



MINUTES

**Meeting of the Investment Committee
of the Board of Trustees of the
State Universities Retirement System
1:00 p.m., Wednesday, March 13, 2013
Abraham Lincoln Presidential Library and Museum
Governor's Conference Room, Library
212 North Sixth Street
Springfield, Illinois 62701**

The following Trustees were present: Ms. Jacqueline Berger, Dr. John Engstrom, Ms. Carrie Hightman, Mr. Paul R. T. Johnson Jr., Mr. Andrew Matthews, Mr. Craig McCrohon, Ms. Dorinda Miller 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. Kimberly Pollitt, Senior Investment Officer; Ms. Marilyn Branson, Investment Governance and Compliance Officer; Ms. Phyllis Walker, Chief Financial Officer; Ms. Beth Spencer, Communications Manager; Mr. Jeffrey Houch, Legislative Liaison; Ms. Lori Kern, Executive Assistant; Ms. Mary Pat Burns of Burke, Burns & Pinelli; Mr. John Jackson, Mr. Mark Kline, Mr. Yosangel Haddad and Mr. Jim McKee of Callan Associates; Ms. Patti Somerville-Koulouris of the Northern Trust Company, Ms. Janet Jones of Janet Jones & Associates, Mr. Steve Zahn of Governmental Consulting Solutions and Mr. Jason Parks of Loop Capital.

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

APPROVAL OF MINUTES

Trustee Mitchell Vogel presented the Minutes from the Investment Committee meeting of February 14, 2013, and the Trustee Educational Forum of February 15, 2013. Trustee Paul R. T. Johnson moved that:

- The Minutes from the February 14, 2013 Investment Committee meeting be approved as presented.
- The Minutes from the February 15, 2013 Trustee Educational Forum be approved as presented.

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

Copies of the staff memorandums, entitled “Report from the February 14, 2013 Investment Committee Meeting” and “Investment Contracts Approved,” are incorporated as a part of these Minutes as [Exhibit 1](#) and [Exhibit 2](#).

CHAIRPERSON’S REPORT

After expressing appreciation for the condolences extended to his family, Trustee Vogel remarked that *Pensions & Investments* continues to rank SURS as one of the largest pensions systems in the country and he thanked the investment staff for their efforts over the past year.

A copy of the graph, “SURS Projected Funding Status through February 2013”, that was distributed at the meeting is incorporated as a part of these Minutes as [Exhibit 3](#).

RECAP OF THE FEBRUARY 15, 2013 SURS TRUSTEE EDUCATIONAL FORUM

Mr. Daniel Allen remarked on the topics covered at the Trustee Educational Forum as well as the current open work projects and the 2013 Investment Plan. It was noted that the core real estate search has concluded, the fixed income asset structure analysis is nearly complete, the private equity emerging manager fund of funds search is in progress, the build out of real estate and private equity is ongoing and the investment consultant search will be presented for approval at the May meeting. Trustee Vogel recommended that a second educational forum be organized this year to explore additional topics and the Committee concurred. At Mr. William Mabe’s suggestion, the Committee decided to include a discussion of potential forum topics in the agenda for the May meeting. Mr. Allen also noted that an actuarial provider search is planned to be conducted later in the year and he referenced the summary work plan document.

Copies of the staff memorandum, entitled “Recap of the February 15, 2013 Trustee Educational Forum,” and SURS Agenda 2013 Investment Plan are incorporated as a part of these Minutes as [Exhibit 4](#) and [Exhibit 5](#).

(Educational Topic) – DISCUSSION OF CBOE S&P 500 BUY-WRITE INDEX STRATEGIES (BXM)

Mr. John Jackson provided opening remarks on the CBOE S&P 500 BuyWrite Index (BXM) strategy, which he noted is one of a number of option-related strategies, and he advised that the session would examine the use of options to hedge risk, pros and cons of the strategy and the rate of adoption by the institutional marketplace.

Mr. Jim McKee of Callan Associates (Callan) conducted the educational session, which began at 1:10 p.m. Mr. McKee discussed the definition and characteristics of covered call options as well as their associated benefits, risks and performance. Mr. McKee advised that shorter-term options provide better liquidity and premium capture and he reviewed the effect

of implied volatility on such investments and the variance of historical returns for periods of high and low volatility. It was noted that tracking error is higher, performance is more attractive when conditions are poor versus when they are good, tolerance is required to stay invested throughout and the timing of an exit is important. The utilization of options by other institutional investors was also reviewed during the presentation.

Mr. Allen noted that details of the portfolio rebalancing undertaken in 2008-2009 were provided in the agenda materials. Discussion of the role that options could play within the overall portfolio and the benefits that might accrue during rebalancing actions followed. The topic was recommended to be further explored at the next Trustee Educational Forum.

The educational session lasted for 50 minutes and concluded at 2:00 p.m.

Trustee Vogel thanked Trustee Hightman for her assistance with arranging meeting space at the Abraham Lincoln Presidential Library & Museum for the SURS Board. Trustee Hightman commented that the organization's Lincoln Leadership Prize will be presented to President Bill Clinton on May 4, 2013.

A copy of the staff memorandum, "Information Request on CBOE S&P 500 BuyWrite Index (BXM)," is incorporated as a part of these Minutes as [Exhibit 6](#). Copies of the Callan reports, "Options for Enhancing Risk-Adjusted Returns" and "An Historical Evaluation of the CBOE S&P 500 BuyWrite Index Strategy," are incorporated as a part of these Minutes as [Exhibit 7](#) and [Exhibit 8](#).

Copies of the staff memorandum, "Information Request on 2009 Portfolio Rebalance," and a compilation of documents related to the 2009 portfolio rebalancing are incorporated as a part of these Minutes as [Exhibit 9](#) and [Exhibit 10](#).

UPDATE OF SURS FISCAL YEAR-TO-DATE INVESTMENT PERFORMANCE

Mr. Jackson remarked that the S&P 500 gained 16% for calendar year 2012, non-U.S. equities 17.3% and emerging markets equities 18%. In addition, the calendar year return was 4.2% for the Barclays Aggregate and 15.8% for high yield fixed income. SURS total fund amounted to \$14.3B as of December 31, 2012, and net returns were 2.1% for the fourth quarter of 2012, 13.87% for the calendar year and 9% annualized for the last three year period. Mr. Jackson also reported that the SURS portfolio has achieved an annualized return of 8.16% net of fees over the last decade. Discussion of peer group comparisons followed. Mr. Allen advised that preliminary data indicates the total fund is approximately \$14.6B as of February 28, 2013, and the return for the fiscal year as of February 28, 2013, amounts to 10.5%.

**IMPLEMENTATION RECOMMENDATION OF PHASE III OF THE ASSET
STRUCTURE ANALYSIS / FIXED INCOME AND TREASURY
INFLATION-PROTECTED SECURITIES (TIPS)**

Mr. Jackson briefly reviewed the two options that resulted from the fixed income structure analysis as discussed at the February meeting. Although both options would reduce passive fixed income exposure from 17% to 12%, the first would employ a tiered allocation based on manager size and performance while the second would reduce the allocation to PIMCO, introduce an unconstrained mandate and adjust the allocations within the TIPS portfolio.

Mr. Michael Chandra and Ms. Sabrina Callin of PIMCO then provided a presentation that included a relationship review, a discussion of current conditions and a detailed overview of their firm's Unconstrained Bond Strategy product.

At the conclusion of the presentation, discussion of the strategy, as well as fees and contract considerations, ensued. In answer to Ms. Mary Pat Burns' inquiry, Mr. Chandra agreed that the unconstrained product is a related strategy meant to complement PIMCO's core bond allocation and he advised that an amendment to the existing contract would suffice. Mr. Douglas Wesley also observed that, currently, all of the PIMCO mandates reside under the same contract which includes different appendices for each.

Mr. Jackson summarized the recommended option, which would reduce overall exposure to PIMCO from 29.3% to 25%, with 10% allocated to Total Return and 15% to the Unconstrained Bond Strategy, and provide greater manager diversification and downside protection. Discussion of the proposed modifications, appropriate benchmarks for the Unconstrained Bond Strategy and the negotiation of fees followed.

Trustee Johnson made the following motion:

- That the target weights for the fixed income portfolio be approved, as presented in Target 2.

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

Copies of the staff memorandum, "Fixed Income Structure Recommendation," the Callan document, "Proposed Restructuring of Fixed Income Portfolio" and the staff memorandum, "Introduction to Fixed Income Structure Analysis," are incorporated as a part of these Minutes as [Exhibit 11](#), [Exhibit 12](#) and [Exhibit 13](#). A copy of the PIMCO presentation is also incorporated as a part of these Minutes as [Exhibit 14](#).

**COMPLIANCE WITH INVESTMENT POLICY
BROKERAGE UTILIZATION GOALS**

Ms. Kimberly Pollitt reported that a compliance conflict has arisen with regard to Aberdeen Asset Management (Aberdeen). After noting the firm's strong performance, Ms. Pollitt discussed the impasse that has developed concerning Aberdeen's trading policy and the

SURS brokerage policy, which sets the minimum expectation for global equity managers for trading with minority-, female- or persons with a disability-owned brokerage firms at 17.5% of total eligible commission dollars. Ms. Pollitt advised that numerous meetings about the issue have occurred; however, in their letter dated February 21, 2013, Aberdeen has proposed retiring from the relationship unless they can be provided an exception. Ms. Pollitt advised that staff and Callan recommend termination as the only viable solution. Discussion of the matter followed. Mr. Allen remarked that, although the SURS expectations are demanding, other managers are achieving compliance. Ms. Pollitt also noted that the staff recommendation includes redistribution of the Aberdeen assets from global equity to the remainder of the equity portfolio and commensurate reduction of the global equity target and increases of the U.S. and non-U.S. equity targets.

Trustee Johnson made the following motions:

- That the new proposed strategic policy allocations be approved, as presented, and incorporated into the SURS Investment Policy.
- That Aberdeen Asset Management be terminated as a global equity manager, with the assets in the portfolio to be reallocated in accordance with the adjusted strategic targets.

Trustee Miller seconded and both motions carried with all Trustees present voting in favor.

Copies of the staff memorandum, “Aberdeen Asset Management/Non-Compliance with Brokerage Policy,” Aberdeen’s letter to SURS dated February 21, 2013, SURS letter to Aberdeen dated December 28, 2012, and Aberdeen’s signed acknowledgement are incorporated as a part of these Minutes as [Exhibit 15](#), [Exhibit 16](#), [Exhibit 17](#) and [Exhibit 18](#).

UPDATE OF THE PRIVATE EQUITY EMERGING MANAGER FUND OF FUNDS PROVIDER SEARCH

Mr. Allen reported that ten responses were received in connection with the private equity emerging manager fund of funds provider search. Staff and Callan will conduct a series of interviews to narrow the candidate pool and finalist presentations will be made to the Committee at the June meeting.

A copy of the staff memorandum, “Private Equity Emerging Manager Fund of Funds Provider Search Update,” is incorporated as a part of these Minutes as [Exhibit 19](#).

INFORMATIONAL ITEMS NOT REQUIRING COMMITTEE ACTION

Mr. Allen noted that the Northern Trust Market Risk Services report, having been introduced at last month’s educational forum, is included in the agenda materials. The report will be updated quarterly and utilized by staff to assist with risk management. At Trustee Engstrom’s request, Mr. Allen advised that an executive summary will be added to the next report.

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

1. [Exhibit 20](#) - SURS Projected Funding Status through January 2013.
2. [Exhibit 21](#) - Northern Trust Market Risk Services report dated December 31, 2012.
3. [Exhibit 22](#) - Staff memorandum entitled "December 2012 Investment Manager Watch List."
4. [Exhibit 23](#) - Investment Compliance Activities 2013.
5. [Exhibit 24](#) - Fiscal Years 2013-14 Summary Work Plan Investment Committee Schedule.
6. [Exhibit 25](#) - Schedule of Formal Reviews for SURS Investment Managers: Defined Benefit Plan & SMP.
7. [Exhibit 26](#) - Staff memorandum entitled "Schedule of Investment Committee Meetings."

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

Respectfully submitted,

A handwritten signature in black ink, appearing to read "William E. Mabe". The signature is written in a cursive style with a large initial "W".

Mr. William E. Mabe
Secretary, Board of Trustees

WEM:mb