



EXECUTIVE CHAMBERS

LINDA LINGLE
GOVERNOR

HONOLULU

January 16, 2004

The Honorable Calvin K. Y. Say, Speaker
and Members of the House of Representatives
Twenty-Second State Legislature
State Capitol, Room 431
Honolulu, Hawaii 96813

Dear Mr. Speaker and Members of the House:

For your information and consideration, I am transmitting (2) copies of the Employees' Retirement System's response in accordance with House Concurrent Resolution No. 109 which was adopted by the Twenty-Second Legislature of the State of Hawai'i, Regular Session of 2003. Pursuant to Act 231, Session Laws of Hawai'i 2001, I am also informing you that the response may be viewed electronically at www.state.hi.us/budget.

Sincerely,

/s/

LINDA LINGLE

Enclosures

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GOVERNOR



STATE OF HAWAII
EMPLOYEES' RETIREMENT SYSTEM

January 13, 2004

The Honorable Calvin K. Y. Say, Speaker
and Members of the House of Representatives
Twenty-Second State Legislature
State Capitol, Room 431
Honolulu, Hawaii 96813

Dear Mr. Speaker and Members of the House:

We are pleased to present this response to House Concurrent Resolution No. 109 (HCR), which was adopted by the Twenty-Second Legislature of the State of Hawaii, Regular Session of 2003.

The HCR requested the ERS to review its investment practices, determine whether any investments are being made with companies based in countries that support terrorism, and rethink its investment policies regarding these companies.

As a result of the HCR the ERS has spent a significant amount of time reviewing its investment practices with respect to companies based in countries known to support terrorism. It is our belief that current policies make use of available resources and include ample precautions to ensure that fund assets are not being used to finance companies based in nations known to support terrorism.

Funds of the Employees' Retirement System are under the direction of professional third-party investment managers. These firms must comply with the regulations established by the Investment Advisers Act of 1940, and therefore must register with the Securities and Exchange Commission. All are subject to strict federal regulations aimed at stopping investment in terrorism. The list of Specially Designated Nationals and Blocked Persons, which is provided by the Office of Foreign Asset Control (OFAC), names individuals, groups, and companies that represent a risk to national security. Investment advisers check this federally sponsored list against any possible investment opportunity and are prohibited from investing with, or for, anyone named therein. Additionally, the Patriot Act of 2001 has called for all investment managers to establish a written anti-money laundering program to help stop the financing of terrorism. Official rules for regulation of such programs are pending final approval. Thus, by employing professional investment managers, system assets must go through a federally mandated screening process that protects against the financing of terrorism.

Beyond the provisions established by federal law enforcement agencies, investment managers follow their own set of internal regulations to ensure that they are not investing client assets in an

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January 13, 2004
Page 2

irresponsible manner. Some managers prefer to do business only with firms based in countries known to oppose terrorism and money laundering. They restrict investments to companies within the member nations of the Financial Action Task Force (FATF) or the MONEYVAL committee of the Council of Europe, for example. Managers generally will invest solely in credible and established companies in developing or emerging markets. They will also limit investments to companies listed on established exchanges, each of which having their own set of requirements for their listed firms. These types of screenings alone help to preclude investment in any company based within a country known to support terrorism.

In addition to these initial procedures, investment managers extensively research all potential investment opportunities. This includes quantitative inquiry into financials, but also qualitative investigation of management, ownership, reporting quality, political risk, and ethical issues. Any company that chooses to use funds to support terrorism or terrorists should be discovered during this research process and would not be considered for investment. From a purely economic standpoint, companies based in countries that are known to support terrorism are not likely to be attractive investment opportunities.

The use of professional investment managers greatly diminishes the possibility that fund assets are being invested in companies based in countries that support terrorism. Federal regulations and guidelines prevent financing terrorism in general, while internal structure ensures that such investments are never made. The Employees' Retirement System continues to vigilantly monitor any new regulations and guidelines from law enforcement agencies to ensure that it, and any employed third party manager, is aiding in the fight against the financing of terrorism. Ultimately, the Employees' Retirement System believes that policies and practices currently in place are comparable to those of other institutional investors, and ensure that investments are not made with companies based in countries that are known to support terrorism.

Please call Kimo Blaisdell, Chief Investment Officer, at 586-1707 should you have any questions.

Sincerely,

/s/

Jackie Ferguson-Miyamoto, Chair
ERS Board of Trustees



EXECUTIVE CHAMBERS

LINDA LINGLE
GOVERNOR

HONOLULU

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Twenty-First State Legislature
State Capitol, Room 003
Honolulu, Hawaii 96813

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