STATE OF HAWAII
DEFERRED COMPENSATION PLAN
BOARD OF TRUSTEES

OPEN SESSION MINUTES
SEMI-ANNUAL MEETING
MEETING # 342

Date: May 18, 2010

Place: Willows Restaurant
901 Hausten Street
Honolulu, HI 96826

Present: Marie C. Laderta, Chairperson
Sandi Yahiro, Employee Member
Scott Kami, Employee Member
Wesley Machida, Employee Member

Others: Rodney J. Tam, Deputy Attorney General
Cynthia Akiyoshi and Lily Chu, DHRD Staff
Troy Saharic, Mercer Investment Consulting
John Bothwell, Mercer Investment Consulting
Melody Takacs, Plan Administrator Staff (ING)/Honolulu Office
Grace Baracao, Plan Administrator Staff (ING)/Honolulu Office
Jeanne Kanai, Plan Administrator Staff (ING)/Honolulu Office
Ron Campana, Communications Manager (ING-Boston Office)
Carol Cann, Administrator Staff (ING-Boston Office
Brian Merrick, Government Operations Director (ING-Boston Office
Kenje Mallot, Customer Services, (ING-Jacksonville Office)
Natalie Bows, Investment Advisory Services (ING-Boston Office)
Todd Egger, INVESCO
Jennifer Gilmore, INVESCO
Mark Kneische, Alliance Bernstein
Heidi Richardson, Alliance Bernstein
Steve Caruthers, Capital Research (EuroPacific)
Tom Smythe, New York Life (Mainstay)
Gregory Grabar, Sr., PIMCO
Joan Larsen, Prudential
Bill McCloskey, Prudential
Cheryl Lynch, Jennison Associates
Sue Bonfeld, Wellington Management Co.

Sunita Patel, Wellington Management Co.
Lisa Rosenthal, Victory
Ed McGettigan, Vanguard
Lisa Wills, Vanguard
Tom Atchison, Vanguard
Eric Bildt, TD Ameritrade
Jason DiPiazza, BlackRock

Absent: Georgina Kawamura, Ex-Officio Member

Call to Order: There being a quorum present, Chairperson Laderta called the meeting to order at 9:05 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.

Chairperson Laderta welcomed all attendees and opened with introductions from the Board members.

Agenda Item # 1: Annual Report from ING

Mr. Merrick stated that he works with the large government plan sponsors at ING, and provided an update on the organizational structure of ING. ING is refocusing its services to government markets going beyond just plan administration services. ING is holding quarterly meetings with plan sponsors to talk about issues in order to learn from each other. ING is reorganizing its business by splitting the banking from insurance/investment management sections.

Ms. Cann reported on the service review:

- Plan assets in April 2009 were $1.3 billion, compared to April 2010 at $1.4 billion, an increase of 8% over a one year period.
- Average balance in 1st Quarter 2009 was approximately $45,000; in 1st Quarter 2010 was approximately $51,000, which represents an increase of 13%.
- Total deposits (contributions) saw a healthy increase over the one-year period of approximately $1.4 million. It is a pretty significant aspect of how participants are reacting and feeling towards the new products/changes that have been added and the communication efforts that support the changes. Participants showing move towards coming back into the Plan rather than decreasing savings efforts.
- Rollover contributions saw an increase, attributable to the Honolulu office and the communication efforts.

- Distribution activity through September 2009 totaled $56 million compared to the period between October 1, 2009 through April 30, 2010 which totaled $161 million, and the difference of $47 million was transferred to the ERS Hybrid Upgrade Program.
- Recap of the Accomplishments:
    - Coordination with ERS on processing of the Hybrid Upgrade Program remittances which totaled $114 million; 2,106 remittances were received which reflects about 8% of the participants with a balance;
    - Processed 406 early and post-vacation rollovers for a total of $6.2 million;
    - Addition of the Black Rock Index Funds to the Plan's investment options on April 1, 2010;
    - Addition of the Self-Directed Brokerage Account; enrollment of 23 new participants and total assets of $307,391.92; interest was due to the good communications campaign to explain the option/program;
    - Replacement of the Wells Fargo Large Cap Growth Fund with the MainStay Large Cap Growth Fund;
    - Replacement of the Vanguard Institutional Index Fund with the BlackRock U.S. Large Cap Index Fund

- Upcoming Initiatives:
    - Addition of the 2055 Fund; target date is July 2010.

Ms. Takacs reported on the Honolulu office Activities:

- Benefits Fair at the Koolau Golf Course yesterday (May 17, 2010) drew 143 attendees; the Fair tomorrow (May 19, 2010) will be at the Hawaii Okinawan Center;
- Group meetings held totaled 400 with an attendance of 2,924 participants;
- There were 4,904 one-on-one consultations held with Plan participants;
- Supported 1,100 walk-ins and almost 4500 calls to the local office;
- On track to exceed the Plan year goal of 630 group meetings;
- Enrolled 300 State and County employees into the Plan since the last semi-annual meeting. The number of enrollments is lower, and seeing more unforeseeable emergency withdrawal requests, but still encouraging participants to contribute. Mr. Merrick added that across the Plans, ING has seen an overall increase in UEW requests from mid-2009. Ms. Takacs noted that outreach is to the younger group to get them to start saving. Publicly-held educational workshops are scheduled and posted on the website and any employee can attend the workshop meetings, and in addition ING contacts departments/agencies to set-up additional workshop meetings at other various sites more conveniently located to offices, as

well as State-organized events. Ms. Cann pointed out that the contribution activities have increased despite the furlough situation that has been occurring.

Ms. Bows reported on the Investment Advisor Service review:

- Investment Advisor Service usage for the period ending March 31, 2010 illustrates the number of users at 2,437, about a 9% rate;
- Personal Online Advisor service saw 1,064 users who accessed the service; within this group 234 were first-time users which represents just under 25% and is a big jump within a short time frame; about 95 adopters who went on to take action on the investment advice recommendations;
- In the Professional Account Manager program, there is a total of 871 enrolled participants since the rollout of the program, and of the total, 71 new enrollments since September 2009;
- Redesign of the POA was launched on March 20, 2010, to give a more contemporary look, make information more accessible, more visual designs, and various web enhancements;
- Legislative update on a proposed rule, RIN 1210-AB35 Investment Advice, ING does not anticipate any changes to its advice program as it is structured right now
- Mailing of the Personal Evaluation Statements is planned for later this year.

Mr. Campana reported on the highlights of the Communications Campaign:

- Highlights of completed campaigns:
  - Education on the new index funds through the various mediums of the website, newsletter, and at the Benefits Fairs;
  - Education on the launch of the Self-Directed Brokerage Account with TD Ameritrade via development of communication materials through partnership with TD Ameritrade and ING such as the Frequently Asked Questions.
- Highlights of Upcoming Initiatives:
  - To support the launch of the 2055 Fund;
  - To support the Advice mailing of the Personal Evaluation Statements;
  - Identify gaps where participant education can be enhanced, which is the Retiree group, and how to better service retirees, through establishing an Association for Public Sector Retirees that will be a forum and collection of resources for retirees to find out what to do with assets, where to invest, talk with other retirees, read articles, use calculators, etc.;
  - Conducting market research to focus on purely government

employees and help benchmark industry; independent group commissioned to do surveys, to help tailor communication campaigns.

Chairperson Laderta acknowledged the good work done by ING and thanked them for their hard work and for partnering with the Board to accomplish all the initiatives to make the Plan better.

Agenda
Item # 2: Semi-annual Performance Evaluation Report from Mercer

a. Economic and Capital Market Environment

Mr. Bothwell provided the following report:

- GDP ended at 3.2% for 1st Quarter 2010;
- 10 year yield stabilized after falling 1 bp during the Quarter;
- 10 year inflation expectations remained modest;
- Unemployment rate was at 9.7% for the quarter;
- Retail sales were stronger than expected with an increase of 1.6, the largest gain in 4 months;
- Many states are struggling with keeping their State's budgets in balance due to the high unemployment rates, depressed property values, and depressed sales tax revenues;
- Long term unemployment has reached a 60-year peak, with 44% of the unemployed looking for work for 27 weeks or longer. Mr. Saharic added that what you see is a jobless recovery; consumers are deleveraging, see a lot of debt racking up so need to watch what is happening in Europe closely with the bailouts that are occurring. Mercer is optimistic on some parts of what is seen on the economic recovery but there are other parts that are still playing catch up, and is still concerned where the consumer sits for the short term;
- 1st Quarter 2010 shows small cap outperforming large cap; and in reversal from last quarter shows value outperforming growth;
- MSCI EAFE gained 0.9% in the 1st Quarter 2010; international stocks generally underperformed domestic stocks during the quarter which contributed to slight underperformance of the Vanguard Wellington fund; the MSCI All Country World Index gained 1.7% in the 1st Quarter, and this is what was added through the BlackRock Fund that was added on April 1, 2010;
- Emerging markets index gained 2.5% in the 1st Quarter, led by Israel and Malaysia;
- In the fixed income category, the Barclays Capital Aggregate Index

had a strong quarter which returned at 1.8%; PIMCO fund saw benefits in performance due to financial companies leading the way in corporates;

- Plan ended quarter with $1.448 billion, increased by $18.1 million, and a 1.3% increase from the previous quarter-end;
- Plan had 28,364 participants with account balances, and the average account balance was $51,068;
- Plan had top 5 funds with about 85% of the Plan assets
- Lifecycle funds up to 3.3% of Plan assets from 2.9% of assets in last quarter;
- Transfer activity shows heavy transfer activity out of the American EuroPacific fund, and most participant contributions went into the Stable Value Fund;
- There was a spike in withdrawals in 4Q 2009 which came back down in 1st Quarter 2010;
- Mr. Saharic noted that the heavy withdrawals were due to the Hybrid Plan rollover option. The Plan asset level would have been higher if the option was not available. Mercer is continuing to monitor the withdrawal activity occurring in the Plan and hope that contributions continue to outpace withdrawals.

b. Mr. Saharic provided a report on the Investment Review:

- There was a mixed performance for quarter in the investment options; Hawaii Stable Value Fund, which makes up about 55% of the total Plan assets and has a mandate which splits the fund between Prudential/Jennison and INVESCO, has had good results. The 1 year, 3 year, and the 5 year periods had positive results relative to the Mercer Stable Value Universe median. INVESCO had a great quarter and year, with the underlying funds up 13.9% versus the Intermediate Government Core at 6.9%, indicative of Jennison's positive strategy. Jennison is also a component of the INVESCO Intermediate strategy. INVESCO was managing the Western Asset Management (WAM) portion while finding a replacement manager. Goldman Sachs replaced WAM.
- Mercer is monitoring the wrap provider market, which smoothes out the returns over time, because financial and insurance industry have been shaken to the core. Risk management committees on these insurance companies are concerned about the wrap provider coverage that they have. Want to watch so that the market value remains above the book value.
- Market value of the combined portfolio is considerably higher than the book value, so the Fund is in really good shape in the event there is a high volume of participant withdrawals.

- Mercer is seeing a high increase in the wrap provider fees as the contracts are being renegotiated, anywhere from 8-9 basis points to 15-20 basis points.
- Saw the yield bottom out in March 2009, but yield is climbing and is at 4.49% for the Stable Value Fund which is good compared to a money market fund.
- PIMCO Total Return Fund had a great quarter, up 3% and ranked in 17 percentile in their peer group. Made some adjustments in their strategies and carrying higher cash due to some turmoil that they foresee.
- On the balanced funds, Vanguard Wellington Fund, which is 60% equity and 40% fixed income, is slightly behind for the quarter but had a good year. Stock selection hurt them a bit; overweight in energy and underweight in consumer discretionary.
- Wellington Research Value Fund, somewhat sector neutral, matched the Russell 1000 Value and had a great year.
- Victory Institutional Diversified Fund is lagging for the one-year period, but not concerned.
- MainStay Large Cap was overweight in the energy sector and so lagged a bit, but not concerned.
- Harbor and Century struggled for the period.
- Harbor was underweight in the consumer discretionary stocks and no REIT exposure so it hurt them. Mercer is watching the 3 year and 5 year performance numbers.
- Century SMID shows continuing lag to the Russell 2500 Growth Index. Mercer met with Lanny Thorndike to review stock selection. Recommends that the Board have a discussion on further details with Century at an upcoming meeting.
- International equity category, the EuroPacific Growth Fund lagged a bit; long-term performance remains good.
- AllianceBernstein International Value Fund had a good quarter relative to the EAFE Value. 1-year performance was strong; the 3 year and the 5 year periods were off due to down 2008 performance of international value stocks in general.
- Departure of Richard Weil at PIMCO; left to go to Janus Capital Group. He headed the advisory group, so Mercer is watching to see who replaces him. PIMCO does have a depth of professionals to continue to assume leadership roles.
- Introduced Eric Bildt from TD Ameritrade which was added to the Plan, as the Self-Directed Brokerage Account.
- Introduced Jason Di Piazza from BlackRock which was also added to the Plan, as the new index provider as of April 1, 2010. BlackRock replaced the Vanguard Institutional Index fund. Although participants had some concerns, believe that most

participants appreciate the low fee structure. Received some positive feedback from the participants at yesterday's Benefits Fair.

- Mercer is monitoring Harbor, Century and AllianceBernstein Value funds.
- The 5 Lifecycle Funds struggled over the 1 year period, but the 3 year and the 5 year remain positive. Lag performance of the small cap managers hurt the 1 year performance; not concerned right now. Will be looking at some potential diversification strategies within the Lifecycle funds beyond the core options.

Chairperson Laderta called a 15-minute break at 10:00 a.m. The meeting resumed at 10:20 a.m.

Agenda
Item # 3: Panel Presentation #1 on Federally Sponsored Patches: Prudential/Jennison; INVESCO; PIMCO.

Presenters: Jennifer Gilmore from INVESCO; Cheryl Lynch from Jennison; and Greg Grabar from PIMCO.

Ms. Gilmore provided recap of events that led up to the financial crisis, and see what is happening so far, and what is to come.

In 2007, saw risk in the market, indication of risk-taking in the market. Then late in 2007, house prices start to decline and signs of financial institution in crisis. In 2008, stock market declines and bank failures; indicators of why the government had to step in.

Federal stimulus actions by Congress in response to market situations:

- Economic Stabilization Act of 2008 which created TARP to inject liquidity into the market and avoid steep decline in prices;
- American Recovery and Reinvestment Act of 2009 – investments in different projects to get long term growth;
- Making Homes Affordable – to help refinance to get better rates;
- Federal Reserve to promote liquidity and lower rates in the markets;
- FDIC – Bank Liquidity Guarantee Program to increase the limit on insured deposits.

Implementation of the programs produced results.

Ms. Lynch reported that federal balance sheet grows significant growth in assets as a result of the impact of the programs.

Ms. Lynch further explained:

- There were changes in the Federal Funds rate since June 2006, with the lowering of the rates at the onset of the credit crisis but not until December 16, 2008 the rate dropped to 0% - 0.25%.
- Before December 2006, markets were calm at around 69 basis points, then see a widening of the spreads dramatically until around March 2009 at 792 basis points, compared to 20 year historical average around 134 basis points. At quarter-end, see the markets tightening at 186 basis points which is an improvement.
- Asset Backed Market was also affected by prices. TALF program designed to help the ABS market ended on March 31, 2010. Asset Backed spreads came down to a more normal level at quarter end. Through TALF, helped to return liquidity to the markets.

In conclusion, can see that the overall markets improved, liquidity returned to the markets, and the spreads have tightened. Market outlook remains positive.

Mr. Grabar noted that the government programs had varying degrees of effectiveness. If government did not take steps, outcome would have been much worse.

As a result of the federally sponsored patches, see short-term positive rebound, in Q3 and Q4, a rebuilding of inventories across all industries. But there are still structural headwinds like high levels of unemployment and where consumer and businesses continue to deleverage.

Sovereign debt issue remains a concern, like the German government debt. The general trend for the developed world is up in the amount of debt they will have outstanding.

Mr. Saharic asked the panel for any comments about the Senate bill to change the definition of swaps which would impact the Stable Value Fund industry. Ms. Gilmore explained that the issue is the definition of swaps is broad, so it could involve wrap contracts and put more pressure on that market. There is a lot of lobbying on the part of representatives to get exclusion for stable value. There are a lot of unintentional implications.

Agenda
Item # 4: Panel Presentation #2 on Emerging Market Equities: Capital Research Management and AllianceBernstein

Presenters: Steve Caruthers from Capital Research Management and Heidi Richardson from AllianceBernstein

Mr. Caruthers explained that although the Plan does not have the dedicated emerging market managers, but within all of the international large cap managers have the flexibility to invest in emerging markets. EuroPacific has about 25% invested; the new BlackRock fund will have about 23-24%. The definition of a financial bubble is when the prices of securities or other assets rise so sharply and at such a sustained rate that they exceed valuations justified by fundamentals, making a sudden collapse likely, at which point the bubble bursts.

Mr. Caruthers noted the comparisons between the MSCI Japan index, the NASDAQ, and the MSCI Emerging Market index; have seen extremely strong results in these market indices for some time.

Mr. Caruthers described the period between 1993-2003 as the lost decade in the U.S. where the S&P was in the negative territory for the 10 year period. Between 2003-2007, there was tremendous earnings growth in the emerging market companies. The last 2 years, emerging markets not caught up in subprime issues so was not really in a bubble scenario.

The PE (price to earnings) ratio is within a reasonable range which is what would be expected coming from a recession to a recovery period.

A forecast of the emerging markets, specifically in China, shows the GDP growth growing at a faster rate relative to the developed world.

Mr. Caruthers covered other points:

- With a lot of the fiscal imbalances seen in the U.S. and the developed world, don't really see those in the emerging markets like the huge debt problems. In the emerging markets, see low debt and the savings rate of consumers at a higher level.

- Currencies are playing a major role in adding to the return that the U.S. investor can get out of the emerging market equities. A lot are primarily commodity driven currencies. As economy grows, see commodities becoming more robust.

- There are macro and global macro events that can affect emerging markets growth, and they are not immune from the rest of the world. Disappointing global economic growth can affect export driven economies.

Ms. Richardson covered the following points:

For bond yields, see a convergence of the yields. This has led to greater country correlation.

Now it is more about the opportunities. Have high quality companies based outside of the U.S. that are getting much of their earnings from the U.S., so want to look at high quality companies regardless of the domicile and want to build portfolios without basing on the country.

More important to look at a company's specific factors like management and reputation of the firm.

AllianceBernstein GDP forecasts show modest global growth in 2010 at 3.8%, coming off of last year when it was a negative market place with GDP growth at negative 2.1%. Seeing economies around the world starting to recover.

Seeing a road to recovery in market economies; upturn/expansion in manufacturing and improvement in productivity, leading to more cash on the books. With increased cash flow, there is more capital investment to make business stronger.

As a result, capital spending is increasing and is helping the economy and GDP.

Labor market is improving, and improved liquidity overall.

Consumer confidence is increasing, after hitting bottom in 1993. Now starting to see a pick up in that spending.

Agenda
Item # 5: Panel Presentation # 2 on Fiduciary Best Practices: Vanguard

Presenters: Ed McGettigan and Lisa Wills, ERISA Attorney.

Mr. McGettigan referred to a copy of a publication on Best Practices for Plan Fiduciaries to help guide plan sponsors on best practices for running a plan.

Ms. Wills, an ERISA attorney and a senior consultant in Vanguard's strategic retirement group, stated that she works with clients consulting and advising on various retirement plan topics and will talk about best practices that she has talked about to various committees.

Ms. Wills stated in general committees find strengths in the committee organization and in listening to the various reports, she noted what practices the Board has adopted to see what other opportunities there are, and she commended the Board for adopting such practices on the process and progress.

Ms. Wills defined a fiduciary as a fiduciary who exercises discretion over the management of the plan or authority over plan assets, and a trustee acting in a fiduciary capacity. Our rules for fiduciary responsibility are outlined in the Plan document which is a part of the statutes and State law.

Plan is governed by HRS chapter 88E and IRC section 457 which is also where the responsibilities come from.

Since the Board members are appointed by the Governor, would follow the governing law to act in the best interest of the participants. Once a member takes responsibility in that role of administration of a plan, then the member owes that responsibility to the participants.

Standards of fiduciary conduct are: to act for the exclusive purpose of providing benefits to participants; defray reasonable expenses of administering the plan are disclosed in participant materials and in FAQs. Also to diversify investments to avoid large losses, the Plan doesn't offer just one fund but offers a diversified range of funds for participants to invest.

Principals for best practices that can help with fiduciary duties:

1. Have a well-organized and effective committee;
2. Select and monitor Plan's investments. Noted that the Board holds semi-annual meetings to review the investments.
3. Oversee the administrative operations of the Plan; and
4. Be attentive to Plan costs.

In looking at Committee best practices:

- Have a clear process for fiduciaries and HRS chapter 88E provides the structure for a committee. So, there is a structure in place.
- Organize effectively by holding regular meetings. So, may want to consider a committee charter to outline roles and responsibilities and how often to meet.
- Ensure all fiduciaries have the necessary qualifications and training. Having investment professionals come and talk supports the training.
- Clearly document your committee organization. Noted that minutes are taken at the meetings and should include topics discussed and decisions that were made.

Investment selection and monitoring best practices:

- Ensure a well-defined and well-articulated purpose, objective, and measure of success. Companies document this in an investment policy statement and drive the investments that will be in the Plan. Noted that the Plan does have an investment policy statement.

Administrative oversight best practices:

- Ensure plan operation is consistent with the terms of your Plan document; and
- Periodically review your documents and processes.

Plan costs best practices:

- Ensure reasonable fees against the plan assets. Does not have to be the lowest costs, but reasonableness and value you get, and
- Disclose to participants. Noted that Plan costs are disclosed to participants.

Agenda
Item # 6: Other Business/Announcements

a. Filling of Board Vacancies

Ms. Akiyoshi provided an update on Board's direction to reach out to former Trustee Wayne Chu. He has indicated that he would be interested in serving on the Board again. Other interested inquiries on the vacancies should be directed to the Governor's Office.

Chairperson Laderta asked if there were any other comments from the guests in attendance. There being none, **Chairperson Laderta adjourned the meeting at 11:41 a.m.**

(Note: Signed copy on file)