

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

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

**Thursday, May 21, 2009
1 p.m. Council Meeting**

MINUTES

Approved July 9, 2009

Present: Orin Kramer, Chair
Jonathan Berg, Vice Chair
W. Montgomery “Monty” Cerf
Jose R. Claxton – *By teleconference*
James Clemente
Susan Crotty – *Arrived at 1:30 pm*
James C. Kellogg
Karl Kleeberg
James P. Marketti
Timothy McGuckin

Absent: Erika Irish Brown, Mark Kandrach and Douglas A. Love

Also

Present: *From the Division of Investment:*
William G. Clark, Director
Ray A. Joseph, Deputy Director
Gilles Michel, Assistant Director
Brian Arena, Investment Officer
Linda Brooks, Senior Portfolio Manager
Jessie Choi, Investment Analyst
James Falstrault, Investment Officer
Susan Burrows Farber, Secretary to the Council
Christine Pastore, Investment Officer
Tim Patton, Senior Portfolio Manger
Susan Sarnowski, Compliance Officer

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

Members of the Public:

Tom Buckley

Members of the Public, continued:

Terrence Dopp, *Bloomberg*

John Gorman, Senate Republican Office

Dusty McNichol

Anthony F. Miskowski

Clayton Mull, SCREA

Rae Roeder, President CWA Local 1033

Raymond Weicker

Note: List is incomplete, sign-in sheets were not circulated

I. Call to Order

Chair Kramer called the meeting to order at 1:07 p.m.

II. Notice of Meeting

Secretary Burrows Farber reported that notice of the meeting scheduled for May 21, 2009 was sent by mail deposited in the post office, by facsimile and email on May 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 March 19, 2009 were approved unanimously on a motion by Mr. Berg, seconded by Mr. Cerf. Mr. Clemente abstained because he was absent from the March meeting. Ms. Crotty was absent for the vote.

IV. New Business

A. For Discussion by the Council

1. Evaluation of trial public comment period introduced by Council in September 2007

Chair Kramer proposed a change of agenda order to permit discussion of Council preferences regarding the public comment period. He said he had received several suggestions for changes, including: moving the public comment period to the beginning of each meeting to allow consideration of public feedback during deliberations that followed; requiring speakers to provide a summary of their remarks when registering to speak; strict enforcement of the three-minute time limit per speaker; more aggressive intervention by the chair in calling remarks out of order; and limiting the number of times the same speaker can address the Council to perhaps two to six times per year, to encourage greater speaker diversity.

Chair Kramer said there appeared to be general agreement that a public comment period was a good idea, but also concern that the comment period had at times been rude and disruptive. He

said he would be more assertive going forward in calling such behavior out of order. He said that personal attacks and attacks on the integrity of Council members were never appropriate, and referenced President Obama's recent speech at Duke University in expressing hope that future public dialog would allow disagreement without demonizing individuals or assuming anyone's intentions were inappropriate.

Mr. Berg reiterated the request that people act civilly, and confine comments to items on the Council agenda. He pointed out that Council members serve the fund without pay and devote substantial personal time to Council business, and that suggestions of wrong-doing from those who simply disagree with Council decisions serve no useful purpose and distract from business.

Mr. Kellogg expressed his preference for leaving the comment period at the end of the meeting, to allow for reaction to meeting proceedings. Mr. Berg asked the chair to request a sense of preferences regarding the comment period from the public present. Ms. Rae Roeder responded from the audience that allowing public comment in the meetings was "better than having us outside with posters, banging on the windows."

The Council expressed general consensus that the comment period should remain at the end of the meetings, that the three-minute limit per speaker should be enforced, with dialog at the discretion of the Council; that there would be no limit on the number of times a person could address the Council in a year; and that rude and disruptive behavior would not be tolerated.

Unrelated to the discussion of public comment, Chair Kramer offered as additional items of new business an opportunity for the Council to express its traditional and strong support to the SEC on two issues: 1) new rules that would open the corporate proxy voting process by permitting shareholders to nominate non-board candidates; and 2) new limits on campaign contributions designed to address recent scandals involving placement agents and pension funds. Chair Kramer noted that any federal limits on contributions were unlikely to be as restrictive as New Jersey's, so it would be important that any new federal rules not preempt state standards that may be more restrictive.

Mr. Cerf said he was inclined to support both opportunities, but was curious about counter-arguments to opening the proxy process. Chair Kramer said opponents of the change believe that board elections would become highly politicized, with elections serving social issues or constituent groups rather than the needs of the corporation, and that it would be harder to get board members to serve, or to maintain productive working board teams. However, Chair Kramer said, without an open process it wasn't a real election. A motion to support both issues in letters to the SEC was moved by Mr. Cerf, seconded by Mr. Marketti, and passed unanimously. Ms. Crotty was absent for the vote.

B. Alternative Investments

1. Verbal report by Director Clark on placement agents.

Director Clark said the Division had watched the unfolding of the placement agent scandals in other states with amazement, even though the basic story was simply related to a few people in public service perverting the process for their own ends.

He summarized the scandals by saying New York State and one or two other pension funds were alleged to have either: 1) made investments in exchange for improper payments by or to a fund's placement agent, or 2) actively sought such payments from legitimate investment firms prior to making an investment. He said such behavior, even though limited, fuel the appetite of an ever-cynical public against all public servants and reinforce a "guilty until proven innocent" mindset with regard to all investors of public funds.

Director Clark said New Jersey is not New York in terms of its pension fund management in several important ways. He said the Division routinely makes public disclosure of all of its alternative investments and the rationale for the investments. He said the independent guidance and market intelligence provided by Council members, and particularly those serving on the Investment Policy Committee, also helped the Division steer clear of potentially troubled business relationships. He pointed out the Division's independent consultants also provided unbiased, competent and thoughtful advice with regard to current and potential advisors. He said in addition, all contracts are reviewed before closing by the Attorney General's office.

New Jersey also differs significantly from New York in how the fund is governed, Director Clark said. He noted the New York State pension fund is run by a single political officer whose re-election is dependent upon political contributions. In New Jersey, neither the Investment Director nor members of the policy Council are elected; furthermore, Council members may not serve in a public office. He pointed out that the Council had strict guidelines which prohibit the pension fund from doing business with any firm or individual who makes contributions above \$250 to a candidate for state office, and that an "onerous but important" set of ethics rules that applied to the Council and Division staff have worked well to date in protecting the pension fund from the missteps now alleged by other public funds.

Even with such precautions in place, he said, it is appropriate for the Council to review the Division's use of placement agents to determine if additional safeguards are needed. He said about 20 percent of the alternative funds in which the Division is invested used a placement agent. In some cases, the Division had no interaction with the fund's agent, and none of the agents were assigned exclusively to New Jersey, as has been alleged for other pension funds. New Jersey does have relationships with two of the major funds named in the New York allegations, he said: Quadrangle, although the placement agent used by that firm in New Jersey was not the same agent used by Quadrangle in New York, but an agent the Division knew to be reputable; and Carlyle, where the Division's investments were in two funds different from those being questioned in New York and both investments were made without placement agent involvement.

Director Clark explained that placement agents serve essentially as brokers for an investment, similar to brokers who help market insurance or benefit plan products. He said agents tend to specialize in markets, and can assist with due diligence, help structure terms, prepare a fund's marketing material and arrange investor meetings. Agents tend to be hired by smaller funds that don't require marketing services full-time.

He said the Division is preparing a full disclosure of funds using placement agents to be delivered shortly to the Council as well as posted on the Division's website. (*Secretary's note: This list was delivered and posted on June 1, 2009.*)

Director Clark said the primary question facing the Council was whether to maintain the current policy regarding placement agents, which requires any agents used to be fully disclosed by the hiring fund and to adhere to the same contributions restrictions as the fund managers; whether the policy could be strengthened; or whether the Division should ban investment in funds that use placement agents. He noted that while a ban may play to public sentiment, it would not eliminate the potential for abuse because funds could simply hire placement agents as staff. Also, he said, a ban would limit New Jersey's investment choices, particularly among the smaller funds that depend on such agents.

Mr. Marketti asked why the Division couldn't work directly with all investment candidates. Chair Kramer said the Division lacked the staff to do the work performed by legitimate agents, and that the impact of such a change would be especially problematic for the Division's ability to identify and invest in minority and smaller funds. Mr. Cerf added that the Division, like most investors, tends to minimize or eliminate the use of agents once it moves deeper into an investment consideration, so that banning the use of agents would have the most adverse impact on the initial identification of fund candidates, with little practical consequence on the following investment decision.

Mr. Cerf said it seemed the Division and Council had done a lot already to ban the issues now arising in other systems. He said his bias, if change were necessary, would be to increase disclosure rather than increase restrictions that could choke normal business activity. Ms. Crotty said that Division staff is doing a good job in cases where it is already working directly with funds, and that the Council should move cautiously in making changes that would increase this burden, especially in a time where staff reductions or other changes might be driven by budget constraints. Mr. Clemente spoke favorably about the current restrictions on agents.

Chair Kramer said that discussions among the states regarding change in placement agent policy were tending in the direction of greater transparency. He said that if New York had New Jersey's system, it would have been immediately seen where investments were going. He said there are also discussions at the federal level about better controls on who can serve as agents, including possible requirements for training and registration.

Chair Kramer said placement agents tend to be used most heavily in jurisdictions where politics and elections play a role in the investment process, which helps explain why the use of agents is limited for New Jersey. He said the perception of agents as political "fixers" could be eliminated with greater industry transparency and controls. He recommended that the Council take a closer look at the options proposed and in use by other public funds to see if transparency and disclosure could be improved, while staying flexible in the face of unfolding events and possible federal action. Director Clark agreed to present options for Council consideration at the next meeting.

C. For Action by the Council

- I. Memorandum from Director Clark to the Council, dated May 14, 2009, entitled "Proposed Amendments to N.J.A.C. 17:16-17" concerning investment in debt obligations, plus briefing memorandum from Deputy Director Joseph, dated May 14, 2009, entitled, "Build America Bonds."*

Deputy Director Joseph said the proposed amendments would allow the Division to invest in either revenue or debt obligations issued by any government entity as long as these are backed by the full faith and credit of the obligor. Currently the pension fund is limited to investment only in general obligation bonds issued by New Jersey or one of its political subdivisions. He said the proposed change was prompted by passage of the federal Economic Recovery and Investment Act and the subsequent creation of “Build America Bonds” for financing capital expenditures, and that such investments could be beneficial for the pension fund.

Mr. Cerf asked if the amendments would permit the fund the same flexibility available from ordinary corporate bonds. Director Clark said the default rate of government bonds was lower than comparably rated corporate bonds. Mr. Kellogg asked if there was a limit on revenue bonds that could be purchased under the current regulations and was told there was not. Sue Crotty asked whether the Division would be required to sell the bonds if their rating dropped subsequently and was told no. Mr. Cerf said he supported the amendments as opening new capital markets to the pension fund.

Mr. Berg read the following resolution into the record for Chair Kramer, who momentarily stepped out of the meeting: “Be it resolved that the State Investment Council hereby approves proposed amendments to N.J.A.C. 17:16-17. The Council hereby 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.”

A motion to support the resolution was moved by Mr. Marketti and seconded by Mr. Berg. It passed unanimously, with Chair Kramer absent for the vote.

D. For the Information of the Council

- 1. Verbal report by Secretary Burrows Farber to the Council on corporate governance and legislation.*

Secretary Burrows Farber reported that the Council and Division had recently supported three activities at the federal level consistent with historic support for the issues. The Division and Council joined other institutional investors in supporting a “Shareholder Bill of Rights” introduced by U.S. Senator Schumer, and in appealing to the SEC to improve corporate disclosures on climate change activities. The Division voted against the re-election of three directors to the Bank of America board for their primary or supporting roles in the bank’s decision to acquire Merrill Lynch without full shareholder disclosure of what it knew of Merrill’s losses; and voted for a shareholder proposal calling for a separation of CEO and Chair positions at the bank. The separation proposal was successful. The Division also voted for proposals calling for a separation of chair and chief executive officer at other companies.

- 2. Memorandum from Chief Administrative Officer Burrows Farber to the Council, dated May 15, 2009, entitled “Investment News Clips for May 2009 Council Meeting.”*

The memorandum was received without comment.

V. *Reports of Director Clark*

A. Memorandum from Director Clark to the Council, dated May 15, 2009, entitled "Investment Reports."

Director Clark said the pension fund was up to \$60.5 billion at the close of April, a "remarkable" month in which the stock market had closed up 35 percent from March 7, 2009, after dropping by 54 percent in the period October 2007 to March 2009. He noted financial services stocks were the primary reason for the improvement, with one bank's stock up by 102 percent.

Investment Officer Arena said the domestic portfolio was up 9.4 percent for April and ahead of the benchmark, the strongest month of the fiscal year to date for this portfolio. He noted that US companies either re-incorporating in Europe or moving their headquarters there for tax advantages were being transferred into the Division's international portfolio. Director Clark noted that a recent performance measure report by R.V. Kuhns & Associates, Inc., showed New Jersey's domestic portfolio performed the fourth best of 89 public funds measured for the calendar year ended December 2008; and second best when comparing three-year averages. He commended Mr. Arena and his team for an excellent job.

Assistant Director Gilles Michel reported that April was also a strong month for the international portfolio, and that the portfolio was slightly ahead of benchmark for the fiscal year to date. He said portfolio was coming out of its defensive posture with regard to financials, and noted the Division was hedging its exposure to the Japanese yen. Director Clark noted the international portfolio ranked 18th out of 89 funds in the Kuhns performance report for 2008.

Senior Portfolio Manager Tim Patton said the fixed income portfolio had gone long in corporate bonds in late 2008 and spreads have come down dramatically. He said the Division was starting to sell them at significant gains. He said the portfolio had shifted to market weight after being overweight in TIPS, which have performed extremely well. Director Clark said the Division remained concerned about inflation for the long-term. He said the fixed income portfolio ranked 8th of 89 funds in the Kuhns performance report for 2008.

He said the Division was working with general consultant Strategic Investment Solutions on asset allocation analyses under different investment and funding scenarios that could be used by the Council in discussing potential changes to the Council's Investment Plan.

Director Clark said the Division had been given permission to operate with a skeleton staff on days when the Department of the Treasury would be furloughed for budget reasons. He said well over half the staff would be furloughed on the first furlough date of May 22, with the second furlough day anticipated for June.

Mr. Marketti asked for comment regarding reported writedowns for private equity and real estate investments. Director Clark said that writedowns represented a loss of 16 percent on private equity investments, with a little more for real estate. He said the losses were what were expected, knowing that private equity performance is volatile by nature and real estate performance is driven by the market. He said the figures were based on audited financials by the Division's general partners in alternatives.

Chair Kramer said it was a widespread issue in the industry that private equity and real estate values were marked at values likely higher than what could be realized in an arms-length transaction. He said it was inconceivable that real estate, in particular, would not go lower in future reports.

Mr. Marketti asked about the impact on the pension fund of renegeing on existing commitments. Director Clark said investors could be charged interest and could see their value of the fund lowered. In additional discussion, he said distributions come when income is earned; investment are made over three-to-four years from the time of the commitment as investment opportunities are identified via "capital calls" issued by the fund for each investor's pro-rata share of the investment.

Mr. Marketti asked if it were possible to unwind alternative investments and whether the Division was inclined to do so. Director Clark said the Division's initial reaction when the world changed in September was to pull back, and that the Division had chosen not to close on all pending alternative investments but one. He said pulling out of existing alternative commitments would incur penalties. He noted, however, the Division had gone to the general partners of some funds and asked them to voluntarily lower their fund size in the belief they were unlikely to invest all they had initially targeted because of changes in market conditions. He said several funds had responded favorably.

Mr. Kellogg asked if Exhibit 17 could be modified to describe bond holdings by interest rate, activity and rating, starting at a minimum with the Build America Bonds. Director Clark said the Division's computer systems were limited for producing this kind of report, but that the Division would explore what could be done.

Mr. Cerf asked if the hedge fund values in Exhibit 2 were current. Director Clark said the figures were current for most funds, and that it appeared hedge fund investments were up 8 percent for the year.

Chair Kramer observed a complete exit from alternative investments would make New Jersey anachronistic against other pension funds, and would mark a retreat from diversification resulting in higher risk. Mr. Marketti said there were other options to diversification outside of a shift to equities, including Build America Bonds. Chair Kramer pointed out that equities were down about 40 percent, but that hedge fund investments had significantly helped offset this decline.

VI. *Committee Reports*

There were no Committee Reports.

VII. Communications

There was no report from the State Treasurer.

VIII. Public Comment

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

Mr. Tony Miskowski congratulated the Council and staff on a strong April performance. He asked if the Council had yet had any discussion with state leaders regarding its letter supporting state funding for the pension plan. Chair Kramer said there had been discussions but that the Council acknowledged that obtaining additional funding in the current economy remained challenging. Mr. Miskowski asked about reports that Chair Kramer and Director Clark had met with federal officials regarding investment in “toxic” financial assets. Director Clark said a discussion of investing in particular financial assets had occurred at the request of the Federal Deposit Insurance Corporation. Director Clark said these potential investments would rank above stocks for repayment in the event of bankruptcy, but that no decision regarding investment had been made.

Mr. Ray Weicker asked for caution in investing in these assets, adding an AAA rating meant little in today’s market. Director Clark noted that investors made a lot of money investing in assets seized by the Resolution Trust Company in the 1980s, a government-owned company created to manage the savings and loans crisis. He said he felt it prudent to explore the current program for that reason, adding if the investment terms were similar, losses were floored and interest rates were attractive it would be irresponsible not to explore such investments. He added that the government’s backing would have to be strong enough to overcome a good deal of skepticism about such investments.

Mr. Tom Buckley distributed a list of compensation totals for 10 corporate executives, and noted CalPERS had been particularly active in the current proxy season on behalf of other shareholders on issues including executive compensation. He asked if the Council had a policy on corporate governance that addressed compensation. Director Clark said the Division had a proxy voting policy, currently being updated, and that the Division would provide Mr. Buckley with a copy. (*Secretary’s note: This was done on June 1, 2009*). Director Clark agreed that institutional investors have a lead role to play on behalf of shareholder rights, and that New Jersey had been active during the current proxy season in supporting say-on-play as well as greater shareholder access to board elections. He noted in the past the Division had occasionally co-sponsored proxy proposals, but that activism was limited by lack of staff.

IX. Next Meeting

June 18, 2009

3 p.m. Meeting

Rutgers Student Center
ROOM 410
126 College Avenue, 4th Fl
New Brunswick, NJ 08901

Secretary's Note: The June 2009 meeting was cancelled by notice posted June 9, 2009.

X. *Adjournment*

The meeting was adjourned by unanimous vote on a motion by Mr. Clemente, seconded by Mr. Berg at 3 p.m.

Respectfully submitted,

Susan Burrows Farber
Secretary to the Council