



## **MINUTES**

**Meeting of the Investment Committee  
of the Board of Trustees of the  
State Universities Retirement System  
1:00 p.m., Thursday, September 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, Ms. Dorinda Miller, 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. Steve Hayward, Director of Internal Audit; 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. Jeffrey Houch, Legislative Liaison; Ms. Lori Kern and Ms. Karen Hipskind, Executive Assistants; Ms. Mary Pat Burns of Burke, Burns & Pinelli; Mr. John Jackson, Mr. Yosangel Haddad and Mr. Mark Kline of Callan Associates; Ms. Patti Somerville-Koulouris of the Northern Trust Company; Ms. Leslie Thompson and Ms. Amy Williams of Gabriel Roeder Smith & Company; Mr. Matthew Moran of the Chicago Board Options Exchange; Ms. Sharon Piet of Podesta & Co.; and Ms. Angela Myers of Loop Capital.

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

## **CHAIRPERSON'S REPORT**

Trustee Craig McCrohon congratulated Mr. Gabriel Ayoroa for successfully completing Level III of the Chartered Financial Analyst Program. Trustee McCrohon also remarked that this will be the final meeting for Mr. Mark Kline as he will retire from Callan Associates (Callan) prior to the end of the year.

## **APPROVAL OF MINUTES**

Trustee McCrohon presented the Minutes from the Investment Committee meetings of June 13, 2013, August 14, 2013, August 15, 2013, and August 22, 2013. Trustee Paul R. T. Johnson moved:

- That the Minutes from the June 13, 2013, August 14, 2013, August 15, 2013, and August 22, 2013 Investment Committee meetings be approved as presented.

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

## **CHIEF INVESTMENT OFFICER REPORT**

Mr. Daniel Allen remarked that Trustee McCrohon attended a buyouts conference in Chicago over the summer, as well as a private equity conference organized by The Pension Bridge. In addition, some staff and trustees visited the Chicago Board Options Exchange (CBOE) where it is planned that the Investment Committee meeting and educational event will be held on February 6-7, 2014. With regard to the Fairview Capital Partners relationship approved at the June meeting, Mr. Allen advised that due to an issue with expedition of the legal review process, prior outside legal counsel has been retained and the transaction is expected to close by year end. Mr. Allen also noted that the investment return for fiscal year 2013 was 12.5% net of fees and performance for the first quarter of fiscal year 2014 to date has been strong.

Copies of the staff memorandums, entitled “Report from the June 13, 2013 Investment Committee Meeting” and “Investment Contracts Approved,” are incorporated as a part of these Minutes as [Exhibit 1](#) and [Exhibit 2](#).

## **(Educational Topic) ACTUARIAL UPDATE – A REVIEW OF RISKS, TRENDS AND RESPONSES TO THE CHANGING PENSION ENVIRONMENT**

The educational session commenced at 1:10 p.m.

Ms. Leslie Thompson of Gabriel Roeder Smith & Company (GRS) provided an overview of the basic types of retirement plans and their distinguishing characteristics, as well as the actuarial process and the funding structure of defined benefit plans. Ms. Thompson also remarked on plan design trends that shift the responsibility for risk, changes to long term investment return assumptions and governmental accounting standards, and the outlook for public sector defined benefit plans. Ms. Amy Williams reviewed recent pension reform proposals in Illinois, which include changes related to benefits and contributions, cost of living adjustments (COLA), the money purchase formula and the State’s funding policy. Mr. William Mabe noted the challenges faced by the retirement system with regard to the numerous legislative requests for actuarial studies and he advised that GRS has responded to the requests promptly and accurately. Finally, Ms. Williams discussed the financial impact of the pension reform proposals on employer contributions and the plan funded ratio and she observed that lowering the COLA from 3% to one-half of the consumer price index has the

greatest potential to reduce employer contributions. Discussion of the information presented followed.

The educational session lasted for one hour and 20 minutes, concluding at 2:30 p.m.

Copies of the staff memorandum, "Actuarial Education," and the GRS presentation, "Actuarial 101 – Pension Basics," are incorporated as a part of these Minutes as [Exhibit 3](#) and [Exhibit 4](#).

### **UPDATE OF SURS INVESTMENT PERFORMANCE AND RISK MANAGEMENT REPORTS**

Mr. John Jackson reported that total assets amounted to \$14.8 billion as of June 30, 2013, and although domestic equity was slightly overweight, the fund's asset allocation remained within the acceptable policy ranges. After reviewing the returns of the various asset classes for the second quarter of 2013, Mr. Jackson remarked that the total fund investment performance was 12.5% for fiscal year 2013, above the median for the large public fund peer group, and 7.74% annualized for the last ten-year period as of June 30, 2013. Mr. Jackson also discussed the nature of the private equity benchmark and the underperformance of global equity relative to its respective benchmark, which has prompted discussions with Calamos Investments regarding reduction of investment management fees.

Mr. Joseph Duncan presented the key findings from the SURS Executive Summary Risk Report for the quarter ended June 30, 2013. The report, which is produced by Northern Trust, is a holdings-based, one year forward-looking forecast, using quarter end security/proxy positions and modeled using the Barra One Risk System. Mr. Duncan reminded the Board that there are many ways to define and measure risk and that this report would be one tool for doing so. Key findings from this quarter's report were that 90.6% of the risk in the portfolio is derived from equity exposure, 8.3% is from real estate exposure, 0.6% is from the Opportunity Fund and 0.5% is from fixed income. Total Plan risk was measured at 12.6% versus 13.0% for the previous quarter, active risk was 1.1% and the majority of Total Plan risk was attributable to exposure to equity industries.

Copies of the staff memorandum, "Executive Summary of Risk Report," the Northern Trust Market Risk Services report as of June 30, 2013, and the Callan research paper, "The Odyssey of Risk," are incorporated as a part of these Minutes as [Exhibit 5](#), [Exhibit 6](#) and [Exhibit 7](#).

### **APPROVAL OF SURS FISCAL YEAR 2014 INVESTMENT PLAN**

Mr. Allen presented the investment plan for the coming fiscal year, which he noted is based on the 2011 asset/liability study. Since 2011, commitments totaling \$900 million have been made to private equity and real estate, and the equity and fixed income programs have been restructured. Mr. Allen advised that investment management fees for fiscal year 2013 amounted to \$49.5 million versus the \$52.7 million budgeted, or 33 basis points as a percentage of total assets, which is low compared to the fund's peer group. The priorities

outlined in the Fiscal Year 2014 Investment Plan include management of residual cash and portfolio volatility, continued investment in alternative asset classes, increased risk management practices and oversight, as well as an investment staff compensation study. Important projects to be completed include the actuarial services provider search and the investment consultant search, followed by a new asset/liability study. After noting plans for further development of the Manager Diversity Program and an examination of the Self-Managed Plan, Mr. Allen advised that staff recommends the Fiscal Year 2014 Investment Plan be approved.

Trustee Mitchell Vogel made the following motion:

**Fiscal Year 2014 Investment Plan**

- That the SURS Fiscal Year 2014 Investment Plan be approved as presented.

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

Copies of the staff memorandum, entitled “SURS Fiscal Year 2014 Investment Plan- Agenda 2014,” and the SURS Agenda 2014 Investment Plan are incorporated as a part of these Minutes as [Exhibit 8](#) and [Exhibit 9](#).

**APPROVAL TO CONDUCT A CASH OVERLAY SEARCH**

Noting the discussion at the educational session, Mr. Allen advised that staff and Callan recommend a search for a cash overlay manager and he presented the proposed timeline.

Trustee Johnson made the following motion:

**Cash Overlay Search**

- That a search be conducted to identify a qualified cash overlay manager.

In response to Trustee Matthews’ inquiry as to whether the investment consultant search would be finalized in time for this search, Mr. Allen agreed that the timeline for the cash overlay search would be modified as necessary.

Trustee Matthews seconded the motion.

Discussion regarding the nature of the investment provider, the mandate and the use of derivatives followed. It was noted that the request for proposal (RFP) process will yield different approaches to consider and that exposures to various financial instruments can be controlled by the investment guidelines. Investment department staffing concerns were also mentioned.

The motion then carried with all Trustees present voting in favor.

Copies of the staff memorandum, “Recommendation to Conduct Cash Overlay Manager Search,” and the letter from Callan dated August 28, 2013, are incorporated as a part of these Minutes as [Exhibit 10](#) and [Exhibit 11](#).

### **APPROVAL OF SURS INVESTMENT POLICIES**

Ms. Kimberly Pollitt remarked that the defined benefit and Self-Managed Plan investment policies are reviewed and presented for approval on an annual basis. The modifications proposed included increasing the strategic policy allocation targets for U.S. Equity and Non-U.S. Equity by one percent each in order to offset the two percent decrease in the Global Equity target that was approved earlier this year. Also, due to recent legislation, the section on investment manager selection and retention was updated to clarify when a search is deemed necessary for certain types of investments. Ms. Pollitt advised that staff recommends both of the revised policies be approved.

After the discussion, Trustee Matthews made the following motion:

#### **Investment Policies**

- That the revised Investment Policy document for the defined benefit plan be approved as presented.

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

Trustee Matthews also made the following motion:

- That the revised Investment Policy document for the Self-Managed Plan (SMP) be approved as presented.

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

Copies of the staff memorandum, “Review of Investment Policy,” the red-lined SURS Investment Policy and the red-lined SURS Self-Managed Plan Investment Policy are incorporated as a part of these Minutes as [Exhibit 12](#), [Exhibit 13](#) and [Exhibit 14](#).

### **SECURITIES LENDING REVIEW**

Mr. Douglas Wesley reviewed the background and current structure of the securities lending program, noting that the program was moved from the custodian to a third party lender in 2007 and the subsequent 2012 search resulted in the hiring of Deutsche Bank. After discussing the mechanics of securities lending transactions, Mr. Wesley remarked on potential risks, which he noted have been mitigated by restricting lending to securities offering a negative rebate rate and by setting conservative reinvestment guidelines for the cash collateral receipts. Mr. Wesley reported that although assets on loan have decreased substantially, the securities lending program generated \$3.9 million for fiscal year 2013 and negative rebates accounted for approximately 75 percent of the total. Noting that Deutsche Bank’s client service has been exemplary and no organizational concerns have arisen, Mr.

Wesley advised that staff and Callan recommend the firm be retained. Discussion of the risk-averse strategy currently being employed followed. Trustee Vogel commended staff for their role in instituting the conservative changes to the program.

Trustee Johnson made the following motion:

#### **Securities Lending Review**

- That Deutsche Bank be retained as a securities lending provider.

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

A copy of the staff memorandum, "Securities Lending Review," is incorporated as a part of these Minutes as [Exhibit 15](#).

#### **STATUS OF ACTUARIAL PROVIDER SEARCH**

Mr. Allen reported that the actuarial services provider search has begun and the RFP has been posted on the SURS website and advertised nationally. Questions related to the RFP are due by September 21, 2013, and the deadline for RFP responses is October 14, 2013. A further update will be provided at the October meeting and it is anticipated that interviews will be held at the December meeting.

A copy of the staff memorandum, "Status Update of Actuarial Services Provider Search," is incorporated as a part of these Minutes as [Exhibit 16](#).

#### **STATUS OF INVESTMENT CONSULTANT SEARCH**

Mr. Allen advised that six RFP responses were received for the general investment consultant relationship. Separate responses for stand-alone real estate consulting services were also reviewed; however, staff believes the asset class can be covered by the chosen general consultant with the current complexity of the program. Mr. Allen remarked that interviews with the six firms were attended by Trustees Engstrom, Johnson, McCrohon and Matthews and that three of the firms are being recommended as finalist candidates. Since an inconsistency arose regarding the fee proposed by Marquette Associates, Mr. Wesley explained that although the fee provided in their interview presentation appeared to be more competitive, the firm's RFP response showed that the amount would not remain level but would escalate from year to year. Discussion of the attributes and capabilities that trustees and staff deem essential for the investment consultant role followed. Trustee McCrohon recommended that the trustees review the summary of candidates that was provided and he noted that up to three trustees can have discussions together without triggering the need to call an open meeting. Mr. Allen also reviewed the schedule set for onsite visits with the three finalist candidates in advance of the final interviews that are scheduled to be held at the October meeting.

Copies of the staff memorandum, "Investment Consultant Search Update," and the Summary of Candidates August 2013 are incorporated as a part of these Minutes as [Exhibit 17](#) and [Exhibit 18](#).

### **INFORMATIONAL ITEMS NOT REQUIRING COMMITTEE ACTION**

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

1. [Exhibit 19](#) - SURS Projected Funding Status through June 2013.
2. [Exhibit 20](#) - June 2013 Investment Manager Watch List.
3. [Exhibit 21](#) - Statement of Investment Expenses Fiscal Year 2013.
4. [Exhibit 22](#) - Investment Expense Variance Fiscal Year 2013.
5. [Exhibit 23](#) - Staff memorandum entitled "Northern Trust Master Custodian Review."
6. [Exhibit 24](#) - Callan report entitled "GASB Update."
7. [Exhibit 25](#) - NASRA Issue Brief: Public Pension Plan Investment Return Assumptions (Updated March 2013).
8. [Exhibit 26](#) - Policy communication to Callan dated June 27, 2013, regarding revised investment guidelines for TCW MetWest.
9. [Exhibit 27](#) - TCW MetWest Amendment dated June 28, 2013.
10. [Exhibit 28](#) - Staff memorandum entitled "Compliance Update."
11. [Exhibit 29](#) - Investment Compliance Activities 2013-14.
12. [Exhibit 30](#) - Fiscal Years 2013-14 Summary Work Plan Investment Committee Schedule.
13. [Exhibit 31](#) - Schedule of Formal Reviews for SURS Investment Managers: Defined Benefit Plan & SMP.
14. [Exhibit 32](#) - Schedule of Investment Committee Meetings.

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

Respectfully submitted,



Mr. William E. Mabe  
Secretary, Board of Trustees

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