

***State of New Jersey***  
***State Investment Council***

**Meeting at**  
**State Pension Boards Meeting Room**  
**50 West State Street, First Floor**  
**Trenton, New Jersey 08625**

**Thursday, September 18, 2008**  
**Noon Lunch/1 p.m. Council Meeting**

***MINUTES***

*Approved November 20, 2008*

***Present:*** Orin Kramer, Chair  
Jonathan Berg, Vice Chair  
Monty Cerf  
James Clemente  
Sue Crotty  
James C. Kellogg – *by teleconference for Executive Session only*  
Mark Kandrak  
Douglas A. Love

*Absent:* Erika Irish Brown, Jose R. Claxton

***Also***

***Present:*** *From the Division of Investment:*  
William G. Clark, Director  
Brian Arena, Investment Officer  
James Falstrault, Investment Officer  
Susan Burrows Farber, Chief Administrative Officer  
Linda Gaspari, Investment Technician  
Maneck Kotwal, Investment Officer  
Carmen Nazario, Administrative Assistant  
Christine Pastore, Investment Officer  
Tim Rollender, Analyst  
Susan Sarnowski, Middle Office Manager and Compliance Officer  
Amanda Truppa, Chief of Staff  
Mary Vassiliou, Accounting Manager

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

*Other Invitees:*  
Harshal Shah, Strategic Investment Solutions  
Faraz Shooshani, Strategic Investment Solutions  
Daniel Stern, Cliffwater

*Members of the Public:*

Frederique Adam-Jupillat, LPS  
Tom Baldwin, Gannett News Service  
Jamie Barker, Revenue  
William S. Bauer, Jr.  
Sharon Brooks, DOL  
Linda L. Brown, DOL  
Shirley Bryant, L&PS  
Adam Cataldo, Bloomberg News  
Shaunelle E. Clark  
Clifford S. Cooper III, DOBI  
Dennis Corny, PhD  
Cheryl A. Gorman, Gibbons Del Deo  
Steven Green, DOBI  
Jim Hooker, NJN News  
Deborah Jacobs  
Jacqueline H. Johnson  
Lawrence "Larry" Johnson  
Sandy Johnson, MVC  
Valerie Kazhdan, NJEA Associate Director of Research  
Patricia Latimer  
Lisa J. Logan  
JoAnn Marshall  
Arthur E. McClearin  
Dusty McNichol, The Star Ledger  
Mary Ann Mesics, DOE  
Don Miller  
Anthony F. Miskowski, Member, CWA Local 1033  
Barbara Montgomery  
Clayton Mull, SCREA  
Anne Marie Newman  
Kevin P. Norton, Bank of NY Mellon  
Dale Parichuk, LPS  
Lisa Radcliffe, MVC  
Rae Roeder, President CWA Local 1033  
John Ruth  
Luz D. Sanchez, LBH  
D. M. Sanders, DMV  
Dianne Spence-Brown, Executive Vice President, CWA Local 1033  
Rodney Stevens  
John Strachan  
Paula S. Van Pelt  
Raymond E. Weicker  
Marianne Winters, MVC

***I. Call to Order***

The meeting was called to order at 1:15 p.m. by Chair Kramer.

***II. Notice of Meeting***

Council Secretary Susan Burrows Farber reported that in compliance with the Open Public Meetings Act, *NJSA 10:4-1 et seq.*, notice of the meeting scheduled for September 18, 2008 was sent by mail deposited in the post office, by facsimile and email on September 1, 2008. 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 Secretary of State.

***III. Announcement Regarding Marshall Brown***

Chair Kramer announced that Council Member Marshall Brown had passed away the previous day. Chair Kramer said that Mr. Brown was “an enormously decent human being” who was serious about the performance of his fiduciary duties on the Council. He asked for a moment of silence in honor of Mr. Brown.

***IV. Executive Session***

Chair Kramer recommended that the Council adjourn to Executive Session in the Division’s conference room to discuss litigation and personnel issues. A motion to this effect was passed unanimously as moved by Dr. Love and seconded by Mr. Berg.

The following resolution was read for the record: “In accordance with the provisions of the Open Public Meetings Act N.J.S.A. 10:4-13, be it resolved that the State Investment Council go into closed (executive) session to discuss matters falling within the attorney-client privilege and/or matters in which litigation is pending or anticipated, pursuant to N.J.S.A. 10:4-12(7) and matters involving the employment of public officers or employees pursuant to N.J.S.A. 10:4-12(8). The minutes of such meeting shall remain confidential until after such time as the Council determines that the need of confidentiality no longer exists and the matters discussed can be disclosed.”

The meeting was adjourned for Executive Session at 1:20 p.m. The public portion was resumed at 2:25 p.m.

***V. Approval of Minutes***

Minutes of the regular meeting of the Council held on July 17, 2008 were amended at the suggestion of the Chair to correct the site of the September meeting from New Brunswick to Trenton. Approval of the minutes as amended was unanimous on a motion by Mr. Kandrak, seconded by Mr. Berg.

**VI. Pending Matters**

*A. Status of Proposed Amendments Filing*

Compliance Officer Sarnowski noted that proposed amendments to the Council's regulations regarding various types of investments (N.J.A.C. 17:16-12, 13, 14, 15, 16, 19, 23, 24, 40, 41, 44, 46, 58, 63 and 69) approved by the Council at the June 19, 2008 meeting were published in the August 18, 2008 issue of the *New Jersey Register*, and that the public comment period extends through October 17, 2008.

**VII. New Business**

*A. Proposed Alternative Investments*

- 1. Memorandum from Director Clark to the Council, dated September 12, 2008, entitled "Proposed Private Equity Investments in the Partners Group Secondary 2008 and the Welsh, Carson, Anderson & Stowe XI, LP funds."*

Mr. Shah of Strategic Investment Solutions said the proposed \$100 million commitment to Welsh Carson would be in a fund focused on middle-market buyouts primarily in the healthcare and business services industries. He noted the investment team included many senior partners who had worked together a long time, and that the opportunity set represented a good mix.

Noting the many new faces in the audience, Chair Kramer explained the due-diligence and vetting process used by the Division in consultation with the Investment Policy Committee, which occurred prior to each Council meeting and the presentation of alternative investments.

Mr. Shooshani said the proposed commitment of \$75 million to the Partners Secondary Group is in a fund that continues the first fund's strategy of investing in younger primary funds ("manager secondaries") and financial secondaries (relatively mature underlying funds). He said the fund's unique assets compliment the overall portfolio.

- 2. Memorandum from Director Clark to the Council, dated September 12, 2008, entitled "Proposed Hedge Fund Investments in the LIM Asia Arbitrage Fund, Inc."*

Mr. Stern of Cliffwater said that the proposed \$75 million commitment to the LIM fund would be managed by a large team headquartered in Hong Kong with offices in the region. He said the fund used arbitrage strategies so that it would not take directional risks, and offered an opportunity for strong returns with low volatility.

In response to a question from Chair Kramer about the performance of hedge funds in general in the current market, Mr. Stern said that hedge funds are down an average of three percent through the end of August, compared with -10 percent for domestic stocks and -20 percent for international equities. He noted that alternative investments in

general are not experiencing the negative returns suffered by the rest of the market, and that hedge funds' goal became preserving capital in this kind of environment.

Dr. Love said that although investment activities and decisions are made by the Division, the Council's Investment Policy Committee gets detailed materials for review between Council meetings. He noted there is more Council oversight than is evident in such brief presentations, and that it was the Committee's job in particular to ensure due diligence was done and raise the right questions.

*3. Memorandum from Director Clark to the Council, dated September 12, 2008, entitled "Clarification on Proposed Investment in Morgan Stanley Real Estate Fund VII Global."*

Director Clark reported that this real estate investment of \$150 million had first been presented to the Council in June, and had not yet closed. The reason for its appearance on the agenda again was to clarify a provision that permitted the Division's investment to rise up to 10 percent above the commitment, or to \$165 million, only if needed to preserve capital. Director Clark said he felt the provision was prudent.

***VIII. Nominating Committee Report – Election of Chair and Vice Chair***

*A. Report by Sue Crotty, Chair of the Nominating Committee, and Committee Members Erika Irish Brown and Mark Kandrac.*

Ms. Crotty said the Committee recommended that Orin Kramer retain his seat as Council Chair, and that Jonathan Berg retain the position of Vice Chair. Given no additional nominations from the floor, the vote was moved by Mr. Kandrac and seconded by Dr. Love and was unanimous, with Mr. Kramer abstaining.

***IX. Appointment of Executive Committee by Council Chair***

Chair Kramer asked Dr. Love and Ms. Crotty to continue their service on the Executive Committee and both agreed. He also reappointed Mr. Kellogg, who was absent from this portion of the meeting, to the Executive Committee and to continued service as Chair of the Auditing Committee, which has the same membership as the Executive Committee. Chair Kramer and Mr. Berg also serve on the Executive Committee under Council bylaws.

***X. Appointment to Committees by Council Chair***

Chair Kramer asked Mr. Clemente to continue as chair of the Communications and Public Employees Committee, and Mr. Kandrac and Mr. Berg to continue their service with the committee. All accepted.

Chair Kramer nominated Ms. Brown in her absence to continue as chair of the Corporate Governance Committee and the Diversity Committee, and nominated Mr. Claxton in his absence to continue service with both committees. He also asked Ms. Crotty to join these committees, and she agreed.

Chair Kramer noted that although the only pension fund investment of the past year targeted to bring new jobs to New Jersey had met with opposition from some, the Economically Targeted Investments Committee would continue. He asked Mr. Kandrac to continue as chair of the Committee, and Mr. Cerf to continue serving; both agreed. He also nominated Mr. Claxton who was absent to continued service.

Chair Kramer appointed Mr. Cerf and Mr. Claxton as co-chairs of the Incentive Compensation Committee, and asked Ms. Crotty to continue her service with that committee. Ms. Crotty and Mr. Cerf agreed.

He asked Dr. Love to continue as Chair of the Investment Policy Committee for a seventh year, noting that Dr. Love had written books in this field and was a recognized expert. He also asked Mr. Berg, Mr. Cerf and Ms. Crotty to continue their service with the Investment Policy Committee. All agreed.

#### ***XI. Reports of Director Clark***

##### *A. Memorandum from Director Clark to the Council, dated September 12, 2008, entitled "Investment Reports."*

Director Clark said recent public focus on a single Lehman investment ignored the other 99.8 percent of the pension fund, and his report would start with that portion.

He described stock market events stretching back into the last year as unprecedented, noting that even though these problems had been identified and discussed at past Council meetings no one had anticipated the series of events that had unfolded in the past few weeks.

He said the current banking crisis was caused in part by the out-and-out panic of human nature, fueled by policy making and crisis management that "had not been helpful" as led by the Administration and the Federal Reserve. The result, he said, was confusion over what was the federal government's policy in light of totally inconsistent behaviors when it came to banking bailouts, takeovers and letting companies fail. He criticized the federal government for "behaving like the largest hedge fund in the world" instead of providing the certainty investors need.

The New Jersey pension fund was better prepared than many for the recent crises, he noted, referring to details as outlined in his September 18 op ed published in *The Star Ledger*. Specifically, the Division took early action in its bond and money market portfolios by never investing in any of the subprime mortgage securities, CDOs or other types of mortgage debt that led to the credit crisis of last summer, forcing at least one state fund to temporarily freeze its cash funds. The Division held only limited amounts of

asset-backed commercial paper, he said, and sold off the last of this in May 2007, well before the credit crisis hit.

In the equities portfolio, the Division had been pulling back its exposure in the financial sector for nearly two years he said, noting the pension fund was underexposed by \$1.7 billion in this sector compared to the overall market. He said that even with the purchase of Merrill Lynch and Citigroup preferred shares in January, the pension fund remained \$1.4 billion underweight in financials at that time, and sold off another \$300 million in financial equities in July and August, before the current banking crisis.

Director Clark concluded that “to the extent anyone could have been prepared, we were prepared.” He noted that a fund the size of New Jersey’s can’t remove its total investments from any one sector without driving stock prices down by the pullout, and without taking on undue risk in the event a total pullout was wrong. He said the Division’s position of being significantly underweight, but not completely absent from the financial sector, was proving to be the right one.

Dr. Love agreed, noting that the Division’s staff bore the burden of having to be right twice on every decision, both about getting in and getting out of particular investments. Director Clark said that though recent events were humbling to all investors, the Division got a lot more right than it got wrong.

Investment Officer Arena reported that July and August had been relatively strong months for the state’s equities portfolio, which was up 1.4 percent compared with a .7 percent increase for stocks in general as measured by Standard and Poor’s 1500 Index. He said the portfolio was being more defensive in the current crisis, but still trying to take advantage of market displacements. Director Clark added that the Division had increased its put option hedges to offset losses.

Director Clark said the preferred shares of Merrill Lynch purchased in January had been swapped for common shares by the Division, along with the other purchasers, and that with the Bank of America buyout of Merrill, those shares were now among the better performing stocks in the portfolio.

The Domestic Fixed Income portfolio was up 1.9 percent, he said, compared with 1 percent for the overall market, a result of the Division’s early pull out of problem bonds and because the portfolio has a higher credit quality than the overall market. He noted that as mortgage yields increased dramatically, the Division was seeing significant gains, particularly in Ginnie Maes.

The International Portfolio was down -6.29 percent, he said, better than the general international market portfolio at -6.7 percent and largely because this portfolio was also underweight in financials.

The Cash Management Fund was yielding 2.23 percent, he said, with only about a third (37 percent) of its holdings in T-bills. The fund holds no Lehman, WaMu, Morgan Stanley or Merrill Lynch securities, he said, noting this had been true for several weeks before the current banking crisis.

Director Clark said that the impact of current market events was so pervasive it would be some time before the full repercussions were known, but that the Division was doing its absolute best to identify and sell problem securities while holding onto quality investments in the face of market panic.

Mr. Kandrak asked where New Jersey stood relative to other funds. Director Clark said that after the end of the last fiscal year in July, the average pension fund reported losses of -4.5 percent, while New Jersey's pension fund stood at -2.9 percent. He said the fund was still out-performing the market in all portfolios.

A brief discussion followed concerning the safety of alternative investments managed by Morgan Stanley and Merrill Lynch. Director Clark explained that the funds were all structured as separate partnerships with no exposure to the banking companies, and that the Division's agreement with those funds allowed it to terminate its participation if it didn't approve of fund management. Ms. Crotty said that Lehman had had some very profitable pieces up to the time of its failure, including the fund management, but that its management had gotten greedy.

Chair Kramer noted that the debate over the Division's use of alternative investments doesn't exist anywhere else in the country. He explained that less than 13 percent of the pension fund is in alternative investments, which is done to reduce risk, making New Jersey's fund much less diversified than many other large pension funds, especially university funds. He said that the fact that the Division had achieved some moderate diversification saved the Fund \$2.9 billion last year, but diversification could have saved the Fund \$10 billion if done years ago, progress that was stopped by opposition to alternative investments. Chair Kramer distributed a handout, attached to these minutes, with analysis demonstrating that the New Jersey Fund, prior to its diversification, had previously produced lower returns and higher risk historically than its peers, and especially states that diversified earlier.

Director Clark concluded his monthly report by noting the Division had informed its custodian in mid-July not to lend financial stocks, and other states were now following New Jersey's lead.

Director Clark noted that the Republican Assembly Office had posted a list of questions aimed at the Council, which challenged the Division's June decision to invest in Lehman Brothers in light of that company's bankruptcy in September. Director Clark said he would respond to the questions publicly.

He said the decision to invest in Lehman followed an in-house process "extremely similar" to that that used for other Division investments, with the only real difference being the stocks involved were part of a secondary offering and not purchased on the open market.

Director Clark said three members of the Division staff in addition to himself conducted the analysis on the Lehman investment. He said he would not release the names of the staff to protect them from hostile reaction and because he assumed ultimate responsibility



for the decision. Director Clark said no one from the Council was involved in the Lehman decision, and no one from the Corzine Administration. He added he had not discussed the investment with anyone in the Administration either before or since the investment was made. He said he would not reveal the names of Lehman representatives involved in the purchase, because the Division was considering litigation.

He said Lehman provided no material about the investment to the Council, or to the Administration. He said the Division reviewed the usual materials involved in an equity purchase, with one exception; the Division was offered on the Friday before the purchase a preview of the following Monday's earnings announcement for its advance consideration.

He said data evaluation for this purchase was handled by the four inside staff members.

He said two Council members have an economic relationship with Lehman Brothers, as previously made public: Erika Irish Brown and Monty Cerf are employees of Lehman. He said that Council members were not and are not consulted on the Division's daily investment decisions. He said the four staff involved in the purchase have no professional or personal relationship with Lehman Brothers.

Director Clark said there were no recusals on the Lehman decision because no Council members participated. He stressed again that ultimately the decision was his.

Director Clark said he did not know whether the state had been given an accurate representation of Lehman's fiscal condition, and that this question may be a subject of litigation.

Director Clark said the purchase was viewed with hindsight as a mistake, but that it was unfair of critics to attack good state workers who had done a lot more right than wrong.

## ***XII. Public Comment***

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

Mr. J. C. McCormack was not present.

Mr. Anthony F. Miskowski, executive secretary of CWA Local 1033, asked for and received confirmation that the Lehman investment made in June consisted of \$120 million in common stock and \$60 million in preferred stock, and that the 4.3 million shares of common stock had been purchased for \$28 each. He then asked for a description of what had happened to the holding.

Investment Officer Arena said the Division had sold slightly more than 3 million common shares at \$18.50 per share, and another 50,000 shares at \$15 per share. He said the Division was down to 1.825 million shares at the time Lehman announced its bankruptcy, and these holdings had already been liquidated by the Division for between 22 and 32

cents per share. He said that one-sixth of the preferred stock had been sold before the bankruptcy, with the remainder liquidated afterward.

Director Clark estimated the total loss resulting from the Lehman holdings at about \$100 million. Ms. Crotty said it was important to note that the Lehman losses represented only a fraction of one percent of the total pension fund. Mr. Miskowski said the amount was still significant to state workers making an average of \$50,000 each year with an average pension of \$27,000.

Several Council members urged the public to keep the loss in context. Ms. Crotty said for example, had the Division made a different decision regarding its significant reduction in financial holdings, including pulling out of Fannie Mae and Freddie Mac holdings, the amount of loss to the fund could have been really huge, adding "Why are you not applauding?" that decision. Chair Kramer said the Division's decision to reduce its financial holdings was helping it outperform its peers. He said the best managers in the world are not going to hit 900, adding that "Cherry-picking a portfolio for losers, especially a portfolio that's done so well, is unfair and demoralizing to the people doing the work."

Dr. Love said that the real benefit of diversification is risk reduction, and that perfect diversification means owning some of everything. "You will always have losses in a well diversified portfolio" he said, adding it is a "winning strategy" nonetheless.

Director Clark said that although, "It burns me up to get one wrong," he estimated the pension fund was \$92 million better off than it would have been had it not sold other financials to make the Lehman investment. "We got one right, one wrong, and we're trying to make sure it doesn't happen again," he said.

Ms. Rae Roeder, president of CWA Local 1033, said no one quibbles with the performance of state workers. She added she was upset by the Court's August 22 opinion that Council regulations did not support the hiring of external managers, and the amount of time and money spent by the union pressing this issue. She said she was glad the Division had decided not to appeal, and for a 90-day stay to work with the Division on a resolution.

John Strachan was critical of the fact that two new union seats on the Council remained unfilled by gubernatorial appointment, and that a fund supported by the Division aimed at increasing business in New Jersey was not appropriate use of pension fund monies. He asked the Council: to urge the Governor and the Legislature to fully fund the pension fund; to not invest in anything not aimed at the growth of the fund; to urge the Governor to fill the vacant Council seats; to reduce the cap on alternative investments to 10 percent; to stop privatizing investment, and to help the fund's shortfall be made up quickly.

Mr. Berg said while the State had "taken a vacation" from its funding obligations, so had county and municipal employers that together represented far more employees than the State alone.

Dr. Love said the Council would like to enlist the audience in advocacy, noting that the Division was operating with the same size staff it had in 1984 when the fund was only \$10 billion with basically two classes of investment, stocks and bonds. He said the Division needed to expand staff in order to support increased investment diversity, which had already begun to reduce the Fund's volatility.

Mr. Cerf said the Council agreed with many of Mr. Strachan's requests. However, he said he was unaware of any investment made for reasons other than to reduce risk, and that investments were not made to create jobs or employment. He said the Division's investment strategy had never been designed to catch up on the fund shortfall, and that there was nothing reasonable or responsible to be done with investing alone that would close that deficit. Chair Kramer noted that the Council was the only pension board in the country that publicly doubted the size of the deficit as measured, and that the reason it had so aggressively pursued diversification was to shrink the portfolio's overall risk.

### ***XIII. Committee Reports***

#### ***A. Audit Committee Report***

Director Clark reported that a recommendation to contract with Ernst and Young as the Division's auditor was being appealed by the current auditor, KPMG. He said the Purchasing and Property Division was handling the appeal, which would further delay this fiscal year's audit. In response to a question from the public, he said it would not prevent the presentation of estimated performance figures at the Council's Annual Meeting in November.

### ***XIV. New Business***

#### ***B. For the Information of the Council***

*1. Verbal update by Director Clark on the August 22, 2008 Superior Court opinion on alternative investments and the Division's authority to use external investment managers, and the September 11, 2008 filing by the Division requesting a partial stay.*

Director Clark said the Division was seeking a 90-day stay in order to satisfy the ruling in a manner best for the Fund. He said a meeting with the CWA and NJEA on this issue had been postponed by market events and was being rescheduled.

*2. Memorandum from Director Clark to the Council, dated September 12, 2008, entitled "Fiscal Year 2008 Summary Proxy Voting Report."*

Compliance Officer Sarnowski noted the Division had voted 1,287 proxies of US companies, a slight increase over the previous year, plus 689 international proxies, also higher than last year's total. She said that requiring majority vote in the election of directors was a major issue of the proxy season, and one the Division tended to support.

She noted the Division voted in favor of all 68 domestic shareholder proposals seeking an advisory vote on executive compensation. She added that the Division would prepare a recommendation on proxy policy updates for the Council's Corporate Governance Committee. The full proxy summary report is on file at the Division; copies are available upon request.

3. *Memorandum to the New Jersey Legislature dated August 14, 2008, entitled "Investments in Sudan."*

Compliance Officer Sarnowski said the Division had completed the divestiture of holdings required by legislature three years early. She noted two corporations had challenged the State's position in light of federal divestiture laws, and that the challenges were with the Attorney General's office.

4. *Memorandum from Chief Administrative Officer Burrows Farber to the Council, dated September 12, 2008, entitled "Corporate Governance and Legislative Update."*

Memo was noted without comment.

5. *Memorandum from Chief Administrative Officer Burrows Farber to the Council, dated September 12, 2008, entitled "Investment News Clips for September 2008 Council Meeting."*

Memo was noted without comment.

6. *Council Meeting Calendar for 2008-09*

Memo was noted without comment.

#### ***XV. Communications***

There were no matters presented on behalf of Treasurer Rousseau.

#### ***XVI. Next Meeting***

Thursday, 10/15/08	Noon: Lunch/1 p.m. Meeting	Rutgers Student Center 126 College Avenue MPR B New Brunswick, NJ 08901
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#### ***XVII. Adjournment***

All regular business of the Council being concluded, the meeting was adjourned by unanimous vote at 4:15 p.m. on a motion by Dr. Love, seconded by Mr. Berg.

Submitted respectfully, Susan Burrows Farber, Secretary to the Council