Minutes of Regular Meeting:

Held on October 11, 2012 at 11:00 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
James E. Hanson
Guy Haselmann
James Joyner
Adam Liebtag
Peter Maurer
Timothy McGuckin
Jeffrey Oram
Mitchell Shivers

Roll Call and Meeting Notice

Chair Grady called the meeting to order at 11:12 am. Ms. Christine Eckel performed roll call and reported that notice of the Regular Meeting scheduled for October 11, 2012, was posted to the website of the Division of Investment (the Division) and sent via fax to the Times of Trenton, the Star-Ledger, the Bergen Record, the Courier Post and the Secretary of State on September 5, 2012. The notice was amended on September 5, 2012 and sent via fax to all of the above mentioned. A copy of the notice was posted at the Division and is on file.

Chair Grady welcomed Treasurer Eristoff and the public to the meeting, and wished a speedy recovery to Rae Roeder.

Chair Grady congratulated Division staff for outperforming its benchmark and many of its peers for fiscal year 2012.

Chair Grady referred to a newspaper article highlighting an investment made by one of the Division’s hedge fund investments in a debt offering of Revel casino, which article implied that this investment added undue risk to the portfolio. To offer perspective on the risk represented by this investment, Chair Grady noted that the Division invests in securities of at least 1,500 domestic and international companies, along with over 100 alternative investment funds, each of which invests in 10-30 companies.
Thus, the Pension Fund has a piece of ownership in about 3,000 different companies around the world. He stated that the amount of the Division’s investment in Canyon Partners, the hedge fund referenced in the article, is less than 2/10 of 1% of the entire Pension Fund portfolio, with the casino investment constituting one of 20 to 40 investments by that fund. Chair Grady noted that the Division started its relationship in this hedge fund in 2007, before the current administration took office, before the current membership of the SIC took office, and before Director Walsh started with the Division. Chair Grady stated that the Division is not informed of investments by the hedge fund prior to their being made, but noted that this hedge fund is a top quartile hedge fund, with a return of approximately 32% at a time when investments in the S&P 500 Index were flat. Chair Grady emphasized the Council’s watchword of diversification, and stated that the best way to maximize returns to the beneficiaries while mitigating risk appropriately is to have a highly diversified portfolio.

Chair Grady mentioned that Council Member Haselmann has prepared a draft analysis on the assumed rate of return, and the Investment Policy Committee (“IPC”) will be discussing this analysis at its next meeting. He noted the recent action by the Treasurer in reducing the assumed rate of return to 7.95% for certain pension funds.

Approval of Minutes for Regular Meeting held on May 24, 2012 (as amended) and August 2, 2012

Chair Grady asked the Council members if they had any comments on the amended minutes of the May 24, 2012 Regular Meeting. There were no comments. A motion was made by Chair Grady to approve the minutes of the May 24 meeting, with Council Member Oram seconding the motion. All Council Members voted in favor of the motion, except Mr. Joyner who abstained as he was not present at the meeting. Chair Grady then asked the Council members if they had any comments on the minutes of the August 2, 2012 Regular Meeting. There were no comments. A motion was made by Chair Grady to approve the minutes of the August 2 meeting, with Council Member Haselmann seconding the motion. All Council Members voted in favor of the motion, except for Messrs. Joyner, Hanson and Liebtag who abstained as they were not present at the meeting.

Election of Chair and Vice Chair

Council Member Oram, Chair of the Nominating Committee, stated that the committee members (Messrs. Oram, McGuckin and Haselmann), met telephonically on September 20, 2012 at 1:15 pm to discuss nominations for both Chair and Vice Chair of the State Investment Council. Based on resumes and requisites, the Nominating Committee was unanimous in its decision that current Chair Grady again be nominated for Chair and current Vice Chair Byrne again be nominated for Vice Chair. Mr. Oram proposed a motion to elect Mr. Grady for the position of Chair, with Council Member Barrett seconding the motion. All Council Members voted in favor of the motion, except for Mr. Grady, who abstained. Mr. Oram proposed a motion to elect Mr. Byrne for the position of Vice Chair, with Council Member...
Barrett seconding the motion. All Council Members voted in favor of the motion, except for Mr. Byrne, who abstained.

**Appointment of Executive Committee, Audit Committee and IPC Committee**

Chair Grady stated it was his duty to appoint committee members and, as such, he reappointed the current committee members for the Audit Committee, IPC Committee and the Executive Committee. (The listing can be found on the Division’s public website at [http://www.state.nj.us/treasury/doinvest/pdf/Committees2011.pdf](http://www.state.nj.us/treasury/doinvest/pdf/Committees2011.pdf).)

**Report from Audit Committee on Fiscal 2012 Audit**

Council Member McGuckin reported that the Audit Committee met with staff and the auditors prior to the SIC meeting. No issues were reported with the Fiscal Year 2012 audit, which is not yet final pending receipt of the legal letter and management representation letter by E&Y. The audited financial statements are expected to be presented at the next SIC meeting. For the second year in a row, there were no management letter comments.

Council Member McGuckin updated the Council on the status of the Request for Proposal (RFP) that will combine the financial audits of the Division of Investment and Pensions and Benefits. Council Member McGuckin reported that the combination of the audit is permissible. The RFP has not been issued yet, but is expected to be released shortly.

**Guest Speaker- Jan G. Loeys**

Jan G. Loeys, Managing Director and Head of Global asset Allocation and Alternative Investments from JP Morgan, gave a presentation on Global Investment Strategy. The presentation can be found on the Divisions website. [http://www.state.nj.us/treasury/doinvest/calendar.shtml](http://www.state.nj.us/treasury/doinvest/calendar.shtml).

**Director’s Report/Update**

Director Walsh advised the SIC that the Pension Fund excluding Police and Fire Mortgage for Fiscal Year 2012 outperformed the benchmark significantly, which was better than anticipated. The Fund returned 2.52% versus the benchmark return of 0.26%. It outperformed the respective benchmarks in four out of five asset classes. The fifth asset class, Risk Mitigation, was marginal and is by far the Division’s smallest asset class. The two big outperformers were Liquidity and Income. The 226 bps of out-performance for fiscal year 2012 against the benchmark was the most since fiscal year 2008 and the most in a positive year since fiscal year 2000. The fund, as of August 31, 2012, was up 2.70% for Fiscal
Year-to-date and 8.96% for Calendar Year-to-Date. In addition, the Director advised Council of the Division’s consent to the acquisition of CT Investment Management Co., LLC, a subsidiary of Capital Trust, Inc. and manager of CT High Grade Partners II LLC, by a Blackstone affiliate, as described in more detail in the press release provided in the meeting materials.

Deputy Director McDonough stated the Division terminated its advisory agreement with Pictet, one of the four emerging market advisers, due to performance of the portfolio. He further explained that the assets advised by Pictet of approximately $325 million will be advised by Morgan Stanley and Lazard moving forward. Mr. McDonough stated that while the original anticipated adviser cap of $600 million will be exceeded with Morgan Stanley and Lazard, the emerging market advised portfolios will remain within the aggregate cap of $2 billion. Mr. McDonough stated that the Division had been pleased with the performance of the three remaining advisers. He reiterated that the Division was drafting an RFP as the contracts with the remaining advisers end in the next calendar year, with the goal of increasing the number of advisers given the increase in the target allocation.

**High Yield Fixed Income Advisers and Municipal Bond Advisers**

Director Walsh stated the Division’s contracts with its four high yield fixed income advisers expire in June 2013. He stated that it was the Division’s intent to rebid the mandate, as well as engage advisers for municipal bonds, for which the Division staff lacked the required expertise.

Kevin McGrath of the Division explained that the Division utilizes four high yield advisers, and has a portfolio totaling approximately $1 billion, with all trades being approved by Division staff. He stated that the Division would like to retain up to eight advisers for both U.S. and non-U.S. securities, with the goal of achieving a highly diversified global high yield strategy. Mr. McGrath highlighted the high-yield performance of 12.5% calendar year to date and 5% fiscal year to date.

Philip Pagliaro of the Division stated that the Pension Fund is invested in approximately $1 billion in municipal assets, which are primarily Build America Bonds, yielding an average of 4.5%. He explained that while the Build America program is currently not active, the Division anticipates that some form of the program will be resurrected. Mr. Pagliaro stated that the Division seeks to engage up to two advisers with the required expertise to assist with investments in this asset class at what the Division believes will be a relatively low cost.

**Real Estate Private Equity Investment - TPG Separate Account**

Chair Grady stated that Council Member Oram had recused himself from discussion of this proposed investment during the IPC meeting.
Director Walsh introduced Roman Nemtsov of RV Kuhns, the Division’s lead consultant for the Real Estate portfolio. The Director commented that the Division is very familiar with Texas Pacific Group (TPG) Private Equity firm, which has a lot of experience in the real estate sector. TPG invests in real estate different than any other firm. The Director noted that staff had spent approximately a year on research, and were now ready to present to Council.

Mr. Nemtsov presented the proposed investment of $350 million in TPG/NJ Partnership. The Division will be the only limited partner investor in this fund. The major advantage of this investment would be its primary focus on growing platform investments in real estate-related operating businesses, which differs from the vast majority of the Division’s real estate investments made to date that are focused on investment in single assets or portfolios of assets. The Division was able to negotiate an attractive fee schedule, including a management fee of 95 basis points on invested capital only and a reduced catch-up rate of 30% to TPG over the preferred return of 8%. The Division also was offered the opportunity to review all investments made by the fund prior to allocating capital, which would give the Division veto rights on what goes into the fund. Council Member Haselmann asked how the Division will review investments proposed by the fund. The Director explained the review process and noted that he makes the final decision regarding exercise of the veto right.

Chair Grady reported that the IPC had determined that appropriate and adequate due diligence was performed.

Approval of Cash Management Fund Reserve Fund Fee Reduction

Director Walsh stated the Cash Management Fund (CMF) is the next largest fund after the Pension Fund managed by the Division. Over the last two years it has managed approximately $8-14 billion and is run by Linda Brooks. In connection with the scheduled expiration of a surety bond covering non-State deposits in the CMF in December 2012, the Division reviewed the current level of the CMF reserve fund. Based on that review, the Division determined that the level of the reserve fund exceeded what was necessary for the fund, given the type of investments in the fund. The Division seeks approval from the SIC to lower the CMF Reserve Fund fee currently charged to non-State participants from 5 bps to 1 bps. The Division did not recommend eliminating the charge, because of the operational difficulties of reinstating the charge if it became necessary to do so in the future. Reducing the reserve fund fee would increase the interest income, though fairly marginal, the cities and towns that participate will increase their returns in a very low interest rate environment.

Chair Grady motioned to approve the recommendation to lower the reserve fund fee to 1 bp. The motion was seconded by Council Member Oram. All Council Members voted in favor of this motion.
Approval of proposed amendments to N.J.A.C. 17:16-65 (Deferred Compensation)

Susan Sarnowski of the Division stated that a few months ago the Deferred Compensation Board took action that would open the Deferred Compensation Funds managed by the Division to participants. This action necessitated changes to the SIC Regulations that govern the Deferred Compensation Plan (DCP). The Division presented those amendments and repeal of a liquidation section at the May SIC meeting. The amendments were published in the New Jersey Register and the comment period expired in September. No comments from the public were received and the SIC may now approve a resolution to adopt the amendments and repeal. Once approved, the amendments and repeal will be published in the New Jersey Register and become effective on the publication date.

Ms. Sarnowski also stated that the RFP has not yet been issued for the new plan administrator. While it is anticipated the DCP Board will not open the internal funds until such time as that plan administrator comes on board, the Division looks to have the adoption in place so that the Board can move ahead without delay when ready.

Chair Grady moved the adoption of the resolution adopting the amendments and repeal to N.J.A.C. 17:16-65, authorizing the Director to submit the attached notice of amendment and repeal to the Office of Administrative Law for publication and delegating to staff of the Council and the Division the authority to make revisions to the notice as required and upon advice of the Attorney General. A roll call vote was taken with Messrs. Grady, Hanson, Barrett, Byrne, Joyner, Haselmann, Maurer, Liebtag, McGuckin, Oram, Greaney, Cleary, Shivers and Dolan, constituting all Council Members present at the meeting, voting in favor of the resolution.

Fiscal 2012 Proxy Voting Summary

Chair Grady stated the Division’s proxy voting guidelines can be summarized in two words: Good Governance. The Division votes on a variety of issues. In the last fiscal year, the Division voted on over one thousand proxies on investments in the domestic portfolio, approximately five-hundred of which included votes against the company management on certain proposals. The Division also voted on over one thousand proxies on investments in the international portfolio, having voted against management on 557 proposals. Chair Grady believes this demonstrates a good governance record.

Director Walsh went on to say that the Division does spend a lot of time on its proxy voting. He, along with the Portfolio Manager, is copied on high profile or controversial issues and a discussion ensues before voting

Report from the Treasurer

There was no report from the Treasurer.
Public Comment

Mr. Miskowski, Secretary of CWA Local 1033, stated that he was attending the meeting with approximately 40 members of the local’s Pension Investment Education Committee, who had earlier that morning viewed the HBO movie “Too Big to Fail.” Mr. Miskowski stated that the 2008 fiscal crisis demonstrated the risk in investing in under regulated hedge funds and derivative contracts, and he reported that the Investment Committee of CWA Local 1033 endorsed, Senate Bill S. 1140, which prohibits the State of New Jersey from investing the assets of any pension fund under the management of the Division of Investment in hedge funds and derivative contracts, and directed him to deliver that message to the Council as well as the four Pension Boards.

Chair Grady commented that the Division invests very selectively in derivative contracts. Director Walsh elaborated that the Division uses derivatives such as exchange-traded options to control risk and futures to reduce or increase duration of the fixed income portfolio. Director Walsh noted that derivatives have been around since 1848 and are currently used by institutions such as the Federal Home Loan Bank and the United States Government. He stated that the Division used derivatives to control risk and he rejects any implication that Division staff would improperly use derivatives to introduce risk into the portfolio. Chair Grady went on to note that the Pension Funds’ hedge fund allocation represented a small portion of the overall portfolio and was spread across various investment partners and strategies as part of the Council’s overarching goal of diversification. He emphasized that the Division performs due diligence and screens for quality when selecting top quartile hedge funds, in furtherance of the goal of maximizing returns while maintaining an acceptable level of risk, further noting that the presence of hedge funds in the portfolio in fact helped to ameliorate the effects of the 2008 financial crisis. He promised that the Council would take the opportunity to learn about the bill, but expressed nervousness at the concept of legislators dictating asset allocation.

Vice Chair Byrne cautioned that the public should not be unduly frightened by financial headlines, which focus on outliers, and assured the public that staff was managing risk intelligently. He noted that the bill had no co-sponsor in the Senate and no companion bill in the Assembly, but stated that he along with certain Council members would be willing to sit down with any interested legislator to discuss the matter.

Council Member Haselmann then commented that hedge funds are less risky than other investments, noting that no hedge fund needed a bailout during the 2008 crisis, in part because they are able to hedge against changes in the market. He went on to say that hedge funds are important in reducing risk by providing the portfolio with exposure that is non-correlated to the portfolio’s equity and “hidden equity” exposure.
Chair Grady called on Maneck Kotwal to discuss the use of leverage in the hedge fund portfolio, and asked staff to provide more information on leverage at their next meeting.

Council Member Dolan inquired to what extent the Division staff could deploy hedge-fund type strategies in their investment activities.

Council Member Dolan speculated to what extent the Division staff could deploy hedge-fund type strategies in their investment activities. He questioned whether concerns regarding hedge fund investments are with the term “hedge fund” or the strategies employed by hedge funds.

Director Walsh concluded by referencing the presentation by Mr. Dennis from SIS at the prior Council meeting for the benefit of the absent Council members, emphasizing the point that Council members are fiduciaries representing all of the pension fund beneficiaries, and not just special interests.

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 2:17 pm.