STATE OF HAWAII
DEFERRED COMPENSATION PLAN
BOARD OF TRUSTEES

OPEN SESSION MINUTES
MEETING # 344

Date: August 31, 2010

Place: Department of Human Resources Development
14th Floor Director's Conference Room
235 South Beretania Street
Honolulu, HI 96813

Present: Georgina Kawamura, Ex-Officio Member
Scott Kami, Employee Member
Wesley Machida, Employee Member
Wayne Chu, Employee Member
Michael Okumoto, Employee Member

Others: Rodney J. Tam, Deputy Attorney General
Cynthia Akiyoshi, DHRD Staff
Troy Saharic and John Bothwell, Mercer Investment Consulting – Via Conference Call
Bernie Wong, Marcy Loomis, and Carol Cann, Plan Administrator Staff (ING)/Boston Office - Via conference call
Melody Takacs, Grace Baracao, Jeanne Kanai, Plan Administrator Staff (ING)/Honolulu Office
Lanny Thorndike and Peter Whitlock, Century Capital – Via Conference Call
Eric Bildt, TD Ameritrade – Via Conference Call

Absent: Marie C. Laderta, Chairperson
Sandi Yahiro, Employee Member
Lily Chu, DHRD Staff

Call to Order: There being a quorum present, Trustee Kawamura called the meeting to order at 9:01 a.m.

Agenda: The agenda for this meeting was filed with the Office of the Lieutenant Governor, as required by Hawaii Revised Statutes section 92-7.

Agenda
Item # 1: Welcome of the New Trustees

Trustee Kawamura opened the meeting and welcomed new Trustees Wayne Chu and Michael Okumoto.

Agenda
Item # 2: Approval of Minutes Nos. 341, 342, and 343

The Board reviewed Meeting minutes nos. 341, 342, and 343.

A motion was made by Trustee Kami and seconded by Trustee Machida to approve Meeting Minutes Nos. 341, 342, and 343, as is. The motion passed unanimously.

Trustee Kawamura asked for a motion to amend the agenda to add "Item 4a – Amendments to the Plan's Investment Policy Statement". Mercer will be discussing the amendments after their performance 80
evaluation report.

A motion was made by Trustee Machida and seconded by Trustee Chu to amend the agenda to include "Item 4a – Amendments to the Plan's Investment Policy Statement". The motion passed unanimously.

Agenda
Item # 3: Updates from Century Capital Management

Mr. Peter Whitlock and Mr. Lanny Thorndike are present via conference call to provide an update and overview of the SMID Growth Strategy. Mr. Whitlock stated that they will focus on:

- Why Century's performance has been lagging over the past few years, discuss the performance in the 3-5 year context and tie that in to the favorable shift experienced since the end of April 2010.
- A couple of departures and Lanny Thorndike will discuss its impact and talk about the resources dedicated to this strategy.
- SMID Growth marketing and strategy in conjunction with the research analyst team that supports Century.

Mr. Thorndike provided an update on Century's Organization:

- Organization consists of 32 employees and currently, the investment teams include 2 portfolio managers, 4 senior analysts, and 2 traders.
- The account has about $762 million and includes Hawaii and Vanguard, where Capital manages a sleeve of their funds and that is closed to new

investors unless they are in-flows received from Vanguard and Hawaii.

- The small cap growth portfolio in the SMID Growth Strategy are open to new investors. Don Bisson, who joined in May 2008 manages the other portion of the new SMID Growth Strategy.
- The strategy is focused on research and investment research is the core of what Century does.
- Century's research analysts, each with more than 10 years of experience, are shared resources between the two portfolio managers ("PM").
- Century had two departures, one left to pursue a business degree and the other, Bill Roddy, a Partner and Director of Research who returned to the sell-side.
- Other information provided:
    - Stated that companies that can grow market share and margins and profitability faster than struggling low quality peers perform exceptionally well in a recovery.
    - The early stages of recovery are where differentiations are visible, where the leader of the business begins to invest through research and development, expansion of sales staff and the rolling out of new products that enables them in years 2, 3 and 4 to be able to launch significant higher profitability, which leads to valuation gains.
    - Century is at a point in time where it is a sling-shot approach for them. As they look at where their focus is, they feel that high quality companies win over time.
    - Companies where management teams act as owners are real differentiators. This was not the case in the downturn following the 2008 downfall meltdown in the market and Century got an unusually long low quality rally that lasted about 13 months from the end of 2008 through the first quarter of this year.
    - Now, there's a reversal of that trend. Since April, quality has significantly outperformed and that is will be discussed later.
    - Century in general should be growing earnings and return on equity and EPS faster than their overall peer groups. They are hopefully taking a little less risk in accomplishing that. That appreciation is played out in the stocks and valuations going forward where the companies are continuing to grow at a little bit higher consistent predictable rate than the overall market. We are in a volatile period, so hoping taking a little bit less risk.
    - Mr. Thorndike pointed out that the gap in valuation between the Russell 2500 Value and the R2500 Growth is less than 300 basis points (P/E Ratio of 15.7 versus 12.8). That is the period of time referred to as an inflection point that was also seen back in 2000 where investors had really little visibility on future earnings. Because of that, companies did have higher predictable earnings, generally are warranted higher valuations, but at this point in time murky enough that they are not getting the benefit of that. That gives some degree of

comfort that we are in a period of time where high quality begins to add value over time.

- SMID performance through the second quarter shows that as of July 31, 2010, we are slightly above the benchmark for the Russell 2500.
- What it does not capture is the August performance. August has been a troubling month for the market. That is the period of time where Century picked up a significant amount of performance and the year to date performance for the representative account is up about 20 basis points versus down about 170 basis points for the benchmark. So, Century is about 200 basis points ahead year to date and the gap that is seen in the July 31, 2010 report is continuing to grow.
- The Small Cap product has an even larger gap going forward.
- Mr. Thorndike discussed the underperformance that Century had in years 2, 3, and 4 of the portfolio. Going back in time, 2010 has seen a leadership towards higher quality.
- Over the last 5 years, Century has generally done very well in some of the staples, health care, and technology sectors.
- Underperformance was in the consumer stock selection. That has been an increased area of focus for Mr. Thorndike and the team which has benefited them over the last several months since they have been able to correct that.
- Health care and technology have done well and they think they have corrected the consumer selection that had hurt them in the 3 and 5 year time frame.

Troy Saharic of Mercer asked Mr. Thorndike to elaborate on the number of accounts landing in their strategies and the trend over the last 18 months.

Mr. Thorndike explained that the concentration in their accounts has definitely increased. Vanguard has become a higher proportion of the account, both with inflows and there was some loss of accounts over time. Mr. Whitlock explained that SMID including Vanguard had about $780 million in the small cap growth strategy and about $350 million in the small cap strategy. Assets from the small cap strategy are lower than where they have been partly due to the high concentration of accounts that Century took in during the 2005 timeframe. It has been net negative but higher quality is the place to be. There is however, a lag effect between when you start to see your strategy show signs of outperformance in conjunction with the shift in leadership rotation. It's sort of the lag effect between when you start to outperform and when assets start to flow. So, in response to the questions about the net negatives in the accounts, those are the asset numbers when Vanguard recently added $75 to $100 million to their position so that might give you a couple data reference points.

Mr. Troy Saharic commented that Don Bisson joined Century in the spring of 2008 and feels that Century is doing something a little bit unusual in that there are two flavors of small cap being managed: one under Bisson's direction and Lanny running Small/Mid. Mr. Saharic asked that Century explain the rationale behind that and the focus of the firm.

Mr. Thorndike stated that Century sensed that they had excess capacity in their research staff with such a senior group just focused on Small/Mid and how could they best utilize that. In Boston, where there are a lot of equity managers, Century only met a couple that had good quality track records as well as sort of a cultural fit with their firm. Don was at that point with Evergreen, which was part of Wachovia. There was a capacity of names that overlapped with him and he was looking for resources consistent with what he had managed before. It was a win-win situation all around. Mr. Thorndike discussed the focus of Century and that of Don's focus. So while they are buying and selling different things at different times, but at the same time they are both leveraging the resources of the senior analysts that work underneath them. What catalyzed the event was the selection by Vanguard for Century to manage the fund meant a certain size of capacity going forward that they felt was needed to close the SMID strategy into 2008 and feeling there was ample capacity for the team to manage more assets above the assets that Mr. Thorndike was leading them to think that Don was a good fit to augment their existing resources.

Mr. Saharic asked what the focus of the firm from a marketing standpoint.

Mr. Thorndike indicated that they are really trying to market Don's product on the SMID front. The existing strategy is closed with Hawaii and Vanguard. The small cap strategy and SMID strategy with Don are open. With SMID growth, Century has been marketing a separate account and possibly opening a mutual fund under Don, who has been effective at managing money at Evergreen for 9 ½ years. They anticipate having $700– 800 million dollars in SMID growth strategy. In a little over 24 months, Century has raised an estimated $1.5 billion in its capacity, which is tremendous progress based on Don Bisson's reputation and accomplishments dating back to 1998. There were some net losses partly due to vintage of when the accounts came on, but at the same time, for the early adopters looking to make a tactical move towards the small cap space, there are wins. Small cap growth and small cap funds are open to new investors and early indications show that people who are looking for a more tactical move are moving toward small cap growth. At the end of the day, Century is known as small cap managers of constrained quality franchises and businesses and that remains their focus regardless of the portfolio.

Mr. Saharic asked how can Century assure the Board that the product that is offered to the participants is getting analyst support given their other products.

Mr. Thorndike explained that seventy percent of the analysts' time is dedicated to buying products and that is still the majority. The excess was filled up in the domain expertise the analysts had in their specific coverage areas and at some time in the beginning of 2011 they are likely to hire a junior analyst. But today, they feel they have excess capacity and a director of research was added as there was a perceived need for that resource between the portfolio managers and research analysts. At this time, with four analysts and two PMs, it is the largest teams dedicated to small cap growth investing and that would continue. There are not any sectors that Century does not have covered and covered well except probably for utilities, which is generally more value oriented, where they feel a dedicated analyst is not needed there. Mr. Whitlock also emphasized Don Bisson, being a micro-manager is responsible for generating 80% of his ideas. Lanny and the four analysts, conversely, work more collaboratively on a daily basis when it comes to the execution of buys and sells in the Small Cap Growth and SMID portfolios. Also, they have Vanguard as an investor and a number of organizations doing due diligence on Century and that maybe a point of reference.

Mr. Saharic asked Lanny Thorndike, having 40% interest in the company, how much time does he spend on the strategy. Lanny responded that the SMID strategy takes up about 70% of his time. The administrative running of the firm, are taken care of by people such as the general counsel, the CFO, Pete's team, and so forth so that the market hours can be focused on the research and investment pieces.

Mr. Thorndike stated that Vanguard has been very terrific partner and they have had a productive relationship considering Vanguard is a much larger company compared to Century's 34 employees total. When Century wanted to invest more in their disaster recovery capabilities, being able to call Vanguard and visit their disaster recovery sites and to get best practices was very helpful. Vanguard joined them in June of 2008, their experience as an investor has been a positive relative performance result in the two year that they have been investing.

Trustee Machida inquired whether there were any other large owners of the company since Lanny owned 40% of the company. Mr. Thorndike stated that there are two lines of business in the company: a private equity arm and a public securities group arm. On the public securities side, which is the business that is tied to Hawaii, there are 7 partners. Lanny's share of the business on the public side is a little higher, with the combined total being around the 40%. There are 7 partners that make up remaining percentage of the public securities line of business.

Trustee Machida also inquired whether the 4 analysts work on the SMID strategy only. Mr. Thorndike stated that they work on the small cap and both SMID strategies and they work on companies below $10 billion. Trustee Machida asked Mr. Thorndike to speak about their 10 top holdings and any changes forthcoming. Mr. Thorndike referenced some names in the portfolio such as BJ's Wholesale Club, that focused on families and is a Costco competitor based on the east coast and mid-west which had a tremendous increase in stock over the last 60 days as a private equity firm is thinking about taking them private; and Bruker Corp, which creates large life sciences equipment and has been a beneficiary of the stimulus spending from the National Institute of Health.

Since there were no other questions from the trustees, Trustee Kawamura thanked Century Capital for their presentation.

Agenda
Item # 4: Performance Evaluation Report by Mercer for 2nd Quarter 2010, Period Ending June 30, 2010

Mr. Saharic provided a report on the Market Environment report which shows the economy in a very fragile state:

- Economic growth, looking at the GDP rate came in originally at 2.4%, but that was revised down last week.
- Mercer thinks that the economy will sputter along until unemployment drops.
- The unemployment rate now is at 9.5% and if you count that that have stopped working, have given up looking for a new job, or are under-employed, the rate is close to 16%. So, as long as the consumer, which makes up two-thirds of the economy, continues to sit at the sidelines, it won't amount to a major recovery.
- There are prospects of a double dip recession. The Feds have very limited tools to jump start the economy. The short term rates are still very low, in some cases, there is a negative return when you incorporate fees, and so it is a good thing that we have Stable Value.
- There is an overall return of 80% in the US equity market. In the second quarter, there was a 10 - 11% correction across all market caps.
- The Russell 1000 showed negative returns on all major sectors, with technology, financials, and energy being among the weaker areas caused by the BP disaster in the Gulf, putting a moratorium on drilling and affecting energy prices, and then the meltdown in Europe.
- Bond market results were respectable as the Barclays Capital Aggregate Bond Index came in at 3.5%.
- The international markets as MSCI EAFE lost 13.8% and on the local currency basis, it was down 10.9%.
- Emerging markets were down only 8.3% for the quarter.

For the Plan:

- Plan assets as of June 30, 2010 in the amount of about $1.4 billion. There was a decrease of assets of $63 million since the prior period as a result of basically two things: (1) the negative equity market and (2) the withdrawals totaling $26 million which outpaced contributions of $19.3 million. So there was a combination of capital market underperformance along with negative cash flows coming out of the Plan.
- The Hawaii Stable Value Fund makes up the bulk of the portfolio with 57%

of total assets for the plan.

- Assets in the BlackRock Index funds was 11.5% and if you totaled up the Lifecycle Funds, that came to about 3.2% of total assets.
- There was some transfer activity was seen by participants moving assets out of EuroPacific, BlackRock US Large Cap Equity, and Mainstay Large Cap Equity funds. They all had negative net transfer activity and money went into some more conservative options including the US Bond Index, but also interestingly into Non US Index Funds and the BlackRock US Small Cap Index Fund. So, this quarter, there was movement in more conservative options and also movement into the brokerage window as those participants continue to diversify.
- The total transfer activity was fairly muted and has been the trend since the meltdown in the market since 2008. There seems to be more inertia by participants not taking action relative to their portfolios and not moving money around, which is not necessarily a bad thing as you can get whipsawed in this underlying environment.

Mr. Bothwell reported on the investment management:

- For the Stable Value Fund, the three month period ended well with the Hawaii Stable Fund beating its index and universe median.
- The Stable Value Fund market to book yield shows a higher credit rating and a more secure stable value fund. The Stable Value Fund credit rating has bounced back at 4.56% for the quarter and it is expected to stay about there the next quarter or two.
- The BlackRock US Bond Index Fund has performed as expected, checking in at 3.5%. The Barclays Capital US Aggregate was at 3.5% as well. The fund rank in the Universe was an 8, which tells you that the index performed almost better than 90% of the funds in the universe. So the index was a very strong performer due to the flight to quality. The treasury performance was really, really strong this quarter and therefore, those funds that didn't have such a high allocation, treasuries underperformed.
- The PIMCO Total Return Institutional fund underperformed that index, 2.8% versus 3.5%. It had only one bad month. In May, they were underweight treasuries; however, in June, they made up a significant overweight in treasuries, and that worked out well for them. As of August 29, 2010, PIMCO has outperformed 2.5% versus 1.8% of the index.
- The Vanguard Wellington Fund underperformed in stock selection in the energy and financial sectors.
- The Lifecycle Funds had a tough quarter with the Income Fund being the only fund to outperform this quarter. This was primarily due to the Mainstay and AllianceBernstein funds' underperformance. There are a couple of observations in the Lifecycle Funds: the 2055 fund was added in July of this year and so younger investors will have an opportunity to join those Lifecycle funds. Also, Mercer's PH chief, Louis Spinnie, is reviewing the Hawaii plan

to analyze what the 2011 lifecycle allocations should be and to look at other options such as tips, global real estate, and commodities to be added to these funds to improve the diversification and risk return profile. The allocations or recommendations have not been received yet, but when they are received in October, Mercer will be recommending that a search of those classes to be joined in with the lifecycle funds.

Mr. Saharic noted that Mercer is looking at additional diversification in the Lifecycle Funds to provide a little more downside as well as wanting to see better performance from AllianceBernstein.

Mr. Bothwell reported on the equities:

- Wellington Research Value at -12.5% was hurt by the stock selection in the energy and financial sectors.
- Black Rock US Large Cap Index performed as expected, tracking in at -11.4%.
- Victory Institutional Diversified Stock Fund came in at -13.8% and -11.4% of the S & P 500 due to underweight in consumer staples and no exposure to the utility sector.
- The Mainstay Large Cap Growth Fund underperformed at -13.1% versus 11.7% of the index due to stock selection in financials. The news item is that Mainstay hired Patrick Burton, who has a wealth of knowledge in consumer staples and has over 25 years of experience. He is a positive addition to the firm and Mercer is watching his contribution over the next few years.
- The Harbor Small Cap Value Fund came in at -9.2% versus an index of -10.2%. The fund outperformed due to its underweight allocation to consumer discretionary and no exposure to the consumer staple sector.
- The Black Rock US Small/Mid Cap Index tracked the index at -9.8%.
- Century SMID Growth outperformed at -9.1% versus an index of -9.8% due to an overweight in the healthcare sector. Lanny Thorndike mentioned that the director of research, Bill Roddy, left the firm. Mercer viewed his departure as a negative event and has a concern as to the focus of the analysts at the firm.
- The AllianceBernstein underperformed at -18.3% versus -15.5% mainly hurt due to the B&P stock. A news item is that Sharon Fay, a leading member of the cross border team which is involved in the day to day investment decisions in the AllianceBernstein fund, announced that she will be having new responsibilities. Mercer is concerned that her focus is being taken off the international value fund and that her responsibilities in managing the growth side of the business will detract from her stock selection abilities. A couple more concerns are that there's been more turnover in the advisory members to that cross border team and Lew Standers left the firm about a year ago and at least one member of the advisory team left to join him. A couple of concerns there along with the 3 and 5 year performance below the

benchmark means that we should be watching the firm more closely.

- Black Rock Non-US Equity Fund came in at -13.2% versus -12.4%.
- The American Funds Euro Pacific Growth fund outperformed the index due to exposure to Australia and its outperformance was due to exposure in an emerging market.

Mr. Saharic referenced Mercer's recommendation to put Century and Alliance Bernstein on the watch list. Century made a curious move with the opportunistic hire of Don Bisson in 2008. It is confusing from a research standpoint with two strategies in the same space and questions about what is the focus of the firm in terms of growth. Another concern is the concentration of SMID assets in the strategies and Century is thinking how to best diversify. If Vanguard were to make a decision to go somewhere else or get more favorable pricing, Hawaii very quickly could be the only account in Century's Small to Mid Cap strategies. The first recommendation is to put Century on the watch list through another quarter or at least through the end of the year and see where it goes. The second recommendation is Bernstein has gone through a number of personnel losses, such as Lew Sanders leaving and setting up shop and additional turnovers, and Mercer is also concerned about their losses. For personnel reasons and underperformance reasons, Mercer recommends that the Board consider putting both of these strategies on watch at the present time.

Trustee Machida asked that Troy Saharic review the criteria for the watch list as well as termination. Mr. Saharic stated that managers are evaluated from two aspects. One is a quantitative standpoint - how well are you doing relative to your primary index and also relative to a peer group meeting over a three and five-year period. There are also qualitative criteria that managers are evaluated on. The criteria are detailed in the Board's investment policy statement. Qualitative factors are: violation of stated investment guidelines and contract terms; deviation from stated investment style and philosophy; change in ownership deemed not to be aligned with investor interests; turnover of key investment personnel related to the management of the investment option; litigation; and failure to disclose relevant information that could negatively impact the organization. All these are different qualitative factors as outlined in the investment policy statement with the evaluation measures and action steps. The things that are being discussed with AllianceBernstein and Century Capital here fall under the turnover category and the action step would be to place them on the watch list and terminate them if performance continues to deteriorate.

Trustee Kami asked Mr. Saharic to clarify why Hawaii cannot move to Century's new open fund where Century is focusing more attention there. Mr. Saharic stated that the other strategy is rated at B+ now and has not gotten Mercer's highest rating because of concern with the focus of the analyst staff. Mr. Bisson did not have a good track record at Evergreen. Technically, what the Board may have to do is to follow Procurement to get a bid rather than switch over automatically. DAG Tam stated that if it is a different class, then the Board would need to do that.

Trustee Machida asked whether it is a different strategy from when they were hired. Mr. Saharic said yes. DAG Tam and Trustee Machida stated that the Board would need to go back and review the RFP that was submitted. DAG Tam commented that the Board had put Invesco on watch for a year and they were not terminated but was recently taken off the watch list. Mr. Saharic clarified that "watch list" means a heightened scrutiny of the underlying strategy, and Invesco went through some pretty significant turnover and results still look positive but wanted to wait and make sure there wasn't any additional turnover in the firm.

Mr. Saharic stated that AllianceBernstein has been in the Plan since May 2008.

Mr. Saharic recommended that the Board give Century and AllianceBernstein until the year end and have them present and make a decision at the December meeting whether to continue to keep them on watch and do nothing, or conduct a RFP search, or if they rebound or stabilize, take them off the watch list.

Trustee Machida asked if AllianceBernstein has been in the plan for 2 ½ years and their performance was in the 97 to 98 percentile for the 1 and 3 year numbers, why were they not recommended for watch list before.

Mr. Saharic mentioned that when AllianceBernstein was added, it was right in the middle of the financial crisis and performance up until that time actually held up. Basically, AllianceBernstein doubled down on some of the financial bets and as a consequence, they lost a lot of performance trail, lost a lot of accounts, and then they went through a number of layoffs to control expenses. These layoffs and staff departures have culminated up until today when those losses add up and we see their need to back fill those losses. Then there are people leaving because of discontent with the situation occurring there. Mr. Saharic stated that this recommendation is timely because Lew Sanders just left about 3 months and Mercer had further research business on some of the information within AllianceBernstein that confirmed their thoughts about some of the turnovers. There was not enough evidence to have this conversation 6 months ago.

Mr. Saharic used page 13 to show the Board the difference between Invesco, Century, AllianceBernstein, and Invesco's sub-components. Invesco manages certain sleeves, like the short term bond funds and other core funds. There were other managers managing the portfolio. At that time Invesco was lagging as well and that is why it was kept on the watch list. First, it was because of the turnover and then performance but less so because it was diversified among the different managers.

A motion was made by Trustee Machida and seconded by Trustee Kami to adopt the recommendation of Mercer to place the Century SMID Growth and AllianceBernstein International Value funds on the "watch list". The motion passed unanimously.

Agenda
Item # 4a: Amendments to the Plan's Investment Policy Statement

DAG Tam mentioned that subsequent to the Board adopting the Plan's Investment Policy Statement at the last meeting, some minor changes were made to reflect the current language in HRS chapter 88E regarding the types of investments the plan can offer. Other changes were grammatical and did not change the substance of the policy. The date will be changed to reflect today's date.

A motion was made by Trustee Machida and seconded by Trustee Chu to adopt the changes to the Board's Investment Policy Statement. The motion passed unanimously.

Item # 5: Discussion on Adding Options in the Self-Directed Brokerage

Ms. Akiyoshi reported that at the last Board meeting, two participants submitted inquiries regarding adding options to the brokerage window. Mercer explained some of the features, the calls and puts, and provided definitions for them. The decision to add them to the window was more of a philosophical one. Eric Bildt of TD Ameritrade provided to the Board some information and statistics of the brokerage window, which was handed out to the Board. Mr. Bildt mentioned that in order for participants to use this option feature, they had to submit an upgrade form to request this change in account to their account and in order to submit this request form there had to be a second signature, a trustee signature, on the form. So, the question was who would sign the form, ING or a Board trustee.

Mr. Bildt stated that the request form information for the brokerage option is an obligation of them, the broker and asks for participant information such as name, SSN, and birth date and demographic information which discloses their investment experience, their goals and objectives, the average size of transactions they are intending to execute, and the number of transactions per day. Their answers are used to determine whether they are suitable to the investment strategy they are requesting. It does not mean that TD Ameritrade is affirming that they will be making the right choices, it is just that TD Ameritrade has to deem them suitable in order to grant them permission to trade that level of options. In the retirement plan, 99% of the time, when people talk about options, they are just talking about covered calls. This level 1 option is the most basic form of options activity and does not have the same inherent open-ended risks a standard full permission option contract, where you just go buy a contract on one side of the market and lose against it where you have to mortgage your house to pay it off. It is not to say there are no risks in options, but the covered call is the most basic. The form is required to be filled out by a participant in order for TD Ameritrade to review that individual account for the ability to grant option privileges on that account. Normally, it is signed by the participant and the trustee or plan fiduciary. There are reasons for this, but in talking through the scenario with the Plan, TD Ameritrade was okay with the form being signed by the participant only. Mr. Bildt indicated that with the letter, he sees no problem in waiving the need to have a trustee signature on each individual participant applicant form.

Ms. Akiyoshi clarified that what TD Ameritrade is proposing is a blanket letter to authorize them from the Plan level. ING explored the possibility of signing off on this and they did not feel they could do it on their side.

Trustee Kami asked whether only covered options will be allowed or is it any source option. Mr. Bildt responded that it would definitely not be any source option. There are two full levels of options privileges currently on the plan that TD Ameritrade provides brokerage windows for. The first level has to have the most basic, and the most common is covered calls only. That means I own a 100 shares of ABC stock and I sell 1 call against that so I receive some funds into my account. If the stock goes up dramatically, basically, my gain will be capped because of my call. That is the most basic level where you have to own the stock already and you are promising your stock if it goes up to a certain point, but you pay some premium in the interim and if your stock goes flat or goes down, you keep the premium. On the other side of the covered options, there are cash covered puts. This was recently added as a brokerage window option. It is the opposite of covered calls, a different strategy, and is relegated to only the assets you have in the account. You have to hold cash in the account to cover the value of your option contract. It is on the second level where you actually buy a put or call. For example, you take a couple thousand dollars to buy a couple calls of stock ABC, the stock doesn't move your way, and then expires, your couple thousand dollars is gone. There are no underlying shares. So, there is this complicating factor of cash covered puts being slightly different and locking up a chunk of cash if you are involved in one. For that reason, the majority of plans just stick only with covered calls.

The Board recognized that they had many discussions before getting to this point. The fact that only a limited number of people requested it caused the Board to take such a long time in deciding whether to have it. Basically, it is for a few people who understand it.

DAG Tam added that in the beginning there were a handful of funds. Over time, we kept expanding the Plan and adding funds. Lifecycle Funds were added and people were still not happy. Then, the brokerage window was added and participants want to trade in options now. The Board has to decide what is adequate for the Plan.

Trustee Okumoto asked whether Mercer could share what other plans provide, whether this is on the edge or the standard. Mr. Saharic stated that there are some brokerage window offerings that do not have the ability to turn on the option feature, so it is not available at all. The trend has been to offer it and turn it on if possible and barring any administrative complexity that could not support it. Mr. Saharic feels this is a philosophical question that the Board must answer.

Mr. Bothwell shared information about another State with a brokerage window. They had about 16,000 participants and only 2 participants have applied for the options process. Mr. Bildt echoed that their experience inside the brokerage window has been often asked for, but when added has not been heavily used. Also, this option is not on-line where people can stumble onto it. People that have applied for it will be provided access.

Ms. Takacs of ING commented that feel that there should not be too much concern because people utilizing the product are hedging what they already have or making a bet that something is going to go down and they already have the money in their account. Over time, the concern is suitability. In speaking with participants, they want to have some hedging option to cover investments. Basically, that is what they are looking for.

Trustee Machida asked Mercer how many plans are allowing this. Mercer said they do not have any survey data on how many plans offer the options feature. They only track how many brokerage windows have stock and mutual funds. He only knew of one state that opened up this type of option feature.

Ms. Carol Cann of ING did a survey and found no other government plan that offered options.

Trustee Chu mentioned that the Plan has had a "more safe that sorry" philosophy. Since the Hybrid plan came in, and the buy back option was made available, people who feel they can manage their plan, self directed or have input will use this option. Giving 6% into the ERS, the participant has no input into that. They have money to burn, the kids are out of college. Two or three years ago, the Board would have played it safe and not given the participant this option, and if they did it would be just mutual funds. Those participants that actively manage their funds want more. Most of the people who want this are older, in their twilight years. If participants are not happy with the plan, they may take their money elsewhere. We are being participant friendly.

Trustee Machida inquired which state had this option feature. Mr. Bothwell stated that New Mexico had this feature.

A motion was made by Trustee Kami and seconded by Trustee Machida to allow covered calls in the brokerage window and authorize a blanket letter from the Board to TD Ameritrade that authorizes the offering of this type of option to the Plan's participants. The motion passed with one opposing vote by Trustee Okumoto.

<u>Agenda</u>
<u>Item # 6</u>: <u>Discussion on American Funds' Revenue Sharing</u>

Ms. Carol Cann of ING updated the Board on American Funds' 12b-1 revenue sharing fees, an issue that was just discovered this year with American Funds. Senior members of ING's legal team and investment services team are in discussions with American Funds to try to resolve this as quickly as possible. This issue dates back to 2003 and it will take some time to get this resolved. Ms. Cann assured the Board that this issue has been elevated at ING and American Funds to get it resolved quickly.

A brief history regarding this is that the American Funds has a 12b-1 revenue sharing with the Plan that gives 25 basis points back to participants and there's a 5 basis point recordkeeping fee that gets allocated back to participants. The application for that revenue sharing was filed in 2003 with American Funds for the two types of revenue sharing. The 5 basis points revenue sharing had been allocated back to the participants in 2003, but it was discovered recently that the second 12b-1 revenue sharing of 25 basis points has not been received from American Funds and has not been allocated to the participants as it should have been. So what they have been doing is going back to American Funds, looking through the contracts and original applications to determine how best to resolve this issue and get it resolved to the benefit of the Plan and its participants.

DAG Tam asked what was the general estimate of the value of the 25 basis points. Ms. Cann said it was about $1.3 million and they are at the stage of negotiation now where they need to determine who pays the $1.3 million. ING has not reached the point where American Funds will cover that amount of money or not. ING is analyzing the applications that were filed in 2003 and American Funds is saying basically that the application forms were not filled out correctly and that is why the 12b-1 revenue sharing fees were never allocated to ING to be allocated back to the participants. Consequently, there is a lot of legal interaction back and forth and analyzing the contracts, analyzing the applications. The 12b-1 revenue sharing fees were never sent to ING, they are still with American Funds.

Ms. Cann noted that back then, it was a contract application between the recordkeeper (State Street) and American Funds.

Ms. Cann stated that there will be many more discussions to decide how to allocate the funds once there is a resolution of where the monies are coming from.

Trustee Machida inquired whether Citistreet or State Street could be culpable in the whole situation. Ms. Cann stated that that is part of the review also. According to ING's legal counsel, the applications were filled out correctly and American Funds alleges that there were discrepancies and so all this has to be determined at this point.

DAG Tam inquired whether American Funds took the position that the application did not indicate that we wanted revenue sharing in the 25 basis points and in only the

5 basis points. Ms. Cann reported that American Funds claims that the 5 basis points applications were filled out correctly and the 25 basis points applications were not and that they did not indicate a broker dealer assigned to the account. So there are specific spots on the form, on the application that either has the correct information or did not have the some information that American Funds thinks that are necessary in order to have these 12b-1 funds to be automatically sent to ING. There is no invoice that goes with these 25 basis points. It was supposed to be paid automatically and ING came to the conclusion that they were not allocated in the manner expected.

Trustee Machida inquired whether any statute of limitations (i.e., time limit) apply to this or how far back can we go. Ms. Cann said that they are reviewing applications from 2003 and actually looking at agreements that State Street set up with American Funds back in 1997 and so all of the agreements are being analyzed and reviewed with ING and American Funds.

Ms. Cann stated that she will follow up with ING , as they are the ones that complete these applications and she does not see why going forward, they cannot get this rectified.

DAG Tam commented that this should be started as soon as possible so that participants can start getting more money back into their accounts. He suggested that ING send a letter stating that here is the application authorizing or saying that we want the 25 basis points or 12b-1s and not acknowledge nor waive any of our rights to the prior 12b-1s.

Trustee Kawamura asked that this item be placed on future monthly Board meeting agendas and Ms. Cann will report back any new progress or updated information.

Agenda
Item # 7: Plan Administrator's Report

a. Status on Plan Activities

Jeanne Kanai of ING provided the Executive summary for the month of July:

- She and Melody Takacs met with the County of Hawaii Personnel and Carol Arikawa and had a positive meeting with no issues.
- Ms. Kanai and Ms. Takacs also met with Kauai County Payroll and Personnel contacts on July 15, 2010 which was very positive and no issues.
- The Hybrid Plan, vacation pay outs, and everything else was running well. Now that counties have furloughs, Unforeseeable Emergency Withdrawals (UEWs) were explained to them. They understand that requests go through the local office.

- Also met with the County of Kauai Department Personnel Officers (DPOs) regarding plan updates. They also discussed with them UEWs; made sure the Personnel staff were clear on all the features of the Plan as well as the broadening of the investment options of the Plan; talked about the upcoming Benefits Fair; the advice offerings; and made sure the DPOs, who were the frontlines were able to communicate the different options to their employees and what they could look forward to at the Kauai Benefits Fair.
- The Hybrid Upgrade program is closing out on September 30, 2010 and so there is a mad rush. As of July 31, 2010, ING processed 2,318 upgrades for a total of about $124 million since October 2009 and processed over 70% of all ERS Hybrid Plan upgrades .
- To date, ERS has received over $200 million of Hybrid Plan upgrades. For the Early Vacation and Post Separation Vacation Pay Deferral program, where people roll over their monies, through the month of July, ING collected a little over $9 million.
- ING will be meeting with Maui on September 29, 2010 because it was a little difficult getting all of them together to meet. Also, Maui changed over to a new payroll system so now was a good time to meet them too.
- For the upcoming initiatives, ING has the Personnel Evaluation (PE) campaign to promote the professional account manager program.
- National Save For Retirement Week is October 17 through 23, 2010. In observance, there is the upcoming Kauai Benefits Fair and ING will be hosting its first Webinar which will be focusing on saving for retirement on October 22, 2010. State and County employees can sit at their computer during lunch and listen to this webinar. Announcements will be in the newsletter, memo to department heads and personnel officers, flyer, and announced at the Fair.
  Board members had no objections to ING hosting this webinar as this is part of the education.

- On the administration side, for the month of July 2010, ING processed 105 ERS Hybrid Plan upgrades totaling $4.7 million that was transferred to the ERS.
- Rollovers into the Plan for July 2010 totaled 5 for $56,000 and 6 ERS rollovers into the Plan.
- Since ING took over the process of UEWs on November 20, 2009, ING processed 182 UEWs of which 151 had been approved and processed for $1.7 million for the year. In July 2010, there were 31 new applications and 33 were approved.
- There 7 new setups for TD Ameritrade accounts for a little over $.5 million.

- For the local office, in the month of July, there were 66 educational group meetings held attended by 373 employees. They also had 791 one-on-one consultations, 85 walk-ins, and supported 501 calls.

Ms. Akiyoshi posed the question to the Board whether we should do an open enrollment period for the Personal Account Manager (PAM) campaign where the three month trial period would be free at the higher advice level to encourage people to enroll. This was similarly done in the initial launch of the PAM campaign in 2008. The normal fees are 60 basis points a year or 5 basis points a month. There would be no cost to the Plan or participants during the three months. The Board had no objections as long as there are adequate reminders about the end of the trial period and that if participants wanted to continue, there would be a fee.

b. Upcoming Employees' Benefits Fair in October

Kauai Benefits Fair is on October 20, 2010 at the Kauai War Memorial Convention Hall. The semi-annual meeting is on October 21, 2010 at the Kauai County Moikeha Building Conference Rooms 2A and 2b.

Agenda
Item # 8: PTS Plan

a. Approval of Report on Funds Not Deposited in the State/County Treasuries

Ms. Akiyoshi presented the PTS Plan asset report for the period ending June 30, 2010 for review and approval.

A motion was made by Trustee Machida and seconded by Trustee Kami to approve the report on funds not deposited in the State/County Treasuries. The motion passed unanimously.

Also, for the Board's information, the quarterly management report is provided.

b. Status of Audit of the PTS Plan

Ms. Akiyoshi explained that LSW, administrator for the PTS Plan, provided a report on the amount of funds available for reimbursement in the PTS Plan, which was enough to cover the costs of an audit of the Plan. Thus, LSW engaged Traveller & Company to conduct the audit of the PTS Plan for the period July 1, 2009 through June 30, 2010. This was the same firm that conducted the audit in 2007 and is scheduled to come down in September and visit Comprehensive Financial Services and hold some site visits with departments.

Agenda
Item # 9: Other Business/Announcements

a. 2010 National Save For Retirement Week Campaign as mentioned earlier.

b. 2010 NAGDCA Conference

Michael Okumoto, Cynthia Akiyoshi, and Lily Chu are attending the NAGDCA Conference.

Motion to Adjourn: **A motion was made by Trustee Machida and seconded by Trustee Kami to adjourn the meeting at 11:40 a.m. The motion passed unanimously.**

(Note: Signed copy on file)