

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

**OPEN SESSION MINUTES
SEMI-ANNUAL MEETING
MEETING # 367**

Date: October 17, 2012

Place: The King Kamehameha Golf Clubhouse
Ho`oheno Room
2500 Honopiilani Highway
Wailuku, HI 96793

Present: Wayne Chu, Chairperson
Scott Kami, Employee Member
Kalbert Young, Ex-Officio Member
Barbara Krieg, Ex-Officio Member
Wesley Machida, Employee Member
Michael Okumoto, Employee Member

Others: Rodney J. Tam, Deputy Attorney General
Cynthia Akiyoshi, DHRD Staff
Troy Saharic, Mercer Investment Consulting
David Williams Mercer Investment Consulting
Melody Takacs, Plan Administrator Staff (ING)/Honolulu Office
Grace Baracao, Plan Administrator Staff (ING)/Honolulu Office
Brian Merrick, Plan Administrator Staff (ING-Boston Office)
Jamie Ohl, (ING-Boston Office)
Carol Cann, (ING-Boston Office)
Kenje Mallot, (ING-Boston Office)
Kristine Matthews, (ING-Boston Office)
Peter Winterbottom, Investment Advisory Services (ING-Boston Office)
Nathan Glassey, National Benefit Services
Dave Smith, National Benefit Services
Cris Hernandez, Wellington Management Co.
Sue Bonfeld, Wellington Management Co.
Robert Atwell, Harbor Funds
Peter Whitlock, Century Capital Management
Steve Clear, Winslow Capital/MainStay Investments
Tom Smythe, MainStay Investments

Michael Bowman, American Funds/Capital Group
James Carville, BlackRock
Joan Larsen, Prudential
Todd Egger, INVESCO
Maddi Desner, JP Morgan Asset Management
Joel Damon, JP Morgan Asset Management
James Macmillan, Schroder
Lisa Rosenthal, Victory Capital Management
Michael Chandra, PIMCO
Eric Bildt, TD Ameritrade
Carl Lutz, Life Insurance of the Southwest

Absent: Neal Miyahira, Employee Member

Call to Order: There being a quorum present, Chairperson Wayne Chu called the meeting to order at 9:27 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 everyone to the meeting. Introductions of Board members (Trustee Miyahira was excused from today's meeting), Board staff, and guests were made.

Agenda

Item #1:

Annual Report from ING

Presented by Brian Merrick, Peter Winterbottom, Melody Takacs

Mr. Merrick provided opening remarks to report that the Plan had a successful Benefits Fair yesterday which was very well attended. Overall, there was very positive feedback.

Mr. Merrick provided an Executive Summary Overview:

- Plan assets as of FY June 30, 2012 increased by \$30 million to \$1.587 billion.
- The average account balance increased to \$56,000.
- Contributions increased slightly; and distribution activities decreased over the past year.
- Participation within agencies showed increase in active participation within County of Kauai, County of Maui, Public Safety, and University of Hawaii. Decreases for some departments were likely due to retirements and reductions in staff.
 - Ms. Takacs stated that the local office has utilized this report to

work with agencies to meet with employees. Local office has been focusing attention on and working with the University of Hawaii to create opportunities to enroll the professors; the Department of Defense to allow opportunities to meet with its employees; and the Hawaii Health Systems.

- Mr. Merrick stated that the overall participation rate is about 34%, and without the DOE and UH the rate is about 56%.

Ms. Takacs provided highlights of the Local Office education and support:

- Local Office conducted 645 educational group meetings across the islands with an attendance of 4,226 state and neighbor island county employees.
- Supported 641 walk-ins and 4,892 calls to the Local office.
- Enrolled 550 state and county employees into the Plan during the Plan year.
- Conducted 6,885 one-on-one consultations.
- Added a value-added enhancement to the Plan by partnering with the RIGHT Team which assists participants one-on-one with rollovers-in to the Plan from start to finish.
- Received wonderful feedback from the attendees to yesterday's Benefits Fair to say how much value they got out of the Fair. There were a total of 451 attendees to the Fair. Two activities were conducted – one in which the Lei card (for the Asset Allocation/Diversification education campaign) was handed out and resulted in 391 cards being returned. The activity allowed participants to interact with the various investment managers and other plan providers. The second activity focused on National Save For Retirement Week that asked participants what actions they took to think about their retirement future. The responses revealed that the top action taken was coming to a Benefits Fair which they find to be very valuable and helpful in achieving their retirement goals.

Mr. Winterbottom reported on the Investment Advisory Services within the Plan:

- Service is designed to help individual participants assess whether they are investing correctly, saving enough, and what that translates into in terms of retirement income.
- Utilization by the end of the Plan Year ending June 30, 2012 was at 15.61%.
- Total usage among active participants is higher at 16.62% which is tied to the Retirement Evaluation campaign.
- Usage through the Personal Online Advisor totaled 1,651.
- There were 1,843 enrollees in the Professional Account Manager (PAM) program.

- Assets under management in the PAM program are at \$106,091,597.
- For the Retirement Evaluation Campaign:
 - Kickoff started in September through November.
 - This is a personalized mailing that gives participants an idea if they're investments are on track, their risk level, if they're saving enough, and what that translates into in terms of retirement income.
 - Campaign is done annually; 68,500 have been sent to participants since the campaigns began.
- 7% of Plan participants are enrolled in the PAM; retention rate in the program is about 94%.
- Average savings rate is at 10.3% for individuals who have engaged through the online service and the average savings rate is at 7.2% for individuals who have engaged through the PAM program. For individuals who do not use any advisory services earn an average savings rate of 6.3%. So, getting people to save more is the primary goals of the investment advisory service.
- In working with Financial Engines, ING has worked to include different asset classes in participant portfolios to round out the portfolios.
- Communications have also been enhanced/streamlined in the PAM program.

Mr. Merrick reported on a study that was conducted, called Retirement Across the Ages, which revealed some generational behaviors:

- On full-time employees who are working:
 - Generation Y – Ages 25-34
 - Generation X – Ages 35-49
 - Baby Boomers – Ages 50-64
 - Mature – Ages 65-69
- Found mature workers are generally less likely to participate for reasons such as already have a pension, or feel all set for retirement.
- Mature women are the exception to this range.
- Most groups appear to have some other sources of retirement savings outside the Plan; mature workers most likely to have additional sources.
- Have seen a decline in traditional pensions which makes these types of plans more critical.
- The millennial group need more help feeling in control of their investment, especially having gone through the recent recession.
- Because about half of the population does not know how to achieve their retirement goals, so there are more opportunities to provide the education.
- Younger workers are not planning for their retirement needs relative to their peers across the generations.

- About a third identified that insufficient income is a barrier to saving. Objective would be to help participants break down the barriers and help them save.
- Found that millennial and matures are the most conservative investors. Snapshot of the Hawaii Plan participants showed that 73% of the millennial group has some monies invested in the Stable Value Fund, and about 13% of the millennial group has invested in only the Stable Value Fund.
- Study identified debt behaviors among the younger workers, credit card behaviors, and use of discretionary income.
- Recognize that different participants have different biases towards communications such as one-on-one interactions through the Benefit Fairs, prefer to talk with their peers, or learn through electronic tools.

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Item # 2: Investment Performance Presentation from Mercer Investment Consulting

Mr. Saharic provided the 3Q Year to Date, through September 30, 2012, snapshot:

- Conservative market rally during this period after fluctuating periods; saw macro factors drive the markets.
- For the quarter, the S&P was at 6.35%; the Russell 2000 was only up 5.25%.
- Saw markets favoring of the large cap stocks but was a selective market environment.
- Energy and consumer discretionary were driving factors.
- Non-U.S. sector, emerging market stocks rallied.
- Strong results out of Asia; oil up considerably.
- In the fixed income sector, corporates and long corporates did well. High yield also did well.
- In the REITS sector, US REITS came down but commodity stocks did well during the period. Oil was up 8.5% and gold was up 10.6%.

Mr. Williams provided highlights in Plan:

- Equity valuations were up relative to Stable Value and Fixed Income values.
- Asset allocations to the Lifecycle Funds will be updated this month and the Bernstein International Value Fund is going to be replaced and a new product available to participants next week.
- Average fees at .32% expense ratio; the Stable Value Fund has a .31% expense ratio.
- Performance for the Lifecycle Funds:

- Shorter dated funds performing well; the longer dated funds slightly behind benchmarks, largely due to the underperformance of the Bernstein International Fund.
- BlackRock Fund has been tracking the index.
- Stable Value Fund continues to add value over cash.
- Fixed income, PIMCO, continues to do well.
- Solid performance from the Vanguard Wellington Fund.
- JP Morgan Fund is the new option which had a nice rebound during the quarter; commodity stocks helped.
- Wellington Research Value Fund had a solid long term performance.
- Victory Diversified Stock Fund had a nice rebound in the last 2 months.
- MainStay Large Cap Growth Fund benefited from overweight in technology stock selection as well as allocations to industrials and consumer staples stocks.
- Harbor Small Cap Value Fund slightly lagging the index for the quarter; long term performance is around median. Fund remains on the watch list.
- Century SMID Growth Fund has a positive 3-year return, 5 year slightly behind. Fund remains on the watch list.
- American Funds/EuroPacific Growth Fund had very good returns.
- Schroder Emerging Market is the new option with solid returns.

Mr. Saharic added that a more detailed quarter report will be provided at a future meeting.

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Item # 3: Annual Report from Life Insurance Company of the Southwest
Presented by Mr. Carl Lutz.

Mr. Lutz provided a summary of the Plan highlights as of June 30, 2012:

- After 2008, contributions declined, but premiums have been going up.
- Plan assets reached over \$90 million.
- Benefits paid out totaled almost \$60 million, up \$2 million from the past year. This was due to initiating a bad address search which provided new address information for a successful mailing to inactive participants with accounts.
- The State savings totaled \$7.2 million, up \$300,000 from the prior year.
- The total State savings since inception is just under \$99.5 million.
- The number of active participants increased slightly.
- The total number of participants was relatively flat.
- The vast number of employees are from the DOE and the UH.
- The rate for the 3rd Quarter 2012 was 3.72%; and the 4th Quarter 2012 is 3.68%.

- The amount in the escrow account was about \$87,000,000.
- The number of inactive participants who have not had contributions in 12 months is about 63,000. The average number of active participants per month is about 10,000.

Chairperson Chu called a short break at 10:34 a.m. The meeting resumed at 10:56 a.m.

Chairperson Chu acknowledged the individual Investment Fund managers for their support in helping to sponsor yesterday's Benefits Fair and today's Board meeting.

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Item # 4:

Management Report by Century Capital Management

Presented by Peter Whitlock

Mr. Whitlock reviewed the performance history of the Century SMID Growth Fund and some preview on the outlook going forward.

- Century has about \$3 billion of assets under management, investing in quality growth companies.
- Strategy has about \$980 million in assets.
- Provided some updates on the firm and experience of the team.
- Began the relationship with the Hawaii plan in October 2006.
- The fund has about \$38 million in the Plan as of September 30, 2012.
- Saw a severe downturn in 2008; the markets reversed in 2009 and there were a number of low-quality businesses that were left for dead and potentially going out of business.
- Explained the low-quality rally in the 2nd Quarter and 3rd Quarter of 2009, and as such noted that it was a difficult time to match or beat the index in this environment.
- As markets normalized, was able to generate relative out performance in 2010 and 2011.
- Relative out performance comes from stock selection.
- In response to events, have broadened the turnover in the portfolio and concentrated bets in high conviction positions.
- Provided comments on Century's positioning and outlook; and reviewed the top holdings in the portfolio.

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Item # 5:

Management Report by Victory Capital Management

Presented by Lisa Rosenthal

Ms. Rosenthal reported on the performance of the Victory Institutional Diversified Stock Fund:

- Had a difficult Second quarter, but rebounded in the Third quarter.
- Provided updates on the firm and the experience of the team. Larry Babin who is 64 years old is committed to the company for at least two years or longer. Team has been together since 2000. Paul Danes will step in when Larry decides to retire/leave.
- Explained the construction methodology of the portfolio.
- The fund is at \$38 million.
- At the end of 2011, performance dragged down, but overall long term performance was strong. Expect to have the opportunity to out perform more.
- Explained the positioning within the portfolio that shows a bias in companies that generate domestic sales. See companies are continuing to reinvest.
- Overall the positioning in the portfolio has paid off, so expect that they will continue with the same trends.

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Item # 6:

Panel Presentation by Wellington Management, New York Life Investments/MainStay Funds, Schroder Investment Management and J.P. Morgan Asset Management on the State of the Global Economy
Presented by Sue Bonfeld/Wellington, Steve Clear/Winslow, Jamie Macmillan/Schroder, and Maddi Desner/J.P. Morgan

Ms. Bonfeld provided information on indicators on employment, capital expenditures, and what companies are doing. Findings in a CFO survey with a focus on regulatory issues and the fiscal cliff revealed:

- Small businesses hire tremendous amount of the workforce.
- Survey has a mix of business types, with a higher focus on manufacturing because 50% of respondents had sales revenue of less than \$100 million annually, and 70% of the respondents had less than 500 employees.
- Provided survey highlights within the U.S., such as concerns on attracting and retaining qualified employees. Most see that the regulatory and fiscal cliff issues are main concerns that are causing the problems on hiring plans.
- In the optimism survey, growth is not growing as quickly.

Mr. Macmillan reported on the outlook for emerging markets by economists:

- Much of the focus is in Europe with Greece to leave the euro in early 2013 and the Spanish bailout.
- Economists see about a 2% GDP growth in the U.S., and in the emerging world it's about 5.5% which is larger because they are not as dependent on the rest of the world as it used to be.
- Stronger trades going on with China than the U.S.
- Explained the earnings rate and the risk level between the developed markets and the emerging markets.
- Biggest risk is in China; see that there is slower growth in China of about a 7.5% growth rate and bank tightening as factors. See that pressures are easing.

Ms. Desner presented information on the inflationary bubble:

- Illustrated the path of inflation for the past 6-7 years, but it is a difficult thing to predict.
- Shared some risks seen out there. Seen central banks lower interest rates and the printing of money and throwing it into economy to stimulate growth.
- Tendencies for scarcity of food spur food inflation. With the increases in population especially in the emerging markets, with more urbanization which is resulting in consumers needing more protein, and less farmland, these factors will increase the need to grow more food.
- There is an event risk. There is more consumer dollars in food. As food becomes more expensive especially in the Middle East, it has implications to the energy supply and could see spiking oil prices.
- Rather than trying to time a decision, for portfolio construction see a need to diversify in inflation sensitive assets to go around the problem and ride out the bumps in the road.
- Explained that inflation cycles correlate with economic growth. Look at asset classes to see what rotates out or in.

Mr. Clear presented on the innovation drivers in the current economy:

- Historically, economists have seen innovations increase during difficult economic times, and innovations have unleashed when the economy picks up.
- Provided some highlights that are going on in the economy, such as the smartphone penetration which is happening globally. People are using the smartphones to search for things and to buy things.
 - Explained the impact of mobile devices on the infrastructure.
- Second area of innovation with so much data that has been created, companies are trying to anticipate how to store data. This has led to cloud

computing that stores data outside the computer. Companies find opportunities to be more efficiency and use less capital to buy software licensing.

- Provided information on another innovation area which is energy production. The use of hydraulic fracturing has taken off and has impacts on the economic chain.
- Noted that there is tremendous innovation occurring in the U.S. which will lead the global economy going forward.

Trustees Krieg and Okumoto were excused from the meeting at 12:20 p.m.

Chairperson Chu acknowledged the presenters for their time in preparing the presentations for the Board which helps the Board members to understand. The Board appreciates the efforts in these meetings.

Chairperson Chu adjourned the meeting at 12:31 p.m.

(Note: Signed copy on file.)