New Jersey State Investment Council
May 27, 2015 Regular Meeting

Minutes of the Regular Meeting

Held May 27, 2015 at the Trenton War Memorial, George Washington Ballroom, 1 Memorial Drive, Trenton, New Jersey.

Council Members in Attendance:

Brendan T. Byrne, Jr., Chair
Marty Barrett
Michael Cleary
Charles Dolan
Michael Greaney
James Hanson
Guy Haselmann
James Joyner
Adam Liebtag, Vice Chair
Timothy McGuckin
Jeffrey Oram
Mitchell Shivers

Benjamin "Max" Hurst was unable to attend.

Roll Call and Meeting Notice

The Regular Meeting was called to order by Brendan T. Byrne, Council Chair, at 10:08 AM. Ernestine Jones-Booker, Council Secretary, performed roll call and reported that a quorum of the State Investment Council (Council) was present. Ms. Jones-Booker reported that notice of the Regular Meeting, scheduled for May 27, 2015, was posted on the website of the Division of Investment (the Division), faxed to the Times of Trenton, the Bergen Record, and the Courier Post, and e-mailed to the Secretary of State on April 23, 2015. A copy of the notice was posted at the Division and is on file.

Announcement of appointment of additional member to Investment Policy Committee

Mr. Byrne announced that he had appointed Adam Liebtag, Council Vice Chair, to the Investment Policy Committee (IPC). Mr. Liebtag attended the most recent IPC meeting.

Audit Committee report and presentation of FY2014 Pension Fund Financial Statements

Timothy McGuckin reported that the Audit Committee had met and that the FY2014 financial statements were finalized and published. He introduced John Megariotis of the Division of Pensions and Benefits (DPB), who presented the FY 2014 Pension Fund Financial Statements. Mr. Byrne inquired about the different assumed rates of return for TPAF versus PERS and PFRS, to which Mr. Megariotis responded that the funds have different system actuaries. Michael Cleary asked why there was no breakdown between the local and state funding ratios for PERS and PFRS. Mr. Megariotis discussed changes in GASB financial reporting requirements and stated that GASB 67 required the numbers to be reported on a combined basis. He said that a breakdown of the numbers may be found on an informational basis on the DPB website. Mr. Liebtag inquired regarding the allocation of administrative expenses. Mr. Megariotis responded that administrative expenses of DPB were allocated between the pension funds and non-pension funds administered by DPB, and then further allocated among the pension funds. Mr. Liebtag also asked about the timing of local government contributions. Mr. Megariotis responded that employers make annual contributions in April and May.

Jeffrey Oram asked if there was a breakdown of expenses between the Division and DPB. Mr. Megariotis offered to provide one upon request, but noted that DPB expenses were higher than Division expenses.

Minutes of Regular Meeting held March 25, 2015

Mr. Byrne presented for adoption the minutes for the regular meeting held March 25, 2015. Guy Haselmann made a motion to approve the minutes, with James Hanson seconding the motion. All Council Members present voted in favor, with the exception of Messrs. Cleary and Shivers, who abstained since they were absent from the March meeting.

Directors Report/Update

Director Chris McDonough and Deputy Director Corey Amon presented the Director's Report, providing a capital markets overview and an economic update. Mr. McDonough discussed fluctuations in the strength of the US dollar and oil prices, and their respective impacts on certain asset classes. Mr. Amon discussed economic and market conditions in the United States, Europe and China. Mr. Haselmann cautioned against chasing returns in response to governmental intervention in Europe and China. Mr. McDonough provided an update on the performance of the portfolio as a whole and specific asset classes year to date. He noted that the Fund is up 3.8% FYTD, which was 3 basis points ahead of the benchmark. Mr. McDonough noted that risk mitigation was the best performing asset class, and summarized recent changes to allocations to various asset classes.

Mr. Barrett arrived during the presentation.

Pursuant to the Council's Alternative Investment Modification Procedures, Mr. McDonough notified the Council of two hedge fund redemptions, including full redemptions from BlueCrest Capital and Regiment Capital due to disappointing performance. He reported that the Regiment fund is in the process of being liquidated.

Mr. McDonough announced that Brady O'Connell of Aon Hewitt had accepted another opportunity and that Kristen Doyle, who has worked with Mr. O'Connell on Fund matters, is expected to take on Mr. O'Connell's role at Council meetings. Chair Tom Byrne thanked Mr. O'Connell for his service to the Fund and wished him well.

Asset Allocation Discussion

Mr. McDonough and Mr. Amon discussed the FY16 asset allocation plan recommendations. Mr. McDonough stated there were slight changes to the proposal that was presented to the Council in March, noting specifically a smaller increase in the allocation to equity-related real estate based on an updated pacing analysis performed by the Division. Mr. Hanson asked the reason for the slowdown in the pace of real estate investments, to which Mr. Amon responded that fund managers are being disciplined as prices have increased, causing less capital to be called for new investments. Mr. Liebtag inquired about the use of capital distributed from real estate investments. Mr. McDonough said that this money is commingled with other cash flows which are used to fund, among other things, benefit payments. Mr. Liebtag also asked the time frame contemplated by the "long term" targets. Mr. McDonough replied that there was no fixed time contemplated, but that the idea was to give the Division flexibility to respond to market conditions. Mr. Shivers asked how the Division's expected return, Sharpe ratio, and volatility compare to other public pension funds. Mr. O'Connell replied that the proposed plan had similar assumptions to those of other public pension funds, and Mr. Haselmann commented that the Division's Sharpe ratio recently outperformed those of other public pension funds.

With respect to the proposed plan benchmarks, Mr. McDonough noted that the proposed benchmark used to evaluate the performance of the Police and Fire mortgage program was different than the benchmark used in prior years. Mr. Haselmann asked if there were alternative benchmarks to those being proposed, to which Mr. McDonough responded that there were alternatives, but the Division determined that the proposed benchmarks were the most appropriate. Mr. Shivers asked if the benchmarks being proposed were similar to those used by other similar plans. Mr. O'Connell responded that the proposed benchmarks were consistent with those used by other large, sophisticated institutional investors.

Mr. Liebtag asked for an explanation of an apparent increase in the allocation to alternative investments. Mr. McDonough noted that allocations to certain categories including real estate, private equity and hedge fund investments increased, but added that those categories also included investments that were not traditionally designated as "alternative investments," such as REITs and direct hedges. Mr. Barrett asked about the recent decision by CalPERS to eliminate portions of its alternative investment portfolio. Mr. Byrne explained that the CalPERS decision was directed at specific investments, and not a statement regarding alternative investments as a whole.

Mr. Shivers made a motion to adopt the FY16 asset allocation plan recommendations, with Mr. Haselmann seconding the motion. All Council members present voted in favor of the motion, except for Mr. Barrett and Mr. Liebtag, who abstained. Mr. Haselmann made a motion to adopt the proposed plan benchmarks, with Mr. Oram seconding the motion. All Council members present voted in favor of the motion.

Alternative Investments Sourcing Overview

Mr. McDonough and Jason MacDonald of the Division outlined the Division's alternative investment sourcing process. Mr. Hanson expressed concern regarding concentration risk, in response to which Mr. McDonough responded that the Division attempts to balance the benefits of diversification with the risks of over-diversification. Mr. Dolan asked if the Division inquires about regulatory investigations of fund managers, to which Mr. MacDonald responded in the affirmative. Mr. Haselmann commented that it was important that the Division has the resources (including sufficient staff and competitive salaries) to perform its duties, and Mr. Liebtag suggested the Division consider doing a resource analysis. Mr. Byrne recommended that the matter be discussed in detail during the next IPC Meeting.

Selection of External Investment Advisers for International Developing Markets Equity and International Small Capitalization Equity

Mr. McDonough provided a summary of the bidder selection and evaluation process for international developing markets equity advisers and international small capitalization equity advisers. Mr. McDonough reported that the Division had selected nine advisers for developing markets and three advisers for small cap pursuant to the Council's procurement procedures for advisers and consultants. Mr. Liebtag inquired whether adding advisers would increase costs to the Division, to which Mr. McDonough responded that an increase in costs is possible, but that the increase would be offset by lower costs related to reduced reliance on international ETFs.

Och-Ziff Relationship – Separate Accounts and Fund Investments

Mr. McDonough and Meghna Desai of the Division presented a $900 million aggregate investment in various Och-Ziff funds, including an additional commitment of $300 million to OZSC II, L.P.; an additional commitment of $200 million to OZNJ Private Opportunities, L.P.; an additional commitment of $100 million to OZNJ Real Estate Opportunities, L.P.; and an additional commitment of $100 million to OZNJ Real Asset Opportunities, L.P. The remainder of the $900 million would be comprised of a $100 million commitment to OZ Energy Partners and a $100 million commitment to Och-Ziff Real Estate Credit Fund. Ms. Desai stated the Division is recommending these investments based on Och-Ziff's history of strong returns, the fit of the investment opportunities into the Division's overall portfolio, and its favorable fee structure. At Mr. Dolan's request, Ms. Desai explained how the hurdle rate is implemented. There was a general discussion of fees, with Mr. Haselmann and Mr. Oram encouraging critics to view the fees in the context of the entire portfolio, and Mr. Byrne noting for the record that the Division's staff, while underpaid, has been working hard to negotiate favorable fees for the beneficiaries. Mr. Liebtag inquired regarding the term of the investment, with Ms. Desai responding that the investment was for a five year renewable term, terminable with one year's notice. Mr. Byrne reported that the Investment Policy Committee discussed the investment and was satisfied that the due diligence that was performed was adequate and appropriate. He also reported that Mr. Oram recused himself from discussion of the Real Estate portion at the IPC and Council meetings.

Private Equity Investment

RRJ Capital Master Fund III, L.P.

Mr. MacDonald and Faraz Shooshani of SIS presented an investment of up to $150 million in RRJ Capital Master Fund III, L.P., a global investment fund providing the Division with direct access to the pan-Asia region. Mr. MacDonald reported that the Division recommends this investment due to its strong performance, experienced team, exit discipline, proven sourcing capabilities, and significant GP commitment. Mr. Byrne reported that the Investment Policy Committee discussed the investment and was satisfied that the due diligence that was performed was adequate and appropriate.

Real Estate Investment

TPG Real Estate Partners II, L.P.

Mr. MacDonald presented a $125 million investment in TPG Real Estate Partners II, L.P., reallocated from its existing commitment to TPG/NJ RE Partnership, L.P. Mr. MacDonald reported that the Division recommends this investment due to the real estate team's strong past performance, strategy diversification within the Division's portfolio, and favorable negotiated fee terms. Mr. Byrne reported that the Investment Policy Committee discussed the investment and was satisfied that the due diligence that was performed was adequate and appropriate. Mr. Oram recused himself from discussion of this investment at the IPC and Council meetings.

Procedures and Regulations

Report of Soft Dollar Expenditures/Brokerage Commission

Director McDonough reported on the Division's soft dollar expenditures, which are payments made to acquire certain services and systems critical to trading and research functions. These types of arrangements are governed by the Securities and Exchange Act of 1934. Mr. McDonough reported that expenditures are expected to increase from FY14 to FY15, primarily due to increased technology costs incurred as the Division's trade order management system moves to a cloud based system.

JLL Partners V, L.P. Investment in ACE Cash Express Inc.

Mr. McDonough discussed recent media reports regarding a 2006 investment by JLL Partners V, L.P. ("JLL V") in ACE Cash Express Inc. Mr. McDonough noted that the Division had invested in JLL V in 2005. Chair Byrne invited comment from those members of the public who had signed up to speak on this topic. Ms. Beverly Brown Ruggia and Ms. Phylliss

Salowe-Kaye of New Jersey Citizen Action described concerns with ACE Cash Express' lending activities, and asked the Division to divest from JLL V and to adopt a policy requiring socially responsible investments. Mr. Bruce Davis of the New Jersey NAACP stated his organization's opposition to the payday lending industry and asked the Council to divest from any investments that support that industry. Mr. Byrne reported that the Council had also received correspondence from Reverend Soaries of the First Baptist Church of Lincoln Gardens regarding the issue. After Council discussion, Mr. Byrne asked Mr. McDonough to explore various options that were discussed, including reviewing the Division's due diligence procedures, considering any possible policies or procedures with respect to socially responsible investing, monitoring the potential sale of ACE Cash Express by JLL V, and determining the viability of a secondary sale of New Jersey's interest in JLL V.

Update on Committee to Review Campaign Contribution Policy

As an update, Mr. Byrne mentioned that he was in the process of setting up a meeting of those Council members who had expressed an interest in participating on the committee reviewing the Council's campaign contribution policy.

Mr. Hanson left the meeting at this point.

Treasurer's Report

Dr. Cohen of the Treasurer's office provided an update on revenue forecasts for FY15 and FY16.

Public Comment

Denise Cole, Curt Hamilton and Trina Scordo of NJ Communities United expressed concerns about the State's investments in hedge funds, especially those funds owned in part by Wells Fargo Bank. Mr. Byrne acknowledged receipt of a memorandum from NJ Communities United prior to the meeting, and noted certain inaccuracies in the memorandum.

Adjournment

Mr. Byrne made a motion to adjourn the meeting, with Mr. Oram seconding the motion. All Council Members present voted in favor. The meeting was adjourned at 2:08 pm.