



MINUTES

**Meeting of the Investment Committee
of the Board of Trustees of the
State Universities Retirement System
9:00 a.m., Thursday, April 24, 2014
The Northern Trust
181 West Madison Street, Madison Conference Room
Chicago, Illinois 60602**

The following Trustees were present: Mr. Craig McCrohon, Chair; Ms. Lindsay Anderson, Ms. Jacqueline Berger, Dr. John Engstrom, Mr. Paul R. T. Johnson Jr. (by audio conference), Mr. Andrew Matthews, Ms. Dorinda Miller, Mr. Peter Newell, Mr. Antonio Vasquez (by audio conference) and Mr. Mitchell Vogel (by audio conference).

Others present: Mr. William Mabe, Executive Director; Mr. Daniel Allen, Chief Investment Officer; Mr. Douglas Wesley, Deputy Chief Investment Officer; Ms. Kimberly Pollitt and Mr. Joseph Duncan, Senior Investment Officers; Ms. Lou Ann Fillingham, Investment Officer; Ms. Angela Lieb, Director of Member Services; Mr. Keith Johnson, SMP Manager; Ms. Marilyn Branson, Investment Governance and Compliance Officer; Ms. Lori Kern, Executive Assistant; Ms. Mary Pat Burns of Burke, Burns & Pinelli; Mr. Douglas Moseley, Ms. Kristin Finney-Cooke, Mr. Timothy McCusker and Mr. Kevin Cress of NEPC; Ms. Patti Somerville-Koulouris and Ms. Cristina Ilyes of the Northern Trust Company; Mr. William Suh of Northern Trust Risk Services; Mr. Jason Parks of Loop Capital; Mr. Julian Bostic of Neuberger Berman.

Investment Committee roll call attendance was taken. Trustee Engstrom, present; Trustee Figueroa, absent; Trustee Johnson, absent; Trustee Matthews, present; Trustee McCrohon, present; Trustee Vasquez, absent; Trustee Vogel, absent; Trustee Anderson, present.

APPROVAL OF MINUTES

Trustee Craig McCrohon presented the Minutes from the Investment Committee meeting of March 20, 2014. After referencing the long-form resolutions that were distributed regarding the Adams Street 2014 Global Fund and the Macquarie Infrastructure Partners III, L.P. Fund, Trustee McCrohon moved that:

- The Minutes from the March 20, 2014 Investment Committee Meeting be approved as presented subject to supplementation with the resolutions.

Trustee John Engstrom seconded and the motion carried with all Trustees present voting in favor.

Copies of the staff memorandums, entitled “Report from the March 20, 2014 Investment Committee Meeting” and “Investment Contracts Approved,” are incorporated as a part of these Minutes as [Exhibit 1](#) and [Exhibit 2](#).

CHAIRPERSON’S REPORT

Trustee McCrohon provided a short presentation in which he discussed the distinction between passive and active investment strategies, the concept of efficient market theory and the factors that have contributed to improved efficiency in the public markets.

Trustee McCrohon made the following motion shortly after Trustee Mitchell Vogel joined the meeting by conference call at 9:12 a.m.:

- That Trustees be allowed to participate via teleconference per §7(a) of the Open Meetings Act.

Trustee Dorinda Miller seconded and the motion carried with all Trustees present voting in favor.

CHIEF INVESTMENT OFFICER REPORT

Mr. Daniel Allen reported that total fund assets amounted to approximately \$16.7 billion as of March 31, 2014, and the investment return for the fiscal year as of March 31, 2014, is 13.4% net of fees. Mr. Allen also remarked on the differences between the current asset allocation policy targets versus the 2003 targets and he noted the increase in the level of alternative investments since then as well as the high allocation to passive equity that existed a decade ago. Trustee Peter Newell requested that Mr. Allen provide a copy of the asset allocation policy target comparison. Mr. Douglas Moseley remarked that NEPC’s position on passive investing varies according to asset class and while they believe active management can add value in most asset classes, talented managers must be identified and then hired at the right time. Mr. William Mabe also noted that alternative investments can present challenges for public pension funds where there is typically emphasis on transparency and increased scrutiny of fees.

(Educational Topic) DEFINED CONTRIBUTION (DC) INDUSTRY OVERVIEW AND SURS SELF-MANAGED PLAN (SMP) ANNUAL REVIEWS

The educational session commenced at 9:25 a.m., lasted for 1 hour and 30 minutes and concluded at 10:55 a.m.

Trustee Antonio Vasquez joined the meeting by conference call at 9:40 a.m.

Mr. Kevin Cress of NEPC presented an industry overview regarding defined contribution retirement plans and he advised that the Self-Managed Plan (SMP) is consistent with trends to simplify the fund menu of investment options, to move to institutional investment pricing and to monitor plan expenses. Mr. Cress also discussed emerging best practices and the annual NEPC DC Plan and Fee Survey results as well as material changes made by SMP providers over the past year, SMP investment performance and proposed initiatives for 2014. Discussion followed. Trustee Vogel inquired whether additional data on plan expense reimbursement accounts could be provided. It was noted that plan expense reimbursement account proceeds must be used for the benefit of the plan and Ms. Mary Pat Burns observed the importance of having the correct structure in place.

After the industry overview, the following representatives of the two SMP providers discussed the role of their firms, current trends for plan design optimization and key statistics related to the SMP:

- Fidelity Investments – Mr. Lou Gadoury
- TIAA-CREF – Ms. Eileen Finnegan

During the session, discussion centered on topics such as participant asset allocation decisions, effective and appropriate ways to provide education and the new defined contribution plan mandated by the pension reform legislation. Trustee Andrew Matthews expressed concern that participants should be provided more assistance to make educated decisions. The potential for reenrollment to address the problem of inertia as well as available methods and strategies for providing education to participants were considered. Mr. Mabe suggested that staff report back at the September meeting regarding participant demographics, outreach efforts, SMP provider contract terms and the providers' recommendations regarding the implementation of Public Act 98-599 or modification of its provisions. Other issues to be examined include the sufficiency of education provided at the time of plan choice, the legal definition of education versus advice, SMP staffing concerns and frequency of SMP provider searches.

After the discussion, Mr. Allen referenced the annual reviews of the SMP service providers, as well as the executive summary that was distributed, and he advised that staff recommends retention of Fidelity Investments and TIAA-CREF.

Trustee McCrohon made the following motions:

- That Fidelity Investments be retained as an investment service provider for the SURS Self-Managed Plan.
- That TIAA-CREF be retained as an investment service provider for the SURS Self-Managed Plan.

Trustee Engstrom seconded and the motions carried with all Trustees present voting in favor except for Trustee Lindsay Anderson who abstained.

Trustee Vasquez departed the conference call at 10:55 a.m.

Copies of the NEPC presentation, “DC Plan Industry Overview & Self-Managed Plan Review,” the Fidelity presentation, “Your Defined Contribution Retirement Plan: A Strategic Discussion,” and the TIAA-CREF presentation, “TIAA-CREF Overview for the State Universities Retirement System of Illinois,” are incorporated as a part of these Minutes as [Exhibit 3](#), [Exhibit 4](#) and [Exhibit 5](#). Copies of the staff memorandums, entitled “Fidelity Investments Self-Managed Plan (SMP) Annual Review,” “TIAA-CREF Annual Review” and “Fiscal Year 2013 Self-Managed Plan Review,” are incorporated as a part of these Minutes as [Exhibit 6](#), [Exhibit 7](#) and [Exhibit 8](#). A copy of the staff memorandum, “Executive Summary of the SMP Providers,” which was distributed is incorporated as a part of these Minutes as [Exhibit 9](#).

(Educational Topic) DISCUSSION OF THE ROLE OF PROGRESS INVESTMENT MANAGEMENT WITH THE SURS INVESTMENT PROGRAM

The educational session commenced at 11:15 a.m., lasted for 45 minutes and concluded at 12:00 noon.

Mr. Thurman White and Ms. Mona Williams of Progress Investment Management Company (Progress) discussed their firm’s focus on investing with emerging managers, and in particular, the manager of emerging managers program it provides for SURS, which consists of managers across various asset classes with up to \$10 billion in assets and that are at least 51% owned by minorities, women and disabled veterans (MFDB). Mr. White and Ms. Williams reviewed their firm’s approach to source and nurture new investment talent and to actively manage and monitor the program. The investment performance of the Progress program, the universe of emerging managers in alternative asset classes and the role of manager databases were also discussed. Trustee McCrohon noted the importance of the manager databases to SURS’ diversity program and he inquired whether Progress could provide additional data on the firms.

Trustee McCrohon also referenced the Fairview Capital Partners (Fairview) document that was distributed and discussion followed regarding the availability of emerging managers in the new asset classes under consideration. Mr. Moseley noted that while the asset allocation policy decision is fundamental, the goal would be to maintain the existing level of exposure to emerging managers. Mr. White agreed that today’s universe of emerging managers should serve to complement the policy determination and that the manager field will evolve over time. The role of the Fairview relationship with respect to private equity emerging managers was also briefly discussed.

The lunch break followed the educational session. Trustee Vogel departed the conference call at 12:00 p.m. and rejoined the meeting by conference call at 12:15 p.m.

A copy of the Progress presentation, “Manager of Emerging Managers Overview,” is incorporated as a part of these Minutes as [Exhibit 10](#). Copies of the Progress document, “MWBE Database Overview,” the Fairview report, “Emerging Manager Market Overview,” and the NEPC document that were distributed are incorporated as a part of these Minutes as [Exhibit 11](#), [Exhibit 12](#) and [Exhibit 13](#).

DISCUSSION OF SURS U.S. EQUITY ASSET CLASS ANNUAL REVIEW

Mr. Joseph Duncan provided an overview of the U.S. equity asset class for the year ended December 31, 2013. Approximately \$5.6 billion or 34.1% of the total fund was invested in U.S. equity as of December 31, 2013, with over 90% of the active U.S. equity and 46% of the total U.S. equity portfolio managed by MFDB investment managers. The total U.S. equity portfolio returned 34.08% for the calendar year 2013, with the overall active and structured active components exceeding the benchmark by a comfortable margin. Mr. Duncan also advised that the U. S. equity portfolio demonstrates lower standard deviation, lower tracking error and higher risk adjusted performance than the median for its peer group.

Ms. Kimberly Pollitt advised that retention of all of the U.S. equity managers except for Profit Investment Management (Profit) would be presented as a consent agenda. Profit was placed on the Watch List in June of 2013 due to performance, which has continued to lag compared to its benchmark and peer group. After discussing the firm's performance and organizational concerns in greater detail, Ms. Pollitt advised that staff and NEPC recommend termination and reallocation of the assets to the core fixed income managers in the Manager Diversity Program to reduce the current overweight to U.S. equity. Mr. Moseley concurred with the assessment to terminate.

A copy of the staff memorandum, entitled "U.S. Equity Asset Class Portfolio Review," is incorporated as a part of these Minutes as [Exhibit 14](#).

CONSENT AGENDA - U.S. EQUITY ASSET CLASS ANNUAL MANAGER REVIEWS

Trustee McCrohon presented the following motions, which were numbered 5 through 15, in the form of a consent agenda and he also noted that a long-form resolution pertaining to all of the U.S. equity managers was distributed.

Consent Agenda Topics

U. S. Equity Asset Class Manager Reviews

- That CastleArk Management be retained as a domestic equity manager.
- That Lombardia Capital Partners be retained as a domestic equity manager.
- That Fiduciary Management Associates be retained as a domestic equity manager.
- That EARNEST Partners be retained as a domestic equity manager.
- That Holland Capital Management be retained as a domestic equity manager.
- That Channing Capital Management be retained as a domestic equity manager.
- That Jacobs Levy Equity Management be retained as a structured active U.S. equity manager.
- That PIMCO be retained as a structured active U.S. equity manager.
- That Piedmont Investment Advisors be retained as a structured active U.S. equity manager.
- That T. Rowe Price Associates be retained as a structured active U.S. equity manager.

Manager of Emerging Managers Review

- That Progress Investment Management be retained as a manager of emerging managers.

Trustee Engstrom seconded the consent agenda and the motions carried with all Trustees present voting in favor.

Trustee McCrohon then moved:

- That Profit Investment Management be terminated as a domestic equity manager, with the assets reallocated in approximately equal amounts to the following fixed income managers in the Manager Diversity Program
 - Garcia Hamilton & Associates
 - LM Capital Group
 - Pugh Capital Management
 - Smith Graham & Co.

Trustee Vogel seconded and the motion carried with all Trustees present voting in favor.

The formal resolution reflecting the analysis provided in support of retention of the managers included in the consent agenda and in support of termination of Profit Investment Management is presented in Appendix A.

Copies of the staff memorandum, “Consent Agenda for the U.S. Equity Asset Class,” the SURS DB Plan Domestic Equity Composite Performance Detail, the staff memorandum, “Profit Investment Management Annual Review,” and the NEPC memorandum, “Termination Recommendation – Profit Small Cap Growth,” are incorporated as a part of these Minutes as [Exhibit 15](#), [Exhibit 16](#), [Exhibit17](#) and [Exhibit 18](#).

**(Educational Topic) REVIEW AND CONSIDERATION OF
ASSET / LIABILITY STUDY OUTPUTS**

The educational session commenced at 12:40 p.m., lasted for 1 hour and 25 minutes and concluded at 2:05 p.m.

Trustee Vasquez rejoined the meeting by conference call at 12:40 p.m. and Trustee Paul R. T. Johnson Jr. joined by conference call at 12:45 p.m.

Mr. Moseley introduced NEPC’s Chief Investment Officer, Mr. Timothy McCusker, who led the educational session regarding the outcomes of the Asset/Liability study. The session covered a number of financial concepts such as active versus passive investing, alpha and beta investment returns, volatility and other forms of risk, and correlations between asset classes. Mr. McCusker discussed in depth the asset allocation policy recommendations (Mix A and Mix B) resulting from the Asset/Liability study, projected impacts to plan liabilities and funded status, and scenario analyses of the performance of these policies as compared to the current policy under extreme economic market environments. Both Mix A and Mix B

would introduce allocations to emerging markets debt, commodities and hedged equity to the portfolio, which is expected to reduce risk overall while maintaining similar returns to the current policy, resulting in a more efficient portfolio. Mr. McCusker discussed the significance of the expected return assumption, which is currently 7.75%, and noted that he will follow up on Trustee McCrohon's request for additional data regarding the levels set by other public funds. Mr. McCusker also reviewed NEPC's general recommendations for 2014 as well as those specific for public funds.

During discussion of the proposed asset allocation mixes, tradeoffs, correlations, timing, alternative actions and other considerations were discussed at length. Trustee McCrohon requested feedback from the trustees regarding the asset allocation decision, which elicited differing opinions. At Trustee Engstrom's request for staff opinion, Mr. Allen suggested initiating the search for emerging markets debt and he advised preference for Mix A but noted that the final decision could be made in June. Trustee Matthews observed the concern surrounding hedged equity and recommended Mix A minus the allocation to hedged equity at present.

In order to narrow the decision, Trustee McCrohon moved:

- That the Board decide and select an asset allocation at the June 12, 2014 meeting.

Trustee Vogel seconded the motion. Disfavor emerged during the discussion and the motion did not carry as all Trustees present voted against except for Trustee McCrohon who abstained and Trustee Vogel who voted in favor.

Based on the staff recommendation and the sentiments expressed by the Board, Trustee Matthews proceeded to make the following motion which Ms. Burns formalized:

- That the strategic policy allocation target set forth in Mix A as recommended by the staff and the investment consultant be approved as amended to reflect that the 5% hedged equity portion would remain in equities until further direction of the Board.

Trustee Vasquez seconded the motion. Discussion followed regarding the disposition of the 5% portion that would not be assigned to hedged equity. Mr. Moseley concurred with the proposed motion but recommended that Mix A be adjusted so that the U.S. equity target is set at 26% and the non-U.S. equity target is maintained at 21%, reducing home-country bias in the portfolio. Concerns raised during the discussion with respect to hedged equity indicated desire for additional education and for advance communication with members and participants. Trustee Vogel suggested that a presentation be provided at the State Universities Annuitants Association's June meeting.

Consensus formed to accept the NEPC recommendation to source the combined 3% allocation to emerging markets debt and 2% to commodities entirely from U.S. equity, fixing the Total Equity portion of Mix A at 26% U.S. equity, 21% non-U.S. equity and 8% global equity as shown in the table on the following page.

Asset Class	Prior Policy Target	Mix A Target	Mix B Target
U.S. Equity	31%	26%	22%
Non-U.S. Equity	21	21	18
Global Equities	8	8	8
Total Equity	60%	55%	48%
Core Fixed Income	19	19	19
Emerging Markets Debt	0	3	5
TIPS	4	4	4
Total Fixed Income	23%	26%	28%
Private Equity	6	6	6
Real Estate	6	6	6
REITS	4	4	4
Hedged Equity	0	0	5
Opportunity Fund	1	1	1
Total Alternatives	17%	17%	22%
Commodities	0	2	2
Total Other	0%	2%	2%
Grand Total	100%	100%	100%

The motion to approve the Mix A Target shown in the above table then carried with all Trustees present voting in favor except for Trustee Vogel who voted against.

Trustee McCrohon also moved:

- That a search be conducted to identify qualified emerging markets debt managers.

Trustee Matthews seconded and the motion carried with all Trustees present voting in favor except for Trustee Vogel who voted against.

Copies of the staff memorandum, “Status Update of the Asset / Liability Study,” and the NEPC report, “Asset Liability Study,” are incorporated as a part of these Minutes as [Exhibit 19](#) and [Exhibit 20](#).

RECOMMENDATION OF OUTSIDE LEGAL COUNSEL

Ms. Burns reported that interviews for outside legal counsel were conducted with seven candidate firms on April 8 and 9, 2014, at the offices of Burke, Burns and Pinelli in Chicago. In addition to Ms. Burns, Mr. Allen and Mr. Michael Weinstein, Trustee Anderson and Trustee McCrohon participated in the interview process. Ms. Burns advised that it was decided to be in the best interest of SURS to recommend a group of three legal firms from which the investment team could choose at their discretion depending on the issue or the need to avoid conflicts of interest. Trustee McCrohon remarked that there was a strong consensus among those who participated for the firms selected, which were Jackson Walker L.L.P., Mayer Brown, and Chapman and Cutler L.L.P.

Trustee McCrohon moved:

- That Jackson Walker L.L.P., Mayer Brown, and Chapman and Cutler L.L.P. be retained as SURS Outside Legal Counsel, contingent upon successful contract negotiations.

Trustee Miller seconded the motion. Discussion of the fee structure followed. Ms. Burns advised that rates were provided; however, the fees will be negotiated and contracts executed with each firm. Furthermore, payment will only be due if and when a firm is engaged with no guarantee that any of the firms will be used. After the discussion, the motion carried with all Trustees present voting in favor.

Copies of the staff memorandums, "Status Update of Outside Counsel Search," dated April 11, 2014, and April 23, 2014, are incorporated as a part of these Minutes as [Exhibit 21](#) and [Exhibit 22](#).

INFORMATIONAL ITEMS NOT REQUIRING COMMITTEE ACTION

Trustee McCrohon referenced the informational items included in the agenda materials and he noted the list of conferences and training opportunities.

The following items were provided for reference and are incorporated as a part of these Minutes:

1. [Exhibit 23](#) - SURS Projected Funding Status through March 2014.
2. [Exhibit 24](#) - NEPC letter dated April 2, 2014, announcing new CIO appointment.
3. [Exhibit 25](#) - CastleArk letter dated April 4, 2014, announcing new CEO appointment.
4. [Exhibit 26](#) - Staff memorandum entitled "Investment Manager Watch List Update" updated January 29, 2014.
5. [Exhibit 27](#) - PIMCO leadership transition notification dated January 2014.
6. [Exhibit 28](#) - Staff memorandum entitled "December 2013 Investment Manager Watch List."
7. [Exhibit 29](#) - Investment Compliance Activities 2014.
8. [Exhibit 30](#) - Fiscal Years 2014-15 Summary Work Plan Investment Committee Schedule.
9. [Exhibit 31](#) - Schedule of Formal Reviews for SURS Investment Managers: Defined Benefit Plan & SMP.
10. [Exhibit 32](#) - Staff memorandum "Schedule of Investment Committee Meetings."

PUBLIC COMMENT

There were no public comments presented to the Investment Committee.

Since there was no further business before the Committee, Trustee McCrohon moved that the meeting be adjourned. The motion was seconded by Trustee Matthews and carried with all Trustees present voting in favor.

Respectfully submitted,

A handwritten signature in cursive script, appearing to read "William E. Mabe". The signature is written in black ink and is positioned centrally below the text "Respectfully submitted,".

Mr. William E. Mabe
Secretary, Board of Trustees

WEM:mb

RESOLUTION OF THE INVESTMENT COMMITTEE
STATE UNIVERSITIES RETIREMENT SYSTEM OF ILLINOIS
Adopted April 24, 2014

RECITALS:

1. The SURS Investment Policy, dated September 13, 2013 (the “Investment Policy”), Section VIII(D) (Investment Manager and Fund Monitoring), permits the Staff or Consultant to present managers to the Board for termination by the Board. The Investment Policy provides that the Staff may recommend “changes in funding for an investment manager, outside the rebalancing process.”
2. The Staff has elected to review the performance of each of its U.S. Equity securities managers, as identified in Schedule 1 to this Resolution (the “U.S. Equity Securities Managers”).
3. The Staff has reviewed the performance of the equity mandates and risk measures relative to performance benchmarks as deemed appropriate by the Staff. The Staff has further reviewed the turnover of key management of each of the U.S. Equity Securities Managers, changes in the total assets under management, and other factors identified in Sections VIII(D) and X (Investment Manager Termination Guidelines) of the Investment Policy. Selected information regarding such review has been presented to the Board for review and discussion.
4. Each manager is the subject of agreements permitting termination with less than 90 days notice.
5. The Staff recommends that, as of the date of this Resolution, SURS retain and not terminate the U.S. Equity Managers as listed in Schedule 1.
6. The Staff recommends that Profit Investment Management be terminated for investment performance, organizational concerns and limited growth in the number of accounts in the small cap growth strategy over time per Section X of the SURS Investment Policy (Schedule 2).
7. Capitalized terms used, but not defined, in this Resolution shall have the meanings given in the Investment Policy.
8. The Staff and Investment Consultant recommend the strategic policy allocation targets be approved as presented, giving staff the discretion to gradually implement those policy targets in coordination with the actual transition of assets.

RESOLUTIONS:

Now, Therefore, be it resolved as follows:

The Investment Committee of SURS recommends that the Board approve the retention, without additional funding, of the U.S. Equity Securities Managers by SURS and that SURS shall maintain its investments with the Equity Securities Managers. Such decision shall be subject to periodic or other review as the Staff or the Board may deem appropriate (Schedule 1).

The Investment Committee of SURS recommends that the Board approve the termination of Profit Investment Management by SURS. Reasoning for the decision includes investment performance, organizational concerns and limited growth in the number of accounts in the small cap growth strategy over time that is utilized by SURS (Schedule 2).

The Investment Committee of SURS recommends that the Board approve the strategic policy allocation targets as stated be approved as presented, giving staff the discretion to gradually implement those policy targets in coordination with the actual transition of assets.

The Investment Committee of SURS recommends that the Board approve a search to identify qualified emerging markets debt fixed income managers.

**SCHEDULE 1:
U.S. EQUITY SECURITIES MANAGERS**

CastleArk Management

Lombardia Capital Partners

Fiduciary Management Associates

EARNEST Partners

Holland Capital Management

Channing Capital Management

Jacobs Levy Equity Management

PIMCO

Piedmont Investment Advisors

T. Rowe Price Associates

Progress Investment Management

**SCHEDULE 2:
U.S. EQUITY SECURITIES MANAGERS**

Profit Investment Management