

**STATE OF HAWAII  
DEFERRED COMPENSATION PLAN  
BOARD OF TRUSTEES**

**OPEN SESSION MINUTES  
SEMI-ANNUAL MEETING  
MEETING # 354**

Date: October 4, 2011

Place: Aupuni Center  
County of Hawaii Conference Room  
101 Pauahi Street  
Hilo, HI 96720

Present: Wayne Chu, Chairperson  
Barbara Krieg, Ex-Officio Member  
Kalbert Young, Ex-Officio Member  
Scott Kami, Employee Member  
Wesley Machida, Employee Member  
Dennis Vanairsdale, 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  
Carol Cann, Plan Administrator Staff (ING-Boston Office)  
Brian Merrick, Relationship Manager (ING-Boston Office)  
David Malatesta, Investment Advisory Services (ING-Boston Office)  
Todd Egger, INVESCO  
Molly Ono, INVESCO  
Mark Kneische, Alliance Bernstein  
Michael Bowman, Capital Research (EuroPacific)  
Tom Smythe, New York Life (Mainstay)  
John Maschoff, Winslow Capital  
Michael Chandra, PIMCO  
Joan Larsen, Prudential  
William McCloskey, Prudential  
Cheryl Lynch, Jennison Associates

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Sue Bonfeld, Wellington Management Co.  
Sunita Patel, Wellington Management Co.  
Lisa Rosenthal, Victory  
Peter Whitlock, Century Capital  
Robert Atwell, Harbor  
Jason DiPiazza, BlackRock  
Marco Mertz, BlackRock  
Eric Bildt, TD Ameritrade  
Carl Lutz, Life Insurance Company of the Southwest  
Nathan Glassey, National Benefit Services  
Wendy Botelho-Cortez, East Hawaii Governor's Liaison Office

Absent: Neal Miyahira, Employee Member

Call to Order: There being a quorum present, Chairperson Wayne Chu called the meeting to order at 9:16 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 Chu welcomed all attendees and opened with introductions from the Board members, Board staff, and Mercer.

Agenda

Item # 1a: New, Incoming Trustee

Chairperson Chu announced that Trustee Sunshine Topping, the Director of the Department of Human Resources Development, has left the department and replacing her is Trustee Barbara Krieg. Chairperson Chu welcomed Trustee Krieg to the Board and a lei was presented.

Agenda

Item # 1b: Annual Report from ING

Presenting from ING are Mr. Brian Merrick, Ms. Carol Cann, Ms. Jeanne Kanai, and Ms. Melody Takacs.

Mr. Merrick opened with opening remarks, and Ms. Kanai presented the Executive Summary overview for the Plan Year July 1, 2010 through June 30, 2011:

- Plan assets increased to \$1.556 billion, as of June 30, 2011, an increase of \$170 million (a 13% increase) since June 30, 2010;

- There was a small negative cash flow out of \$24 million due to the Hybrid purchase, the Unforeseeable Emergency Withdrawals, and the rollovers out;
- Average plan balance was approximately \$56,532;
- Total deposits (contributions) were \$81.286 million which include vacation payouts;
- Total rollover contributions were \$5.528 million; and
- Distribution activity remained consistent; total distributions were \$104.852 million.
- Investment enhancements, which included the addition of the 2055 Fund; changed the EuroPacific Growth Fund from Class A to R6 which reduced the fees from 85 basis points to 52 basis points; the addition of the covered call option to the Self-Directed Brokerage Account;
- Plan Administration highlights include the completion of the ERS Hybrid Plan Upgrade; reallocated approximately \$1.144 million in 12b-1 fees back to over 11,000 participants who invested in the EuroPacific Growth Fund from 2003 through 2010; opened 143 participant accounts in the Self-Directed Brokerage account with TD Ameritrade; processed 27 UEW applications in the amount of approximately \$4 million.

Ms. Takacs presented an overview of the Local Office support:

- Some initiatives over the Plan Year July 1, 2010 through June 30, 2011:
  - Launched the first Plan webinar in October 2010, in conjunction with the National Save For Retirement Week campaign;
  - Created retiree workshops;
  - Coordinated and successfully conducted the Benefits Fairs in October 2010 and May 2011;
  - Conducted 702 educational group meetings with 4,616 employees in attendance;
  - Held 8,352 one-on-one consultations with State and County employees;
  - Exceeded the group meeting goal of 630 for the Plan Year
  - Serviced 875 walk-in employees, and 5,572 calls for assistance;
  - Enrolled 570 employees into the Plan.

Mr. Merrick presented some participation statistics/rate among the departments reflecting of the 55,945 eligible workforce, there are 19,222 active participants which represents a 34% participation rate.

Ms. Cann presented highlights on the Communications:

- The Plan received two (2) awards at the NAGDCA conference; one for

Achievement in Plan Design & Administration related to how the Plan was helping employees cope with market fluctuations, and the second for Achievement in Communications & Education related to the National Save For Retirement Week campaign.

- An update on current activities include the upcoming Benefits Fair on October 6, 2011, the mailings that were sent out for the Advice campaign that is currently going on, and the promotion materials for activities surrounding this month's National Save For Retirement Week campaign.
- A focus on new media to increase interactions with younger participants (e.g., e-books to download, release of additional mobile apps).

Mr. Merrick reported on the Investment Advisor Service usage:

- There was a mail out of approximately 18,600 personal evaluation statements, program brochure and stoplight analysis for those participants with salary information on file;
- Campaign is to build awareness of program and saving for retirement;
- Reviewed a snapshot of the diverse savings projection (e.g. look at all participants, those participants calling and using advice, and those not using advice), and noted that those participants who are using the on-line advice service are saving at a higher rate;
- About 14% of the overall Plan participants are using the investment advice program in some capacity;
- Those participants who are using professional advisory services are well diversified;
- The PAM program does add value, but with a fee.

Mr. Merrick reported on other updates:

- Announced new addition to ING's executive management team;
- Recent client additions;
- Other initiatives in outreaching participants:
  - Added new pWeb features such as new charts and graphs to website to provide better illustrations on how their accounts are changing;
  - Legislation passed to allow 457 plans to add the Roth 457 features, and ING can provide more information if the Board is considering implementing this option;
  - Researching behavioral finance to understand what drives participants' investing habits, and to identify strategies that will engage participants towards saving.

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Item # 2:

Semi-annual Performance Evaluation Report from Mercer

a. Economic and Capital Market Environment

Mr. Saharic provided the following report:

- The 3 themes occurring in the marketplace:
  - Slowdown of overall U.S. economy;
  - Debt crisis in Europe; and
  - Emerging markets staving off inflation and are raising their short term interest rates.
- Domestic equity has been flat during the quarter; small cap stocks have been down; emerging markets have been down;
- In the fixed income sector, Treasuries rallied; U.S. Aggregate Bond market index year to date performance is up 7%; rates have been low.

Mr. Saharic reported on the Plan's investment structure:

- Plan assets at \$1.6 Billion at the end of 2<sup>nd</sup> quarter; 51% of Plan assets remain in the Stable Value Fund; about 80% of the assets are in the top 5 funds
- TD Ameritrade which opened in March 2011 is seeing activity with \$51 million in assets.
- Lifecycle Portfolios has about 4% of the assets.
- Transfer activity – despite seeing flight to quality trend, the total transfer activity still remains low.
- Contributions and withdrawals have normalized.
- Fund expenses are below institutional medians. The 33 basis points remain very competitive compared to other plans.
- Stable Value Fund struggled with the fixed income positions resulting in some managers' performance lagging a bit.
- Market to book ratio is at 107%, the largest spread seen.
- Domestic fixed income options: BlackRock performance is continuing to do well, up 3.8%; PIMCO is lagging its index on quarter to date basis.
- Vanguard Wellington Fund did well on year to date period.
- Lifecycle Portfolios long-term performance has been satisfactory.
- Domestic equity options have done well over the year.
- Monitoring Victory's performance due to some lagging performance relative to S&P 500. Mercer continues to have confidence in Victory.
- MainStay Fund did lag but long term results are still positive.
- Harbor's performance has shown recovery and good results.
- Century has seen a rebound and slight improvement. Mercer will

continue to monitor the performance.

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Item # 3: Annual Report from Life Insurance Company of the Southwest

Mr. Lutz explained the background of the PTS Plan and summarized highlights and provided a current analysis of the Plan:

- To date, Plan assets total \$85 million and total contributions are over \$100 million.
- By the end of next year, the State is projected to save close to \$100 million in savings as the State does not have to match the 6.2% Social Security portion. The State would still pay the 1.45% for Medicare.
- There are approximately 74,000 participants in the Plan;
- About 35,000 participants identified without a forwarding mailing address;
- LSW hired a service provider to conduct an address search which resulted in finding 32,000 addresses of which 10,000 are still in the Plan. They expect to see an increase in the distributions;
- Current interest rate for the portfolio, net of fees, is 4.22% effective October 1<sup>st</sup>.

Mr. Lutz introduced Mr. Nathan Glassey from NBS, the record keeper for the Plan.

Chairperson Chu called a break at 10:30 a.m.; meeting resumed at 10:50 a.m.

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Item #4: Panel Presentation # 1 on U.S. Equities – Large Cap: Wellington Management; Victory Capital Management; and New York Life.

Presenters: Sue Bonfeld from Wellington Management; Lisa Rosenthal from Victory Capital Management; and John Maschoff from Winslow.

Ms. Bonfeld provided an overview of Wellington Management's history and structure, with a focus on the value portion of the portfolio. She explained the key differences in strategies between value, core, and growth.

Ms. Bonfeld reviewed the Wellington Management strategy which is managed by their group of Global Industry analysts who pick stocks to go into the portfolio. She noted that there is no one single portfolio manager. The portfolio is managed industry neutral and explained how they evaluate the stocks. She noted cash is not looked at as a diversifier.

Ms. Rosenthal explained large cap equities. Victory's benchmark is the S&P 500

index and is the best gauge for the U.S. Large Cap equities. The S&P 500 represents 75% total market capitalization.

Ms. Rosenthal explained that as an active manager Victory has the ability to tilt/lean either towards value or growth. She further provided some performance trends and characteristics seen in the Russell 2000 (represents smaller cap managers) and the Russell 1000 (represents larger cap managers) indices. The Victory portfolio is positioned to capture this discrepancy (capturing the undervalued large cap names) during periods of shifts between value and growth. Victory tends to lean and position for slow steady growth.

Mr. Maschoff reviewed the MainStay Large Cap Growth Fund in which Winslow is the sole subadvisor. He provided an overview of the partnership between Winslow and New York Life. Mr. Maschoff discussed how Winslow manages the large cap growth portfolio and its portfolio construction process, how high quality sustainable growth companies operate, sell and buy process, and the types of exposure/expansion opportunities of these companies such as China's growth and expansion opportunities.

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Item # 5: Panel Presentation # 2 on U.S. Equities – Small Cap: Harbor Funds and Century Capital Management

Presenters: Robert Atwell from Harbor Funds and Peter Whitlock from Century Capital Management

Mr. Atwell provided a summary of Harbor's partnership with Earnest Partners and a historical review/reference of the small cap asset class, including annualized returns and periods of over performance. He noted that the small cap class carries more risk than the large cap class, and that three quarters of all stocks in the universe are in small cap stocks. It gives small companies an edge to exploit inefficiencies and provide value over time.

Mr. Whitlock provided an overview of the Century SMID Cap Growth portfolio strategy and how it seeks and adds value. Over time, historical small caps tend to get hit the hardest in a bear market environment. Working out of a bear market environment in years 1, 2, and 3 following a downturn, you will see an inverse relationship taking place. Mr. Whitlock explained that having exposure to growth and value styles is a sound strategy since hard to predict which will be in favor during a period.

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Item # 6: Panel Presentation # 3 on Global Index Portfolio Management: BlackRock

Presenters: Jason DiPiazza and Marco Merz

Mr. DiPiazza provided a review and snapshot of the assets in the four (4) current index fund options within the Plan, and the company's philosophy.

- Within the fixed income sector, there is a 40/60 split between passive (which manages the U.S. debt fund) and active management.
- It is a globally integrated platform which allows BlackRock to source liquidity across the \$1.2 trillion in assets. The benefit to participants is that it lowers their transaction costs significantly.
- Looks at return, risk, and costs.
- Construction of the U.S. Debt Index fund is diversified across all the major U.S. fixed income segments and allows for efficiency.

Mr. Merz provided an overview and investment philosophy of the Equity Index management.

- Have three (3) portfolio management teams that focus on: U.S. equities that includes exposure to mid, small and micro cap securities; developed international markets; and emerging markets. Goal is to avoid liquidity and higher t-costs which results in lower costs and better execution.

#### Agenda

#### Item # 7:

#### Other Business/Announcements

Chairperson Chu thanked all the presenters for their presentations and all the attendees to today's meeting. Chairperson Chu called a short break in the meeting at 12:10 p.m. The meeting resumed at 12:20 p.m.

- a. Discussion on Proposals Received for RFP No. DCP-11-1, Emerging Markets Equity Option; and RFP No. DCP-11-2, Diversified Inflation Hedge Investment Option (in Executive Session Pursuant to HRS §§92-5, 103D-105, and 103D-303), Including But Not Limited to:
  1. Review and Evaluation of Proposals
  2. Scheduling of Interviews with Priority-Listed Offerors

**A motion was made by Trustee Machida and seconded by Trustee Kami to move into Executive Session at 12:21 p.m. to discuss the agenda item related to procurement (RFP Nos. DCP-11-1 and DCP-11-2). The motion passed unanimously.**

All guests were excused with the exception of Mercer.



EXECUTIVE SESSION

Meeting

Reconvened: **A motion was made by Trustee Machida and seconded by Trustee Vanairsdale to move out of Executive Session at 1:30 p.m. The motion passed unanimously.**

Chairperson Chu adjourned the meeting at 1:30 p.m.

**(NOTE: Signed copy on file.)**