SENATE, No. 1509

STATE OF NEW JERSEY

218th LEGISLATURE

INTRODUCED FEBRUARY 5, 2018

Sponsored by:
Senator SHIRLEY K. TURNER
District 15 (Hunterdon and Mercer)

SYNOPSIS

Prohibits investment by State of pension and annuity funds in hedge funds and derivative contracts.

CURRENT VERSION OF TEXT

As introduced.

AN ACT prohibiting the investment by the State of pension and annuity funds in hedge funds and derivative contracts, and amending and supplementing P.L.1950, c.270.

BE IT ENACTED *by the Senate and General Assembly of the State of New Jersey:*

1. Section 11 of P.L.1950, c.270 (C.52:18A-89) is amended to read as follows:

11. a. Limitations, conditions and restrictions contained in any law concerning the kind or nature of investment of any of the moneys of any of the funds or accounts referred to herein shall continue in full force and effect; provided, however, that subject to any acceptance required, or limitation or restriction contained herein: the Director of the Division of Investment shall at all times have authority to invest and reinvest any such moneys in investments as defined in subsection c. of this section and, for or on behalf of any such fund or account, to sell or exchange any such investments.

b. In investing and reinvesting any and all money and property committed to the director's investment discretion from any source whatsoever, and in acquiring, retaining, selling, exchanging and managing investments, the Director of the Division of Investment shall exercise the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. In making each investment, the director may, depending on the nature and objectives of the portfolio, consider the whole portfolio, provided that, in making each investment, the director shall act with the reasonable expectation that the return on each investment shall be commensurate with the risk associated with each investment. The director shall be under a duty to manage and invest the portfolio solely in the interests of the beneficiaries of the portfolio and for the exclusive purpose of providing financial benefits to the beneficiaries of the portfolio.

c. For the purposes of this section, "investments" means and includes property of every nature, real, personal and mixed, tangible and intangible, and specifically includes, solely by way of description and not by way of limitation, bonds, debentures and other corporate obligations, direct and indirect investments in equity real estate, mortgages and other direct or indirect interests in real estate or investments secured by real estate, capital stocks, common stocks, preferred stocks, diversified pools of venture capital which otherwise could be made consistent with the standard

EXPLANATION – Matter enclosed in bold-faced brackets ⟦thus⟧ in the above bill is not enacted and is intended to be omitted in the law.

Matter underlined <u>thus</u> is new matter.

of care required by subsection b. of this section, common trust funds as defined in and regulated by sections 36 through 46 of P.L.1948, c.67 (C.17:9A-36 through 17:9A-46), repurchase agreements, securities loan transactions secured by cash, securities issued by the United States government or its agencies, or irrevocable bank letters of credit, whether directly or through a bank or similar financial institution acting as agent or trustee, mutual funds, and any other security issued by an investment company or investment trust, whether managed or not by third parties, registered under the "Investment Company Act of 1940," ⟦15 U.S.C.s.80a-1 et seq⟧ Pub.L. 76-768 (15 U.S.C. s.80a-1 et seq.). "Investments" does not mean and does not include derivative contracts and hedge funds as defined under subsection a. of section 2 of P.L. , c. (C.) (pending before the Legislature as this bill). No investment that is otherwise permissible under this subsection shall be considered to be unlawful solely because the investment is made indirectly or through a partnership, trust, or other legal entity.

(cf: P.L.1997, c.26, s.26)

2. a. (New section) As used in this section:

"Absolute return strategy" means an investment strategy with the goal of achieving consistent positive returns with less correlation to traditional performance benchmarks than long position only strategies.

"Derivative contract" means a financial contract whose value is based on the values of an underlying asset, reference rate, or index of asset values or reference rates that allows one party to transfer the financial risk of an exposure to another party. "Derivative contract" means and specifically includes, solely by way of description and not by way of limitation, financial instruments known as forwards, futures, options, and swaps.

"Hedge fund" means a firm, foreign or domestic, that provides investment management services to third parties, pursues an absolute return strategy, may use leverage as part of its investment strategy, does not offer the placement of investments in the hedge fund to the general public, and charges performance-based fees as part of its remuneration. "Hedge fund" includes a domestic "investment company," as defined in Section 3(a)(1) of the "Investment Company Act of 1940," Pub.L. 76-768 (15 U.S.C. s.80a-3), that claims an exemption under Section 3(c)(1) or Section 3(c)(7) of that act and whose offering of securities is deemed to be transactions not involving any public offering under Section 230.506 of title 17, Code of Federal Regulations and Section 4(a)(2) of the "Securities Act of 1933," Pub.L. 73-22 (15 U.S.C. s.77d).

"Long position only strategy" means an investment strategy that relies on the expectation that an asset in which the investor places moneys will rise in value.

b. Notwithstanding any provision of law to the contrary, no assets of any pension or annuity fund under the jurisdiction of the Division of Investment in the Department of the Treasury, or its successor, shall be invested in any derivative contract or hedge fund.

c. The State Investment Council and the Director of the Division of Investment shall sell, redeem, divest or withdraw any investment held in violation of subsection b. of this section. This section shall not be construed to require the premature or otherwise imprudent sale, redemption, divestment or withdrawal of an investment, but such sale, redemption, divestment or withdrawal shall be completed not later than three years following the effective date of P.L. , c. (C.) (pending before the Legislature as this bill).

d. Within one year after the effective date of P.L. , c. (C.) (pending before the Legislature as this bill (pending before the Legislature as this bill) the Director of the Division of Investment shall file with the Legislature, in accordance with section 2 of P.L.1991, c.164 (C.52:14-19.1), a report of all investments held as of the effective date that are in violation of subsection b. of this section. Every year thereafter, the director shall report on all investments sold, redeemed, divested or withdrawn in compliance with subsection c. of this section.

Each report after the initial report shall provide a description of the progress that the division has made since the previous report and since the enactment of P.L. , c. (C.) (pending before the Legislature as this bill) in implementing subsection b. of this section.

e. State Investment Council members and State officers and employees involved therewith, shall be immune to any legal or disciplinary action arising from their decision to reduce or eliminate investments pursuant to P.L. , c. (C.) (pending before the Legislature as this bill).

3. This act shall take effect immediately.

STATEMENT

This bill prohibits the State of New Jersey from investing the assets of any pension or annuity fund under the management of the Division of Investment in the Department of the Treasury in hedge funds and derivative contracts. The division has up to three years to complete the divestiture of holdings in prohibited investments that predate the enactment of this legislation.

The 2008 financial meltdown has brought to light the enormous risks that investors take when they dabble in under-regulated hedge funds and derivative contracts. Hedge funds suffered debilitating losses when credit markets dried up. Since the investment strategy of many hedge funds relies on the availability of cheap credit, the credit crunch tore asunder the foundation of many highly leveraged hedge funds. The derivative market fared no better, as derivative contracts turned out to have been largely unsecured. American International Group Inc. (AIG), a major player in the scantily regulated derivatives market, did not even remotely have the financial wherewithal to meet its obligations when the assets underlying its derivative contracts soured. A massive bailout of AIG by the federal government staved off a complete collapse of the derivative market and the global financial system.

Considering the horrid events of the fall of 2008, it has become abundantly clear that the fiduciary responsibility of the State of New Jersey is incompatible with investing pension and annuity funds in exceedingly risky and poorly supervised hedge funds and derivatives. This assessment holds true notwithstanding the real regulatory improvements ushered in by the ‘‘Dodd-Frank Wall Street Reform and Consumer Protection Act’’ of 2010.