State of New Jersey
State Investment Council

Meeting at **III**
Pensions Board Room, First Floor
50 West State Street
Trenton, NJ 08608

Thursday, July 9, 2009
2 p.m. Council Meeting

MINUTES

Approved September 17, 2009

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

Absent: James Clemente and Mark Kandrac

Also Present:
From the Division of Investment:
William G. Clark, Director
Ray A. Joseph, Deputy Director
Gilles Michel, Assistant Director
Brian Arena, Investment Officer
Susan Burrows, Secretary to the Council
Jessie Choi, Investment Analyst
James Falstrault, Investment Officer
Maneck Kotwal, Investment Officer
Michelle Narvaez, Division Summer Associate
Christine Pastore, Investment Officer
Susan Sarnowski, Compliance Officer
Camilo Varela, Division Summer Associate
Mary Vassiliou, Accounting Manager

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

Other Invitees:
Pete Keliuotis, Strategic Investment Solutions
Daniel Stern, Cliffwater

Members of the Public:
Michael Aron, NJN TV
Sandy Coia
Regina Fedorenke, Intern, Attorney General's Office
Frank Foulkes, NJREA
Steven R. Green
Valerie Kazhdan, NJEA
P.G. Maurer
Dusty McNichol
Nicole Micheroni, Intern, Attorney General's Office
Anthony F. Miskowski
Clayton Mull, SCREA
Meko K. Palmer, Treasury/Revenue
Bob Pursell
Rae C. Roeder, President CWA Local 1033
James Shanley, Bank of New York Mellon
Nicole Smaha, Office of the State Auditor
Mike Tantum, Office of the State Auditor

I. *Call to Order*

Chair Kramer called the meeting to order at 2:05 p.m.

II. *Notice of Meeting*

Secretary Burrows reported that notice of the meeting scheduled for July 9, 2009 was sent by mail deposited in the post office, by facsimile and email on July 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 May 21, 2009 were approved unanimously. Ms. Brown and Mr. Cerf were absent for the vote, arriving at 2:10 p.m.

IV. *New Business*

B. For the Information of the Council

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

Chair Kramer asked Director Clark to share the Director's experience at a recent meeting with the Federal Deposit Insurance Corporation (FDIC), noting that the Director was the only public pension fund representative at the meeting of some two dozen banking, private equity and legal leaders from across the nation.

Director Clark said the FDIC hosted the meeting to solicit guidance on the role private capital should play in the recapitalization of the private banking industry, given the insufficient level of banking capital to support under-capitalized banks and the sector's aversion to investment risk. He said the pension fund has an interest in the stabilization of the banking system, because without stabilization both the fund and taxpayers will suffer. He said that in general the FDIC wanted to limit the role of private equity assistance and profits, but it appeared receptive to the group's consensus that the FDIC's proposed rules were so onerous that they would preclude private equity participation in the sector's recovery. Chair Kramer noted that by permitting private equity investment, the federal government presented public pension funds with the same investment opportunities available to private equity funds. He said there was broad concern among policymakers that the proposed FDIC rules would suppress capital flows, leading to hundreds of bank failures. Both men commended the FDIC for seeking the input of the public pension fund community.

Director Clark also reported briefly on his recent participation on the Investor Advisory Committee of the New York Fed. While the group's deliberations were private, he said, there was a shared relief that federal intervention had begun to improve market conditions, and much concern about how to end their various initiatives: staying in too long increased the risk of inflation, Director Clark said, and getting out too soon could put the economy into a tailspin.

Director Clark said the Division had not yet completed a portfolio and asset allocation analysis of the pension fund, but results to date indicated there was more than ample liquidity for pension payments and capital calls for private equity and real estate for the foreseeable future. He said that reports of tight liquidity conditions for some pension and endowment funds did not apply to New Jersey, and cited four reasons why he believes the pension fund is in good shape:

1) The Council's 2005 decision to move into alternatives over a long period (i.e., five to seven years) "certainly helped preserve liquidity."
2) Unlike many other funds, the Division came into 2009 holding a very large cash position of about 7 percent, compared with 2 to 3 percent at most funds. The fund's cash position remains high, he said, at about 5.6 percent.
3) With the market's collapse last September, the Division took immediate steps to preserve liquidity through reducing its planned commitments to private equity and real estate by not closing on some $115 million and $250 million in anticipated investments, respectively, and by redeeming another $200 million from hedge fund investments not performing to the Division's satisfaction.
4) The Council also strengthened the fund's liquidity by approving in December a shift in allocation to fixed income.

Director Clark said two issues identified in the analysis carried policy implications for the Council's consideration. First, the Division would likely be required to reduce its public equity and fixed-income portfolios by about 3 to 5 percent over the next several years to fund anticipated benefit payments. While the amount targeted for reduction was manageable, he said, the Division did not want to be forced to sell into a bad market and so had started to hedge a portion of the portfolio. The Division would return to the Council with recommendations on how this issue might best be addressed, he said.

Secondly, he said, assumptions about how private equity commitments would be called could theoretically cause the Division to butt up against the Council's seven percent maximum allocation level, and may require future Council discussion about the merits of raising that cap, noting any such calculation requires subjective judgment on a multiple of variables. According to the analysis, it does not appear that the fund will approach maximum allocation levels for real estate and hedge fund investments.

Chair Kramer noted that private equity investments were now less than 5 percent, that the lag effects of private equity valuation were unclear, and that reaching the threshold was several years away under current scenarios. Mr. Cerf confirmed that the potential increase may not fully anticipate the level of future losses. Director Clark added that the Division was working on a formal valuation policy to bring to the Council to increase assurance that the portfolio was properly marked.

Mr. Cerf observed that the pressure anticipated in two to three years on private equity might also create relative opportunities in small cap and even real estate investments, noting it would be a shame to be constrained from those opportunities. A brief discussion followed on the merits of liquidity versus a bias toward illiquidity in order to create value for the portfolio, with a consensus that the issue should be monitored carefully. Chair Kramer noted that several major university portfolios, where historical performance was substantially superior to public funds, were 70 percent illiquid, versus nine percent illiquidity in New Jersey's pension fund. Mr. Cerf added that in recent conversations he'd held with Ivy League CIOs, all admitted struggling with the lack of liquidity for funding operations, but at the same time all carried "a belief unaltered" that they would receive big premiums on their illiquid options. Mr. Kellogg questioned whether the fixed income portion of the portfolio might be thought of as liquid.

Ms. Crotty noted that the Division was buying into portfolios increasingly more mature. Director Clark agreed, noting that secondary transactions had grown from $20 billion in 2008 to $30 billion this year to date. In response to a question from Ms. Brown, he said the Division was seeking a manager to help identify opportunities in the private equities secondary market, adding that while not a lot of deals were being done at present, such opportunities would likely get more attractive over time.

Chair Kramer observed that a heavy weighting in Treasuries had constrained long-term returns, and that the historical record of endowment performance showed that favoring alternatives, and especially hedge funds, over Treasuries "had not been a close call." Mr. Cerf asked about hedge fund performance. Mr. Stern of Cliffwater responded at the request of the Chair, saying June was another strong month for hedge funds, which were up 16 percent for the last six months. Chair Kramer said hedge funds were outperforming US and international equities by 15 to 16 percent, matching last year's outperformance.

Mr. Marketti asked if he could see individual reports on five alternative investments up 40 to 50 percent since last fall, and was told this would be provided in the coming month's Director's report. He also asked about the amount of fees paid to alternative managers, and was told this would be forthcoming in the audited report due later this fall. Mr. Marketti also asked about the Governor's response to the Council's letter urging full state contributions to the pension fund. Chair Kramer said some discussions had been held between the Chair and the Governor, who was fully aware of the contributions shortfall. Mr. Marketti agreed to check the Governor's schedule for a follow-up meeting with the Governor, himself, Chair Kramer and Vice Chair Berg to discuss the issue.

V. Committee Reports

Chair Kramer asked if Mr. Kandrac, Mr. Claxton and Ms. Brown would serve as the nominating committee for Council officers for the 2009-2010 year. They agreed. Chair Kramer called for additional nominees, and there were none. The nominating committee was approved by unanimous vote on a motion by Dr. Love, seconded by Mr. Berg.

VI. Pending Matters.

A. Status of Proposed Amendments

Compliance Officer Sarnowski reported that proposed amendments to N.J.A.C. 17:16-17 concerning investment in debt obligations as approved by the Council at the May 21, 2009 meeting had been approved by the Office of the Governor and the Smart Growth Ombudsman and reviewed by the Office of Administrative Law before their publication in the *New Jersey Register* on July 6. The 60-day comment period ends September 4.

VII. New Business, continued

A. For Action by the Council

1. Memorandum from Director Clark to the Council, dated July 2, 2009, entitled "Placement Agents."

Director Clark reported that in follow-up to the Council's May request, the Division had researched the placement agent policies of other states and organizations and reviewed its findings with the Investment Policy Committee. It was concluded that New Jersey's current policy pertaining to political contributions by current and potential investment firms, and their placement agents, remains the toughest in the nation. Given recent alleged abuses concerning the use of placement agents in other states, however, additional disclosure requirements pertaining specifically to placement agents were offered for Council review.

Specifically, the recommended requirements were that: placement agents be registered with the appropriate state or federal regulatory body; individual professionals involved in a fund's solicitation be licensed, and hold a minimum of three years experience in the securities industry; fee arrangements between the agent and the hiring fund be fully disclosed; and contracts describing the agent's services for the fund's partners be fully disclosed. Additionally, these requirements would be incorporated into due diligence documents provided at the time an investment was proposed.

A discussion followed in which registration and licensing requirements were briefly debated; Mr. Kellogg objected to these additional disclosures as too intrusive into the business of the firms who retain such agents. A consensus developed that these were reasonable standards to require. Chair Kramer said that although the Division had not done business with the firms in the controversy, and although its use of placement agents was lower than at most funds, the additional requirements represented a good middle ground to an outright ban in the use of agents, the majority of whom provided honest and valuable service especially in presenting partnership opportunities with smaller and minority funds.

The additional restrictions were approved 10 to 1 on a motion by Dr. Love, seconded by Mr. Cerf, with Mr. Kellogg opposed.

2. Memorandum from Director Clark to the Council, dated July 2, 2009, entitled "Proposed Amendments to N.J.A.C. 17:16-12, 16 and 40 regarding Minimum Market Capitalization for Corporations Issuing Domestic and International Debt and Non-Convertible Preferred Stock."

Compliance Officer Sarnowski said the proposed amendments would give the Division the ability to invest in high-yield debt and non-convertible preferred stock trading at attractive levels even if the company's securities are not publicly traded or the market capitalization falls below the current $100 million threshold. She noted that such issues are already included in the portfolio's benchmark.

Vice Chair Berg moved the following resolution on a second from Ms. Brown in the absence of Chair Kramer, who left the room momentarily: "Be it resolved that the State Investment Council hereby approves proposed amendments to NJAC 17:16-12, 16 and 40 regarding domestic and international corporate obligations and non-convertible preferred stock of US corporations. The Council herby authorizes the Director of the Division of Investment to submit the attached proposals to the Office of Administrative law for publication and public comment, and hereby delegates to staff of the Council and the Division of Investment the authority to make revisions to the proposals as required and as shall be made upon the advice of the Attorney General. This resolution shall take effect immediately." The motion passed by a vote of 10 to 1, with Mr. Marketti opposed.

3. Addition to agenda: Draft letter from the Council to Mary L. Schapiro, Chairman of the Securities and Exchange Commission, dated July 9, 2009, entitled, "Comments on Political Contributions and Pension Funds Comments on File No. S7-10-09: Facilitating Shareholder Director Nominations."

Mr. Kramer provided a draft letter to the Securities Exchange Commission from the Council, asking that any regulations imposed on political contributions by the SEC not pre-empt state restrictions that may be broader. Additionally, the letter voiced formal support for SEC rules that would broaden shareholder rights by permitting contested elections for corporate directors. There was a brief discussion about shortening the section of the letter describing rationale, and that the letter should be submitted on the Council's behalf. (Note: This was done immediately following the meeting. A copy of the letter is attached to the official record of these minutes.)

VIII. Reports of Director Clark

A. Verbal report by Director Clark to the Council on June 2009 and fiscal yearend results as available.

Director Clark said it was too soon to report officially on June performance, but very rough estimates suggested that the pension fund had ended the fiscal year on June 30 in the $63 billion range, up one percent for the month, and down by -14 to -15 percent for the year. While no other fund had yet shared June performance numbers, Director Clark noted that New Jersey had performed in the top 10 to 15 percent of all pension funds through December, and expected to come out at the top end of the performance range for the fiscal year.

Investment Officer Arena said the domestic equity portfolio was attempting to build up its underweight position in financials in response to positive changes in that sector. Assistant Director Michel said for the first time in years the international portfolio was slightly overweight in Japanese equities but in line with the market index in Asia ex-Japan.

Director Clark said the corporate bonds that the fund purchased in the fall of 2008 were up approximately 22 percent, and that the Division was starting to take those profits. He said that investment in Treasury Inflation-Protected Securities (TIPS) was performing at 5.25 percent, or slightly over benchmark, noting all of the Division's long-term investments were doing well.

IX. New Business, continued

B. For the Information of the Council

2. Memorandum from Chief Administrative Officer Burrows Farber to the Council, dated July 2, 2009, entitled "Investment News Clips for July 2009 Council Meeting."

The memo was noted without comment.

X. Communications

There was no report from the State Treasurer.

XI. Public Comment

Two members of the public who had submitted speaker request forms prior to the meeting were invited to address the Council.

Mr. Tony Miskowski inquired about the Council bylaws, noting they had last been updated 20 years ago. He suggested that the Council update the bylaws with definitions for officers, terms, vacancies, procedures, duties, the role of the chair, the purpose and duties of committees, the structure of the Council, and add Council rules and procedures, including a process for revising the bylaws. He also suggested that the bylaws be posted to the Division's website in addition to a link to the New Jersey Administrative Code. He also asked for a report on the Division's meeting with the Chair of the FDIC and inquired whether the Division had been approached for investment by any of three distressed hedge funds named in press coverage of the meeting. Director Clark said the Division had not been approached, and had made no decision on possible investment in distressed debt. Dr. Love quipped that debt once labeled "toxic" had evolved to "distressed" and now was considered "opportunistic."

Ms. Rae Roeder questioned whether a representative of a pension board not re-elected to that board could continue to sit on the Council. She was advised that the law allowed four pension boards to elect any active or retired member of their respective retirement systems to serve as a Council member for a three-year term.

XII. Next Meeting

September 17, 2009	*Note*: 3 p.m. Meeting	Rutgers Student Center *Multi-Purpose Room B* 126 College Avenue New Brunswick, NJ 08901

(Secretary's Note: The site for this meeting was changed to the Rutgers Inn and Conference Center in New Brunswick by amended notice posted on September 3).

XIII. Adjournment

The meeting was adjourned at 3:45 p.m. by unanimous vote on a motion by Mr. Cerf, seconded by Dr. Love.

Respectfully submitted,

Susan M. Burrows
Secretary to the Council