

State of New Jersey
State Investment Council

Meeting at
The Rutgers Inn and Conference Center
178 Ryders Lane
New Brunswick NJ 08901-88556

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September 17, 2009
3 p.m. Council Meeting

MINUTES

Approved November 19, 2009

Present: Orin Kramer, Chair
Jonathan Berg, Vice Chair
Erika Irish Brown
W. Montgomery "Monty" Cerf
Jose R. Claxton
James Clemente
Susan Crotty
Mark Kandrak
James C. Kellogg
Karl Kleeberg
Douglas A. Love
James P. Marketti
Timothy McGuckin

Also

Present: *From the Division of Investment:*
William G. Clark, Director
Ray A. Joseph, Deputy Director
Brian Arena, Investment Officer
Susan Burrows, Secretary to the Council
Jessie Choi, Investment Analyst
James Falstrault, Investment Officer
Maneck Kotwal, Investment Officer
Christine Pastore, Investment Officer
Susan Sarnowski, Compliance Officer

From the Governor's Office, Dept of the Treasury and Attorney General's Office:
Tom Bell, Director-Public Information
Rubin Weiner, Deputy Attorney General

Other Invitees:

Scott Booth, Townsend Group
Pete Keliuotis, Strategic Investment Solutions
Stephen Masarik, Strategic Investment Solutions
Daniel Stern, Cliffwater

Members of the Public:

Frederique Adam-Jupillat
Jamie Barker
William S. Bauer, Jr
Gloria Jean Berry
Sharon Brooks
Linda L. Brown
Shirley Bryant
Mike Calabrese
Jose Carduna
Sandy Coia
Clifford S. Cooper III, Banking, Insurance & Real Estate Commission
Barbara Counts
David Dovidio, Division of Revenue
Steven Green
Harvey Grossman
Jeff Grossman
Valerie Kazhdan, NJEA
Regina M. Jackson
Deborah Jacobs
Sandra Johnson
Rufus Jones, CastleOak Securities
Patricia Latimer
P.G. Maurer
JoAnn Marshall
Mitchell Mercer
Mary Ann Mesics, Department of Education
Anthony Miskowski
S.M. Newman
Kevin Norton, Bank of NY Mellon
Shameko K. Palmer, Division of Revenue
Dave Parker
Rae C. Roeder, President CWA Local 1033
Jean Richmond
John Ruth
Luz Sanchez
Betty M. Sanders, Department of Motor Vehicles
Christine M. Smith, Motor Vehicle Commission
Denise Winters
Paula Van Pelt

I. *Call to Order*

Chair Kramer called the meeting to order at 3:06 p.m.

II. Notice of Meeting

Secretary Burrows reported that notice of the meeting scheduled for September 17, 2009 was sent by mail deposited in the post office, by facsimile and email on August 4, 2009, with an amended notice announcing a change of location issued September 1, 2009. A copy of the notice is on file as posted in the Division and sent to the Council, the **Times of Trenton**, **The Star-Ledger**, the **Bergen Record**, the **Courier Post** and the Secretary of State.

III. Approval of Minutes

Minutes of the regular meeting of the Council held on July 9, 2009 were approved unanimously on a motion by Mr. Berg, seconded by Mr. Claxton. Mr. Kandrak abstained because he was absent from the July meeting.

IV. Reports of Director Clark

A. Memorandum from Director Clark to the Council, dated September 11, 2009, entitled "Investment Reports."

Director Clark reported that the pension fund had a new balance of \$66.7 billion at the end of August, up from \$63.2 billion as of June 30, 2009, with a positive return for the month of 2.98 percent against 2.74 percent for the Council benchmark.

He noted that the fund underperformed in both the domestic and international equity portfolios in August because both portfolios have a lower risk profile than the overall market and are underweight in financial services relative to the benchmark. He said the underperformance was offset by the fund's overweight position in stocks, which proved the best performing asset class in July and August. Director Clark said the economic environment remained weak overall, but stocks were moving in anticipation of an economic recovery in the coming months.

Investment Officer Arena noted that the domestic equity portfolio was underperforming the benchmark S&P 1500 Index, mainly due to the fund's continued underweight position in financial services stocks. The Division has been gradually increasing the portfolio's exposure to take on a more pro-cyclical stance; he noted that the Division has been purchasing financial services and technology stocks in recent months. He also noted that the Division's preferred stock investment in Citigroup (which was initially purchased in January 2008) had been converted into common stock, and the Division had since sold the majority of this stock and realized over a 10 percent gain on the investment.

Mr. Kandrak asked whether the Division believed that the recovery in the markets and the economy was being "engineered" by fiscal and monetary policy, and how the Division factored that into their thought process. Director Clark agreed with that description, and indicated that the Division believed the economic recovery would be much more muted than past recoveries because of the excessive amounts of debt in the system.

Senior Portfolio Manager Patton discussed the fixed income performance, which exceeded its benchmark for the first two months of the fiscal year. He noted that spreads on both investment grade and high yield debt continue to compress, and the Division had taken profits by selling investment grade corporate bonds in July and August. He said that a portion of those proceeds were invested in Build America Bonds.

Finally, Director Clark indicated that the international portfolio, like the domestic equity portfolio, was lagging its benchmark for the first two months of the fiscal year, primarily because of an underweight position in financial services stocks. He said that the majority of the fund's hedge versus the Japanese yen was removed in early September.

Chair Kramer inquired as to hedge fund performance for 2009, which was positive 19 percent for the year. Chair Kramer noted that the pension fund's performance was positively impacted by the fund's move out of public equities into hedge funds.

B. Memorandum from Director Clark to the Council, dated September 11, 2009, entitled "Review of Fiscal Year 2009 Performance."

Director Clark said the pension fund's estimated performance for the 2009 fiscal year was -14.2 percent. He said that the Division compared the fund's performance with two peer groups. First, it compared the fund's performance to the Wilshire TUCS database, which is the largest database of investment funds consisting of public funds, corporate pension funds and endowments/foundations. Director Clark noted that New Jersey outperformed all subgroups within the database, and focused on New Jersey's performance relative to the universe of public funds with assets greater than \$5 billion. For that peer group, New Jersey outperformed over the prior one-year period -14.2 percent versus -18.8 percent. For the prior three years, New Jersey returned -0.7 percent versus -2.8 percent for the peer group; and for the prior five years, New Jersey returned 3.2 percent versus 2.4 percent for the Wilshire TUCS peer group.

The Division also compared New Jersey's performance with other state funds that had reported performance results for the fiscal year ending June 2009. For that group, the average state fund was down 19.5 percent, and New Jersey was tied with North Carolina as the best-performing fund in the country.

Mr. Claxton asked whether the fund's allocation to alternative investments contributed to the fund's outperformance. Director Clark stated that it did, along with outperformance in public equities, the fund's move into corporate bonds in late 2008, and the decision to fund margin calls on several bank loan funds in 2008.

Chair Kramer and other Council members congratulated the Division staff for the fund's investment performance.

Finally, Director Clark reported that there had been a recent story in NJ Biz magazine concerning the Neuberger Berman NJ Direct Fund that was created to make private equity investments in funds and/or companies in New Jersey. At the time of the story, Division staff had not received permission from Neuberger Berman to disclose the underlying investments in the Fund. He noted that it is standard for private equity firms to require confidentiality about their underlying investments. Since the printing of the story, the Division received permission

from Neuberger Berman to release the underlying investments of the Fund, and Director Clark circulated a list of the investments to Council members and the audience. He also indicated that the Division would make the list available to the general public.

V. *Committee Reports*

Mr. Kandrac reported that the nominating committee was nominating Chair Kramer to serve as Council Chairman and Vice Chair Berg to serve as Vice Chairman for the 2009-2010 year. There being no other nominations, a motion was made by Mr. Cerf and seconded by Dr. Love to approve the nominations of Chair Kramer and Vice Chair Berg. All Council members voted for the nomination except for Mr. Marketti, who abstained. (Note: Ms. Irish Brown was absent during the vote.)

Chair Kramer thanked his fellow Council members for their support and service to the state.

Chair Kramer then initiated a discussion with Council members concerning the appointment of members to various committees of the Council. As a result of this discussion, the following committee assignments were made.

- Executive Committee: Chair Kramer, Vice Chair Berg, Mr. Kellogg, Ms. Crotty, and Dr. Love.
- Audit Committee: Mr. Kellogg (Chair), Chair Kramer, Vice Chair Berg, Ms. Crotty, Dr. Love and Mr. McGuckin.
- Communications and Public Employee Relations Committee: Mr. Clemente (Chair), Vice Chair Berg, Mr. Kandrac and Mr. McGuckin.
- Corporate Governance and Diversity Committee: Ms. Irish Brown (Chair), Mr. Claxton and Mr. Cerf.
- Economically Targeted Investment Committee: Mr. Kandrac (Chair), Mr. Cerf and Mr. Claxton.
- Incentive Compensation Committee: Mr. Claxton (Co-Chair), Mr. Cerf (Co-Chair), Ms. Crotty and Mr. Kandrac.
- Investment Policy Committee: Dr. Love (Chair), Chair Kramer, Ms. Irish Brown, Mr. Cerf, Ms. Crotty and Mr. Kleeberg.

VI. *Pending Matters.*

A. Status of Proposed Amendments Filing

Compliance Officer Sarnowski reported that proposed amendments to N.J.A.C. 17:16-11, 16 and 40 concerning investment in fixed income and non-convertible preferred stock as approved by the Council at the July 9, 2009 meeting were published in the *New Jersey Register* on September 8, 2009. The 60-day comment period ends on November 7, 2009.

VII. New Business

A. For Action by the Council

1. Memorandum from Director Clark to the Council, dated September 9, 2009, entitled "Adopted Amendments to N.J.A.C. 17:16-17."

Compliance Officer Sarnowski reported that these amendments that were previously approved by the Council will allow the Division to purchase state and municipal general obligation bonds issued throughout the United States. The current regulations only permit the Division to invest in general obligation bonds issued by or in New Jersey. These amendments have been published in the *New Jersey Register*, and the 60-day comment period has expired with no comments being received. If the Council votes to adopt these amendments, they will be published in the *New Jersey Register* and become effective on October 19, 2009. After a brief discussion, the Mr. Kandrac made a motion to approve these amendments, which was seconded by Mr. Claxton. The Council voted unanimously to adopt the following resolution: The State Investment Council (the "Council") hereby adopts amendments to N.J.A.C. 17:16-17 regarding investments in State and Municipal General Obligations. The Council hereby authorizes the Director of the Division of Investment to submit the attached notice of adoption to the Office of Administrative Law for publication, and hereby delegates to staff of the Council and the Division of Investment the authority to make revisions to the notice of adoption as required and as shall be made upon the advice of the Attorney General. The resolution shall take effect immediately.

2. Memorandum from Director Clark to the Council dated September 9, 2009, entitled "Approval of Proposed Repeal of N.J.A.C. 17:16-2 for filing with the Office of Administrative Law; proposed repeal of the State Investment Council Policy and Procedures with respect to the engagement of external investment managers; proposed adoption of the State Investment Council Policy and Procedures with respect to the engagement of investment advisors.

Director Clark started by explaining that the Appellate Court had ruled that the Division was unable to retain external investment managers whereby the Director delegates decision-making authority to outside entities, and that the State, the CWA and the NJEA had jointly agreed not to challenge that decision. The Council currently has a regulation governing the process for selecting external investment managers, so the first part of this motion is for the Council to repeal that regulation since it is inconsistent with the Appellate Court ruling.

In addition, the Appellate Court recognized that the Division could retain external investment advisers who can make recommendations to the Division on investment matters, but did not have decision-making authority over those investments. The Division was also proposing that the Council adopt a policy governing the selection of such external investment advisors in the event that the Division desired to retain investment advisors in the future.

Mr. Marketti questioned the term “non-discretionary advice” that was contained in the policy. Director Clark responded that non-discretionary advice meant that the advisor did not have the discretion to make decisions on behalf of the customer (in this case, the Division). Mr. Marketti also asked whether this policy governed the evaluation of firms providing investment advice, and more generally what were the proposed termination provisions governing investment advisors. Director Clark responded that this policy does not incorporate procedures for evaluating advisors after they are retained, but that the Division will develop a separate policy to address this issue for Council approval at a future meeting. With respect to termination provisions, Director Clark noted that the Council would have the opportunity to inquire about these provisions if and when an investment advisor was presented to the Council, but that these agreements generally would allow the Division to terminate the contract within thirty days or less.

Mr. Claxton made a motion to adopt these proposals, which was seconded by Ms. Crotty. All Council members voted for this motion except for Mr. Marketti, who abstained.

3. Memorandum from Director Clark to the Council dated September 9, 2009, entitled “Alternative Investments Valuation Policy and Due Diligence Procedures.”

Director Clark indicated that these policies and procedures were intended to address two items. First, in last year’s management letter, Ernst & Young indicated that the Division should formalize its policy for determining the valuation of alternative investments. Second, Deputy Director Joseph has been leading an effort to develop more rigorous due diligence procedures that would provide the council and the public with a better understanding of the investment process for selecting alternative investments. Director Clark indicated that these procedures would be a “living document” that would be updated as the Division further refines its investment process.

Mr. Kandrac asked whether the Division performs reference checks with other public funds that were and/or are investors with the same firm. Investment Officer Pastore indicated that such reference checks are part of our procedures, and such checks often produce valuable information for the staff.

Mr. Claxton made a motion to adopt these policies and procedures, which was approved unanimously by the Council. After the vote, Dr. Love asked whether it was appropriate to post these policies and procedures on the Division’s website, and Director Clark concurred.

B. For the Information of the Council

1. Verbal Updates from industry involvement by Director Clark and Council Members

Deputy Director Joseph stated that the Division was evaluating potential investments in the PPIF (“Public Private Investment Fund”) program sponsored by the U.S. Department of the Treasury. The Division has met with all nine managers selected by Treasury for participation in the program, but had not reached any conclusions as to whether this would be an appropriate investment for the fund.

Director Clark noted that he serves on an advisory committee for the Financial Accounting Standards Board, and that the FASB was under tremendous political pressure to relax their rules for fair value accounting for various financial instruments. Dr. Love added that he has been working with the Government Accounting Standards Board on the issue of fair value accounting for public pension plans. It was his view that the GASB was the last entity that has not adopted fair value accounting, and that their accounting standards had contributed to the poor funded status of many public plans across the country. A discussion followed concerning the overall status of public funds generally.

Finally, Director Clark indicated that Chair Kramer had led an effort for public funds to have input in proposed rules by the FDIC pertaining to private equity involvement in the recapitalization of the banking system. Director Clark said that the joint letter signed by many public funds requested that the FDIC adopt rules that would be less restrictive on private equity recapitalization of failed banks. Subsequent to this letter, the FDIC issued revised rules that were responsive to the issues identified in the joint letter.

2. Memorandum from Senior Investment Analyst Joanna Ng to the Council dated September 11, 2009, entitled "Proposed Change to Fixed Income Benchmark."

Senior Investment Analyst Ng explained that the Division changed its fixed income benchmark in December 2008 from the Barclays Long Government/Credit Index to a custom benchmark that was the same index adjusted to reduce the exposure to U.S. Treasuries by 50 percent. The logic behind this change was that the Division wanted to adjust the portfolio to significantly increase the exposure to corporate bonds, and the adjusted benchmark was a better reflection of the portfolio's desired allocation at the time.

Since then, the spreads (i.e., the incremental yields) on corporate bonds have come down, and the Division no longer feels it is appropriate to have such a large exposure to corporate bonds. As a result, we are proposing to revert back to the original benchmark for the portfolio – the Barclays Long Government/Credit Index.

3. Verbal update by Investment Officer Christine Pastore on the search for funds and fund managers focused on private equity secondaries.

Investment Officer Pastore said that the Division, in conjunction with its consultant SIS, had sent out nearly 70 questionnaires to firms that have created or are in the process of creating funds investing in private equity secondaries. Secondaries represent existing limited partnership interests acquired directly from other limited partners. She said that responses to the questionnaire are due by September 25, 2009, and the Division and SIS would work together to evaluate the responses.

4. Memorandum from Director Clark to the New Jersey Legislature, dated September 3, 2009, entitled "Report to the New Jersey Legislature (Investments in Sudan)".

Director Clark indicated that under the Sudan Divestment Law, the Division is required to make an annual report concerning the status of any investments in the portfolio that are doing business in or with Sudan. The Division has already divested of all such investments, and the report updates the list of companies that the Division has determined are ineligible for investment under the law.

VIII. *Communications*

There was no report from the State Treasurer.

IX. *Public Comment*

No speakers registered for the public comment section of the meeting.

X. *Executive Session*

Chair Kramer indicated that several Council members had asked to receive an update on several litigation matters, and that the Council intended to go into executive session to receive an update from a representative of the Attorney General's office. Vice Chair Berg made a motion to go into executive session, which was seconded by Dr. Love. The Council voted unanimously to go into executive session at 4:35 p.m.

At 4:53 p.m., the Council emerged from executive session

Need executive committee minutes

XI. *Next Meeting*

October 15, 2009	Noon Lunch/1 p.m. Meeting	Rutgers Student Center <i>Multi-Purpose Room B</i> 126 College Avenue New Brunswick, NJ 08901
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(Secretary's Note: This meeting was canceled by amended notice posted on October 9).

XI. *Adjournment*

The meeting was adjourned at 4:53 p.m. by unanimous vote on a motion by Mr. Marketti.

Respectfully submitted,

William Clark
Director, Division of Investment