STATE OF HAWAII
DEFERRED COMPENSATION PLAN
BOARD OF TRUSTEES

OPEN SESSION MINUTES
MEETING # 368

Date: November 7, 2012

Place: Department of Human Resources Development
14th Floor Merit Appeals Board Conference Room
235 South Beretania Street
Honolulu, HI 96813

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

Others: Rodney J. Tam, Deputy Attorney General
Cynthia Akiyoshi, DHRD Staff
David Williams and Andrew Ness, Mercer Investment Consulting
– via conference call
Brian Merrick, Carol Cann, ING/Boston Office – via conference
call
Melody Takacs, Grace Baracao, and Jeanne Kanai, ING Honolulu Office
Robert Atwell, Harbor Funds – via conference call
Trey Greer and Margaret Champagne, Earnest Partners – via conference call
Bill Kunstman, DLIR
Maricar Pilotin-Freitas, DLIR
Carol Kanayama, DLIR/Workforce Development

Absent: Scott Kami, Employee Member

Call to Order: There being a quorum present, Chairperson Wayne Chu 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 Chu welcomed Trustees and guests, and noted for the record that

Trustee Kami has been excused from today's meeting. Introductions of ING's staff, attendees on the conference phone line, and guests were made.

Agenda
Item #1: Management Report by Harbor Funds

Mr. Atwell introduced Mr. Greer and Ms. Champagne from Earnest Partners, subadvisors of the fund portfolio, who will also be presenting fund information and updates.

Ms. Champagne discussed the Small Cap Value strategy, provided updates on Earnest Partners, and some details as follows:

- Earnest Partners manages $20 billion in assets.
- Public client plans like Illinois, North Carolina, and New York also invest in this Small Cap Value strategy, along with larger corporate plans.
- No changes to the investment team; are 100% employee owned.

Mr. Greer discussed the current positioning in the portfolio:

- Year-to-date performance in the strategy is up about 9%; the benchmark is up about 14%. So although the strategy had had positive returns, the strategy is trailing the benchmark by about 5%.
- In 2011, the strategy outperformed by about 8% thus giving back some in performance.
- Some positioning in the portfolio has worked against it in terms of relative performance. One is due to an underweight in financials. Commercial banks have done extremely well and the portfolio does not hold many commercial banks. Need to feel that the individual banks have the balance sheet necessary to grow its business and survive over time. Have a concern on small cap banks and because loan growth is not strong they do not feel it's not an ideal time to invest in banks. So, they will not make changes unless they feel comfortable.
- Although REITS have done well. In certain areas, investors are oblivious to the risk they are taking like mortgage REITS and can be risky securities. It has not been an area where Earnest Partners has been interested in.
- Explained the minimum weighting to the benchmark and the comfort they have on this bet against the benchmark has towards the portfolio performance. Explained that they look at drivers that drive the risky ness of a stock.
- They are finding opportunities in industrials, energy, information technology, and materials.

Mr. Atwell provided some closing comments and pointed out their ten (10) year relationship with Earnest Partners. Harbor has a high degree of confidence in them and feels they want to continue the relationship. In response to Trustee Machida's question on the use of the Russell 2000 index by Harbor versus the Russell 2500 index, Mr. Greer explained that in managing risk, they are indifferent to either benchmark.

Agenda
Item # 2: Performance Evaluation Report by Mercer for the 3rd Quarter 2012

Mr. Williams provided highlights on the market environment:

- Market performance for the 3rd Quarter was good and a solid year-to-date performance.
- Risk assets rallied, particularly out of Europe.
- Emerging markets outpaced developed markets. Within the U.S., large cap outperformed small and mid-cap; and value outperformed growth.
- Expectation of a 1.8% growth in the 3rd Quarter.
- In the Fixed Income sector, yields were down during the quarter; credit outperformed Treasuries.

Mr. Williams reported on the performance of the Funds:

- Major asset classes are being covered.
- There are no significant organizational updates to report that would affect Mercer's recommendations.
- Total assets in the Plan total just over $1.6 billion; there was a $51 million increase for the quarter.
- Provided some detailed comments on the performance summary that were not reported at the last meeting - the Semi-Annual meeting in Maui.
- The index funds are all tracking their indices.
- The Stable Value Fund continues to add value relative to cash.
- The Jennison portfolio is doing well relative to its benchmark; and the INVESCO's underlying strategies are beating its benchmark.
- Good performance from PIMCO and Vanguard.
- JP Morgan portfolio outperformed.
- Victory had a good quarter from its good stock selection; and the 3-year performance is starting to bounce back.
- MainStay was in-line with the index; Mercer has no concerns.
- Noted again that with the Harbor Funds, financials have been the detractor; Mercer recommends continued retention of the strategy.
- Century has seen a slight performance bump in the quarter; recommends continued retention.
- American Funds has had a solid performance.

- Schroder was behind its benchmark in the quarter; long-term is favorable. Noted that Mercer is monitoring their process that they use due to some deviations.
- Total average expense ratio is about 32 basis points.

Agenda
Item # 3: 2013 Legislative Initiatives

Chairperson Chu stated that DLIR is asking to amend HRS chapter 88-F relating to the PTS Plan to specifically exempt DLIR's Work Experience program participants from the PTS Plan.

Chairperson Chu invited DLIR representatives to explain its request.

Ms. Kaneyama from DLIR's Workforce Development Division ("WDD") addressed the Board and provided some background on the request.

The WDD has operated different types of federally fund employment and training programs for over forty (40) years. The intent is to help people get back into the workforce or have them re-trained. The work experience training offers real life work experiences; and the program has established temporary, exempt positions that provide short-term employment.

Currently, the mandatory participation requirement of the PTS Plan has applied to WDD participants. However, in the past, there was a specific exemption in federal law for the predecessor WDD program that prohibited them from participating and receiving "retirement benefits", and this exempted them from mandatory participation in the PTS Plan. The current WDD program is under the Federal Workforce Investment Act, and under this Act there is no similar specific prohibition on paying any federal funds toward retirement benefits. The federal funds pay for wages and any fringe benefits, so there is no impact to the State. The benefit for the trainees to not participate in the Plan is that the FICA that the ER pays is paid for by the Federal government. The benefit to the trainees is that they get the cash right away and have the earnings credited towards social security.

When asked how many people DLIR is talking about, Ms. Kaneyama noted that there are currently only a couple of trainees in the WDD program. The average is about two to five per year in the WDD program. The only time the numbers increase is when there are additional funds to run a big program like a summer youth program of about 1,500 employees.

She added that DLIR is planning to submit the legislation to clarify that the WDD program participants be exempted from mandatory participation in the PTS Plan.

Trustee Miyahira noted that participants would not see a difference being in the Plan; that the participant pays into the PTS Plan what they would have to pay into social security. Furthermore, he stated that these employees are considered transient employees so if they were to leave they would get the monies back right away under the PTS Plan versus Social Security. Trustee Young added that the amount of the paycheck that the employee would receive, whether in the PTS Plan or exempted, is essentially the same. Ms. Kaneyama confirmed that the desired benefit for the participants is for them to receive the social security credits versus being in a deferred compensation retirement plan.

DAG Tam explained section 4.2 of the Plan Document lists the exemptions from the Plan. There are five (5) categories followed by examples. The WDD program does not appear to fit into any of these categories. Also, under the current laws and rules, the Board does not have the authority to exempt the WDD participants from the PTS Plan. In addition, the Board is not in favor of piecemeal legislation that exempts only a small number of employees from the Plan.

DAG Tam further added that since the Legislature wanted PTS employees to be covered by a retirement plan, they made participation mandatory and in doing so, saved the State a significant amount of money. He said that the DLIR could inform the WDD participants about the mandatory PTS Plan and have them sign an agreement at the beginning of their employment indicating whether the employee wants to withdraw the funds from the Plan or keep them in when they separate from service. This would make it simple and involve the least amount of inconvenience to the employees. Ms. Kaneyama responded that she believed that many of the participants would want to do this.

The Board questioned why there would be an issue with this since part of the purpose of the WDD program is to educate participants about financial matters and have them be more financially independent. The proposed set-up makes it so simple for the employees – if they decided to withdraw their funds upon separation from service, a check would be mailed to their home address.

DAG Tam suggested that DLIR go back to the U.S. Department of Labor to ask for written confirmation that the federal monies paid to WDD participants cannot be used for retirement purposes.

Ms. Kaneyama stated that the WDD does not have a specific prohibition as the predecessor program had under prior federal law. There is no history on why the provision was taken out. The Act leaves the decision up to the State.

Chairperson Chu noted that the Legislature will likely ask the same questions. So it would be worth looking into getting clarification from the federal government now.

In response to questions, Ms. Kaneyama stated that the information presented to the Board today was more for information and comments.

Trustee Young commented that the FICA portion consists of 6.2% for social security and 1.45% for Medicare. The PTS Plan takes 7.5% in pre-tax contributions. So, whether the employee pays the 7.65% or pays it into the PTS Plan, the net amount taken would amount to about the same on their paycheck. DLIR would need to determine the desired accomplishment – whether it is a greater benefit having the social security service credits than the benefit or value of being in a retirement plan which is the equivalent of a pension program for them. The State's original intent of the statute was to save general funds monies that would have gone to Social Security. As the Budget and Finance Director, Trustee Young noted that he would seek that any proposed legislation should be made clear that the exemption is only given where the Federal government actually reimburses for all fringe benefits paid to these positions including the FICA contribution.

The Board agreed that no Board action or position would be taken at this time.

Agenda Item # 4: Plan Administrator's Report

a. Plan Updates for 3rd Quarter 2012

Ms. Kanai stated that this item needs to be deferred and will be reported at the next meeting.

b. Quarterly Budget Report

Mr. Merrick reported that all expenses have been paid through September 30, 2012. Through the contract term period ending on June 30, 2013, the amount of the remaining available balance is $1.4 million for the Plan to pay for remaining expenses. The outstanding audit expenses that are pending will need to be paid out from the remaining available balance. The amount of the reserve will be discussed at a future meeting, tentatively after the completion of the TPA search and the outstanding expenses can be determined.

c. Updates on Fee Disclosures Reporting for the Plan

Mr. Merrick reported that the U.S. Department of Labor finalized fee disclosure guidelines for plans that are covered by ERISA. Non-ERISA plans are choosing to follow those guidelines as well. ING has been helping its clients adhere to these requirements and are making these disclosures available to non-ERISA clients. Steps taken:

- Add a new section to participant statements. Shows fees that came out of participant's account and that are tied to specific transactions or administrative fees. Call Center representatives have been provided these updates so as to be able to address any participant calls/inquiries.
- ING is working on a Sponsor Fee Disclosure to disclose what fees are being paid to the record keeper. Template is based on DOL guidelines. It should be completed this quarter.
- For the Participant Fee Disclosure, the objective is for Plan Sponsors to send out what the fees are such as administrative and investment fees. ING is working on the template for Board review.

d. Status Report on Plan Audit

Ms. Cann reported that ING is making good progress with N&K; sharing reports; confirmation letters were sent to employers and additional confirmation letters will also be sent to individual participants. Mr. Merrick added that N&K has asked for a Management Discussion and Analysis be prepared by the Board. ING is drafting this report for review.

Agenda
Item # 5: Discussion on Revenue Rebate Received from TD Ameritrade

Mr. Merrick summarized the ING memo prepared on this rebate:

- The Plan offers a SDBA through TD Ameritrade.
- ING partners with TD Ameritrade in order to offer this service.
- ING has terms and conditions with TD Ameritrade to facilitate the processing of the accounts.
- ING has negotiated revenue sharing with TD Ameritrade for services. In its contract with the State, ING cannot keep the compensation it receives.
- Since ING cannot keep the compensation, ING proposes to turn over the compensation and recommends allocating the rebate to current participants within the SDBA. This practice would be consistent as with those mutual fund rebates. Through the calendar year ending December 31, 2011, ING received $2,052. There will be an additional amount for 2012.
- As of last week, there were 113 SDBA holders.

A motion was made by Trustee Miyahira and seconded by Trustee Machida to approve the recommendation to allocate the TD Ameritrade revenue

sharing amounts back to participants in the brokerage window as proposed by ING. The motion passed unanimously.

Agenda
Item # 6: Status on Amendments to INVESCO's Contract and Investment Guidelines

DAG Tam reported that the contract amendments are close to being finalized. He recently received comments back from INVESCO on a proposed draft.

Agenda
Item # 7: Payment of Legal Fees and Discussion on DHRD Administrative Support Fees

Ms. Akiyoshi reported that at a prior Board meeting, the Board reviewed and discussed the payment of legal fees for services provided by the Department of Attorney General, and payment for administrative support services by DHRD. DAG Tam indicated that the fee amount was discussed internally and their decision is to leave the amount at $20,000.00 for this current fiscal year.

A motion was made by Trustee Miyahira and seconded by Trustee Krieg to approve the bill for legal services in the amount of $20,000.00 for the current fiscal year, July 1, 2012 to June 30, 2013. The motion passed unanimously.

Ms. Akiyoshi stated that the administrative support services DHRD provides to the Plan and a reasonable estimate of the cost to provide those services have been discussed internally. Trustee Krieg stated that in the internal review, as a Trustee felt that there should be more oversight of the contract reporting requirements and monitoring obligations. The Board should delegate to staff the responsibility to actively monitor the TPA, and to collect and review the reports. Staff should report back to the Board and the Board should be doing an annual performance evaluation to validate that time is being dedicated to overseeing that the Contractors are meeting their requirements. DHRD estimates the amount of time staff spends on the Plan is approximately 70%.

A motion was made by Trustee Young and seconded by Trustee Machida to move into Executive Session to discuss confidential salary information. The motion failed to pass.

A motion was made by Trustee Miyahira and seconded by Trustee Machida to accept the DHRD proposal that reflects a compensation amount of staff support services to the Board at 70% of salary plus fringe, as proposed, and increase the amount from $40,000.00 to $66,866.00 per year. The motion passed unanimously.

Trustee Krieg added that DHRD will amend the current Memorandum of

Understanding that is in place.

Agenda Item # 7: Discussion on RFP No. DCP-12-1, For Independent Third Party Administration Services

A motion was made by Trustee Miyahira and seconded by Trustee Krieg to move into Executive Session at 10:45 a.m. to confer with legal counsel on procurement matters. The motion passed unanimously.

ING and all guests were excused from the meeting. Mercer joined the conference call for the meeting.

EXECUTIVE SESSION

Meeting Reconvened: A **motion was made by Trustee Miyahira and seconded by Trustee Machida to move out of Executive Session at 11:08 a.m. The motion passed unanimously.**

Agenda Item # 9: Other Business/Announcements

a. Upcoming Scheduled Board Meeting(s)

Ms. Akiyoshi stated that the next meeting will be on December 6, 2012, to evaluate the proposals for the TPA RFP.

Ms. Akiyoshi reported that a response letter was prepared and sent to a participant who was having problems obtaining a distribution because the participant only has a rotary phone and is currently living out-of-state. ING was working with the employee, and a form was developed for the employee in order to facilitate the distribution. This issue has been resolved.

Ms. Akiyoshi reported that the surveys from the Maui Benefits Fair in October were compiled, and the overall results were very positive. The only negative comment was that not all the health plan providers were at the Fair. The participants stated that they liked the location.

Chairperson Chu adjourned the meeting at 11:10 a.m.

(Note: Signed copy on file.)