



## State of New Jersey

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November 13, 2020

MEMORANDUM TO: State Investment Council

FROM: Corey Amon  
Director

SUBJECT: **Proposed Investment in Separate Account with Nephila Capital**

The Division of Investment (the “Division”) is proposing an investment of up to \$100 million in a separately managed investment vehicle (the “Fund”) to be managed by Nephila Capital Ltd. (“Nephila”). This memorandum is presented to the State Investment Council (the “Council”) pursuant to N.J.A.C. 17:16-69.9.

The Division is recommending this investment based on the following factors:

### **Exposure to investment strategy which offers uncorrelated returns and a differentiated source of return and alpha**

The Fund has an attractive return/risk profile, particularly in relation to credit investments. Returns are expected to have a low correlation to other investments in the Risk Mitigating Strategies Portfolio, as well as to public equity and fixed income investments. Historically, Nephila has outperformed during equity market dislocations due to uncorrelated returns. It is currently an attractive entry point due to recent reinsurance market dislocation from high insured losses, less available investor capital, and greater demand for protection. Additionally, there are higher reinsurance premiums and improved terms and conditions for privately negotiated trades.

### **Flexible customized mandate**

The Fund will combine investments in Catastrophe bonds (“Cat bonds”) along with other insurance-linked-securities (ILS) positions with an anticipated allocation of 50/50. The proposed structure provides several benefits, one of which includes exposure to reinsurance beta (Cat bonds) and reinsurance alpha (bespoke selection and structuring). The customized structure allows for liquidity due to the ability to trade Cat bond positions.

### **Stable, institutional firm with long term track record**

Nephila is one of the largest and most established ILS managers. The team has extensive experience in underwriting and trading in the sector. The firm has deep relationships with brokers, reinsurance companies and other counterparties. Nephila is registered with the US Securities and Exchange Commission (SEC) and Commodities Futures Trading Commission (CFTC).

**Alignment of interest and attractive terms**

Nephila possesses a diverse institutional investor base, with over 90% represented by pension funds. Nephila's partners have substantial GP commitment across Nephila's products and will invest in the Fund as well. The Fund features attractive terms with a 0.85% flat management fee and no performance fee.

A report of the Investment Policy Committee (the "IPC") summarizing the details of the proposed investment is attached.

Division Staff and its consultant, Cliffwater LLC, undertook extensive due diligence on the proposed investment in accordance with the Division's Alternative Investment Due Diligence Procedures.

As part of its due diligence process, staff determined that the Fund has not engaged a third-party solicitor ("placement agent") in the fundraising of the Fund.

Nephila has a formal ESG policy and formed an ESG Committee which consists of three members to guide decisions arising from the ESG policy and to supervise reporting and update the components of this policy over time. Nephila runs annual ESG trainings specific to each line of business to educate staff on relevant ESG issues and how to integrate ESG considerations into decision-making, messaging, counterparty selection and product design. Nephila has been a member of the Ceres Investor Network on Climate Risk and Sustainability since 2018, and one Board Member of Nephila has served on the Board of Ceres since 2011 (and as Chair since 2018). Nephila is to become a signatory to the United Nations Principles for Responsible Investment (UN PRI) and the United Nations Environmental Program Finance Initiative Principles for Sustainable Insurance (UNEP PSI).

Staff will work with representatives of the Division of Law and outside counsel to review and negotiate specific terms of the legal documents to govern the investment. A preliminary Disclosure Report of Political Contributions has been obtained in accordance with the Council's regulation governing political contributions (N.J.A.C. 17:16-4) and no political contributions have been disclosed. An updated Disclosure Report will be obtained at the time of closing.

Note that the investment is authorized pursuant to Articles 69 and 95 of the Council's regulations. The Fund is considered an Opportunistic Investment, as defined under N.J.A.C. 17:16-95.1.

A formal written due diligence report for the proposed investment was sent to each member of the IPC, and a meeting of the IPC was held on November 9, 2020. In addition to the formal written due diligence report, all other information obtained by the Division on the investment was made available to the IPC.

We look forward to discussing the proposed investment at the Council's November 18, 2020 meeting.

Attachment

## Opportunistic Funds

**Fund Name:** Separate Account with Nephila Capital

November 13, 2020

**Contact Info:** Marc Stern, 3811 Bedford Avenue, Suite 101, Nashville, TN 37215

**Fund Details:**

<b>Total Firm Assets (\$bil.):</b>	\$9.6 billion	<b>Key Investment Professionals:</b> Frank Majors - Mr. Majors is a Co-Founder of Nephila Capital Ltd. and is Managing Principal at its affiliate, Nephila Advisors LLC. He is also a Director of Nephila Capital Limited and Nephila Holdings Ltd. Mr. Major has been involved in all aspects of the business in 1997, but is currently focused on counterparty relations, risk management and firm strategy. Mr. Majors began his career as a reinsurance broker in New York in 1991 for Willcox (part of Johnson & Higgins and now Marsh). Mr. Majors left Willcox in April 1993 to join Willis Faber North America, Inc. ("WFNS"), an indirect subsidiary of Willis Group Ltd., being named Divisional Director in the Retrocession Division in July 1996. Prior to focusing full time on Nephila, his primary responsibility was developing and brokering alternative risk transfer contracts, including derivative-based and financial reinsurance agreements, for clients of various subsidiaries of Willis. While with Willis, Mr. Majors was appointed to the Chicago Board of Trade ("CBOT") Catastrophe Advisory Group, which facilitated the design of the first PCS Catastrophe Options. Greg Hagood - Mr. Hagood is a Co-Founder of Nephila Capital Ltd. and is a Managing Principal at its affiliate, Nephila Advisors LLC. He is also a Director of Nephila Capital Ltd. and Nephila Holdings Ltd. Mr. Hagood has also been involved in all aspects of the business since its inception in 1997, but is currently focused on investor relations, risk management and firm strategy. He began his career in 1993 when he joined Bear Stearns & Co. in New York where he managed the mortgage servicing desk. Mr. Hagood left Bear Stearns in 1997 to join Willis Group Ltd. in London to start specifically what is now Nephila Capital Ltd. He has been a licensed broker at Lloyd's of London.
<b>Strategy:</b>	Opportunistic	
<b>Assets in Similar Strategy (\$bil.):</b>	\$2.1 billion	
<b>Year Founded:</b>	1997	
<b>SEC Registration</b>	Yes	
<b>GP Commitment:</b>	1%	

**Investment Summary**

Nephila provides institutional investors with access to diversified exposures in the insurance, reinsurance and climate markets. Nephila is one of the largest and longest running ILS managers and the team has extensive experience in underwriting and trading in the sector. The firm also has deep relationships with brokers, reinsurance companies and other counterparties. Nephila has experience executing a variety of different types of transactions in the ILS market, including but not limited to exposure in the US hurricane market, US earthquake market, Japanese earthquake and typhoon markets and European wind market. Nephila's size and reputation allow for a greater number of private transactions and therefore, higher expected returns. Nephila offers a customized portfolio that combines exposure to Nephila's Catastrophe Fund with a cat bond index replication. The firm has a diverse institutional investor base, including a large number of pension funds. Nephila's founders, Frank Majors and Greg Hagood, have worked together for over 20 years and are the recognized industry leaders in reinsurance investing.

**Existing Fund**

	Nephila Pro Forma 50-50 Portfolio	Eurekahedge ILS Benchmark	HFRI Relative Value Benchmark
<b>1 Year</b>	4.00%	3.85%	0.40%
<b>3 Year</b>	0.98%	-2.79%	2.14%
<b>5 Year</b>	1.86%	0.03%	3.23%
<b>10 Year</b>	3.78%	2.39%	4.36%
<b>Since Inception</b>	5.66%	4.26%	5.04%
<b>YTD</b>			
<b>2020</b>	2.12%	2.26%	-1.84%

As of August 2020 Source of Returns - Cliffwater LLC

**Vehicle Information:**

<b>Fund Inception:</b>	1-Jan-21	<b>Subscriptions:</b>	Monthly
<b>Fund Size:</b>	up to \$100 million	<b>Redemptions (notice):</b>	Weekly/Quarterly (7 Days/ 90 days)
<b>Management Fee:</b>	0.85%	<b>Lock-up:</b>	None
<b>Profit Allocation:</b>	none	<b>Prime Broker:</b>	N/A
<b>Highwater Mark:</b>	none	<b>Administrator:</b>	MUFG Fund Services Limited
<b>Hurdle Rate:</b>	none	<b>Auditor:</b>	Deloitte Ltd.
<b>Admin Expenses:</b>	-25 bps (excluding setup costs)	<b>Legal Counsel:</b>	Willkie Farr & Gallagher LLP

**NJ AIP Program**

<b>Recommended Allocation (\$mil):</b>	up to \$100 million	<b>LP Advisory Board Membership:</b>	N/A
<b>% of Fund:</b>	99.00%	<b>Consultant Recommendation:</b>	YES
		<b>Placement Agent:</b>	NO
		<b>Compliance w/ Division Placement Agent Policy:</b>	N/A
		<b>Compliance w/ SIC Political Contribution Reg:</b>	YES

\*This review memorandum was prepared in accordance with the State Investment Council rules governing the Alternatives Investment Program and the policies and procedures related thereto.