



MINUTES

**Meeting of the Investment Committee
of the Board of Trustees of the
State Universities Retirement System
1:00 p.m., Thursday, December 12, 2013
The Northern Trust
50 South LaSalle Street, London Room B9
Chicago, Illinois 60603**

The following Trustees were present: Mr. Craig McCrohon, Chair; Ms. Lindsay Anderson, Ms. Jacqueline Berger, Dr. John Engstrom, Mr. Richard Figueroa, Mr. Paul R. T. Johnson Jr., Mr. Andrew Matthews, Mr. Antonio Vasquez and Mr. Mitchell Vogel.

Others present: Mr. William Mabe, Executive Director; Mr. Michael Weinstein, General Counsel; Mr. Daniel Allen, Chief Investment Officer; Mr. Douglas Wesley, Deputy Chief Investment Officer; Ms. Phyllis Walker, Chief Financial Officer; Mr. Albert Lee, Associate General Counsel; Ms. Kimberly Pollitt and Mr. Joseph Duncan, Senior Investment Officers; Ms. Lou Ann Fillingham and Mr. Gabriel Ayoroa, Investment Officers; Ms. Marilyn Branson, Investment Governance and Compliance Officer; Mr. Steve Hayward, Director of Internal Audit; Mr. Jeffrey Houch, Legislative Liaison; Mr. Keith Johnson, SMP Manager; Ms. Lori Kern and Ms. Karen Hipskind, Executive Assistants; Ms. Mary Pat Burns of Burke, Burns & Pinelli; Mr. Douglas Moseley, Ms. Kristin Finney-Cooke and Mr. Kevin Leonard of NEPC; Ms. Leslie Thompson and Ms. Amy Williams of Gabriel Roeder Smith & Company; Ms. Angela Myers of Loop Capital.

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

APPROVAL OF MINUTES

Trustee Craig McCrohon presented the Minutes from the Investment Committee meetings of October 17, 2013. Trustee Andrew Matthews made the following motions:

- That the Minutes from the October 17, 2013 Executive Session be approved and remain closed, as presented.
- That the Minutes from the October 17, 2013 Investment Committee meeting be approved, as presented.

Trustee Paul R. T. Johnson Jr. seconded and the motions carried with all Trustees present voting in favor.

CHAIRPERSON'S REPORT

Trustee McCrohon remarked that the hearings held yesterday by the Senate Committee on Pensions and Investments went well and details of the event would be discussed later in the agenda. Trustee McCrohon also discussed the new reporting being developed to synthesize monthly investment data into a big picture format designed to assist the trustees in making informed decisions. Trustee McCrohon provided examples of the types of data and concepts involved and he invited the trustees to advise him of any comments.

A copy of the example document that was distributed, "Selected SURS Statistics," is incorporated as a part of these Minutes as [Exhibit 1](#).

CHIEF INVESTMENT OFFICER REPORT

Mr. Daniel Allen reported that the investment portfolio returned 5.4% for the quarter ended September 30, 2013, and total assets amounted to approximately \$15.7 billion. For the fiscal year to date as of October 31, 2013, the investment return was 8.4% and total assets were approximately \$16 billion. Mr. Allen remarked that reviews were provided for each of the index fund providers as well as the global equity, non-U.S. equity and real estate investment managers. Since staff and NEPC, SURS' investment consultant, recommend retention of all the existing managers, Mr. Allen proposed the use of a consent agenda, which he explained in further detail. Mr. Douglas Wesley observed that whenever termination is recommended, a full discussion would be held, and any manager concerns are discussed in the Watch List which will be reviewed later in the agenda. Mr. William Mabe also noted that any of the topics could be withdrawn from the consent agenda if desired and Ms. Mary Pat Burns concurred.

Trustee McCrohon presented several motions, which were numbered 3 through 22, in the form of a consent agenda. For future consent agendas, Trustee McCrohon suggested language similar to "The staff has recommended that the managers identified in 3 through 22 be retained and therefore the Investment Committee votes to accept that recommendation and to not terminate and to continue the relationships with these managers identified in 3 through 22."

Consent Agenda Topics

Global Equity Manager Reviews

- That Mondrian Investment Partners be retained as a global equity manager.
- That Wellington Management be retained as a global equity manager.
- That Calamos Advisors be retained as a global equity manager.
- That T. Rowe Price be retained as a global equity manager.

Non-U.S. Equity Manager Reviews

- That Ativo Capital Management be retained as a Non-U.S. equity manager.

- That GlobeFlex Capital be retained as a Non-U.S. equity manager.
- That Herndon Capital Management be retained as a Non-U.S. equity manager.
- That Martin Currie be retained as a Non-U.S. equity manager.
- That Strategic Global Advisors be retained as a Non-U.S. equity manager.
- That BlackRock Institutional Trust Company be retained as a structured active Non-U.S. equity manager.
- That Pyramis Global Advisors be retained as a structured active Non-U.S. equity manager.

Real Estate Manager Reviews

- That CBRE Clarion Securities be retained as a U.S. REIT manager.
- That CBRE Clarion Securities be retained as a global REIT manager.
- That UBS Trumbull Property Fund be retained as a direct real estate manager.
- That JP Morgan Strategic Property Fund be retained as a direct real estate manager.
- That Heitman America Real Estate Trust Fund be retained as a direct real estate manager.

Index Fund Provider Reviews

- That Northern Trust Asset Management be retained as a U.S. equity index fund manager.
- That BlackRock Institutional Trust Company be retained as an index fund manager.
- That RhumbLine Advisers be retained as a U.S. equity index fund manager.
- That State Street Global Advisors be retained as a U.S. fixed income index fund manager.

Trustee Matthews seconded the consent agenda. Discussion of certain performance lags and concentration considerations followed. After the discussion, the consent agenda carried with all Trustees present voting in favor.

Copies of the staff memorandums, entitled “Report from the October 17, 2013 Investment Committee Meeting” and “Investment Contracts Approved,” are incorporated as a part of these Minutes as [Exhibit 2](#) and [Exhibit 3](#). Copies of the staff memorandums, “Executive Summary of the Global Equity Asset Class,” “Executive Summary of the Non-U.S. Equity Asset Class,” “Executive Summary of the Real Estate Asset Classes” and “Executive Summary of Index Fund Provider Reviews,” are incorporated as a part of these Minutes as [Exhibit 4](#), [Exhibit 5](#), [Exhibit 6](#) and [Exhibit 7](#).

REVIEW AND RECEIPT OF THE FISCAL YEAR 2013 ACTUARIAL VALUATION REPORT

Ms. Leslie Thompson presented the responses provided by Gabriel Roeder Smith & Company (GRS) to the State Actuary (Cheiron) regarding its preliminary report on the assumptions and methods used for SURS June 30, 2013 Actuarial Valuation Report and future valuations. After Ms. Thompson reviewed the points raised in Cheiron’s preliminary report, discussion followed regarding the directive to lower the assumed investment return assumption from 7.75% to 7.25% by the next valuation or to provide rationale as to why not,

the concern with the amount of benefit recipient loss resulting from differences between estimated benefit payments and final benefit calculations, the recommended use of the most conservative range of assumptions in all cases and other points that were raised. (Trustee Antonio Vasquez joined the meeting during the discussion at 1:55 p.m.) Ultimately consensus formed that Cheiron should be contacted to advise that the Board will respond to its recommendation to set the assumed investment return assumption at 7.25% once the results of the upcoming Asset/Liability study have been evaluated.

Ms. Amy Williams then presented the key findings of the June 30, 2013 Actuarial Valuation Report. The assumptions used were unchanged from the previous valuation except for the assumed effective rate of interest which was decreased from 7.75% to 7.00%. Ms. Williams noted that a comprehensive review of assumptions will be undertaken during the experience study that is due following the fiscal year 2014 valuation. Although the market value rate of investment return for fiscal year 2013 was 12.5%, the actuarial (smoothed) value rate of return was 4.91%; however, this is the final year of recognizing the fiscal year 2009 investment loss. The unfunded actuarial accrued liability amounted to approximately \$20.1 billion as of June 30, 2013, and the funded ratio was 41.5% based on the actuarial (smoothed) value of assets. The statutory contribution for fiscal year 2015 was computed to be \$1.59 billion under the statutory funding policy, but Ms. Williams noted that the GRS recommended funding policy would have set the amount at \$1.73 billion.

Trustee Richard Figueroa made the following motions:

Fiscal Year 2013 Actuarial Valuation Report

- That the Cheiron preliminary report regarding review of assumptions and methods used in the June 30, 2013 Actuarial Valuation be received and filed.
- That the Fiscal Year 2013 Actuarial Valuation Report be received and filed.

Trustee Matthews seconded and the motions carried with all Trustees present voting in favor.

Ms. Burns remarked that Public Act 97-0694 requires that the certification of the required net State contribution must include a written response regarding any deviations from the State Actuary's recommended changes as well as the reasons for not following those recommendations and the resulting fiscal impact, and therefore she advised adding specific language to the draft motion to ensure that this requirement is met.

Trustee McCrohon made the following motion worded according to Ms. Burn's recommendation:

Fiscal Year 2013 Actuarial Valuation Report

- That the Board certify to the Governor and the General Assembly the required net State contribution for Fiscal Year 2015 in the amount of \$1,544,200,000, based upon the Fiscal Year 2013 Actuarial Valuation Report conducted by Gabriel Roeder Smith & Company and that any deviations from the State Actuary's recommended changes, as well as the reasons for not following those recommendations and the resulting fiscal impact of not doing so, be noted in the certification.

Trustee Mitchell Vogel seconded the motion. During the discussion, Ms. Thompson noted that Cheiron's recommendation to lower the assumed investment return assumption to 7.25% applies to future valuations. After discussion concluded, the motion carried with all Trustees present voting in favor.

A copy of the GRS letter dated December 12, 2013, is incorporated as a part of these Minutes as [Exhibit 8](#). Copies of the staff memorandums, entitled "State Actuary Preliminary Report – Cheiron" and "Actuarial Outputs," are incorporated as a part of these Minutes as [Exhibit 9](#) and [Exhibit 10](#). Copies of the GRS presentation, "SURS June 30, 2013 Valuation Results December 12, 2013," as well as SURS Actuarial Valuation Report as of June 30, 2013, are incorporated as a part of these Minutes as [Exhibit 11](#) and [Exhibit 12](#).

APPROVAL OF FISCAL YEAR 2014 RECOMMENDATIONS FOR NORMAL COST RATE AND EFFECTIVE RATE OF INTEREST

Mr. Allen discussed the annual process to set the employer normal cost recommendation and he advised that staff recommends approval of 11.71% as the employer normal cost for fiscal year 2015 per the GRS calculation, which is a decrease from 11.91% for fiscal year 2014.

Mr. Allen remarked that the Board must also approve an effective rate of interest (ERI) to be used for purposes other than money purchase formula retirement benefit calculations, such as separation refunds and purchases of service credit. Mr. Allen discussed the factors considered in the analysis and he advised that staff recommends maintaining 7.0% as the ERI for fiscal year 2015, but he noted that the percentage will change to the U.S. Treasury rate plus 75 basis points when the recent pension reform legislation takes effect.

Trustee Vogel then made the following motions:

Normal Cost & Effective Rate of Interest

- That the Employer Normal Cost Rate of 11.71% be approved for Fiscal Year 2015.
- That the Effective Rate of Interest remain at 7.0% for Fiscal Year 2015, to be used for all purposes other than the Rule 2 (money purchase) calculation.

Trustee Matthews seconded and the motions carried with all Trustees present voting in favor.

Copies of the staff memorandum, entitled "Normal Cost Recommendation," and the GRS letter dated November 4, 2013, regarding breakdown of Normal Cost for FY 2014-2015 are incorporated as a part of these Minutes as [Exhibit 13](#) and [Exhibit 14](#). A copy of the staff memorandum entitled, "Effective Rate of Interest Recommendation – Fiscal Year 2015," is incorporated as a part of these Minutes as [Exhibit 15](#).

ACTUARIAL PROVIDER CANDIDATE INTERVIEWS

Mr. Phyllis Walker reviewed the process followed for the actuarial services provider search that was approved at the June meeting. Ms. Walker advised that the request for proposal (RFP) was issued at the beginning of September and that Trustee John Engstrom, Mr. Mabe

and several other senior staff participated on the search committee. Responses were received from three firms, which the search committee interviewed at the SURS office in Champaign in November. Trustee Engstrom remarked that the two finalist candidates selected, Gabriel Roeder Smith & Company and Segal Consulting, were clearly the best qualified for the assignment.

Presentations were given by the following representatives of the two finalist candidate firms under consideration for the role of actuarial services provider:

- Gabriel Roeder Smith & Company – Ms. Leslie Thompson, Ms. Amy Williams, Mr. Lance Weiss, Ms. Kristen Brundirks and Mr. Brian Murphy
- Segal Consulting – Ms. Kim Nicholl, Mr. Matt Strom and Ms. Cathie Eitelberg

CLOSED SESSION

After the presentations concluded, Trustee Matthews moved that the Committee go into closed session under the Open Meetings Act to consider the appointment of an actuarial services provider pursuant to §2(c)(1). Trustee Johnson seconded and the motion carried in a roll call vote:

Trustee Engstrom	- aye
Trustee Figueroa	- aye
Trustee Johnson	- aye
Trustee Matthews	- aye
Trustee McCrohon	- aye
Trustee Vasquez	- aye
Trustee Vogel	- aye

RETURN TO OPEN SESSION

The Investment Committee returned to open session.

Trustee McCrohon made the following motion:

Actuarial Provider Search

- That Gabriel Roeder Smith & Company be retained as actuarial services provider for a five-year term, subject to successful completion of contract negotiations, which shall include, but not be limited to, a request for commitment concerning diversity goals and reporting and for commitment to act as a fiduciary.

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

A copy of the staff memorandum, entitled “Actuarial Services Provider Search Analysis,” is incorporated as a part of these Minutes as [Exhibit 16](#). Copies of the presentations provided

by Gabriel Roeder Smith & Company and Segal Consulting are incorporated as a part of these Minutes as [Exhibit 17](#) and [Exhibit 18](#).

INTRODUCTION AND EXPECTATIONS OF THE NEPC INVESTMENT CONSULTING RELATIONSHIP

Trustee McCrohon and Mr. Allen welcomed the NEPC team, Mr. Douglas Moseley, Mr. Kevin Leonard and Ms. Kristin Finney-Cooke, to the SURS relationship. Mr. Moseley remarked that historical data is being collected from Northern Trust and Callan Associates, that contracts have been executed and that the Asset/Liability study will soon be underway. Mr. Moseley expressed his desire to keep an open line of communication and he encouraged the trustees to provide any feedback.

A copy of the staff memorandum, entitled “Introduction of the NEPC Investment Consultant Relationship,” is incorporated as a part of these Minutes as [Exhibit 19](#). A copy of the NEPC letter dated November 27, 2013, is incorporated as a part of these Minutes as [Exhibit 20](#).

PRESENTATION OF MARKET RISK REPORTS

Mr. Joseph Duncan reviewed the key findings from the Executive Summary of the SURS Risk Report for the quarter ended September 30, 2013. As of the end of the period, total plan risk was measured at 12.3% versus 12.6% for the previous quarter, indicating that over the next one-year period, the return of the portfolio is expected to be between -12.3% and +12.3% based on a normal distribution of outcomes and a one standard deviation confidence level (68% of the time). Equity exposure accounted for 90.7% of total plan risk with the private equity program being the single largest asset class contributor. Changes in inflation expectations caused the total risk of the TIPS program to increase slightly but total plan risk was reduced by portfolio diversification. Mr. Duncan also advised that Northern Trust will be introducing enhancements to the risk report and that NEPC’s periodic reports will include risk information as well.

Mr. Moseley commented that the Asset/Liability study is critically important as a risk management exercise as policy mix targets are re-examined, alternatives are evaluated and theories are tested under different market environments.

Copies of the staff memorandum, “Executive Summary of Risk Report,” and the Northern Trust Market Risk Services report as of September 30, 2013, are incorporated as a part of these Minutes as [Exhibit 21](#) and [Exhibit 22](#). Copies of the NEPC memorandum dated November 29, 2013, and the NEPC white paper, “Shedding Light on the Future,” are incorporated as a part of these Minutes as [Exhibit 23](#) and [Exhibit 24](#).

COMMENCEMENT OF THE ASSET/LIABILITY STUDY PROCESS

Mr. Allen opened the discussion of the Asset/Liability study, noting that previous studies were conducted in 2008 and 2011 and that market conditions and asset strategies continue to evolve. Mr. Moseley provided an overview of the factors that will be examined in the study

and the conclusions that can be drawn from studying how the fund is expected to perform under various scenarios given current economic and capital market conditions, potential adjustments to asset class allocation targets and different market environments. Mr. Moseley advised that the study will also focus on new market opportunities, balancing risk and return, liquidity concerns and implementation considerations. Mr. Moseley reviewed the timeline for the Asset/Liability study, which will begin next month, and discussion followed. The trustees agreed that asset class education is vital and appropriate time should be devoted to the topic, including such asset classes as emerging debt, commodities and absolute return strategies. Trustee Vogel also suggested that the Board meetings commence earlier in the day and include sufficient time for breaks.

Copies of the staff memorandum, entitled “Asset / Liability Study,” and the NEPC presentation, “Overview of the Asset-Liability Study Process,” are incorporated as a part of these Minutes as [Exhibit 25](#) and [Exhibit 26](#).

STATUS OF CASH OVERLAY MANAGER SEARCH

Mr. Allen advised that the cash overlay manager search is currently in progress and the RFP was advertised in the press and posted on the SURS website. Responses to the RFP are due in January and it is anticipated that finalist candidates will make presentations to the Committee at the March meeting.

A copy of the staff memorandum, entitled “Status of Cash Overlay Manager Search,” is incorporated as a part of these Minutes as [Exhibit 27](#).

REVIEW AND RECEIPT OF REPORT TO THE GOVERNOR AND GENERAL ASSEMBLY REGARDING USAGE OF EMERGING INVESTMENT MANAGERS AND RECAP OF THE SENATE PENSIONS AND INVESTMENTS COMMITTEE HEARINGS

Trustee McCrohon reported that the hearings regarding emerging investment managers held on December 11, 2013, by the Senate Committee on Pensions and Investments was attended by a number of staff and trustees. Trustee McCrohon remarked that there was acknowledgement that SURS has operated a relatively successful emerging manager program to date that is ahead of its peers. Noting that the concept of creating a subcommittee on emerging managers and diversity matters was discussed at a special Investment Committee meeting held last month and that Trustee Figueroa agreed to chair the subcommittee, Trustee McCrohon advised that the Senate Committee was informed of the initiative. On behalf of Board Chairwoman Anderson, Trustee McCrohon commended Mr. Mabe for his efforts at the Senate hearing and he also expressed his appreciation to Mr. Allen and Ms. Kristin Finney-Cooke for their participation.

Mr. Allen noted that the annual Report to the Governor and General Assembly regarding Use of Emerging Investment Managers was provided to the trustees and he recommended that the document be received and filed.

Trustee Matthews made the following motion:

Report to the Governor and General Assembly on Use of Emerging Investment Managers

- That the annual Report to the Governor and General Assembly Regarding Use of Emerging Investment Managers for the period ending June 30, 2013, be received and filed.

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

Trustee McCrohon remarked that Board Chairwoman Anderson, Trustee Matthews and Trustee Vasquez have also expressed interest in involvement with the subcommittee on emerging managers and diversity matters and he noted the importance of following through with the initiative.

Copies of the staff memorandum, entitled “Report to the Governor and General Assembly Regarding Use of Emerging Investment Managers,” and the letter to Senator Raoul dated November 20, 2013, with the Senate questionnaire response are incorporated as a part of these Minutes as [Exhibit 28](#) and [Exhibit 29](#). A copy of the staff memorandum, “Annual Review of Minority-, Female- and Persons with a Disability- Owned Broker/Dealer Usage by SURS Investment Managers,” is incorporated as a part of these Minutes as [Exhibit 30](#).

PRESENTATION OF THE SURS INVESTMENT MANAGER WATCH LIST

Mr. Gabriel Ayoroa reported that Herndon Capital Management was added to the Investment Manager Watch List for December 2013 due to performance concerns; however Channing Capital Management and T. Rowe Price were both removed as a result of improved performance. Profit Investment Management and Calamos Advisors continue to be retained on the list.

A copy of the staff memorandum, entitled “December 2013 Investment Manager Watch List,” is incorporated as a part of these Minutes as [Exhibit 31](#).

STATUS OF OUTSIDE LEGAL COUNSEL SEARCH

Mr. Michael Weinstein reported that the RFP for outside legal counsel for investments and tax related matters will be posted tomorrow; however, it is still planned for the Board to make its decision at the March meeting. Mr. Weinstein also noted that the quiet period policy goes into effect once the RFP is posted and the RFP does not place a limitation on the number of firms that can be hired.

A copy of the staff memorandum, entitled “Status Update of Outside Counsel Search,” is incorporated as a part of these Minutes as [Exhibit 32](#).

INFORMATIONAL ITEMS NOT REQUIRING COMMITTEE ACTION

Mr. Allen observed that performance compared to other Illinois public pension funds has been strong over longer periods and while there has been underperformance recently, the portfolio is outperforming its benchmark. Mr. Allen referenced the Self-Managed Plan (SMP) status report that was provided, noting that additional discussion of the SMP is planned for 2014. Mr. Allen also remarked that the trustee educational event is scheduled on February 7, 2014, at the Chicago Board Options Exchange and discussion topics will include board governance best practices and the Asset/Liability study. In response to Trustee Vogel's inquiry, Mr. Weinstein advised that SMP participants will not transfer into the new defined contribution plan mandated by the pension reform bill as it is separate and apart from the SMP.

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

1. [Exhibit 33](#) - SURS Projected Funding Status through October 2013.
2. [Exhibit 34](#) - Illinois Public Pension Funds Total Fund Performance as of 6/30/13.
3. [Exhibit 35](#) - Staff memorandum entitled "Fiscal Year 2013 Self-Managed Plan Review."
4. [Exhibit 36](#) - Possible Topics for SURS Trustee Educational Forum.
5. [Exhibit 37](#) - Investment Compliance Activities 2013-14.
6. [Exhibit 38](#) - Staff memorandum entitled "Compliance Update."
7. [Exhibit 39](#) - Fiscal Years 2014-15 Summary Work Plan Investment Committee Schedule.
8. [Exhibit 40](#) - Schedule of Formal Reviews for SURS Investment Managers: Defined Benefit Plan & SMP.
9. [Exhibit 41](#) - Schedule of Investment Committee Meetings.

PUBLIC COMMENT

There were no public comments presented to the Investment Committee.

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

Respectfully submitted,



Mr. William E. Mabe
Secretary, Board of Trustees

WEM:mb