategic class benchmark. Similarly, for timber, mixed benchmark relative results have underperformed the CPI + 3% target over each period except the 5-year period.

HAMILTON LANE
ADVISORS, LLC –
PRIVATE EQUITY
PROGRAM UPDATE – MAY
2018

Investment Officer – Illiquid Markets (IO-IM), Aaron Au gave a brief background and introduced Mr. Paul Yett of Hamilton Lane Advisors, LLC, gave an oral and written presentation on the Private Equity Program Update – May 2018:

PORTFOLIO REVIEW

PE Portfolio Highlights – December 31, 2017

- Performance
- Value Creation

Portfolio Snapshot

- Portfolio in 2017 – growth and value creation
- Significant NAV growth in 2017:

Quarterly Cash Flow Summary

- 2017 cash flow activity – largest on record
- 2015-2017 vintage years driving contributions activity over past five quarters

Performance Review by Strategy

- The Buyout strategy represents 61% of commitments and 62% of NAV, is the third strongest performance strategy with a since inception IRR of 12.43%

Foundation Manager Performance

- Foundation Managers generating strong IRR performance
- All Foundation Managers, including newer relationships are generating positive performance

Portfolio Diversification

- Portfolio remains reasonably diversified by strategy and geography in terms of total exposure and market value

2018 Commitment Summary

- 6 of 10 commitments represent re-ups for HIERS
- Average approved investment size, consistent with 2017

Portfolio Review by Vintage Year

- 2015 and 2016 are Portfolio's top two performing vintage years
- 2018 Foundation Manager re-ups driving returns in their respective vintages

FUND SIZE DISCUSSION: Large/Mega vs. SMID

Who has the Advantage?

- Different strategies; different skill-sets
- Fund size does matter – look beyond returns and understand risk and portfolio construction

Fundraising

- Mega/Large and SMID have raised similar amounts of capital in recent years
- When measured by count, SMID is generally 10-15x as populous

SMID Portfolios Are More Concentrated

- Good for driving upside impact; less cushion for loss

HAMILTON LANE
ADVISORS, LLC –
PRIVATE EQUITY
PROGRAM UPDATE – MAY
2018 (CONT'D)

TOWNSEND GROUP, AN
AON COMPANY – FOURTH
QUARTER 2017 REAL
ESTATE PERFORMANCE
REVIEW

UPDATE OF CHIEF
INVESTMENT OFFICER
SEARCH

Looking at the Whole Picture

- Don't just consider the top quartile – consider the full universe
- Despite cyclical outperformance, SMID and Large/Mega returns are closely correlated to each other and market cycles

Mr. Chae Hong of Townsend Group, an Aon Company (Aon) gave an oral and written presentation on the Fourth Quarter 2017 Real Estate Performance Review:

EXECUTIVE SUMMARY

Real Estate Markets Performance and Overview

- U.S. transaction volume continued to demonstrate a declining trend in early 1Q, with February data marking a 10% drop in transaction volume YoY. Property sales remain weakened due to fewer entity and portfolio deals over the past year, as well as concern over a rising interest rate environment and a widening gap between buyers' and sellers' future return expectations.
- Despite the declining trend in sales, pricing is holding fairly firm or still growing, up 8% nationally YoY in February, with apartment and industrial leading these results. Cap rates, have remained low and sticky, sitting today at similar levels in Q1 2017.
- Dry powder for non-core real estate investments currently stands at another all-time peak for all regions. While this should help support current sector pricing for a bit longer, moderating trends in underlying fundamentals (e.g. rent growth, supply-demand balance), interest rates, and economic tailwinds raise investment risk levels at this mature point in the cycle. To-date, the U.S. continues to benefit as a global safe haven.

Portfolio Funding Status and Real Estate Portfolio Composition

HIERS' Summary of Portfolio Returns (Time-Weighted)

- The table shows the time-weighted returns for HIERS' Total Real Estate
- Overall the portfolio is performing well

HIERS Returns vs. Benchmark (Time-Weighted)

HIERS Real Estate Portfolio Highlights

Significant Events

REAL ESTATE PORTFOLIO

Core Portfolio Returns (Net Time-Weighted Return)

Non-Core Portfolio Returns (Net Internal Rate of Return)

INFRASTRUCTURE PORTFOLIO

Infrastructure Performance

TIMBER PORTFOLIO

LOWE SEPARATE ACCOUNT

Executive Director Williams, member and Trustee Chan, Chair of the Chief Investment Officer (CIO) Search Ad Hoc Committee gave an oral and written update of the CIO Search. Executive Director Williams reported that Kumabe HR is conducting the national search to fill the position. He also shared the current timeline for the search and stated that the final interviews and selection by the Board is scheduled to be made at its next meeting on July 9, 2018.

UPDATE OF CHIEF
INVESTMENT OFFICER
SEARCH (CONT'D)

Executive Director Williams credited Trustee Chan who was instrumental in establishing a Confidentiality Policy to be signed by the members of the CIO Search Ad Hoc Committee. The CIO Search Ad Hoc Committee members in addition to Trustee Chan as Chair are: Trustees Barfield, Ley, Machida, and Executive Director Williams.

LEGISLATIVE PROPOSALS
RELATED TO THE
EMPLOYEES'
RETIREMENT SYSTEM
FOR THE 2018
LEGISLATIVE SESSION

Program Specialist, Donna Curry and Executive Director Williams presented to the Board, a list of related proposals which were passed by the 2018 State Legislature and enrolled to the Governor for his review as follows:

- HB 2336 HD1 SD2, Relating to Employer Contributions to the Employees' Retirement System, Companion Bill SB 22763;
- HB 2341 HD1 SD2 CD1, Relating to Qualified Domestic Relations Orders, Companion Bill SB 2768;
- SB 2766 SD2 HD1 CD1, Relating to the Employees' Retirement System, Companion Bill HB2339; and
- SB 2767 SD2 HD1 CD1, Relating to the Employees' Retirement System, Companion Bill HB 2340.

Ms. Curry also mentioned that ERS will be presenting briefings to the employers on each island once the acts are completed.

Executive Director Williams welcomed and acknowledged in attendance: Mr. Riley Fujisaki, House Finance; Mr. Robert Nishimoto, Senate Ways and Means; and Mr. Hovo Harutyunyan from Senator Dela Cruz's Office. Executive Director Williams thanked them for their assistance this past session with the ERS Bills and also mentioned that ERS looks forward to working with them during the next legislative session. The Board also acknowledged and thanked Ms. Curry for her excellent job during this past legislative session.

Trustee Laurel Johnston mentioned that Governor Ige will need to sign these bills by July 1, 2018.

INVESTMENT POLICY
REVISIONS: MANAGER
MONITORING POLICIES &
PROCEDURES

Investment Officer – Liquid Markets (IO-LM), Anthony Goo, gave an oral and written presentation to the Board on recommendations for approval relating to the 2017 KMH Investment Audit Findings: Two Proposed Revisions to the ERS Investment Policy, Guidelines, & Procedures Manual (IPS) Status of 3 KMH Internal Audit Findings Related to Investments:

Revision 1: Audit Item #3 – Policy Manual Does not Reflect Actual Monitoring Program.

Rationale: Add last bullet point to complete the alignment of the IPS with actual public manager monitoring program to:

Section B: Plan Overview (page 5),
B.5. Responsibilities of the Various Parties
Bank Custodian

Main Responsibilities

- Provides a daily guideline compliance report to Investment Staff for ERS public markets managers.

Revision 2: Audit Item #1 – Private Equity Monitoring Procedures Need Enhancement.

INVESTMENT POLICY
REVISIONS: MANAGER
MONITORING POLICIES &
PROCEDURES (CONT'D)

Rationale: The revised wording clarifies that the quarterly reporting and monitoring applies to the private equity consultant and that Investment Staff will use a sampling methodology to investigate funds and the consultant's effectiveness in identifying significant issues:

Section D: Broad Growth Program (page 52),
Appendix: Private Equity Sub-Component
2. Implementation of Private Equity Program
C. Monitoring and Reporting
1. Reporting System

There shall be a quarterly comprehensive reporting and monitoring system for the entire portfolio, ~~by the Private Equity Consultant, Specialty Manager(s) and individual investments.~~ The monitoring shall include asset/risk allocation and portfolio performance in sufficient detail to identify situations of underperformance, diversification deficiencies and conflicts of interest. Due to the large number of funds, the ERS investment staff will employ a sampling methodology to verify that the Private Equity Consultant is adequately executing the monitoring program and detecting major performance issues within the private equity portfolio. Situations of underperforming investments, portfolio diversification deficiencies from the Policies & Procedures, and conflicts of interest can then be identified, facilitating active portfolio management.

IO-LM Goo concluded with a review of the Status Report for the Three Findings by KMH's June 2017 Internal Audit of the HIERS Investment Department.

On a motion made by Trustee Machida, seconded by Trustee Chan, and unanimously carried, the Board accepted the proposed revisions and the three findings in the status report by KMH as presented and noted above.

ENTER EXECUTIVE
SESSION

On a motion made by Trustee Machida, seconded by Trustee Chan, and unanimously carried, the Board entered into Executive Session at 11:27 a.m.

RECESS

Acting Chair Ferguson-Miyamoto called for a recess at 11:28 a.m.

RECONVENE

A quorum being present (Acting Chair Ferguson-Miyamoto, and Trustees Chan, Johnston, Ley, and Machida), Acting Chair Ferguson-Miyamoto reconvened the meeting at 11:33 a.m.

EXECUTIVE SESSION
(cont'd)

- Pursuant to HRS § 88-27.5(a)(1), to conduct discussions, deliberations, and if appropriate, to make decisions relating to an investment by the Employees' Retirement System in Fortress Japan Opportunity Fund IV;
- Pursuant to HRS § 88-27.5(a)(1), to conduct discussions, deliberations, and if appropriate, to make decisions relating to the Extended Global Credit Implementation;
- Pursuant to HRS § 88-27.5(a)(1), to conduct discussions, deliberations, and if appropriate, to make decisions regarding the Global Equity-oriented Options-Based Manager Search Update (Finalists);
- 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 a recommended compromise or settlement of the Employees' Retirement system's claim for

EXECUTIVE SESSION
(cont'd)

- overpayment against a member's beneficiary; appropriate action;
- Pursuant to HRS § 92-5(a)(4), to update the Board regarding a pending securities class action suit that the ERS is involved 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 such litigation, and appropriate action;
- Pursuant to HRS § 92-5(a)(4) and HRS § 88-27.5(a)(1) and (3), to conduct discussions, deliberations, and if appropriate, to make decisions relating to an investment by the Employees' Retirement System with respect to property held by or for the benefit of the ERS.

EXECUTIVE SESSION,
PURSUANT TO HRS § 88-
27.5(a)(1), TO CONDUCT
DISCUSSIONS,
DELIBERATIONS, AND IF
APPROPRIATE, TO MAKE
DECISIONS RELATING TO
AN INVESTMENT BY THE
EMPLOYEES'
RETIREMENT SYSTEM IN
FORTRESS JAPAN
OPPORTUNITY FUND IV

RECESS

Acting Chair Ferguson-Miyamoto called for a recess for lunch at 12:00 p.m.

RECONVENE

A quorum being present (Acting Chair Ferguson-Miyamoto, and Trustees Chan, Johnston, Ley, and Machida), Acting Chair Ferguson-Miyamoto reconvened the meeting at 12:11 p.m.

EXECUTIVE SESSION,
PURSUANT TO HRS § 88-
27.5(a)(1), TO CONDUCT
DISCUSSIONS,
DELIBERATIONS, AND IF
APPROPRIATE, TO MAKE
DECISIONS RELATING TO
THE EXTENDED GLOBAL
CREDIT
IMPLEMENTATION PLAN

EXECUTIVE SESSION,
PURSUANT TO HRS § 88-
27.5(a)(1), TO CONDUCT
DISCUSSIONS,
DELIBERATIONS, AND IF
APPROPRIATE, TO MAKE
DECISIONS REGARDING
THE GLOBAL EQUITY-
ORIENTED OPTIONS-
BASED MANAGER
SEARCH UPDATE
(FINALISTS)

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 WITH
RESPECT TO A
RECOMMENDED
COMPROMISE OR
SETTLEMENT OF THE
EMPLOYEES'
RETIREMENT SYSTEM'S
CLAIM FOR
OVERPAYMENT AGAINST
A MEMBER'S
BENEFICIARY;
APPROPRIATE ACTION

EXECUTIVE SESSION,
PURSUANT TO HRS § 92-
5(a)(4), TO UPDATE THE
BOARD REGARDING A
PENDING SECURITIES
CLASS ACTION SUIT THAT
THE ERS IS INVOLVED 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 SUCH
LITIGATION, AND
APPROPRIATE ACTION

EXECUTIVE SESSION,
PURSUANT TO HRS § 92-
5(a)(4) AND HRS § 88-
27(a)(1) AND (3), TO
CONDUCT DISCUSSIONS,
DELIBERATIONS, AND IF
APPROPRIATE, TO MAKE
DECISIONS RELATING TO
AN INVESTMENT BY THE
EMPLOYEES'
RETIREMENT SYSTEM

WITH RESPECT TO
PROPERTY HELD BY OR
FOR THE BENEFIT OF THE
ERS

APPROVAL OF
EXECUTIVE SESSION
MINUTES

– JANUARY 8, 2018
– JANUARY 24, 2018

EXIT EXECUTIVE SESSION

On a motion made by Trustee Machida, seconded by Trustee Johnston, and unanimously carried, the Board exited Executive Session at 1:32 p.m.

Mr. Nishimoto, Senate Ways and Means, re-entered the meeting at 1:33 pm.

EXECUTIVE DIRECTOR'S
REPORT

Executive Director Williams gave an oral presentation of his report as follows:

- Press releases from the Star Bulletin: “ERS Joining United Nations – Support Principles for Responsible Investment” and the Pacific Business News: “Hawaii State Pension Fund Commits to Impact Investing.” Bob Kay also helped us with this initiative.
- Success with Budget approvals with the Legislature, with thanks to B&F Director Laurel Johnston. Major items approved: Chief Compliance Officer, Internal Audit continuation, \$1.45 million for the HiDRO. Director Johnston also recommended during Conference Committee, ERS write to the Committee members to support our bills.
- ERS’ Policy regarding release of contact information of our Board members. We do not release any information such as telephone or email addresses. ERS Executive Director will be the point of contact.
- BoardWorks and tablet acquisition in an attempt to go paperless for our Board meetings. We hope to start using the software and tablets on July 25-27, 2018, at our Investment Education Summit meeting.
- FOIA regarding OIP posting of Board meeting records starting July 1, 2018. Also discussed FOIA requests and the large amount of manhours it entails of ERS staff and the AGs as well.
- Working with the Deputy Executive Director and ERS Branch Managers on contracts and projects to be concluded by fiscal year end. All funds need to be encumbered.
- Working with B&F Director and Department of Human Resources Development on reallocation of Investment Specialist positions.
- Will do a presentation on Monday, May 21, 2018, at the State Capitol to speak about the pension plan, invited by the Grass Root Institute.
- Support the RBB Big Island staff to let them know that the ERS, as well as the Department, has their safety as a number one priority, as it relates to the emergency evacuation due to the lava flow.
- PCA will send out an RFI in relation to proxy voting.
- Update on the ERS Investment Education Summit, everything is on track and ready for July 25-27, 2018.

OPERATIONS REPORT

Deputy Executive Director, Kanoe Margol presented the written operations report as receive and file.

APPROVAL OF MINUTES
– JANUARY 8, 2018
– JANUARY 24, 2018

On a motion made by Trustee Chan, seconded by Trustee Machida, and unanimously carried, the Board approved the minutes for the January 8, 2018, meeting as presented and the January 24, 2018, meeting with the correction that Trustee Laurel Johnston be noted as excused.

ADJOURNMENT

On a motion made by Trustee Johnston, seconded by Trustee Machida, and unanimously carried, the Board adjourned the meeting at 1:58 p.m.

REDACTED SIGNATURE

Thomas Williams
Executive Director

TW:dkik