

# Keeping our promises

Securing and delivering the  
benefits promised to our  
members

# Addressing our challenges

Achieving long-term  
sustainability of  
the System

# INTRODUCTORY

The Comprehensive Annual  
Financial Report for Fiscal Year  
Ended June 30, 2012



## A Message from Our Executive Director



This report reflects our continued efforts to secure and deliver the retirement promises made to our members while addressing the ongoing funding challenges facing SURS.

During the past year we received the full fiscal year 2012 annual statutory contribution of \$980,485,000 as well as \$51,253,495 in other employer contributions. Additionally, we earned \$25,726,765 in investment income (net of fees). In a challenging environment, assets decreased from \$15.2 billion to \$14.7 billion, and the actuarial funding ratio decreased from 44.3% to 42.1%.

It is encouraging to note that the legislature has agreed to fully fund the fiscal year 2013 annual contribution of \$1.4 billion, which represents 95% of the Annual Required Contribution (ARC), suggesting a renewed effort to address the severe underfunding status of SURS.

Our investment professionals continue to execute a board-approved investment plan focusing on a highly diversified and cost-efficient investment program consisting of both public securities and private investment strategies. SURS staff developed an investment plan, available on the SURS website, to formalize the strategic direction of the investment portfolio for the coming year and to provide transparency of the planning process. Additional details on the investment program can be found in the Investment section of this report.

We are constantly analyzing and updating our financial assumptions and investment plans to maintain the financial health and ensure the long-term sustainability of SURS. Our management team, working with the assistance of outside actuarial, investment and legal experts, stands ready to assist the legislature in developing effective funding solutions for the state pension systems.

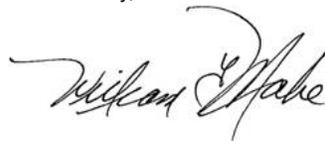
Our Member Services and Outreach divisions continue to achieve high levels of customer satisfaction for member counseling and education, in spite of a significant increase in member retirements resulting in part from the uncertainty surrounding pension reform legislation. We continue to meet or exceed our service standards because of employee dedication and our ongoing efforts to find more efficient ways to deliver service excellence.

Like other organizations, SURS expects an increase in staff attrition as many of our employees have reached or will soon reach retirement age. To that end, our team leaders have been proactive in developing succession plans for each of their areas.

Finally, we are expanding our risk management capabilities to deal with ever-increasing, complex and challenging legal, regulatory, investment and technology strategies. We continue to learn and grow in order to become a more effective organization.

In conclusion, SURS continues to be proactive and strives to achieve its mission statement as described.

Sincerely,



William E. Mabe  
Executive Director  
State Universities Retirement System

## Letter of Transmittal



### State Universities Retirement System of Illinois

Serving Illinois Community Colleges and Universities

1901 Fox Drive • Champaign, IL 61820  
1-800-ASK SURS • (217) 378-8800 (C-U)  
(217) 378-9800 (FAX)

December 18, 2012

Board of Trustees and Executive Director  
State Universities Retirement System  
1901 Fox Drive  
Champaign, IL 61820

I am pleased to present the 71st Comprehensive Annual Financial Report for the State Universities Retirement System of Illinois (SURS or the System, a component unit of the State of Illinois) for the fiscal year ended June 30, 2012.

The management of SURS is responsible for the compilation and accuracy of the financial, investment, actuarial, and statistical information contained in this report. To the best of our knowledge and belief, the enclosed information is accurate in all material respects and is reported in a manner designed to present fairly the financial position and results of operations of SURS.

The Illinois Pension Code requires an annual audit of the financial statements of the System by Certified Public Accountants selected by the State Auditor General. This requirement has been complied with, and the independent auditors' unqualified report on the System's 2012 financial statements has been included in this report.

Accounting principles generally accepted in the United States of America require that management provide a narrative introduction, overview, and analysis to accompany the basic financial statements in the form of Management's Discussion and Analysis (MD&A). This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. The System's MD&A can be found immediately following the report of the independent auditors.

### Summary of Financial Information

The following table summarizes the change in the System's plan net assets available for benefits between fiscal years 2012 and 2011.

(\$ millions)

	2012	2011	Increase/(Decrease)	
			Amount	%
Additions	\$ 1,369.9	\$ 4,102.0	\$ (2,732.1)	(66.6)
Deductions	1,856.4	1,709.0	147.4	8.6
Change	\$ (486.5)	\$ 2,393.0	\$ (2,879.5)	(120.3)

The overall decrease of \$2.9 billion in net assets available for benefits is primarily due to a decrease in additions of \$2.7 billion, composed of a decrease in net investment income of \$2.9 billion offset by an increase in employer contributions of \$0.2 billion. Deductions in the form of benefit payments showed a relatively small increase of \$0.13 billion over the prior year. More detailed analysis can be found in the Financial Section of this report.

### Profile

SURS is the administrator of a cost-sharing, multiple-employer public employee retirement system established July 21, 1941, to provide retirement annuities and other benefits for staff members and employees of the state universities, community colleges, and other agencies, and the survivors, dependents, and other beneficiaries of those employees. SURS services 65 employers and 199,622 members and annuitants. The plans administered by SURS include a defined benefit plan established in 1941 and a defined contribution plan established in 1998.

### Funding

The State of Illinois, the largest employer covered by SURS, provides funding from three sources: the General Revenue Fund, the Educational Assistance Fund, and the State Pensions Fund, which is funded with proceeds from unclaimed property. The determination of the total employer contributions for fiscal year 2012 was based on Public Act 97-0065 which appropriated \$980.5 million. Further information is presented in the required supplementary schedules related to employer contributions and the funding of the plan.

## Letter of Transmittal

The actuarial accrued liability for the defined benefit plan at June 30, 2012, was \$33.17 billion. The actuarial value of assets available for benefits at June 30, 2012, equaled \$13.95 billion. The amount by which the liability exceeds the assets is called the unfunded accrued actuarial liability, and it equaled \$19.22 billion at the end of fiscal year 2012. The System's actuary assumes that the System's investments will return 7.75% over the long term. It is expected that the growth in state required contributions versus benefit payments will continue to result in a deficit of contributions over expenses, requiring the Board of Trustees to utilize investment assets to cover benefit payments as needed.

### Investments

Investments are made under the authority of the prudent expert rule, which states that fiduciaries must discharge their duties with the care, skill, prudence, and diligence that a prudent person acting in a like capacity and familiar with such matters would use under conditions prevailing at the time. This standard has enabled the System to invest in different types of asset classes seeking to increase return while lowering risk through diversification.

The investment policy adopted September 16, 2011, provides for a goal of 67% of the fund to be invested in equities, 31% of which may be invested in U.S. equities, 30% in non-U.S. common stock and global equities, and 6% in private equities; 21% in fixed income; 7% in real estate investment trusts and direct real estate; 4% in treasury inflation-protected securities, and 1% in the Opportunity Fund. The System retains professional investment firms who serve as fiduciaries and are afforded full discretion to manage the assets entrusted to them in accordance with written policies and guidelines established by the Board of Trustees.

The majority of SURS investments are collateralized with securities held by its agent except for mutual funds, variable annuities, and commingled pools, which are not evidenced by securities that exist in physical or book entry form.

Yield information is detailed in the Investment Section of this report. Taken as a whole, the SURS portfolio of investments produced a return of 0.5%, net of fees, for the year ended June 30, 2012, 12.7% over the last three years, and 6.8% over the last 10 years.

The System has shown a positive return of 4.4% through October 31, 2012, bringing total investments to approximately \$14.0 billion.

### Major Initiatives

The mission statement of SURS provides the foundation for the System's initiatives and ongoing programs. The mission of SURS is "to secure and deliver the retirement benefits promised to our members."

We established a satellite office in Naperville to better respond to SURS membership providing counseling and employer and member seminars.

Public Act 97-0609, signed by the Governor on August 26, 2011, suspends the pension of a retired member who returns to work as an independent contractor with the same entity from which he or she retired.

Public Act 97-0651, signed into law on January 7, 2012, provides that any reasonable suspicion of a false statement by appointed or elected commissioners, trustees, directors, board members, or employees of a retirement system or pension fund governed by the Pension Code or the State Board of Investment shall be immediately referred to the board of trustees of the pension or the State Board of Investment. The Act also prohibits members of SURS from earning any statewide or national teacher organization service credit.

Public Act 97-0694, signed by the Governor on June 18, 2012, provides that a State Actuary is created under the Office of the Auditor General. The State Actuary will review actuarial assumptions utilized by the State Retirement Systems and may make recommendations concerning System assumptions used to determine the proposed certified contributions.

Public Act 97-0695, signed into law on June 21, 2012, reforms state retiree health insurance. The bill provides that the Department of Central Management Services will determine the state's contribution to the health insurance program and influence the level of annuitant premium reimbursement. Subsequent to the bill becoming law, individual lawsuits were filed challenging the constitutionality of the bill.

In keeping with best practice, SURS engaged a second independent actuarial firm to perform an actuarial review of the June 30, 2011, Actuarial Valuation performed by Gabriel, Roeder, Smith & Company. An actuarial review is generally done to confirm that the valuation and process are performed accurately and the methods and assumptions utilized are reasonable and prudent. The report, which can be found in the Actuarial Section, concluded that SURS is following appropriate actuarial principles.

## Letter of Transmittal

### Accounting System and Internal Control

SURS uses the accrual basis of accounting to record assets, liabilities, revenues, and expenses. Revenues for SURS are taken into account when earned, without regard to date of collection. Expenses are recorded when the corresponding liabilities are incurred, regardless of when payment is made. Market value has been used to present the assets of the System in accordance with Governmental Accounting Standards Board Statements #25 and #27, implemented effective July 1, 1996.

In developing and evaluating the accounting system, consideration has been given to the adequacy of internal accounting controls. These controls are designed to provide reasonable assurance regarding safekeeping of assets and reliability of financial records. These controls include appropriate segregation of duties and responsibilities and sound practices in the performance of these duties. SURS' objective is to provide reasonable, instead of absolute, assurance that the financial statements are free of material misstatements. The cost of internal controls should not exceed the benefits obtained. SURS maintains an internal audit program that employs the services of two internal auditors to determine that all controls implemented are as designed. The internal audit personnel provide a continuing review of the internal controls of SURS and reports to the SURS Board of Trustees. Audit findings and recommendations for improvements are presented to the Board.

### Certificate of Achievement for Excellence in Financial Reporting

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to SURS for its component unit financial report for the fiscal year ended June 30, 2011. This is the twenty-eighth consecutive year the System has earned this award.

To be awarded the Certificate of Achievement, a governmental unit must publish an easily readable and efficiently organized comprehensive annual financial report whose contents conform to program standards. The report must satisfy both generally accepted accounting principles and applicable legal requirements. A Certificate of Achievement is valid for a period of one year only.

We believe our current report continues to conform to the Certificate of Achievement Program requirements, and we are submitting it to GFOA to determine its eligibility for another certificate.

### Appointment of Trustees

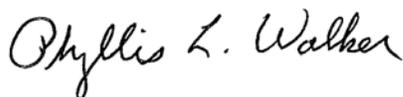
As of June 30, 2012, the composition of the SURS eleven-member Board of Trustees is as follows. Serving as active member-elected trustees are Ms. Dorinda Miller, who concluded the third year of her three-year term and Mr. Antonio Vasquez, who concluded the third year of his six-year term. Serving as annuitant-elected trustees are Dr. John Engstrom, who concluded the third year of his three-year term, and Mr. Mitchell Vogel, who concluded the third year of his six-year term. Serving upon appointment by the Governor is Mr. Matthew Berns, who concluded the third year of his six-year term. The seats formerly held by Ms. Patricia Cassidy, Dr. Marva Williams and Mr. Steven Rogers were vacant as of June 30, 2012. Ms. Cassidy, Dr. Williams and Mr. Rogers served as trustees appointed by the Governor. The seats formerly held by Mr. Jeffrey Beaulieu and Dr. J. Fred Giertz were vacant as of June 30, 2012. Mr. Beaulieu and Dr. Giertz were active member-elected trustees. As called for by Public Act 96-0006, the chairperson of the SURS Board of Trustees will be the appointed Chair of the Illinois Board of Higher Education, Ms. Carrie Hightman.

### Acknowledgements

The continuing dedication of our staff members is the foundation for our improvements and our ability to provide a secure financial future for all we serve. The preparation of the annual report by the finance division reflects the combined efforts of the SURS staff under the leadership of the SURS Board of Trustees. The report is made available to all employers covered by the State Universities Retirement System and is also available to members and other interested persons upon request.

On behalf of the Board of Trustees, I would like to express my gratitude to the staff, the consultants, and the many other people who work so effectively to assure the successful operation of this System.

Respectfully submitted,



Phyllis L. Walker  
Chief Financial Officer

## Board of Trustees



**Carrie J. Hightman**  
Chairwoman  
Chicago



**Matthew Berns**  
Highland Park



**Antonio Vasquez**  
Vice-Chairman  
Chicago



**John Engstrom**  
Sycamore



**Dorinda Miller**  
Treasurer  
Urbana



**Andrew Matthews**  
Normal



**Jacqueline Berger**  
Chicago



**Mitchell Vogel**  
Evanston

## Administrative Staff



**William E. Mabe**  
Executive Director



**Brenda Dunn**  
Interim Director of  
Human Resources



**Daniel L. Allen**  
Chief Investment Officer



**Angela Lieb**  
Director of  
Member Services



**Michael B. Weinstein**  
General Counsel



**Pam Butler**  
Director of  
Outreach



**Douglas Wesley**  
Deputy Chief  
Investment Officer



**M. Christopher Hansen**  
Director of Operations



**Phyllis Walker**  
Chief Financial Officer

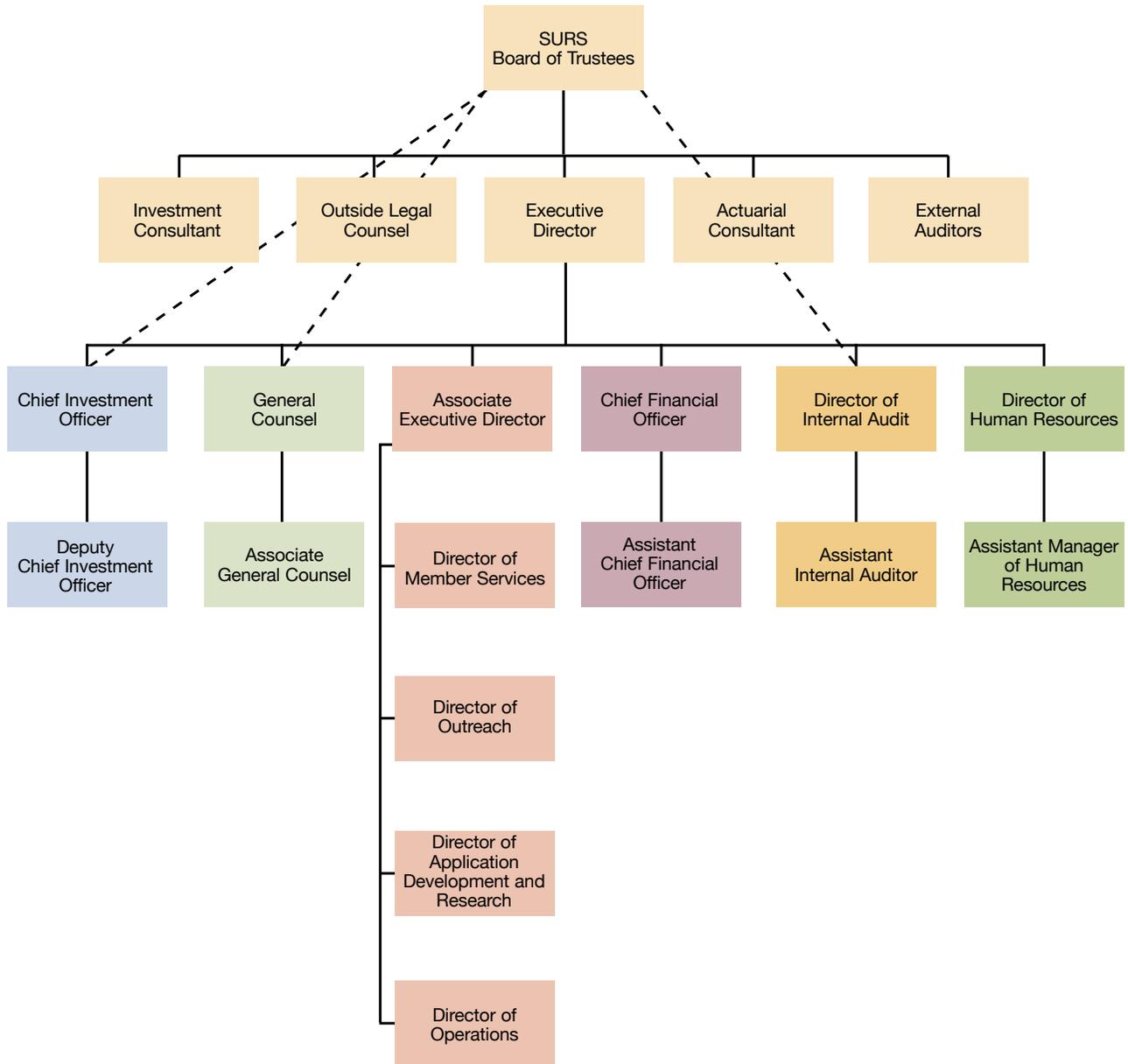


**Douglas J. Steele**  
Director of Application  
Development & Research



**Steven L. Hayward**  
CPA  
Internal Auditor

# Organizational Chart



## Consulting and Professional Services

### Actuary

Gabriel, Roeder, Smith & Co. – Chicago, Illinois

### Auditors

McGladrey LLP – Schaumburg, Illinois  
(Acting as Special Assistant Auditor for the Illinois  
Office of the Auditor General)

The Segal Company, Ltd. – Chicago, Illinois

### Legal Counsel

Burke, Burns & Pinelli, Ltd. – Chicago, Illinois  
Katten Muchin Rosenman, LLP – Chicago, Illinois

Mayer Brown, LLP – Chicago, Illinois  
Thomas, Mamer & Haughey, LLP – Champaign, Illinois

### Informational Systems

Adjacent Technologies, Inc. – Champaign, Illinois  
Champaign Systems, Inc. – Champaign, Illinois  
CTG Inc. of Illinois – Springfield, Illinois  
Document Access Systems – Richmond, Virginia

Gartner Inc. – Dallas, Texas  
MRC Information Technology, Inc. – Omaha, Nebraska  
Sirius Computer Solutions, Inc. – Dallas, Texas  
Vision Solutions, Inc. – Palatine, Illinois

### Master Custodian & Performance Measurement

The Northern Trust Company - Chicago, Illinois

### Investment Consultant

Callan Associates Inc. - San Francisco, California

### Investment Advisors

Aberdeen Asset Management - Edinburgh, Scotland  
Adams Street Partners - Chicago, Illinois  
Alinda Capital Partners - New York, New York  
Angelo Gordon GECC - New York, New York  
BlackRock Institutional Trust Company - San Francisco, California  
Calamos Advisors - Naperville, Illinois  
CBRE Clarion Real Estate Securities - Radnor, Pennsylvania  
Chicago Equity Partners - Chicago, Illinois  
Dune Capital Management - New York, New York  
Franklin Templeton Real Estate Advisors - New York, New York  
GlobeFlex Capital, L.P. - San Diego, California  
Jacobs Levy Equity Management - Florham Park, New Jersey  
Macquarie Capital - New York, New York  
Martin Currie, Inc. - Edinburgh, Scotland  
Mesirow Financial Investment Management - Chicago, Illinois  
Metropolitan West Asset Management - Los Angeles, California  
Mondrian Investment Partners - London, England

Muller and Monroe - Chicago, Illinois  
Neuberger Berman - Chicago, Illinois  
Northern Trust Investments - Chicago, Illinois  
Oaktree Capital Management - Los Angeles, California  
Pacific Investment Management Company - Newport Beach, California  
Pantheon Ventures - San Francisco, California  
Piedmont Investment Advisors - Durham, North Carolina  
Progress Investment Management Company - San Francisco, California  
Pyramis Global Advisors Trust Company - Smithfield, Rhode Island  
RhumbLine Advisers - Boston, Massachusetts  
RLJ Western Asset Management - Bethesda, Maryland  
RREEF - Chicago, Illinois  
State Street Global Advisors - Boston, Massachusetts  
T. Rowe Price - Baltimore, Maryland  
Taplin, Canida & Habacht - Miami, Florida  
UBS Realty Investors - Hartford, Connecticut  
Wellington Management Company - Boston, Massachusetts

### Manager Diversity Program Investment Advisors

Ativo Capital Management - Chicago, Illinois  
Channing Capital Management - Chicago, Illinois  
EARNEST Partners - Atlanta, Georgia  
Fiduciary Management Associates - Chicago, Illinois  
Garcia Hamilton & Associates - Houston, Texas  
Herndon Capital Management - Atlanta, Georgia  
Holland Capital Management - Chicago, Illinois  
LM Capital Group - San Diego, California

Lombardia Capital Partners - Pasadena, California  
Longfellow Investment Management - Boston, Massachusetts  
NCM Capital Management - Durham, North Carolina  
New Century Advisors - Bethesda, Maryland  
Profit Investment Management - Silver Spring, Maryland  
Pugh Capital Management - Seattle, Washington  
Smith Graham & Company - Houston, Texas  
Strategic Global Advisors - Newport Beach, California

### Progress Investment Management Company

#### Emerging Manager Investment Advisors

AH Lisanti Capital Growth - New York, New York  
Ambassador Capital Management - Detroit, Michigan  
Bowling Investments - Cincinnati, Ohio  
Brown Capital Management - Baltimore, Maryland  
Cheswold Lane Asset Management - West Conshohocken,  
Pennsylvania  
Fortaleza Asset Management - Chicago, Illinois  
Garcia Hamilton & Associates - Houston, Texas  
Graham and Dodd Fund - New York, New York  
GW Capital - Bellevue, Washington

Hahn Capital Management - San Francisco, California  
Herndon Capital Management - Atlanta, Georgia  
Holland Capital Management - Chicago, Illinois  
John Hsu Capital Group - New York, New York  
LM Capital Group - San Diego, California  
New Century Advisors - Bethesda, Maryland  
Piedmont Investment Advisors - Durham, North Carolina  
Sky Investment - Toronto, Ontario  
Strategic Global Advisors, Newport Beach, California

### Self-Managed Plan Service Providers

Fidelity Investments – Boston, Massachusetts  
Teachers Investments Annuity Association-  
College Retirement Equities Fund – New York, New York