

ASSEMBLY, No. 654

STATE OF NEW JERSEY

214th LEGISLATURE

PRE-FILED FOR INTRODUCTION IN THE 2010 SESSION

Sponsored by:

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SYNOPSIS

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

CURRENT VERSION OF TEXT

Introduced Pending Technical Review by Legislative Counsel



(Sponsorship Updated As Of: 5/7/2010)

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

4
5 **BE IT ENACTED** *by the Senate and General Assembly of the State*
6 *of New Jersey:*

7
8 1. Section 11 of P.L.1950, c.270 (C.52:18A-89) is amended to
9 read as follows:

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

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

37 c. For the purposes of this section, "investments" means and
38 includes property of every nature, real, personal and mixed, tangible
39 and intangible, and specifically includes, solely by way of
40 description and not by way of limitation, bonds, debentures and
41 other corporate obligations, direct and indirect investments in
42 equity real estate, mortgages and other direct or indirect interests in
43 real estate or investments secured by real estate, capital stocks,

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 thus is new matter.

1 common stocks, preferred stocks, diversified pools of venture
2 capital which otherwise could be made consistent with the standard
3 of care required by subsection b. of this section, common trust
4 funds as defined in and regulated by sections 36 through 46 of
5 P.L.1948, c.67 (C.17:9A-36 through 17:9A-46), repurchase
6 agreements, securities loan transactions secured by cash, securities
7 issued by the United States government or its agencies, or
8 irrevocable bank letters of credit, whether directly or through a
9 bank or similar financial institution acting as agent or trustee,
10 mutual funds, and any other security issued by an investment
11 company or investment trust, whether managed or not by third
12 parties, registered under the "Investment Company Act of 1940,"
13 【15 U.S.C.s.80a-1 et seq】 Pub.L.76-768 (15 U.S.C. s.80a-1 et seq.).
14 "Investments" does not mean and does not include derivative
15 contracts and hedge funds as defined under section 2 of P.L. ,
16 c. (C.) (pending before the Legislature as this bill). No
17 investment that is otherwise permissible under this subsection shall
18 be considered to be unlawful solely because the investment is made
19 indirectly or through a partnership, trust, or other legal entity.
20 (cf: P.L.1997, c.26, s.26)

21

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

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

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

34 "Hedge fund" means a firm, foreign or domestic, that provides
35 investment management services to third parties, pursues an
36 absolute return strategy, may use leverage as part of its investment
37 strategy, does not offer the placement of investments in the hedge
38 fund to the general public, and charges performance-based fees as
39 part of its remuneration. "Hedge fund" includes a domestic
40 "investment company," as defined in Section 3(a)(1) of the
41 "Investment Company Act of 1940," Pub.L.76-768 (15 U.S.C.
42 s.80a-3), that claims an exemption under Section 3(c)(1) or Section
43 3(c)(7) of that act and whose offering of securities is deemed to be
44 transactions not involving any public offering under Section
45 230.506 of title 17, Code of Federal Regulations and Section (4)(2)
46 of the "Securities Act of 1933," Pub.L.73-22 (15 U.S.C. s.77d).

1 “Long position only strategy” means an investment strategy that
2 relies on the expectation that an asset in which the investor places
3 moneys will rise in value.

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

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

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

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

32 e. State Investment Council members and State officers and
33 employees involved therewith, shall be immune to any legal or
34 disciplinary action arising from their decision to reduce or eliminate
35 investments pursuant to this act.

36
37 3. This act shall take effect immediately.
38
39

40 STATEMENT

41
42 This bill prohibits the State of New Jersey from investing the
43 assets of any pension or annuity fund under the management of the
44 Division of Investment in the Department of the Treasury in hedge
45 funds and derivative contracts. The division has up to three years to
46 complete the divestiture of holdings in prohibited investments that
47 predate the enactment of this legislation.

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

15 Considering the horrid events of the fall of 2008, it has become
16 abundantly clear that the fiduciary responsibility of the State of
17 New Jersey is incompatible with investing pension and annuity
18 funds in exceedingly risky and poorly supervised hedge funds and
19 derivatives.