

**Testimony of Jim Marketti, Representative of the
Public Employee Committee, New Jersey AFL-CIO on the
State Investment Council**

N.J. Senate Budget and Appropriations Committee, November 24, 2008

My name is Jim Marketti and since September 26, 2008, I have represented the Public Employee Committee of the New Jersey AFL-CIO on the State Investment Council. I am not an investment professional. For forty years I was a union activist and union officer, most recently President of CWA Local 1032. I retired October 31, 2008. From 1996, I served as Co-Chair of the NJ Communications Workers of America Pension and Investment Committee. I monitored the activities of the NJ Division of Investments for more than a dozen years. I am more attuned than many to the attitudes of state and local government workers towards the investment policies of the Division of Investment which affects the security of their pensions.

I am one of the two newest members of the State Investment Council. It is with this limited experience as an engaged layman that I appear before you today to offer this testimony on the investment policies of the Division of Investment.

This special hearing was called because of public comment about three hedge fund purchases by the Division in the individual sums of \$49,500,000. State Investment Council policy does not require the Council to make prior review of such purchases below \$50,000,000. In the month of October, 2008 investment report of William Clark, Director of the Division of Investment to the Council, Exhibit 24 reports that 19 of the 20 largest total purchases and sales for alternative investments were for less than \$50,000,000. Collectively, these 19 purchases in the month of October accounted for \$361,300,000 of investments. The twentieth listed purchase of Blackrock Credit Co-Investment for \$144,000,000 was actually broken into two transactions: \$49,500,000 was purchased without prior review and \$94,000,000 was brought to the Council in October before the transaction was made. So, in reality, 20 out of 21 purchases totaling \$410,800,000 were made without prior Council review.

I do not know how this policy was established. It was established prior to my coming on to the Council. However, a policy which permits the Division to make more than 80% of its alternative investments without prior review is a bad policy.

More to the point, you should be clear what a review by the State Investment Council really means. After my appointment to the Council, in my very first meeting with the Council Chair, Mr. Orin Kramer, and with Mr. Clark, I was emphatically informed that “nothing in the law requires Mr. Clark to comply with a decision of the Investment Council” (even a majority decision) with regard to an investment decision. The Investment Council’s discussions are informative but also advisory.

In fact, real discussions and votes on investment decisions are not made by the entire Council. An Investment Committee made up of five members of the Council and Mr. Clark meet monthly to review proposed investments. They report their decisions to the Council who in my short experience, approve their decisions pro forma. I know this because at the two Council meetings I have attended I have intervened during the brief discussion of the Committee’s recommendations to state that I wanted to go on the record as opposed to the proposed investments. No formal vote is held by the Investment Council on the recommendations of the Investment Committee.

The Investment Committee, I am informed, reviews the due diligence reports of the various consultants hired by the Division to review the proposed investments. I am informed that there is some discussion of the investments and the Committee makes a decision. Because this Committee is made up of a minority number of the Council, the meetings are not open to the public and no formal minutes are taken of their discussions. I have been given access to the due diligence reports relied on by the Committee (by making a special request and then coming to the Division’s offices on my own time prior to the Council meetings). However, I am still in the dark as to who is steering the proposed investments to the Division, Committee and Council, and am not enlightened by any discussions in depth of the proposed investments.

The lack of transparency in this process is self-evident. It is my belief that this structure was established when the Council and Division established its Alternative Investment program. By keeping the public (and indeed the majority of the Council) in the dark about the details of the investments, the effect is to avoid public discussion, hearing and controversy about these investments.

I am opposed to the Division's Alternative Investment program. In two meetings of the Council, I have gone on record as opposing five alternative investment proposals – hedge fund and private equity investments. My opposition is based on my belief that the alternative investments have not shown by actual results that they will add positive value to the pension portfolio. The hedge fund portfolio, for example, has lost 14.3% of the initial investments since its inception in 2006 – more than \$500 million. These alternative investments (hedge funds, private equity, real estate, commodities, emerging markets, and junk bonds) now make up 18% of the pension fund portfolio. The alternative investments are on track to grow to 28% of the portfolio. Adding to the cost of any losses resulting from those funds are the \$150 million paid to managers of the funds since the introduction of the alternative investment program in 2006. I believe firmly that the Alternative Investment program has gone too far too fast, has had meager results but at great expense.

To date, I am the only member of the Investment Council to be on record as opposed to the alternative investments. I will state that the other members of the Investment Council have given me a full and respectful hearing of my views. So far, no other member of the Council has publicly agreed with my position. However, I am only two months into my term.

There is one other substantive issue which I believe must be brought to your attention. I will step carefully here for reasons which will become obvious to you. Shortly after my appointment to the Council, I asked to review the contracts between the Division of Investment and the hedge fund operators. A time was scheduled by the Division for me to come to review the contracts. I was ushered into a room where 39

large binders of contracts were displayed – each 200 to 400 pages of contract material. I was reminded that I had signed an acknowledgement and agreement of confidential information and informed that these contracts were confidential to protect certain proprietary information of the fund operators. I managed to read three of the agreements. Those were enough for me to see certain patterns in the agreements which I found discomfoting.

I would urge you to authorize an independent review of the contracts for all alternative investments. I am not talking about the routine review of the Attorney General's representative regarding legal issues. You need a review conducted by an independent security analyst who specializes in contract issues. The questions which need to be answered are first, whether the contracts permit sufficient supervisory authority by the Director of the Division of Investment over the investments made by those funds. My reading of the contracts indicates that the Director has just three choices: whether to buy, whether to sell and whether to sue over decisions made by the funds. Second, you need to review the contracts to determine whether the investment strategies permitted to the General Partners of the funds are appropriate for pension fund investments. Many of them, I believe, are strategies that the Director would not engage in with direct investments of the pension funds. I know this because at the November Investment Council meeting, the Director listed numerous investment strategies which the Division did not and would not engage.

What disturbs me is that the investment strategies in which the Division Director would not engage as a "prudent investor" are the stock in trade of many of the hedge funds operators. The Blackrock Credit Investors fund, for instance, which recently came back to the Council for bail-out money, got itself into trouble by leveraging its initial investments with borrowed money. My question is how does the contracting out the investment dirty work free the Director from the "prudent investor" standard?

Hedge Funds are basically unregulated mutual funds. It is no accident that most are licensed to do business in the Cayman Islands – outside the reach of the Securities

and Exchange Commission. We should hope that the Division of Investment and the State Investment Council would take as much care to preserve the capital in the pension funds of hard working state and local government workers, teachers, police and firemen as it is taking in the care and feeding of hedge fund managers. It is up to you as elected representatives of the taxpayers and government workers to ensure that they do so. I would suggest that greater Legislative oversight in the form of guidelines and restrictions for the Division of Investment and the State Investment Council is in order.