<u>TREASURY - GENERAL</u>

STATE INVESTMENT COUNCIL

Purchase and Sale of International Currency

Proposed Amendment: N.J.A.C. 17:16-81.1
Proposed Repeal and New Rule: N.J.A.C. 17:16-81.3
Proposed Repeals: N.J.A.C. 17:16-81.2 and 81.4

Authorized By:	State Investment Council, William G. Clark, Director, Division of Investment
uthority:	N.J.S.A. 52:18A-91
Calendar Reference:	See Summary below for explanation of exception to calendar requirement.
Proposal Number:	PRN 2006-90

Submit comments by May 19, 2006 to:

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The agency proposal follows:

<u>Summary</u>

The proposed amendments, new rule and repeals to N.J.A.C. 17:16-81 are intended to conform the subchapter with changes being proposed elsewhere in this issue of the New Jersey Register to N.J.A.C. 17:16-20. Specifically, the amendments amend N.J.A.C. 17:16-81.1 to delete references to the "Approved List of International Governments" and to allow foreign exchange contracts involving the purchase or sale of any international currency in which Division assets are denominated.

The proposed amendments, new rule and repeals also rearrange sections of the subchapter to make the subchapter more readable and to be consistent with the structure of analogous subchapters. For example, the objective in N.J.A.C. 17:16-81.2(a) is

proposed to be deleted, in that it duplicates the purpose set forth in N.J.A.C. 17:16-81.3, which is in turn proposed to be moved to N.J.A.C. 17:16-81.1(a). Also, the limitation in N.J.A.C. 17:16-81.2(b) is proposed to be moved to N.J.A.C. 17:16-81.3(a).

The Council is also proposing to move the definitions from N.J.A.C. 17:16-81.4 to N.J.A.C. 17:16-81.1(b). At the same time, the Council is proposing to amend the definition of “foreign exchange contracts” to clarify that commercial banks may be chartered in either the United States or Canada, and to amend the definition of “hedging” to clarify that the purpose of hedging an asset denominated in currency other than United States dollars is to offset fluctuations in international currency that affect the value of such an asset.

Finally, to be consistent with analogous subchapters, the Council is proposing to add paragraph (c) to N.J.A.C. 17:16-81.1 to provide the Council with flexibility to approve foreign exchange contracts that would not otherwise be permitted under N.J.A.C. 17:16-81.1, on a case-by-case basis.

Because the Council is providing a 60-day comment period on this notice of proposal, this notice is exempt from the rulemaking calendar requirement pursuant to N.J.A.C. 1:30-3.3(a)5.

Social Impact

There will be no social impact from the proposed amendments, new rule and repeals.

Economic Impact

There will be a positive impact from the proposed amendments, new rule and repeals on participants in those pension and annuity funds eligible to invest in international assets. The amendments expand the ability of the Division to enter into hedging transactions to improve and protect the inherent returns of the international portfolio.

Federal Standards Statement

A Federal standards analysis is not required because the investment policy rules of the State Investment Council are not subject to any Federal requirements or standards.

Jobs Impact

The State Investment Council and the Division of Investment do not anticipate that any jobs will be generated or lost by virtue of the proposed amendments, new rule and repeals.

Agriculture Industry Impact

The proposed amendments, new rule and repeals will have no impact on the agriculture industry.

Regulatory Flexibility Statement

A regulatory flexibility analysis is not required, since the proposed amendments, new rule and repeals impose no requirements on small businesses as the term is defined in the Regulatory Flexibility Act, N.J.S.A. 52:14B-16 et seq., but regulate only the Director of the Division of Investment.

Smart Growth Impact

The proposed amendments, new rule and repeals are not anticipated to have an impact on the achievement of smart growth and implementation of the State Development and Redevelopment Plan.

Text of Changes

Full text of the proposal follows (additions indicated in boldface **thus**; deletions indicated in brackets **[t**hus**]**):

17:16-81.1 Permissible investments

(a) Subject to the limitations contained in this subchapter, the Director may enter into foreign exchange contracts for the **purpose of hedging a fund's international portfolio. Such foreign exchange contracts may involve the purchase or sale of**

international currency **[**of any of the countries listed on the Approved List of International Government and Agency Obligations Bonds or any other currency in which the obligations of those countries on the Approved List are denominated**]**.

(b) As used in this subchapter:

1. "Foreign exchange contracts" mean forward contracts to sell or buy a specified amount of a specified foreign currency at a rate fixed at the time of the transaction but with delivery at a specified future time, entered into with any commercial bank chartered in the United States or Canada having total assets of at least $US 2 billion; any United States broker-dealer (or subsidiary or affiliate thereof) having a net capital of at least $100 million; or any other foreign exchange counterparty approved by the Council.

2. "Hedging" means combining a long position in an asset denominated in a currency other than United States dollars with a short position in the international currency in which the asset is denominated in order to offset fluctuations in the value of the underlying asset attributable to international currency fluctuations.

(c) Notwithstanding the restrictions contained in (a) above, the Council may approve the entering into foreign exchange contracts on a case-by-case basis.

17:16-81.2 **[**Objectives**]** **Reserved**

[(a) With respect to international bonds, the objective of the hedging program is to improve and protect the inherent returns of the international portfolio.

(b) With respect to international stocks, the portfolio should be unhedged, except in such instances in which the Director believes that unusual circumstances exist in which hedging would serve to improve and protect the inherent returns of the international portfolio.**]**

17:16-81.3 Limitations

[(a) The following limitation applies to those investments permitted under N.J.A.C. 17:16-81.1:

1. The foreign exchange contract must be for the purpose of hedging the international portfolio.**]**

With respect to international stocks, the portfolio should be unhedged, except in such instances in which the Director believes that unusual circumstances exist in

<u>which hedging would serve to improve and protect the inherent returns of the international portfolio.</u>

[17:16-81.4 Definitions

The following words and terms, as used in this subchapter, shall have the following meanings, unless the context clearly indicates otherwise:

"Foreign exchange contracts" means forward contracts, to sell or buy a specified amount of a specified foreign currency at a rate fixed at the time of the transaction but with delivery at a specified future time, entered into with any U.S.-Canadian-chartered commercial bank having total assets of at least $2,000,000,000 or its equivalent in Canadian dollars (qualified bank); any U.S. broker-dealer (or subsidiary or affiliate thereof) having a net capital of at least $100,000,000 (qualified broker); or any other foreign exchange counterparty approved by the State Investment Council.

"Hedging" means combining a long position in an asset with a short position in the hedging instrument in order to offset fluctuations in the value of the underlying asset.**]**