STATE OF HAWAII
DEFERRED COMPENSATION PLAN
BOARD OF TRUSTEES

OPEN SESSION MINUTES
SEMI-ANNUAL MEETING
MEETING # 328

Date: November 19, 2008

Place: County of Hawaii
Aupuni Conference Room
101 Pauahi Street
Hilo, HI

Present: Marie C. Laderta, Chairperson
Georgina Kawamura, Employee Member
Ryan Ushijima, Member
Sandi Yahiro, Employee Member
Ken Taira, Member

Others: Rodney J. Tam, Deputy Attorney General
Cynthia Akiyoshi and Tracy Kiyabu, DHRD Staff
Troy Saharic, Mercer Investment Consulting (via conference call)
Carol Cann, Kristine Matthews, and Peter Winterbottom - ING-Boston Office
Melody Takacs and Grace Baracao - ING – Honolulu Office
Carl Lutz, Life Insurance Company of the Southwest
Nathan Glassey, National Benefits Services
Mark Kneische, Alliance Bernstein
Peter Whitlock, Century Capital Management
Ed McGettigan and Tom Atchison, Vanguard
Molly Newcomb Ono, Invesco
Sue Bonfeld and Matt Mithun, Wellington
Ben Coll, Harbor Funds
Lisa Rosenthal, Victory Capital Management
Jane Mason, Wells Fargo

Absent: Wayne Chu, Employee Member
Carol Raber, Employee Member

Call to Order: There being a quorum present, Chairperson Laderta called meeting to order at 9:10 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.

Welcome and Introductions

Chairperson Laderta welcomed everyone in attendance at the meeting and asked each person to introduce him or her self.

While awaiting the arrival of ING staff to provide the first agenda item, the Annual Report from ING, Chairperson Laderta requested that the second agenda item be taken out of order and addressed first.

Annual Performance Report on the Part-Time, Temporary, and Seasonal Employees (PTS) Plan by Life Insurance Company of the Southwest

Mr. Lutz reported that the past PTS Plan year had been the smoothest, with no issues. The current PTS Plan crediting rate is 4.71%. PTS Plan contributions, distributions and interest credited were at their highest. Contributions amounts are up while the number of PTS Plan participants has remained about the same.

It was noted that approximately 2 years ago, Internet account access was added to the Plan, which has resulted in decreased calls to the Plan Administrator. The past year has been a record saving year with the PTS Plan - saving the State of Hawaii nearly $7.5 million dollars. The Plan has saved the State a total of approximately $71.3 million during its 12-year existence.

At Mr. Saharic's request, Mr. Lutz reviewed with the Board how assets in the PTS Plan are invested and the crediting rate derived. Mr. Lutz explained the PTS Plan contributions are invested in a fixed annuity and interest is earned on the contributions from the date of deposit until the date of withdrawal. The interest rate is developed through a formula that is a portfolio yield minus 1.45 basis points for Plan Administration fees.

Upon questioning, Mr. Lutz stated that LSW has no sub-prime loan exposure and makes concerted effort to stay away from such. He confirmed LSW's insurance rating is "A". He reminded the Board of the escrow account that LSW maintains for the PTS Plan in which LSW assets are set aside to back the contributions to Plan to ensure that no losses are passed on to participants. LSW takes the risk so participants do not have to.

Trustee Yahiro commented that it is great to see that the PTS Plan has saved the State over $71 million during its 12 years of existence. Noting that the County of Maui was previously interested in participating in the PTS Plan, the Board thought it would be good to share the Plan savings information with Maui County.

Annual Report from ING

Ms. Cann directed the Board to the ING Semi-Annual Service Review report and provided a summary of the local office's support activities, communication initiatives, Plan participation rates, telephone and internet volumes, investment analysis, cash flow, Plan representatives, and an update on the investment advice services.

DAG Tam asked about the status of ING hiring a relationship manager for the Plan, as required in their contract with the Board. Ms. Cann reported that Kim Alger, ING Business Leader – Public Sector, is working to fill the position as soon as possible.

Ms. Matthews provided an update regarding current Plan communication initiatives. In her review of the investment advice communications, Ms. Matthews announced that the deadline for participants to enroll in the Professional Managed Account service free of charge for their first three months of participation has been extended to December 19, 2008.

Trustee Yahiro noted that as of October 31, 2008, 61.59% of Plan assets were in the Stable Value Fund and asked Ms. Cann what the asset percentage was for end of year 2007. Ms. Cann state she did not have that information available; however, would obtain it and report back to the Board.

Mr. Winterbottom provided a summary of the amount of calls, type of calls and investment advice service usage statistics. By far, the most common question they receive from Plan participants is whether they should sell off all of their investments and move their money to the Stable Value Fund. Service representatives review with the participant their goals and objectives to reconfirm what investment allocations are recommended for their personal situations. It was reported that investment advice service usage rates are very good with approximately 2,310 participants using the service on some level and 530 participants enrolling in the Professional Account Manager service. The Board will begin receiving a semi-annual report to aid in their fiduciary monitoring of the service. The report will contain demographics, participant impact, and investment performance information.

Semi-Annual Report on Investment Performance Review and Overview of Marketplace Trends from Mercer Investment Consulting

Mr. Saharic directed the Board to his Third Quarter 1008 Investment Review report and began his presentation with a review of the economic and capital market environment. It was noted that the economy is in a rapid decline and that the country is in a recession that is expected to last 6 to 9 months. Unemployment rates are expected to reach 8-9%. However, Mercer is reminding clients that despite present situation it is possible to still make money and there are good investment opportunities in the market. Mr. Saharic recapped the timeline of events in the market leading up to the present financial crisis noting the very low consumer confidence, the collapse of financial entities and banks not wanting to lend to each other (hoarding cash). In regards to U.S. equities, U.S. stocks fell across all market caps, value-oriented stocks generally outperformed their growth counterparts and small-cap equities generally out-performed larger-cap equities. In regards to Large Cap U.S. Equity, it was reported that eh Russell 1000 Index declined by 9.4% for the quarter and 19.5% for the year to date; seven stock sectors in the Russell 1000 Index reported losses for the quarter; due to plummeting oil prices and sluggish economy, the energy sector suffered the greatest. In regards to small cap U.S. Equity, the Russell 2000 returned negative 1.1% for the quarter, with half of the sectors posting positive returns; year-to-date losses are negative 10.4%; consumer staples, health care, and financial services performed strongly, while energy, telecommunications and materials lagged; small-cap value stock out performed small-cap growth stocks.

For non-U.S. equity, MSCI EAFE declined 20.5% in the third quarter and 28.9% for the year; Japan posted a negative 17.6 return and UK posted a negative 21% return; all countries posted losses for the quarter; and most countries posted higher returns in local currency terms. For emerging markets, it was noted that the MSCI Emerging Markets Index declined 26.9% in the third quarter and 35.4% for the year; Brazil posted a negative 37.9% for the quarter; China posted losses of 25.4% and Russia 45.3% for the quarter; and the Philippines is the only country that posted a positive return of 3.6% for the quarter. In the fixed income market, declines continue due to deteriorating economic fundamentals and deleveraging balance sheets; Lehman Aggregate Index returns were flat at negative 0.5% for the quarter; Lehman U.S. High Yield Index returns of negative 8.9% were the worst quarterly loss since 1990. In regards to private equity, private equity firms raised $82.3 billion during the third quarter; U.S. private equity firms raised $222.6 billion during the first three quarters of 2008, 11% higher than raised during the same period last year; venture capital exit strategies show lower transaction volume. It was reported that for hedge funds, third quarter 2008 and year-over-year returns for most hedge fund strategies placed at or near the bottom percentile of their return distribution; short bias, the only strategy that performed well, returned 22.4% for the third quarter, and 4.8% year-over-year; fixed income arbitrage exhibits the widest dispersion of year-over-year returns.

In regards to real estate, returns in the public REIT markets have been dismal with Asia markets declining 44.5%, Europe declining 34.5% and North America 13.9%; the NAREIT Index returned 4.5% for the third quarter compared to negative 5.1% for the second quarter; NCREIF Property Index was up 0.6% for the second quarter compared to 1.6% the first quarter. For commodities, the S&P GSCI posted a negative 28.6% loss during the third quarter with the DJ AIGCI posting a negative 27.7% loss; oil peaked at over $147 and fell below $91 with the quarter closing at just over $100 per barrel; energy was the worst performing sector along with agriculture; and the strengthening dollar weighed on dollar-denominated commodities. The year-to-date performance of the major market indices was reviewed, as well as market cycles over the past several decades. In summary, Mr. Saharic noted that it is very difficult to time the markets. Participants with long-term time horizons should stay the course in their investment strategies and those who feel the need to make drastic adjustments should be informed of the possible repercussions.

Mr. Saharic then went into his Investment Option Review report. At the end of the third quarter 2008, there was $1.4 billion in Plan assets. This is a decrease of $55.6 million or 3.8% in Plan assets. There are 28,811 participants in the Plan with the average account balance being $49,318. It was noted that the Plan has a high percentage of assets in the Stable Value Fund that is more than most plans; however, it was noted that the State of Hawaii Plan has an older population. Mr. Saharic reviewed the historical asset growth of the Plan from first quarter 2003 through third quarter 2008, noting a decline beginning in 2007. The top 5 funds in the Plan with greatest assets are Hawaii Stable Value Fund at 56.6%, Vanguard Institutional Index at 13.3%, EuroPacific Growth at 6.6%, Vanguard Wellington at 6.2% and Wellington Research Value at 4.1% for a total of 86.8% of Plan assets. The Lifecycle Funds make up 2.8% of the Plan assets

Mr. Saharic reviewed the transfer activity in the Plan noting that, not surprisingly, most assets moved were from the more aggressive funds to the Stable Value Fund; however, less than 6% of total assets moved around in the Plan. Mr. Saharic went on to review the investment option fees and commended the Board for their efforts in keeping fees low for participants. The performance of the Plan's individual investment options was then covered. The Stable Value Fund was up 1.2% overall for the quarter meeting the Fund benchmark; PIMCO Total Return Fund was down 2.1% meeting its benchmark; Vanguard Wellington Fund was down 7.9% underperforming its benchmark; the Lifecycle Income Fund was down 3.4% for the quarter outperforming its benchmark; the 2015, 2025, and 2035 Lifecycle Funds were down 9.0%, 10.8% and 11.4%, respectively, and all outperformed their benchmarks, as well; the 2045 Lifecycle Fund was down 12.3%, underperforming its benchmark; the Wellington Research Value Fund was down 13.3%, underperforming its benchmark; Vanguard Institutional Index Fund was down 8.3% outperforming its benchmark; Victory Diversified Stock, which replaced the Fidelity Fund (Fidelity Growth and Income Fund is down about 50%), is down 10.9% and underperformed its benchmark; Wells Fargo Advantage Large Growth Fund is down 5.2% and outperformed its benchmark; the Harbor Small Cap Value Fund is down 4.8% for the quarter and met its benchmark;

Century SMID Growth Fund is down 8.3% and outperformed its benchmark; the Century Small Cap Fund is down 8.6% and outperformed its benchmark; the American Funds EuroPacific Growth Fund is down 18%, outperforming its benchmark; and the Bernstein International Value Fund is down 22.5% meeting its benchmark. Mr. Saharic reviewed the Stable Value Fund historical crediting rates, noting the crediting rate for the Fund as of December 1, 2008, is 4.37%.

It was reported that Wells Fargo Advantage Large Company Growth Fund was placed on "watch" in August 2006 and remains on "watch" as it continues to underperform over 3 and 5 year periods. INVESCO was placed on probation in August 2007; Mercer continues to monitor both of them closely, gathering and reviewing their monthly performance data.

Mr. Saharic then lead into discussion about opening of a brokerage window in the Plan and Lifecycle portfolio initiatives.

In regards to the Lifecycle Funds, Mr. Saharic noted that implementation of the recommended portfolio rebalancing would be delayed until first or second quarter of 2009; and with the addition of a 2055 Fund, there would be a $7,500 annual fee plus transaction and asset charges per the fee agreement and the asset charge would be a quarter of a basis point per annum with trades being $7.50 each.

Ms. Akiyoshi provided and update regarding the addition of a brokerage window to the Plan. She referred to the memo Mercer addressed to the Board regarding the that addition of a brokerage window to the Plan and providing a comparison between TD Ameritrade and Charles Schwab, two brokerage window providers available through ING. Staff will be participating in a conference call the following week with State Street, a third brokerage window provider that may be available through ING. It was agreed that until it is learned what State Street is able to offer, further discussions would be on hold.

Mr. Saharic stated that State Street was originally not considered as a viable provider for the brokerage window due to their high fees. Mercer was then instructed by the Board to provide a comparison between TD Ameritrade and Charles Schwab; however, it appears State Street may lower their costs and become viable for consideration again. In reviewing the comparison between TD Ameritrade and Charles Schwab that Mercer went ahead and put together for the Board, Charles Schwab fees appear to be consistently lower than TD Ameritrade fees. TD Ameritrade has one office in Honolulu, whereas Charles Schwab has two. Trustee Ushijima asked if the Board could proceed to make a tentative decision between TD Ameritrade and Charles Schwab and should State Street offer more competitive fees during the conference call the following week then they would be re-considered. There was discussion as to whether there is a procurement issue in relation to the brokerage window provider and DAG Tam stated, that after conferring with the State Procurement Office, there is no issue because the Board is going through ING's provider service. Upon being questioned if Mercer has a recommendation between TD Ameritrade and Charles Schwab, Mr. Saharic directed the Board to the memo comparing the two providers and reviewed each of the listed provider features. In summary, Mr. Saharic commented that Mercer likes Charles Schwab; citing their lower fees, more locations on Oahu, more user-friendly website, and more name recognition. In addition, Mercer has other clients who use Charles Schwab and their experience has been positive. They do not have experience with TD Ameritrade. When asked, ING representatives stated they do not have a preference as they work well with both providers.

DAG Tam commented that ING is the record keeper for the City and County of Honolulu's Deferred Compensation Plan and that TD Ameritrade is the provider for their brokerage window.

After some discussion, the Board decided to have decision making on the Plan's brokerage window provider placed on the agenda for the next Board Meeting.

Chairperson Laderta called for a break stating the meeting will resume at 10:45 a.m.

Panel Presentation #1 by Victory Capital Management; Wellington Management Company; and Wells Fargo

Topic: Credit Default Swaps and Counterparty Risks, and Evaluating Risk in CDOs

Ms. Mason started the presentation talking about credit default swaps. Background information on derivatives was provided which lead into credit default swaps. She stated credit default swaps allow investors the ability to separate risk of interest rate movements from risk default – where it is really an option rather than a default, shifts credit exposure from one party to another and the borrower can insure against default. Credit default swaps and outstanding corporate bonds were discussed, as well as growth of credit default swaps.

Ms. Bonfeld presented the segment that explained how credit default swaps work, covering topics such as reference issuer, notional amount, spread and maturity. In regards to risks associated with credit default swaps, counter party, leverage, liquidity and settlement were discussed. Portfolio uses for credit default swaps include modifying exposure in a portfolio, creating a synthetic position, hedging against default risk, and shorting an issuer.

Ms. Rosenthal discussed purpose as limiting downside and purchase insurance, far reaching impacts, market implications, who is most affected, and the lasting effects.

Due to time constraints, Ms. Mason, Ms. Bonfeld, and Ms. Rosenthal just provided the CDO presentation in hard copy and addressed general questions from Board members.

Panel Presentation #2 by Harbor (HCA Securities) and Century Capital Management

Topic: Impact of Credit Squeeze on Economy

Mr. Whitlock and Mr. Coll provided a presentation regarding the Impact of Credit Squeeze on the Economy: Current Market Conditions and Their Effect on Small Cap Stocks. They took turns covering agenda topics such as events that have lead to the current market situation noting the rise in U.S. debt-to-income ratio (rise in the last 7 years equal to the 39 years prior to that); the increase in home foreclosures and arrears; how financial services firms have responded noting write downs and capital raising, the record number of banks tightening consumer credit guidelines, high corporate yield spreads and tightening lending standards; implications for small cap stocks, noting having a quality bias and a smaller cap bias as helping and citing the drivers of small cap index returns in 2008; where all this stands in the historical context of things; and how Century and Harbor are positioned to capitalize on opportunities. In closing, each spoke to how the financial services sector is working through solvency and liquidity challenges; banks are being resuscitated, but lending is still in shock; the current market environment will require patience; and valuations are looking compelling and opportunities exist.

Other Business

a. Ratification of UEW Case Nos. 192, 199, 200 and 203

A motion was made by Trustee Kawamura and seconded by Trustee Taira to ratify the approval of UEW Case Nos. 192, 199, 200, and 203. The motion passed unanimously.

b. Employees' Benefits Fair on November 20, 2008, at the Hilo Hawaiian Hotel

Ms. Akiyoshi announced that the Employees' Benefits Fair will be conducted the following day, November 20, 2008, at the Hilo Hawaiian Hotel from 9:00 a.m. to 3:00 p.m. All investment providers will be represented. A good turn out is expected with many being interested in the new investment advice service available in the Plan and attending the presentations scheduled.

A motion was made by Trustee Ushijima and seconded by Trustee Kawamura to adjourn the meeting at 12:20 p.m. The motion passed unanimously.

(Note: Signed copy on file)