



MINUTES

**Meeting of the Investment Committee
of the Board of Trustees of the
State Universities Retirement System
11:00 a.m., Thursday, September 18, 2014
State Universities Retirement System
1901 Fox Drive, Main Conference Room
Champaign, Illinois 61820**

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. Peter Newell 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 and Mr. Joseph Duncan, Senior Investment Officers; Mr. John Cross, Mr. Alex Ramos and Mr. Shane Willoughby, Investment Officers; Ms. Phyllis Walker, Chief Financial Officer; Mr. Steve Hayward, Director of Internal Audit; Mr. Albert Lee, Associate General Counsel; Ms. Angela Lieb, Director of Member Services; Mr. Keith Johnson, SMP Manager; Ms. Suzanne Mayer, Interim Director of Outreach; Ms. Lou Ann Fillingham, Senior Investment Accounting Officer; Ms. Marilyn Branson, Investment Governance and Compliance Officer; Mr. Chris Hansen, Director of Operations; Mr. Douglas Steele, Director of Application Development/Research; Ms. Lori Kern, Executive Assistant; Ms. Mary Pat Burns of Burke, Burns & Pinelli; Mr. Douglas Moseley, Ms. Kristin Finney-Cooke, Mr. Kevin Leonard and Mr. Kevin Cress of NEPC; Ms. Patti Somerville-Koulouris of the Northern Trust Company; Ms. Renaye Manley of Service Employees International Union; Mr. Eric Harris of Loop Capital.

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

APPROVAL OF MINUTES

Trustee Craig McCrohon presented the Minutes from the Investment Committee meeting of June 12, 2014, and after inviting discussion, made the following motion:

- That the Minutes from the June 12, 2014 Investment Committee Meeting be approved as presented.

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

Copies of the staff memorandums, entitled “Report from the June 12, 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 observed that the Dow Jones Industrial Average has just reached a record high and remarked on the significance of current price-to-earnings (PE) ratios. Mr. Douglas Moseley discussed historical movements in PE ratios during various market periods, implications that PE ratios have for return expectations and recent signals coming from the Federal Reserve regarding interest rates.

Trustee Andrew Matthews joined the meeting near the beginning of the report at 11:10 a.m.

CHIEF INVESTMENT OFFICER REPORT

Mr. Daniel Allen reported that the SURS investment portfolio is currently valued at over \$17 billion and an 18.2% net of fees investment return was achieved for fiscal year 2014. Mr. Allen also reported that the investment portfolio achieved the following returns for longer periods: 10.1% for 3 years, 13.7% for 5 years, 7.8% for 10 years, 8.9% for 20 years, 8.6% for 25 years and 10.0% for 30 years, all calculated as of June 30, 2014, and net of fees. In addition, Mr. Allen remarked that assets in the Self-Managed Plan total approximately \$1.5 billion as of June 30, 2014.

INTRODUCTION OF THE SURS CASH OVERLAY PROGRAM AND STRATEGY

After briefly reviewing the process followed with respect to the cash overlay program, Mr. Allen remarked that the program is now in place and being managed by Parametric Clifton, the firm that was selected by the Board at the March meeting.

The following representatives of Parametric Clifton gave a presentation regarding the establishment of the cash overlay program:

- * Mr. Jack Hansen
- * Mr. Greg Baranivsky

The presentation provided a detailed overview of the objectives of the cash overlay strategy, which are to manage policy risk and improve expected return results over time, as well as the day to day mechanics that are involved. Trustee Paul R. T. Johnson Jr. inquired about access to information available on the Parametric Clifton website and Mr. Allen confirmed that

access can be arranged. Potential additional strategies offered by Parametric Clifton which employ the use of options were also discussed in depth. Mr. Hansen noted that options strategies are useful as a diversifier for institutional portfolios but need to be applied consistently over a long period since short-term returns can be uneven. Mr. Hansen also remarked that options constitute opportunities to buy or sell financial insurance and such strategies have a different objective than the cash overlay program. Other characteristics of options strategies, such as risks, fees, transparency and liquidity, were examined and comparisons with hedge funds were also discussed. In response to Mr. Allen's inquiry regarding the use of options to assist with manager transitions and portfolio rebalancing, Mr. Hansen advised that options are probably not appropriate given the short time horizon usually associated with these processes. Also, as outlined in the memorandum that was provided regarding the cash overlay implementation, it was noted that until active commodities managers are hired, the approved 2% commodities exposure will be accessed using futures to replicate the Bloomberg Commodity Index with implementation spanning a four month period in order to lessen the impact of market volatility.

Copies of the staff memorandum, "Parametric Clifton Cash Overlay Implementation," and the Parametric Clifton presentation, "Traditional Overlay Update & Option Selling Programs," are incorporated as a part of these Minutes as [Exhibit 3](#) and [Exhibit 4](#).

REVIEW OF THE SURS SELF-MANAGED PLAN (SMP)

Mr. Allen remarked that the review of the Self-Managed Plan (SMP) is a continuation of the discussion that was held at the April meeting. Ms. Lou Ann Fillingham provided details regarding the history of the SMP and advised that the plan has over 18,600 current participants and including reserve amounts, approximately \$1.6 billion in assets as of June 30, 2014. Ms. Fillingham remarked that, since inception of the SMP, ongoing due diligence has resulted in the elimination of certain administrative fees and the transfer of several investment options to lower cost share classes. Over the past few months, SURS staff, NEPC and the providers have conducted a review of the pricing structure to identify other ways to reduce fees and both providers have proposed significantly lower pricing structures. Ms. Fillingham noted that the new pricing structures and the approval of a new provider search scheduled for 2015 are being recommended.

Ms. Suzanne Mayer outlined the SURS member enrollment process and reviewed the various educational tools that are provided to new members during the retirement plan choice decision period. As of 2012, monthly Plan Choice webinars are a key component of the education provided, allowing for greater audience reach and playback recordings that are available on demand. Other new techniques include the Life Events section on the SURS website and the use of blast emails to publicize webinars and to send deadline reminders. The possibility of moving the fund choice election directly to the SMP providers was also raised, which would streamline the process and enable the providers to offer lower fees.

During the ensuing discussion, the Trustees inquired about the availability of data regarding fund selection decisions and participant demographics. Trustee McCrohon recommended that available data be analyzed to gain insight as to whether additional education is needed.

Ms. Mary Pat Burns remarked that the Trustees are fiduciaries over the SMP and have responsibilities with respect to plan participants whether they actively make fund selections or are placed in the default fund. Ms. Burns also mentioned the ERISA safe harbors provided for under Securities and Exchange Commission rules, which Mr. Kevin Cress discussed in further detail and recommended that similar procedures be followed for default notifications. Mr. Cress remarked that acceptance of the proposal to move the fund choice election directly to the SMP providers would charge Fidelity Investments responsible for providing notifications of default to the Fidelity Freedom Funds. Ms. Burns advised that the Trustees can delegate this authority and agreed that it would be a prudent decision. Trustee McCrohon requested that staff provide data needed to help identify adverse behaviors and Trustee Mitchell Vogel suggested delegating responsibility to staff to review the type of data necessary to prove adequate due diligence over the program. The issue of whether the providers are acknowledged as delegated fiduciaries was raised and Ms. Burns suggested that matters such as requirements for data, consent to act as a fiduciary and agreement to ensure that all of the safe harbor requirements are met could be incorporated in the contract. Mr. William Mabe also recommended that the SMP provider service be put out to bid.

Mr. Cress reviewed the requests made at the April meeting during discussion of the SMP, noting that today's focus is on potential improvements to communication and fees. Mr. Cress advised that negotiations with both providers resulted in offers of materially lower fees and he discussed the NEPC DC Plan & Fee Survey as well as current trends for lowering investment and recordkeeping fees and for utilizing plan expense reimbursement accounts to reduce the fees paid by participants. Mr. Cress noted that SMP fees are competitive compared to plans of similar size; however, both providers are offering improvements to services and reduced fees.

The following representatives of the two SMP providers then discussed the services they provide and their proposals with respect to improved operational efficiencies, fee structures and participant education:

- * TIAA-CREF – Mr. Richard Hiller, Ms. Elena Zanussi, Ms. Paula Smith and Mr. Robert Murray
- * Fidelity Investments – Mr. Lou Gadoury

During the TIAA-CREF presentation, the proposed fee reduction, the proper handling of a plan expense reimbursement account, the current level of communication with SMP members and the educational enhancements that can be provided by TIAA-CREF were discussed at length. Trustee Matthews expressed favor for more communication in order to assist members to make educated financial decisions. TIAA-CREF also recommended that more education be provided and historical practices were reviewed. It was noted that a number of SMP members have a 100% allocation to the CREF Money Market Account and Trustee Matthews strongly recommended that TIAA-CREF contact each of them to offer education. Similar proposals to streamline various processes, reduce costs, bolster member education and maximize member benefits were discussed during the Fidelity Investments presentation. Inquiries were also made of both providers as to whether they engage in outsourcing practices.

Mr. Cress noted the recommendations made to accept the improvements to the education offered by the SMP providers as well as to the fee structures. Mr. Cress also observed the consensus for plan expense reimbursement accounts to be used exclusively for crediting back to participants and he recommended accepting the fixed dollar pricing structure rather than the fixed basis points pricing structure.

Mr. Allen remarked that a new search for SMP service providers would likely commence next spring and discussion of the undertaking followed. Mr. Mabe recommended that annuity providers also be included as part of the process.

Trustee Matthews made the following motions:

- That the proposed fixed dollar pricing structure of \$59 per participant, the creation of a plan expense reimbursement account to be used for the exclusive benefit of plan participants and the improved education plans that were offered by Fidelity Investments for the Self-Managed Plan be accepted as presented.
- That the proposed fixed dollar pricing structure of \$79 per participant, the creation of a plan expense reimbursement account to be used for the exclusive benefit of plan participants and the improved education plans that were offered by TIAA-CREF for the Self-Managed Plan be accepted as presented.
- That an RFP for SMP providers be conducted in 2015.

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

Copies of the staff memorandum, “Self-Managed Plan (SMP) Communications Review and Pricing Structure Proposals,” the presentation, “SURS Plan Choice Election Process,” and the memorandum, “Fiscal Year 2014 Self-Managed Plan Review,” are incorporated as a part of these Minutes as [Exhibit 5](#), [Exhibit 6](#) and [Exhibit 7](#).

Copies of the NEPC presentation, “NEPC DC Plan and Fee Survey & Self-Managed Plan Update,” the TIAA-CREF presentation, “A Retirement Plan Presentation,” and the Fidelity Investments presentation, “Plan For A Better Retirement,” are incorporated as a part of these Minutes as [Exhibit 8](#), [Exhibit 9](#) and [Exhibit 10](#).

REVIEW OF SURS INVESTMENT PERFORMANCE AND RISK MANAGEMENT REPORTS

Mr. Kevin Leonard discussed the recent market environment and the portfolio’s investment performance as of June 30, 2014. An investment return of 4.2% net of fees was achieved for the second quarter of calendar year 2014 and total assets were approximately \$17.3 billion. Mr. Leonard observed the strong investment performance achieved over various periods of time as well as relative to the large public fund peer universe. Mr. Leonard also advised that NEPC could provide a return comparison with funds over \$10 billion in size per Trustee McCrohon’s request.

Mr. Joseph Duncan presented the key findings from the Executive Summary of the SURS Risk Report for the quarter ended June 30, 2014. Total plan risk declined to 10.4% from 11.2% for the previous quarter, indicating that over the next one-year period, the return of the portfolio is expected to be between +10.4% and -10.4% based on a normal distribution of outcomes and a one standard deviation confidence level (68% of the time). Mr. Duncan discussed changes to the composition of total plan risk, of which equity exposure continues to be the largest driver, and he noted that the portfolio currently exhibits slightly higher risk and slightly higher return versus the Northern Trust peer group.

Copies of the NEPC Second Quarter IPA – Board Report, the staff memorandum, “Executive Summary Risk Report,” and the Northern Trust Risk Services report, “SURS Executive Risk Review 2Q2014,” are incorporated as a part of these Minutes as [Exhibit 11](#), [Exhibit 12](#) and [Exhibit 13](#).

APPROVAL OF FISCAL YEAR 2015 INVESTMENT PLAN

Mr. Allen presented the Fiscal Year 2015 Investment Plan, noting that benefit payments are projected to be \$2.2 billion during that period, and referenced the summary of investment projects as well as the press releases regarding hedge funds that were distributed. Discussion of projects included in the plan followed. Trustee Engstrom expressed concern regarding the proposed allocation to hedged strategies and stated his preference for advance communication with members. Trustee Johnson commented that hedged strategies reduce long-only equity risk and that fees vary according to the type of strategy. Discussion continued regarding the asset class and the topic of education. Trustee McCrohon recommended that additional education be organized for the Trustees via telephone, noting that it would assist to clarify the Trustees’ commitment. Trustee Vogel also expressed favor for additional education, acknowledging that concerns and misunderstandings about the asset class exist, and suggested bringing experts to a public meeting. Mr. Mabe suggested that NEPC and staff prepare communications regarding the plan to utilize hedged strategies, including the pros and cons, and Trustee Vogel recommended that the issue of fees be addressed. Mr. Moseley discussed the news articles that were distributed about the recent withdrawal of some pension funds from hedge funds, observing that SURS would target strategies with a lower risk profile, and he suggested that the topic be revisited on the October agenda. Trustee Matthews agreed that members should be educated regarding the different strategies and fee structures through a public meeting. Mr. Leonard confirmed that NEPC will work with staff to organize a webinar with NEPC hedge fund staff and prepare a memorandum with talking points about the CalPERS press release. Trustee Engstrom noted the upcoming meeting of the State Universities Annuitants Association and Mr. Mabe concurred that more education is needed for the Board and for members. Mr. Allen advised that staff recommends approval of the 2015 Investment Plan; however, it can be changed at any time.

Trustee Matthews also provided a brief report regarding the Emerging Manager and Diversity Matters Subcommittee meeting held on September 15, 2014. Trustee Richard Figueroa and he have discussed next steps with Mr. Allen and would like to organize further workshop discussion to explore ways to enhance diversity inclusion.

Trustee McCrohon made the following motion:

- That the SURS Fiscal Year 2015 Investment Plan be approved, as presented.

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

Copies of the staff memorandum, “SURS Fiscal Year 2015 Investment Plan—*Agenda 2015*,” and SURS Agenda 2015 Investment Plan are incorporated as a part of these Minutes as [Exhibit 14](#) and [Exhibit 15](#). Copies of the summary of investment projects and the Senate questionnaire that were distributed are incorporated as a part of these Minutes as [Exhibit 16](#) and [Exhibit 17](#).

APPROVAL OF THE MULTI-YEAR REAL ESTATE FUNDING PLAN (2015-2017)

Mr. Duncan remarked that the fund has set a 4% target allocation to real estate investment trusts (REITs) and a 6% target allocation to direct real estate via core and non-core funds, and he discussed the current levels invested, noting that the non-core area presents further opportunity to add minority-, female- or persons with a disability-owned (MFDB) managers. Ms. Kristen Finney-Cooke then provided an in-depth discussion of the specific details of the new multi-year real estate funding plan, which targets 65% to U.S. core real estate (private and U.S. REITs) and 35% to non-core real estate (non-core and non-U.S. REITs).

Trustee Matthews made the following motion:

- That a multi-year Real Estate Funding Plan be approved for calendar years 2015, 2016 and 2017 at a level of \$100 million each year. In addition, any uncommitted amounts from a preceding calendar year may be included in the following years through 2017.

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

Copies of the staff memorandum, “Real Estate Funding Plan for Calendar Years 2015 – 2017,” and the NEPC document, “2014 Strategic Real Estate Plan,” are incorporated as a part of these Minutes as [Exhibit 18](#) and [Exhibit 19](#).

APPROVAL TO CONDUCT A NON-CORE REAL ESTATE SEARCH

Mr. Duncan advised that staff and NEPC recommend approval of a search for non-core real estate managers of closed-end funds, either direct or fund of funds, and anticipate that a selection recommendation will be made to the Committee at the March meeting.

Trustee Engstrom made the following motion:

- That a search be conducted to identify qualified non-core real estate managers.

Trustee Johnson seconded and the motion carried with all Trustees present voting in favor. A copy of the staff memorandum, “Recommendation to Conduct Non-Core Real Estate Manager Search,” is incorporated as a part of these Minutes as [Exhibit 20](#).

STATUS OF FIXED INCOME EMERGING MARKET DEBT SEARCH

Mr. Douglas Wesley remarked that the Request For Proposal (RFP) for the emerging market debt search was issued in August. Fifty-five investment managers responded and 85 different products were offered. Although the RFP contained no restrictions, there were few responses from MFDB firms. Staff and NEPC are working to narrow the pool of candidates, semi-finalist interviews are planned to be held after the October meeting and finalists will make presentations to the Committee at the December meeting.

Copies of the staff memorandum, “Emerging Market Debt Search Update,” and the list of responses to the RFP are incorporated as a part of these Minutes as [Exhibit 21](#) and [Exhibit 22](#).

APPROVAL OF SURS INVESTMENT POLICIES

Ms. Kimberly Pollitt remarked that the investment policies for the defined benefit and the defined contribution plans are reviewed on an annual basis. Modifications recommended include revisions to the Emerging Investment Managers and Broker-Dealers section to establish a goal that 20% of total assets be managed by MFDB firms and to specify that the MFDB brokerage goal for global equity be increased from 17.5% to 20%.

After discussion of the diversity goals, Trustee Vogel made the following motions:

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

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

Copies of the staff memorandum, “Review of Investment Policy,” and the red-lined drafts of the SURS Investment Policy and the SURS Self-Managed Plan Investment Policy are incorporated as a part of these Minutes as [Exhibit 23](#), [Exhibit 24](#) and [Exhibit 25](#).

SECURITIES LENDING REVIEW

Mr. Wesley presented the securities lending review, noting that the most recent securities lending provider search was conducted approximately two years ago, at which time the Board decided to move to a lower-risk strategy. Mr. Wesley remarked that the strategy was implemented by Deutsche Bank in April 2012, no organizational issues exist with the firm and retention is recommended by staff and NEPC.

Discussion followed during which Trustee Johnson expressed concern with the fee practices of certain Deutsche Bank entities. Trustee Vogel made a recommendation that Deutsche Bank be informed of this particular concern.

Trustee McCrohon made the following motion:

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

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

A copy of the staff memorandum, “Securities Lending Review,” is incorporated as a part of these Minutes as [Exhibit 26](#).

APPROVAL OF ORGANIZATIONAL ITEMS PERTAINING TO INVESTMENT MANAGEMENT RELATIONSHIPS

Mr. Duncan reviewed the requests that were made by Wellington Management Company and Martin Currie Investment Management for consent to the assignment of the investment management agreement, advising that staff and NEPC recommend approval of both.

Following a brief discussion regarding Martin Currie Investment Management’s ownership change, Trustee Johnson made the following motions:

- That the consent to the assignment of the investment management agreement with Wellington Management Company, LLP be approved, pending legal review.
- That the consent to the assignment of the investment management agreement, along with any additional documents associated with the change in ownership, for Martin Currie, Inc. be approved, pending legal review.

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

Copies of the staff memorandum, “Wellington Client Consent,” the NEPC memorandum, “Wellington Organizational Changes,” and the Wellington consent letter are incorporated as a part of these Minutes as [Exhibit 27](#), [Exhibit 28](#) and [Exhibit 29](#).

Copies of the staff memorandum, “Martin Currie Client Consent,” the NEPC memorandum, “Martin Currie Organizational Changes,” and the Martin Currie consent letter are incorporated as a part of these Minutes as [Exhibit 30](#), [Exhibit 31](#) and [Exhibit 32](#).

INFORMATIONAL ITEMS NOT REQUIRING COMMITTEE ACTION

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

1. [Exhibit 33](#) - SURS Projected Funding Status through June 2014.
2. [Exhibit 34](#) - Staff memorandum entitled "Investment Manager Watch List Update" dated September 2, 2014.
3. [Exhibit 35](#) - Smith Graham letter regarding personnel changes dated June 19, 2014.
4. [Exhibit 36](#) - Staff memorandum entitled "June 2014 Investment Manager Watch List" dated May 30, 2014.
5. [Exhibit 37](#) - Adams Street Partners letter regarding personnel changes dated July 10, 2014.
6. [Exhibit 38](#) - Staff memorandum entitled "Northern Trust Master Custodian Review."
7. [Exhibit 39](#) - Statement of Investment Expenses Fiscal Year 2014.
8. [Exhibit 40](#) - Investment Expense Variance Fiscal Year 2014.
9. [Exhibit 41](#) - Staff memorandum entitled "Compliance Update."
10. [Exhibit 42](#) - Investment Compliance Activities 2014/2015.
11. [Exhibit 43](#) - Staff memorandum entitled "Pension Bridge Conference Highlights."
12. [Exhibit 44](#) - Fiscal Years 2015 Summary Work Plan Investment Committee Schedule.
13. [Exhibit 45](#) - Schedule of Formal Reviews for SURS Investment Managers: Defined Benefit Plan & SMP.
14. [Exhibit 46](#) - 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 Vogel and carried with all Trustees present voting in favor.

Respectfully submitted,



Mr. William E. Mabe
Secretary, Board of Trustees

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