Minutes of the Regular Meeting:

Held on August 2, 2012 at 10:00 AM at the Trenton War Memorial, George Washington Ballroom, 1 Memorial Drive, Trenton New Jersey.

Council Members in Attendance:

Robert Grady, Chair
Marty Barrett
Brendan T. Byrne, Jr.
Michael Cleary
Charles Dolan
Michael Greaney
Guy Haselmann
Peter Maurer
Timothy McGuckin
Jeffrey Oram
Mitchell Shivers

James Joyner, James Hanson and Adam Liebtag were not in attendance for this meeting.

Roll Call and Meeting Notice
Mr. Grady called the meeting to order at 10:06am. Ms. Christine Eckel performed roll call and reported that notice of the Regular Meeting scheduled for August 2, 2012, was posted to the website of the Division of Investment (the Division) on July 10, 2012 and sent via fax to the Times of Trenton, the Star-Ledger, the Bergen Record, the Courier Post and the Secretary of State on July 10, 2012. A copy of the notice was posted at the Division and is on file.

Chair Grady welcomed two new Council members, Charles Dolan and Mitchell Shivers to the Council.

Chair Grady also welcomed John Megariotis, who will be representing the Treasurer's Office.

Chair Grady congratulated Director Walsh on his two years of service with the Division of Investment.

Minutes for Regular Meeting held May 24, 2012

Chair Grady asked whether Council Members had any comments on the May meeting minutes. Council Member Haselmann requested certain revisions to the minutes, including a summary of his comments regarding the importance of the private equity and hedge fund investments to the balance of the portfolio offered in response to Council Member Liebtag's concerns regarding alternative investments. A motion was made by Chair Grady to approve the revisions to the draft minutes of the May 24 meeting, with Council Member Maurer seconding the motion. All Council Members in attendance voted in favor of the motion, except Messrs. Dolan and Shivers who abstained as they were not present at the May meeting. In addition, Mr. Haselmann noted his prior agreement to research assumed rates of return on pension assets. He said that he is finalizing his work and expects to deliver his report at a future meeting.

Election of Nominating Committee Members

Vice Chair Byrne nominated Jeffery Oram, Tim McGuckin and Guy Haselmann to the nominating committee. Marty Barrett seconded the nominations, with all Council Members in attendance voting in favor.

Fiduciary Presentation from SIS

Chair Grady introduced Barry Dennis, CEO of Strategic Investment Solutions (SIS), who presented a general overview of fiduciary responsibilities. Mr. Dennis started by noting that investment decisions made by Council and/or the Division are made on behalf of the pension fund participants and their beneficiaries. He discussed duties of loyalty and prudence, and noted the importance of diversification of the portfolio and attention to controlling fees paid out of pension funds in connection with investments.

Mr. Dennis pointed out the availability of orientation conferences and seminars that are available to new Council Members to instruct them of their duties and standards of care. He noted certain "best practices" for managing pension fund assets that have developed across the country, including strong audit functions, both internal and external, and the adoption of strategic plans of asset allocation. He also noted a relatively new trend in corporate governance - board self-evaluation.

Chair Grady thanked Mr. Dennis and noted Council's focus, over at least the last two years, on diversifying asset allocation and negotiating lower management fees. Council Member Haselmann asked whether Mr. Dennis had materials regarding board self-evaluation. Mr. Dennis said he would suggest appropriate materials.

Director's Report

Director Walsh gave an overview of the Division and how it invests Pension Fund money. He stated that the Division is a long term investor, investing when the market goes down and holding back when the market goes up. He noted that the Division's domestic equity security in portfolio, the largest asset class of the Pension Fund portfolio with $18 billion invested, is managed by ten Division staff members. Director Walsh said the Division manages the portfolio against the S&P 1500, which consists of the 1,500 largest US companies based on market cap and encompasses about 90% of all public US traded companies. The largest is Apple, which is approximately 4% of the index with a market cap of $546 billion, and the smallest is NCI Inc, weighting with 0.00023% of the index and with a market cap of $655 million. As of end of fiscal year 2012, the Division held equity in 859 individual public companies. The Division's second largest asset class is fixed income. In Fiscal Year 2012, the Division traded over 3 billion shares of US and International equities, with a total value of $47 billion, and $20 billion in fixed income. Other funds invested by the Division are the Cash Management Fund and the Supplemental

Annuity Collective Trust, with $8.779 billion and $155 million in net assets, respectively, and NJBEST Fund and the Deferred Compensation Program, with $592 million and $489 million in assets, respectively.

Council Member Haselmann remarked that in his 25 years working in the investment field, there has never been a more difficult investment environment than that of the past two years, and the Division's performance during this time deserves much credit. He noted in particular the Director's and Division's staff's excellent job on yield enhancement through appropriate asset allocation decisions.

Director Walsh advised the Council that preliminary results indicate the NJ Pension fund returned 2.52%, above the benchmark return of 0.25%, for fiscal year 2012. The Director emphasized that these returns were preliminary, pending adjustment of the final June net asset values. The largest single factor of the outperformance was the relative overweight of US stocks versus international. Strong performance in the fixed income portfolio and the underweight to commodities also contributed to the overall returns. International emerging equity advisers and high yield advisers largely outperformed their benchmarks. Underperformance by other domestic and international equity portfolios detracted from overall Pension Fund performance by 26 bps and 46 bps, respectively. Director Walsh also stated that $484.5 million was received from the State for FY2012 Pension Fund contributions. Four pension funds within the system reduced their investment return assumptions from 8.25% to 7.95%.

Council Member Barrett asked about the adequacy of Division staffing and whether it has changed over the past two years. The Director said that the Division expects to hire additional staff over the next few months which should bring staffing to about the same level of staffing as that of two years ago. Mr. Barrett asked the Director to inform Council if additional staffing is needed.

Real Estate Investment

Council Member Oram recused himself from the discussion of this proposed investment.

Real Estate Capital Asia Partners III, L.P (RECAP III) and related co-investment vehicles

Director Walsh introduced Roman Nemtsov of RV Kuhns, the Division's lead consultant for Real Estate, and Bryan Martin of the Division. The Chair noted that RECAP is the single best performing manager of its vintage. He stated that there are very few comparable quality public REIT managers in the International space, especially in Asia.

Mr. Nemtsov presented the proposed investment of $80 million in RECAP III and $40 million in related co-investment vehicles structured to invest alongside the main fund. As summarized in the report furnished to the Council Members, an investment in RECAP III would provide the Division exposure to a high quality manager that continues to take advantage of Asian real estate market dislocation, in which the Division's portfolio is underexposed. RECAP managers have a demonstrated capability to generate top decile returns in various real estate markets throughout Asia. The investment professionals leading the fund have an average of thirteen years of investment experience with each having expertise in real estate investment, development, operations, asset management and capital markets. These professionals have diverse backgrounds in all target property types and geographies. This combination allows the team to identify, evaluate and capitalize on attractive investment opportunities across Asia.

Council Member Haselmann stated his view that Asian real estate is less risky than generally thought and that the portfolio could benefit from exposure in this area. He also noted that the 9% hurdle rate suggests the confidence of these managers in their ability to produce returns.

Chair Grady reported that the Investment Policy Committee has determined that appropriate and adequate due diligence was performed.

Private Equity Investment

Roark Capital Partners III, L.P. and related co-investment vehicles

Director Walsh introduced Harshal Shah, of Strategic Investment Solutions (SIS), who has been the private equity consultant since 2005, and Jason MacDonald, of the Division.

Messrs. MacDonald and Shah presented the proposed Investment of up to $100 million in Roark Capital Partners III, L.P. and up to $75 million in related co-investment vehicles structured to invest alongside the main fund. As summarized in the report furnished to the Council Members, Roark Capital has a unique team with a high level of expertise, focusing on franchising/multi brand opportunities, which differentiates them from many of their mid-market peers and would diversify the Division’s portfolio, which currently does not have exposure to this strategy. Mr. Shah noted that, based on the top quartile performance of prior Roark funds, the proposed investment is expected to generate attractive returns for the Pension Fund. Roark has invested over $1.2 billion across 18 platform investments from 2005 through December 2011, generating an overall Net TVM of 1.7x and a Net IRR of 16.5%. Roark generates a meaningful amount of co-investment opportunities for its LPs, so by investing in Roark, the Division may have the option to increase its allocation through co-investing in select deals.

Chair Grady noted that there is no management fee or performance fee on co-investments, and that the Division will have discretion with regard to participating in co-investment transactions offered by Roark. He asked the Division to address the adequacy of its resources to evaluate the co-investments offered. Mr. MacDonald noted that Division staff meets approximately weekly to review co-investment opportunities and applies the same process in determining whether to co-invest as it does for all alternative investments. In addition, he noted that the Division receives more information from the funds with respect to co-invest targets than it receives in connection with its investments in commingled funds.

Council Member Haselmann asked about the fund’s internal accounting for purposes of determining carry. Mr. Shah said that PriceWaterhouseCoopers is the auditor, which reviews valuations prepared by the fund.

Chair Grady reported that the Investment Policy Committee has determined that appropriate and adequate due diligence was performed.

Review of Hedge Fund Program

Director Walsh introduced Jake Walthour of Cliffwater, the Division's Hedge Fund consultant. Director Walsh asked Mr. Walthour to comment on the following, in addition to the proposed investments: the results of a survey Cliffwater sent to the Division ranking public funds, including New Jersey, and how management fees are negotiated for the Division.

Mr. Walthour said that Cliffwater on an annual basis, polls the largest public pension funds around the country to get a sense of how they compare to each other in terms of performance and asset classes. He said the survey examines Real Estate and Private Equity over a ten-year period and hedge funds over a five-year basis (since most public pension funds have not had hedge funds in their portfolio for more than five years). New Jersey was in the top quartile on a one-year basis and was the top performing portfolio of all the pension funds that responded to the survey on a five-year basis. He noted that one of the key drivers in New Jersey success has been its strategy of investment directly in hedges funds, thereby eliminating a fund-of-fund fee on most of the hedge fund investments. In addition, Mr. Walthour noted the Division's selection of superior hedge fund management has been key to its results.

Mr. Walthour also noted that, since inception of the hedge fund program, the program has gone from being a price taker to a price setter in its investments. In that regard, Mr. Walthour noted Division staff's creativity in challenging managers to structure investments in a way that allows them to negotiate fees. The Division has also learned to use its size to bring down fees. Mr. Walthour remarked that Division has also achieved some of the lowest fund-of-fund fees of the industry.

Och-Ziff Separate Accounts

Director Walsh stated the Division has been invested in Och-Ziff funds since 2005. One initial investment of $150 million was valued at $212 million at the end of fiscal year 2012. He stated that the Division will be redeeming approximately $100 million of this amount over the year and re-investing that amount into the proposed separate accounts. Director Walsh stated that Och-Ziff was started by Dan Och.

Mr. Walthour presented the proposed investment of up to $600 million in various Och-Ziff separate accounts. As summarized in the report furnished to the Council Members, the investments will consist of an additional $200 million to an existing bank loan fund, OZSC, LP, with an extension of the current investment period; $200-$500 million in bank loan fund OZSC II, LP; up to $400 million in a hedge fund OZNJ-Credit Strategies; up to $200 million in a real estate account OZNJ-Real Estate; and up to $150 million in real assets account OZNJ-Real Assets. The investments will be partially funded through the $100 million redemption from an existing hedge fund investment in OZ Domestic Partners II, LP, as noted by Director Walsh, and a new commitment of $500 million. The aggregate new capital allocated across these four accounts will not exceed $600 million.

The proposed commitment would help the Division get closer to the target allocation in high yield, real estate, and real assets in the FY 2013 Investment Plan, which are currently under their targeted exposure. Och-Ziff and its partners have committed 10% of the Division's existing investment in OZSC, LP and will commit to the separate account platform an aggregate amount equal to 5% of Limited Partner capital commitments, subject to aggregate maximum commitment of $100 million. Most importantly, the Division staff will retain significant input into separate account transactions, retaining full veto right on private investments, the ability to suspend the investment period at regular intervals and the ability to adjust committed amounts to the most attractive investment opportunities.

Chair Grady reported that the Investment Policy Committee has determined that appropriate and adequate due diligence was performed.

Hedge Fund Investments

MKP Opportunity Partners, L.P.

Deputy Director McDonough and Mr. Walthour presented the proposed investment of up to $150 million in MKP Opportunity Partners, L.P. Deputy Director McDonough noted that the Division has been in discussions with MKP over the last year to be certain MKP would be a good fit for the portfolio. As summarized in the report furnished to the Council Members, an investment in this fund provides increased Absolute Return exposure through a top decile manager for the Risk Mitigation asset class, where the Division is over $1.4 billion below the FY13 target allocation. MKP has generated strong absolute and risk-adjusted performance and has a since-inception annualized return of 9.79% and a Sharpe ratio of 1.36, placing it in the top decile of all hedge funds and global macro hedge funds on an absolute performance basis and the top percentile on a risk adjusted performance basis. MKP is highly diversified and global in nature as a result of both the pod structures and the portfolio management with specific expertise across global macro, U.S and global rates, currencies, credit, equities and commodities. The 1.5% management fee is attractive relative to the standard 2-3% fee for most top tier global macro mangers. The monthly liquidity with 60-day notice is also better than average for this strategy.

Chair Grady reported that the Investment Policy Committee has determined that appropriate and adequate due diligence was performed.

RC Woodley Park, LP and Arden Investment Fund

Deputy Director McDonough and Mr. Walthour presented the proposed investment of up to $250 million in RC Woodley Park, LP, a fund managed by Rock Creek Group, and a proposed investment of $500 million in a fund managed by Arden Capital Management (consisting of up to $250 million in new investment and approximately $253 million from the existing investment with Arden International Advisors, L.P.). As summarized in the report furnished to the Council Members, the add-on investments allow the Division to take advantage of unique investment opportunities, such as a "first look" at a portfolio of investments being liquidated by Rock Creek and Arden. This would allow the Division to “cherry-pick” the highest quality managers from the group and take advantage of future opportunities of a similar nature that may develop. The Pension Fund portfolio is $3.1 billion underweight across the three hedge fund sub-categories relative to FY13 targets. These add-on investments would allow the Division to move the allocations closer to target. Some add-on capital will be used to assume allocations to closed top tier managers, and in some cases will benefit from fee breaks negotiated by the fund-of-funds, high water marks, and/or seasoned liquidity.

Chair Grady reported that the Investment Policy Committee has determined that appropriate and adequate due diligence was performed.

Dyal Capital Partners

Deputy Director McDonough and Mr. Walthour presented the proposed investment of up to $200 million in Dyal Capital Partners Fund, a fund sponsored by Neuberger Berman. As summarized in the report furnished to the Council Members, Dyal has a unique strategy, focusing on purchasing minority stakes in established hedge fund managers and funds with $1.5 to $5 billion in assets. Dyal has limited competition in this space. Investments are expected to generate steady and rising cash flow from management fees supplemented by variable cash flow from incentive fees earned in the underlying funds. The Division negotiated a very attractive fee structure on the proposed investment which includes a 0% management fee on un-invested capital and 1.25% on invested capital during the 5-year investment period instead of the listed 2% fee on committed capital during the investment period. This concession will result in an estimated fee savings of $12.5 million during the investment period. The Division also negotiated a 0.75% management fee on invested cost after the investment period rather than the listed 1.5% fee, resulting in an estimated recurring fee savings per year of $1.5 million. The investment will also have a 20% performance fee, 8% annualized preferred return and 100% catch-up. The Division will also maintain the ability to veto one to two potential investments.

Chair Grady reported that the Investment Policy Committee has determined that appropriate and adequate due diligence was performed.

Approval of Proposed Amendments to Regulations

Director Walsh introduced the topic to Council Members by stating that the FY13 asset allocation plan approved at the prior Council meeting included a high yield allocation of 6%, while the statutory cap is currently 5%. It was agreed during that meeting that Division staff would draft proposed amendments to raise the cap. The proposed amendment to raise the regulatory cap to 8% would provide further flexibility. Director Walsh further stated that while the Pension Fund can presently invest in international fixed income, historically it has been accounted for as part of Common Pension Fund D, which primarily includes the international equity portfolio bucket, making it more difficult to manage investments and track performance. The proposed amendments would consolidate all global fixed income investments in Common Pension Fund B, to provide for improved portfolio management by portfolio staff.

Susan Sarnowski, Division Director of Operations and Compliance Officer, went on to say that the proposed amendments will broaden investment opportunities in fixed income and at the same time simplify classification. Global diversified credit investments are proposed to be expanded to include mezzanine debt and credit structured products. The proposed amendments will allow investment in global diversified credit investments through separate accounts, funds-of-funds, commingled funds, co-investments and joint ventures, subject to the standard reports being furnished to the Investment Policy Committee and Council prior to investment through these vehicles.

The proposed amendments also provide for investment in international sovereign and corporate obligations and global diversified credit investments denominated in foreign currency and consolidate fixed income investments in Common Pension Fund B. Currently, international corporate obligations must be US dollar denominated and held in Common Pension Fund B, bank loans must be US dollar denominated and held in Common Pension Funds B and E, and international sovereigns must be US dollar denominated and held in Common Pension Fund D.

The proposals also include an allowance for contributed capital to be considered as an alternative to market capitalization when evaluating an obligor. The proposals include the elimination of the limitation of 25% of an issue at time of issue for investment in obligations of US and international corporations. The proposed amendments will also raise the limitation for the Cash Management Fund (CMF) on the amount that can be invested in individual Canadian sovereign issuers from one percent to five percent of fund assets since CMF assets can vary by as much as $8-14 billion.

Ms. Sarnowski noted that another proposed amendment would repeal the requirement that the Director report all purchases of US and international corporate obligations, collateralized notes and mortgages, international sovereign obligations and bank loans at the next regularly scheduled meeting of the Council as redundant. By statue, the Division is also required to report all purchases and sales in the Pension Funds monthly and this report is available on the Division's public website.

In addition, Ms. Sarnowski noted that the Division's Fixed Income group proposed the elimination of the limitation of 25% of issue at the time of issue for investments in obligations of US and international corporations. The Fixed Income group believes that this change is important for duration management.

Ms. Sarnowski noted that if the proposed amendments are approved, they will go to the Governor's office for approval and then to the Office of Administrative Law for publication in the NJ Register, with a sixty day comment period.

Council Member Barrett objected to the proposed repeal of the requirement that purchases of certain fixed income investments be included in the Director's Report that is delivered to Council Members.

Director Walsh stated if there is an interest in continuing the duplicative reporting, the Division can do so and can also provide copies for Council Members on request. In response to Mr. Barrett's request, Chair Grady stated that the proposal should be revised to eliminate the repeal of the provisions requiring inclusion of the purchase information in the monthly Director's report.

Council Member Shivers inquired about the elimination of the limitation of 25% of an issue as it relates to potential liquidity issues upon sale. Mr. McGrath responded that the current limitation does not permit flexibility to purchase more than 25% of an issue in those situations where the Division believes that such a purchase presents a good investment opportunity.

Chair Grady motioned to approve a resolution approving the proposed amendments to N.J.A.C. 17:16-65, as revised to remove the repeal of the requirement that purchases are included in the Director's Report, with Council Member Shivers seconding the motion. A roll call vote was taken with Messrs. Grady, Barrett, Byrne, Haselmann, Maurer, McGuckin, Oram, Greaney, Shivers, Dolan and Cleary, constituting all Council Members present at the meeting, voting in favor of the proposed amendments.

Report from Audit Committee

Council Member McGuckin, Chair of the Audit Committee, gave a briefing on the Audit Committee meeting that was held with Ernst & Young on June 11, 2012. Director Walsh, Ms. Sarnowski and Mr. Reynolds from the Division, were also in attendance at this meeting at which the audit for Fiscal Year 2012 was discussed. Mr. McGuckin stated that the engagement partner and the team of auditors doing the field work have remained the same and the audit program had no real need for change in fiscal 2012. Fieldwork is underway and the Audit Committee has not been notified of any issues.

Mr. McGuckin reported that the Audit Committee also discussed the upcoming RFP for audit firms since this is E&Y's last audit under the current contract. Mr. McGuckin the Committee was reviewing the RFP draft which would provide for a combined audit with the Division of Pension & Benefits. The Audit Committee believes a combined audit would save money and result in more meaningful and comprehensive financial statements. Mr. McGuckin noted by way of example the questions raised by Council Members from time to time regarding the details of the net pension outflows included in the Division of Investment financial statements, which detail is not available in the Division's financial records. He further stated that while Pension and Benefits' financial statements address that question, they do not include detail regarding investment performance and the detailed listing of assets held in trust. The Audit Committee believes combined financial statements will be more meaningful for the users and a single source of information for many of the questions raised by Council Members. Mr. McGuckin also noted that the proposed RFP will not include a separate report for the Trustees for the Support of Free Public Schools as this fund is included in the State CAFR and there is no statutory requirement for separate audited financial statements.

Mr. McGuckin asked staff whether the RFP has been issued. Ms. Sarnowski responded that it has not yet been issued, but was ready to go out, subject to consultation with the Attorney General's office. Mr. McGuckin noted that the Audit Committee does not select the auditor, but can take an active role in the selection by appointing a technical advisor to the Committee, which he will be doing.

Public Comment

Mr. Miskowski, of CWA Local 1033, commended the SIC on the manner in which the SIC handled their concerns regarding the assumed rate of return on investments.

Mr. Abella commented on the amount of management fees paid in connection with investments as compared to smaller budget of the Division of Investment. Council Member Haselmann commented that this comparison of Division salaries and management fees for fund management was comparing "apples to oranges". Mr. Abella then asked for more information on inflow from and outflow to the pension funds. Chair Grady suggested that Mr. Abella submit a template of the information sought and the Council will take it under advisement.

Chair Grady motioned to adjourn the meeting, with Vice Chair Byrne seconding the motion. All Council Members present at the meeting voted in favor. The meeting was adjourned at 1:50 pm.