

SENATE BILL NO. 5
(Second Reprint)

To the Senate:

Pursuant to Article V, Section I, Paragraph 14 of the New Jersey Constitution, I am returning Senate Bill No. 5 (Second Reprint) with my recommendations for reconsideration.

I commend the sponsors of this legislation for their strong commitment and efforts to recognize the unique status and circumstances of the Police and Firemen's Retirement System ("PFRS") within the context of New Jersey's overall pension funding crisis. I certainly sympathize with the motivations underlying the bill, which comes in response to years of partial and deferred State pension payments and mounting unfunded liabilities. Despite recent statutory reforms intended to control costs and increased State pension payments, New Jersey's overall pension system remains one of the worst-funded retirement systems in the nation. The chronically underfunded system is largely responsible for the record number of credit rating downgrades sustained during the previous administration. These downgrades weakened investor confidence and increase our borrowing costs.

To be clear, the challenges we now face should not be blamed on any one governor or a single political party. Actions by governors and legislatures over several decades and on both sides of the aisle have brought us to where we are now. But, without question, now is the time we must take steps together to do better. My proposed budget includes a record \$3.2 billion pension contribution and maintains our path towards full funding. Moreover, in support of this effort, my Administration took swift action to impose a more realistic and responsible assumed rate of return on pension investments, and to implement a plan to gradually lower the rate over time, promoting stability in employers'

contributions and signaling to credit rating agencies and investors that the State takes seriously its commitment to reduce longer-term funding costs within appropriate levels of risk.

Still, the stakeholders advocating on behalf of the bill are rightly frustrated. In relative terms, PFRS is the healthiest of the State's individual pension systems, with a total funded ratio of more than 69 percent. The other systems have an average funded ratio of just 60.2 percent. Unlike the State, New Jersey counties and municipalities have only rarely failed to make their full annual employer contributions when required to do so. And PFRS members contribute ten percent of their salaries to the system, a higher contribution level than many other public sector employees contribute to their respective pension funds. These factors support adopting a different approach for PFRS, to treat it differently than our other retirement systems.

I am convinced that this different approach should include embracing the unions' strongly-held desire to oversee their own investments. Despite my support for the core reforms and the sponsors' efforts to put in place various safeguards, however, there are several technical changes that must be made to ensure that the proposed reforms are implemented in an appropriate manner, as intended, and that taxpayers are protected in the process.

For example, the bill directs the transfer of \$26 billion of pension assets. I am advised by the State Treasurer, that such a massive transfer would risk immediately destabilizing the value of all the State's pension funds, including the PFRS fund. In this regard, more than a quarter of PFRS' assets are tied up in investments that would require significant time, as well as some cost, to liquidate. Immediately transferring assets would also require the Board to replicate investment management functions

currently performed by the State's Division of Investment, creating extra expenses that the Treasurer advises could cost the PFRS fund an estimated \$12 million a year.

Additionally, the bill would vest the newly established board with the discretion to make changes to members' benefits, but would not require an actuary to first certify the long-term viability of the fund - a safeguard statutorily required in every other State pension system. The bill also would allow the Board of Trustees to set its own rate of return for PFRS investments. The assumed rate of return has broad implications for the State, municipalities and counties, as well as for the other pension systems.

My recommended changes address these and related technical concerns while preserving the board's control over the management and allocation of its investments. I am confident that these changes strike an appropriate balance by both empowering the new board with the management of PFRS while continuing to protect the stability of the State's pension funds, the expectations of PFRS members and, ultimately, the financial interests of the taxpayers of this State.

Therefore, I herewith return Senate Bill No. 5 (Second Reprint) and recommend that it be amended as follows:

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| <u>Page 7, Section 5, Line 14:</u> | After "System" insert "or its designee" |
| <u>Page 9, Section 7, Line 25:</u> | Delete "board of trustees" and insert "State Treasurer" |
| <u>Page 9, Section 7, Line 31:</u> | After "6%." insert "This rate shall be distinct from any internally targeted rates used for developing investment policy by the board of trustees pursuant to Section 13 of P.L.1944, c.255 (C.43:16A-13)." |
| <u>Page 16, Section 15, Line 27:</u> | After "trustees" insert ", and, as specified, the committees established pursuant to subsection e. of this subsection" |

- Page 16, Section 15, Line 29: After "may," insert "with the approval of at least eight members of the board,"
- Page 16, Section 15, Line 37: After "member" insert ", so long as an actuarial certification provided by the actuary demonstrates that such change will not result in an increased employer contribution in the current year and that such change will not impact the long term viability of the fund"
- Page 19, Section 15, Line 37: After "(8)" insert "(a)"
- Page 20, Section 15, Line 24: After "operation." insert "(b) A majority of the authorized membership of the board shall constitute a quorum for the transaction of business."
- Page 21, Section 15, Lines 15-16: Delete "may be an employee of the board or" and insert "shall be"
- Page 21, Section 15, Line 19: After "employees" insert "and be a fellow with the Society of Actuaries and an active member of the American Academy of Actuaries"
- Page 22, Section 15, Line 5: Delete "invest and"
- Page 22, Section 15, Lines 6-12: Delete in their entirety and insert "formulate and establish, amend, modify or repeal such policies as it may deem necessary or proper, which shall govern the methods, practices or procedures for investment, reinvestment, purchase, sale or exchange transactions to be followed by the Division of Investment. The board may also review and approve agreements which may be necessary or convenient for the management of the investments of the retirement system. The board shall also have the authority to inspect and audit the respective accounts and funds administered by the Division of Investment, or a successor entity, and take appropriate action as necessary to effectuate the long term viability of the system. Notwithstanding this provision, Common Pension Fund L and the assets held by Common Pension Fund L as of the effective date of this Act and thereafter, including the interest of the Police and

Firemen's Retirement System of New Jersey therein, shall remain within the Division of Investment. The Director of the Division of Investment and the State Investment Council shall retain all functions, powers, and duties relating to Common Pension Fund L assigned to the Division of Investment, the Director of the Division of Investment, and the State Investment Council by P.L. 2017, c. 98 (C.5:9-22.5 et seq.)."

- Page 22, Section 15, Line 14: After "for" insert "recommending and implementing"
- Page 22, Section 15, Line 15: Delete "investment and"
- Page 22, Section 15, Line 18: Delete "investment"
- Page 22, Section 15, Line 19: Delete "investment and"
- Page 22, Section 15, Lines 24-25: Delete "conduct the executive and administrative functions of the Investment Committee;"
- Page 22, Section 15, Line 38: After "director." insert "The executive director shall serve without term but may be removed from office, upon notice and opportunity to be heard at a public hearing, subject to an affirmative vote of the majority of all authorized members of the board of trustees. Any vacancy occurring shall be filled in the same manner as the original appointment. The executive director shall devote his entire time and attention to the duties of the office and shall not be engaged in any other occupation or profession. The executive director shall act as a fiduciary to the retirement system and shall be under a duty to perform the obligations set forth herein according to the interest of the beneficiaries of the system."
- Page 23, Section 15, Line 5: Delete "management of funds and"
- Page 23, Section 15, Lines 6-8: Delete in their entirety
- Page 23, Section 15, Line 9: Delete "manner in which funds shall be invested" and insert "development of the methods, practices and procedures for investment, in coordination

with the Investment Committee. Notwithstanding this provision, Common Pension Fund L and the assets held by Common Pension Fund L as of the effective date of this Act and thereafter, including the interest of the Police and Firemen's Retirement System of New Jersey therein shall remain within the Division of Investment. The Division of Investment and the Director of the Division of Investment and the State Investment Council shall retain all functions, powers, and duties relating to Common Pension Fund L assigned to the Division of Investment, the Director of the Division of Investment, and the State Investment Council by P.L. 2017, c. 98 (C.5:9-22.5 et seq.)"

- Page 23, Section 15, Line 10: After "officer" insert ", in coordination with the Investment Committee,"
- Page 23, Section 15, Line 11: Delete "securities transactions executed" and insert "investments made"
- Page 23, Section 15, Line 18: After "experience" insert ","
- Page 23, Section 15, Line 18: After "in" insert "addition to"
- Page 23, Section 15, Line 20: After "field." insert "The person shall also have experience in the direct management, analysis, supervision or investment of assets."
- Page 23, Section 15, Line 24: After "officer." insert "The chief investment officer shall be precluded from outside employment or other occupation."
- Page 23, Section 15, Line 28: After "system." insert "The board shall also have the authority to inspect and audit the respective accounts and funds administered by the Division of Investment, or a successor entity, and take appropriate action as necessary to effectuate the long term viability of the system."
- Page 25, Section 15, Line 17: After "(2)" insert "Subject to the provisions of P.L. , c. (pending before the Legislature as this bill),"

- Page 25, Section 15, Line 37: After "system." insert "An actuarial certification must be provided by the actuary prior to any enhancement or reduction of a member benefit, including the activation of the application of the "Pension Adjustment Act," P.L.1958, c.143 (C.43:3B et. seq.), showing that such change will not result in an increased employer contribution in the current year and that such change will not impact the long term viability of the fund."
- Page 28, Section 15, Line 30: Delete "investments" and insert "investment policies"
- Page 28, Section 15, Lines 31-32: Delete "and the management of the investments of the retirement system"
- Page 28, Section 15, Line 35: After "trustees." insert "A majority of the Investment Committee members, one of which may be the Chief Investment Officer, shall be qualified by training, experience or long-term interest in the direct management, analysis, supervision or investment of assets and this training, experience or long-term interest shall have been supplemented by academic training in the fields of economics, business, law, finance or actuarial science or by actual employment in those fields. If the board of trustees does not have sufficient members qualified or available to serve on the Investment Committee, or determines to broaden the expertise of the Investment Committee, the board of trustees may request that the State Treasurer recommend one or more qualified individuals to sit on the committee."
- Page 28, Section 15, Line 43: Delete "the Bloomberg Barclays Indices" and insert "other appropriate benchmarks"
- Page 28, Section 15, Lines 46-47: Delete in their entirety and insert "from the Board of Trustees to the State Investment Council and the Division of Investment."
- Page 29, Section 16, Line 6: After "the" insert "formulation, establishment, amendment, modification or

- repeal of any policy, procedure, method or practice on the"
- Page 29, Section 16, Line 6: Delete "of, and" and insert "shall be performed by the board. The"
- Page 29, Section 16, Lines 9: After "the" insert "Division of Investment upon the direction of the"
- Page 29, Section 16, Line 20: After "trustees." insert "Notwithstanding this provision, Common Pension Fund L and the assets held by Common Pension Fund L as of the effective date of this Act and thereafter, including the interest of the Police and Firemen's Retirement System of New Jersey therein shall remain within the Division of Investment in the Department of the Treasury. The Division of Investment, the Director of the Division of Investment and the State Investment Council shall retain all functions, powers, and duties relating to Common Pension Fund L assigned to the Division of Investment, the Director of the Division of Investment, and the State Investment Council, by P.L. 2017, c. 98 (C.5:9-22.5 et seq.)."
- Page 29, Section 16, Lines 21-22: Delete "executive director of the board" and insert "Treasurer of the State of New Jersey"
- Page 38, Section 17, Line 39: After "appropriate" insert ", with the approval of at least eight members of the board,"
- Page 38, Section 17, Line 42: Delete "actuarial"
- Page 38, Section 17, Line 42: After "certification" insert "by the actuary"
- Page 38, Section 17, Line 42: After "in" insert "an"
- Page 38, Section 17, Line 43: Delete "contributions" and insert "contribution in the current year and that such change will not impact the long term viability of the fund"
- Page 45, Section 17, Line 22: Delete "On April 1"
- Page 45, Section 17, Lines 23-32: Delete in their entirety
- Page 45, Section 17, Line 37: Delete "Upon certification by the board of trustees to"
- Page 45, Section 17, Lines 38-47: Delete in their entirety

- Page 46, Section 17, Lines 1-2: Delete in their entirety
- Page 46, Section 17, Line 3: Delete "employer contribution."
- Page 56, Section 35, Line 22: After "hereunder." insert "Notwithstanding this provision, the Board of Trustees of the Police and Firemen's Retirement System shall have the authority to direct investment policy. The purchase, sale or exchange of any investments or securities under the control and management of the Board of Trustees of the Police and Firemen's Retirement System shall be exercised and performed by the Director of the Division of Investment. Notwithstanding this provision, Common Pension Fund L and the assets held by Common Pension Fund L as of the effective date of this Act and thereafter, including the interest of the Police and Firemen's Retirement System of New Jersey therein shall remain within the Division of Investment. The Division of Investment, the Director of the Division of Investment and the State Investment Council shall retain all functions, powers, and duties relating to Common Pension Fund L assigned to the Division of Investment, the Director of the Division of Investment, and the State Investment Council, by P.L. 2017, c. 98 (C.5:9-22.5 et seq.)."
- Page 56, Section 36, Line 32: After "Fund;" insert "The Police and Firemen's Retirement System of New Jersey;"
- Page 56, Section 36, Line 43: After "Council" insert ", or in the case of the Police and Firemen's Retirement System of New Jersey, by regulation of the Board of Trustees of the Police and Firemen's Retirement System of New Jersey, except that notwithstanding this provision, Common Pension Fund L and the assets held by Common Pension Fund L as of the effective date of this Act and thereafter, including the interest of the Police and Firemen's Retirement System of New Jersey therein shall

remain within the Division of Investment. The Director of the Division of Investment and the State Investment Council shall retain all functions, powers, and duties relating to Common Pension Fund L assigned to the Division of Investment, the Director of the Division of Investment, and the State Investment Council, by P.L. 2017, c. 98 (C.5:9-22.5 et seq.)."

- Page 57, Section 37, Line 12: Delete "sole" and insert "the"
- Page 57, Section 37, Line 12: Delete "invest and reinvest moneys" and insert "direct the investment and reinvestment policies"
- Page 57, Section 37, Line 13: After "Jersey" insert ", with the exception of those monies held by Common Pension Fund L as of the effective date of this act and thereafter, which the Board of Trustees of the Police and Firemen's Retirement System of New Jersey shall have no authority to direct investment associated with the Common Pension Fund L." The Director of the Division of Investment shall retain all functions, powers, and duties pursuant to P.L. 2017, c. 98 (C.5:9-22.5 et seq.)."
- Page 57, Section 17, Line 29: Delete "or board of trustees"
- Page 58, Section 38, Line 11: After "powers," insert "and"
- Page 58, Section 38, Lines 11-12: Delete ", equipment, and records"
- Page 58, Section 38, Line 14: Delete "and the Division of Investment"
- Page 58, Section 38, Line 16: After "Jersey" insert ", except that the Board of Trustees of the Police and Firemen's Retirement System of New Jersey may contract with the Division of Pension and Benefits in the Department of Treasury to effectuate the goals of this Act. The Department of Treasury and the Division of Investment shall retain all functions, powers, duties, equipment and records relating to Common Pension Fund L assigned to the Department of the Treasury and the Division of Investment by P.L. 2017, c.98 (C.5:9-22.5 et. seq.). Copies of records

relating to the Police and Firemen's Retirement System of New Jersey in the Division of Pensions and Benefits in the Department of the Treasury and the Division of Investment shall be made available to the Board of Trustees of the Police and Firemen's Retirement System of New Jersey upon request"

Page 58, Line 27:

Insert new section:

"40. Section 5 of P.L.1950, c. 270 (C.52:18A-83) is amended to read as follows:

5. a. There is hereby established in the Division of Investment a State Investment Council which shall consist of 16 members.

(1) Each of the following agencies, namely, the Board of Trustees of the Public Employees' Retirement System, and the Board of Trustees of the Teachers' Pension and Annuity Fund[, and the Board of Trustees of the Police and Firemen's Retirement System of New Jersey,] shall designate one board member elected to serve on the board, to serve as a member of the State Investment Council herein established. The [three] two members of the council so designated shall serve as such for a period of three years from the date of their designation and until their respective successors are in like manner designated.

(2) Eight of the members of the State Investment Council shall be appointed by the Governor, with the advice and consent of the Senate, for a term of five years and shall serve until the member's successor is appointed and has qualified. Of the initial members appointed following the effective date of P.L.2011, c.78, one shall serve for an initial period of three years, and one shall serve for an initial period of two years.

(3) One member of the State Investment Council shall be appointed by the Governor from among three persons nominated

jointly by the President of the Senate and the Speaker of the General Assembly and shall serve for a term of five years and until the member's successor is appointed and has qualified.

(4) Two members of the State Investment Council shall be appointed by the Governor from among six persons nominated by the Public Employee Committee of the New Jersey State AFL-CIO and shall serve for a term of five years and until the member's successor is appointed and has qualified. [At least one of the two members appointed shall be a member of a union representing police officers or firefighters.] If the persons nominated are not acceptable to the Governor for appointment, the Governor may request submission of new nominees.

(5) One member of the State Investment Council shall be appointed by the Governor from among three persons nominated by the New Jersey Education Association and shall serve for a term of three years and until the member's successor is appointed and has qualified. If the persons nominated are not acceptable to the Governor for appointment, the Governor may request submission of new nominees.

(6) One member of the State Investment Council shall be appointed by the Governor from among three persons nominated by the State Troopers Fraternal Association and shall serve for a term of three years and until the member's successor is appointed and has qualified. If the persons nominated are not acceptable to the Governor for appointment, the Governor may request submission of new nominees.

The four members appointed pursuant to paragraphs (4), (5) and (6) of this subsection by the Governor to the council shall be qualified by training, experience or long-term interest in the direct

management, analysis, supervision or investment of assets, and this training, experience or long-term interest shall have been supplemented by academic training in the fields of economics, business, law, finance or actuarial science or by actual employment in those fields.

At least seven of the nine members appointed pursuant to paragraphs (2) and (3) of this subsection by the Governor to the council shall be qualified by training and experience in the direct management, analysis, supervision or investment of assets, which training and experience shall have been acquired through academic training or through actual employment in those fields.

b. No member of the State Investment Council shall hold any office, position or employment in any political party nor shall any such member benefit directly or indirectly from any transaction made by the Director of the Division of Investment provided for herein.

The members of the council shall elect annually from their number a chairman of such council. Any member of the council so elected shall serve as such chairman for a term of one year and until a successor is, in like manner, elected. The chairman of the council shall be its presiding officer.

The members of the council shall serve without compensation but shall be reimbursed for necessary expenses incurred in the performance of their duties as approved by the chairman of the council. The members of the council shall be required to file the same annual financial disclosure statements as those required to be filed by members of other State boards and commissions who are not compensated for their services, as such statements shall be required by law or executive order of the

Governor. The financial disclosure statements of council members shall be made available to the public in the same manner as the statements of members of other State boards and commissions are made available to the public.

Each member of the council, except the member appointed from among persons nominated by the President of the Senate and the Speaker of the General Assembly, may be removed from office by the Governor, for cause, upon notice and opportunity to be heard at a public hearing. Any vacancy in the membership of the council occurring other than by expiration of term shall be filled in the same manner as the original appointment, but for the unexpired term only.

c. The terms of the members of the council serving pursuant to paragraph (1) of subsection a. of this section and serving on the effective date of P.L.2011, c.78 are terminated as of that effective date. A member terminated pursuant to this subsection shall be eligible for reappointment."

Page 58, Section 40, Line 28:

Delete "40." and insert "41."

Page 58, Section 41, Line 30:

Delete "41." and insert "42."

Respectfully,

[seal]

/s/ Philip D. Murphy

Governor

Attest:

/s/ Matthew J. Platkin

Chief Counsel to the Governor