

New Jersey State Investment Council

September 16, 2014 Regular Meeting

Minutes of the Regular Meeting

Held September 16, 2014 at the New Jersey State Museum; Auditorium, 205 W State Street, Trenton, New Jersey.

Council Members in Attendance:

Robert Grady, Chair
Brendan T. Byrne, Jr., Vice Chair
Marty Barrett
Michael Cleary
Charles Dolan
Michael Greaney
James Hanson
Guy Haselmann
James Joyner
Adam Liebttag (joined at 10:53AM)
Timothy McGuckin
Jeffrey Oram
Benjamin "Max" Hurst
Mitchell Shivers (via conference call)

Roll Call and Meeting Notice

The meeting was called to order by Robert Grady, Council Chair, at 10:08 AM. Ernestine Jones-Booker, Council Secretary, reported that notice of the Regular Meeting was posted on the Division's website, faxed to the Times of Trenton, the Star-Ledger, the Bergen Record, and the Courier Post, and e-mailed to the Secretary of State on August 26, 2014. Ms. Jones-Booker further stated that a copy of the notice was posted at the Division and was on file. Ms. Jones-Booker performed roll call and reported that a quorum of the SIC was present.

Minutes for Regular Meetings held on July 23, 2014

Mr. Grady presented for adoption the minutes for the regular meetings held on July 23, 2014. Mr. Grady made a motion to approve the minutes for the regular meeting held on July 23, 2014. Tom Byrne seconded the motion, and all Council Members present voted in favor.

Remarks by Chair

Mr. Grady cited a press release issued by the State Treasurer, announcing that the portfolio was up 16.9% for fiscal year 2014. He stated that the market value of the Fund, after payments to beneficiaries, was a very healthy \$80 billion, up from \$66 billion just four years ago. Mr. Grady commented that private equity was the best performing of the investment asset classes, up 26.3%, with US public equity and non-US developed market equity close behind at 26.2% and 23%, respectively.

Election of Chair and Vice Chair

Jeffrey Oram, Chair of the Nominating Committee, reported that the Nominating Committee, consisting of himself, Guy Haselmann and Timothy McGuckin, met telephonically on September 11th and decided unanimously to nominate Mr. Grady to continue to serve as Chair and Mr. Byrne to continue serve as Vice Chair of the Council. On a roll call vote, all members of the Council voted in favor of Mr. Grady's election as Chair, with the exception of Adam Liebttag, who was

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absent, and Mr. Grady, who abstained from voting. On a roll call vote, all members of the Council voted in favor of Mr. Byrne's election as Vice Chair, with the exception of Mr. Liebttag, who was absent, and Mr. Byrne, who abstained from voting.

Appointments of Members to Council Committees

Mr. Grady made the following appointments to Council Committees:

Executive Committee: Mr. Grady reappointed Mr. Byrne, Mr. Haselmann, Mr. McGuckin, Mr. Oram, and himself to continue to serve on the Executive Committee of the Council.

Investment Policy Committee: Mr. Grady reappointed Mr. Byrne, Mr. Haselmann, Mr. McGuckin, Mr. Oram, and himself to the Investment Policy Committee.

Audit Committee: Mr. Grady reappointed Mr. McGuckin as Chair of the Audit Committee and also reappointed James Hanson, Michael Greaney, and Michael Cleary to the Audit Committee.

Director's Report/Notifications

Director Chris McDonough provided a brief report on Pension Fund performance, announcing a Fiscal Year 2014 return of 16.9%, and a 20 year return of 8.8%. Mr. McDonough noted that private equity, US and developed non-US equities, global diversified credit and real estate were among the best performing of asset classes within the portfolio, while government bonds, cash and absolute return hedge funds were a drag on performance. Mr. McDonough acknowledged that the Council's change in asset allocation away from treasuries and investment grade credit into equity and alternative investments had a positive effect on performance over the past four years.

Mr. McDonough reported that the returns as of June 30, 2014 were ahead of the benchmark for both the fiscal year and for the 3, 5, and 10 year periods. Brady O'Connell of HEK explained the use of benchmarks by funds generally in determining performance on both an absolute and relative basis. Mr. Haselmann complimented the Division and Council for diversifying the portfolio in a manner that created more robust returns with less risk. Mr. Grady explained the rationale for the Fund's overweight cash position.

Brian Arena and Karen Paardecamp of the Division gave an overview of the global equity portfolio. In response to Mr. Haselmann's inquiry about the Division's reaction to increased volatility based on the Scottish secession vote and related separatist movements in Europe, Ms. Paardecamp responded that the developed market portfolio mostly tracks the benchmark with only a few adjustments at the margins. Mr. Haselmann also asked how the Division handled shifts in companies' non-domestic revenues when determining geographic diversification. Ms. Paardecamp responded that it remained a challenge for both the Division and for benchmark providers, and Mr. Arena stated that the recent consolidation of global public equity holdings from multiple common pension funds to a single common pension fund has been helpful in that regard. In response to a question from Mr. Byrne regarding the discrepancy in performance between the S&P and Russell indices, Mr. Arena discussed various potential reasons for this variance. Mr. Grady, Mr. Byrne and Mr. Oram complimented Division staff for its ability to outperform the benchmarks without taking undue risks.

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Jason MacDonald of the Division presented an overview of the Fund's private equity portfolio. Mr. Grady asked for the Fund's current allocation to private equity, and Mr. MacDonald responded the allocation was 8.7%. Mr. O'Connell noted that this percentage was below the average for large public pension plans.

Mr. Liebtag joined the meeting at this point.

Mr. Grady welcomed Max Hurst to the State Investment Council as the new representative of the Public Employees Retirement System, and made a motion to thank Peter Maurer for his service, commitment, and individual contribution to the beneficiaries of the State pension systems and the people of the State of New Jersey during his term as a member of the New Jersey State Investment Council from July 2011 through June 2014. Mr. Oram seconded the motion, and all Council members present voted in favor.

Michael Wszolek and Mr. McDonough provided a macro investment market update. Mr. Grady, Mr. Haselmann and Charles Dolan expressed concern that the public equity markets would not continue to perform at current levels and advised caution in allocating assets to public equity going forward. Mr. Haselmann noted the additional benefit of an increased cash position, in allowing the Division to meet its payment obligations without selling into a distressed market and also to capitalize on opportunistic investments that may arise. Mr. McDonough also provided a further update on Pension Fund performance and portfolio positioning. He announced that the Division had procured Cliffwater as its hedge fund consultant.

In response to recent media reports, Mr. Cleary asked if the Division had a breakdown of investment fees paid. Mr. McDonough responded that this information is included within the annual report, and he agreed to make the information available to Mr. Cleary after the meeting. Mr. McDonough noted that there was an inconsistency among large public pension funds in the manner in which they report fees, with many of the plans reporting only management fees and not incentive or performance fees. Mr. McDonough stated that the Division includes both types of fees in its reports for hedge fund managers. He also said that this difference in reporting has led many to believe that the Division was paying higher than average management fees, which he did not believe was true. Mr. Haselmann and Mr. Dolan expressed their support of paying incentive-based fees, especially when they are combined with hurdle rates, and said the focus should be not on fees alone but instead on returns net of fees. Mr. Byrne pointed out that it is impossible to invest in private equity without paying some sort of fee.

Mr. McDonough notified the Council of a change in terms of the Division's investment in Value Act Capital Partners II, LP. The initial lockup had expired, and the Division elected to maintain its investment in a share class with a 6 percent hurdle rate (down from the initial 8 percent) in return for annual liquidity. The management fee remained the same. Mr. McDonough also notified the Council of the acquisition of Aether Investment Partners, LLC, the management company of Aether Real Assets III, L.P. and Aether Real Assets III, L.P. Surplus, by Northern Lights Capital Group and Treasury Group Limited. The Division consented to the acquisition, because the key employees of Aether Investment Partners will retain primary control over the day-to-day operations of the Aether funds.

Finally, Mr. McDonough notified the Council of the sale of the Division's investment in General Catalyst Group VI, L.P. to Washington University on September 5, 2014. Mr. McDonough reported that after being contacted by a potential purchaser, the Division solicited bids from a number of interested parties, with Washington University offering the

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highest price. It agreed to acquire the Division's interest in General Catalyst at a 5% premium to its net asset value (NAV) as of March 31, 2014, allowing the Division to recoup a multiple of 1.46 on its initial investment, with a 37% net IRR.

Mr. Liebtag expressed his view that the Treasurer's investigation into the reported political contributions by Charlie Baker should continue to its conclusion, regardless of the sale of the Division's interest in General Catalyst. Mr. Liebtag stated that it would be informative to both the Council and the investment management community regarding the application and interpretation of the Council's regulations regarding political contributions. He acknowledged that the Division profited from the General Catalyst investment, but noted that General Catalyst also benefited from the Division's investment through the receipt of management fees, regardless of the sale. Mr. Barrett concurred with Mr. Liebtag and stated that he was looking forward to reviewing the report when completed. Mr. McDonough and Mr. Grady stated that neither was informed that the investigation would be discontinued, and Mr. McDonough agreed to bring their concerns to the attention of the Treasurer.

Mr. Grady introduced Dr. Roger Cohen as the Treasurer's designee to the State Investment Council, and summarized for his benefit the Council's prior discussion regarding General Catalyst.

Private Equity Investment

Hellman and Friedman Capital Partners VIII, L.P.

Meghna Desai of the Division along with Faraz Shooshani of SIS presented a \$100 million investment in Hellman and Friedman Capital Partners VIII, L.P., a fund focused on large-scale, private equity investments in developed markets. Ms. Desai and Mr. Shooshani stated that the investment was being considered because of the firm's top quartile track record and its established investment team. Mr. Grady noted the strong performance of the Division's prior investment with Hellman and Friedman, and reported that the Investment Policy Committee reviewed the investment and determined that adequate and appropriate due diligence had been conducted.

Mr. Liebtag asked that the Council defer its review of the investment pending further review of political contributions made by Patrick Healy and Erik Ragatz to the Republican National Committee in 2012. Mr. Liebtag expressed his discomfort with the investment due to the perception of conflict of interest and lack of disclosure. Mr. McDonough responded that contributions to national committees were not intended to be covered by the Council's regulations, according to Council direction adopted in 2006. Mr. Liebtag was concerned that even if the national committees were not considered parties "organized in the State" under the Council's policy, the contributions could be seen to be indirect violations of the Council's policy, if they were made for the purpose of influencing State elections. Mr. Byrne and Mr. Haselmann expressed concern that there was a risk that the Division would miss the opportunity to make the investment if the Division waited until the next Council meeting. Mr. Liebtag asked for a legal interpretation of the Council rules, and asked whether the contributions at issue would have come up in the course of due diligence by the Division. Deputy Attorney General Pamela Morone stated that she did not have all of the facts and therefore could not comment on this particular case, but referred Mr. Liebtag to the language of the Council political contribution regulation that generally excludes from its scope any contributions made to national committees. Mr. McDonough added that the contributions would only have been discovered by Division staff if reported by the fund in its disclosure reports or if reported on the ELEC website.

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Mr. Haselmann expressed his concern that the Council should not be politicized, and criticized allegations against Mr. Grady by the media and by the AFL-CIO as politically motivated or misinformed. Mr. Liebtag concurred that politics has no place at the Council table, and reiterated his concern that the Council's rules regarding political contributions be better understood and, if necessary, amended to prevent investment managers from using the political process for their own benefit.

Mr. Grady directed staff to complete its due diligence on the investment, including a review of the contributions discussed by Mr. Liebtag, and report back to the Council with its conclusions. Upon receipt of this report, members of the Council could request a special meeting if they wished to discuss the investment further.

Real Estate Investment

True North Real Estate Fund III, L.P.

Jason MacDonald of the Division and Dan Kriviskas of R.V. Kuhns presented a proposed investment of up to \$100 million in True North Real Estate Fund III, L.P., a fund which focuses on opportunistic debt and equity investments with an emphasis on distressed real estate. They noted the attractive opportunities in the commercial real estate debt market, the firm's conservative debt utilization, and the attractive below-market terms being offered. Mr. Grady reported that the Investment Policy Committee discussed the investment and determined that the due diligence that was performed was appropriate. Mr. Oram recused himself on this investment both during IPC and SIC meeting.

Report on Sudan

Susan Sarnowski, Compliance Officer, reported that the Division filed the annual update to the Legislature required by the Sudan Divestment Law concerning the progress of divestment. She noted that the Division divested from three companies during Fiscal Year 2014.

Report on Qualified Independent Representative (QIR) Policy

Ms. Sarnowski reported that the Division obtained all required certifications from Division officers and employees in accordance with the Division's QIR Policy adopted by the Council last year, the purpose of which is to ensure compliance with the CFTC's business conduct rules and the Dodd Frank Act.

Treasurer's Report

Mr. Cohen of the Treasurer's office provided an update on New Jersey economic conditions.

Adjournment

Mr. Grady made a motion to adjourn the meeting, with Mr. Haselmann seconding the motion. All Council members present voted in favor. The meeting was adjourned at 11:52 am.