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SURS2013

BUILDING A SUSTAINABLE FUTURE

The Comprehensive Annual Financial Report
for Fiscal Year Ended June 30, 2013

A MESSAGE FROM OUR EXECUTIVE DIRECTOR



We had an impressive year in 2013. We produced strong investment returns, received our full annual contribution from the state and completed a number of operational improvement projects to enhance service.

The fund earned a strong 12.5% return (net of investment fees), increasing defined benefit plan assets to \$15.0 billion. Investment income and net appreciation totaled \$1.7 billion for the year. Long term, SURS portfolio earned an average return of 7.7% over the last ten years, 8.5% since 1988, and 9.2% for the thirty-year period.

The 2013 investment gains were achieved amid challenging economic conditions. We can attribute part of our performance to our asset allocation, which helps mitigate some of the continued market volatility we experienced during the year. We continue to restructure our portfolio to better diversify risk across the total fund. More collaboration and stronger risk systems help us make appropriate risk/return decisions for the total fund.

I am pleased to report that our rate of return exceeded the funds 12.4% composite benchmark. Balancing asset growth with strong risk management is both responsible and necessary, and supports our mission of achieving pension security for our members.

In addition to investing, we deliver pension benefits and services to over 221,000 members and annuitants. We believe our members deserve timely, accurate, reliable, and cost effective service. We strive to improve every year by tracking member satisfaction through regular customer service surveys. In addition, we have engaged CEM Benchmarking Inc. to compare our service delivery against our peers. This will assist us in providing the best service possible at a reasonable cost.

While the defined benefit plan continues to be underfunded because of shortfalls in prior year contributions from the state, this year we did receive our full contribution of \$1.4 billion. Favorable investment returns and consistent funding from the state are essential if we are to improve the financial health of the fund.

In addition to pursuing asset growth and excellent service, we have made progress during the past year on the following priorities:

- Enhanced risk management systems
- Cost-effective operations
- Operational excellence

The pension system is as much about managing risk as managing assets. We continue to strengthen our risk management systems working with Northern Trust, our asset custodian. Additionally, we have started our Project Management Office to oversee cross-department, multi-year projects, ensuring that large cross-functioning projects are properly planned, resourced and managed.

SURS remains a low-cost provider of service, while making great strides in overall performance. Our operating expenses were 0.09% of the system's total net position. We continue to be trusted stewards of the system.

However, the largest factor in our success continues to be the expertise and commitment of our employees. I am proud of the way our employees remain focused on our investment strategies and customer service, notwithstanding a challenging economic and political environment. We continue to review our talent pool to make sure we possess the right skills and depth of talent to meet our current and future needs.

Our recent employee survey showed that SURS is a great place to work. We continue to have strong employee engagement as indicated by our high survey participation rate, along with high customer service satisfaction scores in completing daily tasks and a strong commitment to performing quality work.

Finally, we appreciate the strong support of the SURS board members and stakeholders. We remain committed to giving and doing our best in the coming years.

Sincerely,

A handwritten signature in black ink that reads "William E. Mabe". The signature is written in a cursive, flowing style.

William E. Mabe
Executive Director

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)

INTRODUCTORY
FINANCIAL
INVESTMENT
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STATISTICAL

December 18, 2013

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

I am pleased to present the 72nd 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, 2013.

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 independent certified public accountants selected by the State Auditor General. This requirement has been complied with, and the independent auditors' unmodified report on the System's 2013 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 on page 16 of the report.

Summary of Financial Information

The following table summarizes the change in the System's plan net position available for benefits between fiscal years 2013 and 2012.

(\$ millions)

	2013	2012	Increase/(Decrease)	
			Amount	%
Additions	\$ 3,598.1	\$ 1,369.9	\$ 2,228.2	162.7
Deductions	2,049.6	1,856.4	193.2	10.4
Change	\$ 1,548.5	\$ (486.5)	\$ 2,035.0	418.3

The overall increase of \$2.0 billion in net position available for benefits is primarily due to an increase in additions of \$2.2 billion, composed of an increase in net investment income of \$1.8 billion and an increase in employer contributions of \$0.4 billion. Deductions in the form of benefit payments showed an increase of \$0.19 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 certain affiliated organizations, certain other state educational and scientific agencies, and the survivors, dependents, and other beneficiaries of those employees. SURS services 65 employers and 221,061 members and annuitants. The plans administered by SURS include a defined benefit plan established in 1941 and a defined contribution plan established in 1998.

LETTER OF TRANSMITTAL

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. Annually, the SURS actuary determines the annual "Statutory Contribution" needed to meet current and future benefit obligations. The determination of the total employer contributions for fiscal year 2013 was based on Public Act 97-0685 which appropriated \$1,402.8 million. Further information is presented in the Required Supplementary Information related to employer contributions and the funding of the plan.

The actuarial accrued liability for the defined benefit plan at June 30, 2013, was \$34.4 billion as calculated by the projected unit credit method. The actuarial value of assets available for benefits at June 30, 2013, equaled \$14.3 billion. The amount by which the liability exceeds the assets is called the unfunded accrued actuarial liability, and it equaled \$20.1 billion at the end of fiscal year 2013. SURS uses a five-year smoothed market value, which is intended to prevent extreme volatility in employer contributions. The actuarial funding ratio is currently 41.5%. The System's actuary assumes that the System's investments will return 7.75% over the long term. The actuary has determined that the current market value of assets is sufficient to provide 43.5% of benefits for active, inactive and retired members. The Actuarial Section contains the actuary's letter and additional information on SURS' funding.

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 provides for a goal of 66% of the fund to be invested in equities, 31% of which may be invested in U.S. equities, 29% in non-U.S. common stock and global equities, and 6% in private equities; 19% in fixed income; 10% 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. Our goal is to optimize the long-term return of the System's investments.

The SURS defined benefit assets held in trust increased from \$13.7 to \$15.0 billion. Yield information is detailed in the Investment Section of this report. Taken as a whole, the SURS portfolio of investments produced a return of 12.5%, net of fees, for the year ended June 30, 2013, 11.8% over the last three years and 7.7% over the last 10 years. The SURS defined contribution assets increased from \$1.0 billion to \$1.3 billion.

The System has shown a positive return of 8.45% through October 31, 2013, bringing total investments to approximately \$16.1 billion.

Major Initiatives

SURS implemented several operational initiatives in key areas to help provide the highest quality service to our members in a timely, accurate, and cost effective manner. Those include:

- **Language Interpreter Service through SURS Call Center**
This new service provides immediate access to over 150 language operators, increasing SURS ability to serve a diverse membership.
- **Plan Choice Webinars**
The outreach department implemented monthly webinars to provide helpful information to new participants concerning their plan choice decision.
- **Electronic Funds Transfer**
To improve customer service, Electronic Funds Transfer (EFT) was implemented for benefit check writing and direct debit of annuitant insurance withholdings.
- **Website Redesign**
The SURS website – www.surs.org – was redesigned to improve navigation and functionality.

LETTER OF TRANSMITTAL

- **Participation in Council of Institutional Investors (CII)**

SURS has maintained its commitment to corporate governance through its long-term affiliation with the CII and through its support of corporate governance reforms such as transparency, accountability, and enforcement of shareholder's rights.

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. Fair 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 those duties. SURS maintains an internal audit program that employs the services of three 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, 2012. This is the twenty-ninth 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

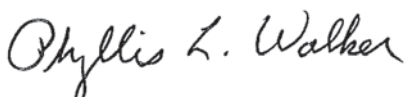
As of June 30, 2013, the composition of the SURS eleven-member Board of Trustees is as follows. Serving as active member-elected trustees are Ms. Jacqueline Berger, who concluded the first year of her three-year term; Mr. Andrew Matthews, who concluded the first year of his six-year term; Ms. Dorinda Miller, who was re-elected and concluded the first year of her six-year term; and Mr. Antonio Vasquez, who concluded the fourth year of his six-year term. Serving as annuitant-elected trustees are Mr. Mitchell Vogel, who concluded the fourth year of his six-year term and Dr. John Engstrom, who was re-elected and concluded the first year of his six-year term. Serving upon appointment by the Governor is Mr. Richard Figueroa, who concluded the first year of his three-year term, Mr. Paul R.T. Johnson, Jr., who concluded the first year of his six-year term, and Mr. Craig McCrohon, who concluded the first year of his six-year term. As called for by Public Act 96-0006, the chairperson of the SURS Board of Trustees, Ms. Lindsay Anderson, will be the appointed Chair of the Illinois Board of Higher Education.

Acknowledgements

This report was prepared through the combined effort of the SURS staff under the leadership of the Board of Trustees. It is intended to provide reliable information to its users for making decisions and for determining responsible stewardship for the assets contributed by the members and the State of Illinois.

The report is made available to the Governor, the State Auditor, the members of the General Assembly, participating employers, and to other interested persons by request. The cooperation of our affiliated employers is significant to the success of SURS. We hope they will find this report informative. A copy of this report and our Annual Report Summary will be available on our website, www.surs.org.

Respectfully submitted,



Phyllis L. Walker
Chief Financial Officer

BOARD OF TRUSTEES



Lindsay Anderson
Chairperson
Appointed



Antonio Vasquez
Vice Chairman
Elected



Dorinda Miller
Treasurer
Elected



Jacqueline Berger
Elected



John Engstrom
Elected



Richard Figueroa
Appointed



Paul R. T. Johnson Jr.
Appointed



Andrew Matthews
Elected



Craig McCrohon
Appointed



Mitchell Vogel
Elected

ADMINISTRATIVE STAFF



William E. Mabe
Executive Director



Daniel L. Allen
Chief Investment Officer



Michael B. Weinstein
General Counsel



Phyllis Walker
Chief Financial Officer



Steven L. Hayward, CPA
Director of Internal Audit



Brenda Dunn
Director of Human Resources



Douglas Wesley
Deputy Chief Investment Officer



Angela Lieb
Director of Member Services



Pam Butler
Director of Outreach

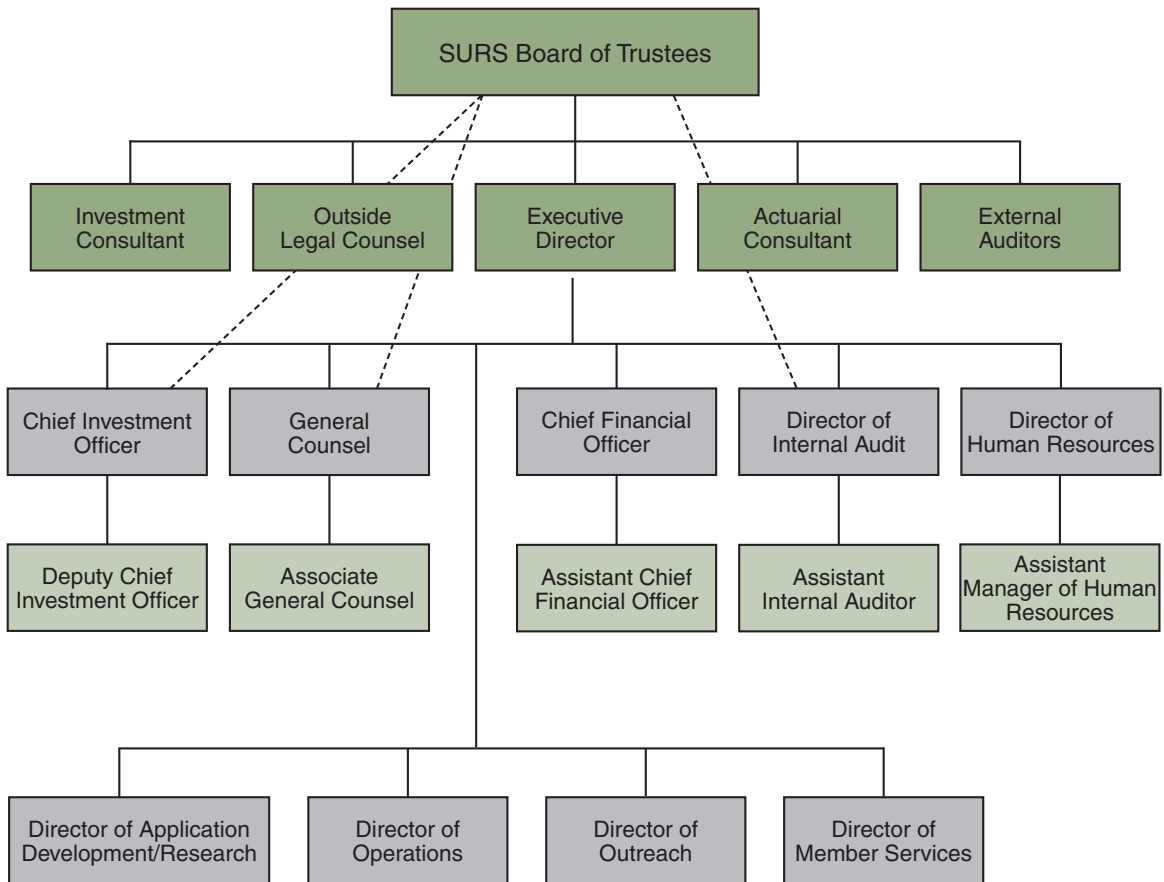


Douglas J. Steele
Director of Application Development & Research



M. Christopher Hansen
Director of Operations

ORGANIZATIONAL CHART



CONSULTING AND PROFESSIONAL SERVICES

Actuary

Gabriel, Roeder, Smith & Co. – Chicago, Illinois
The Segal Company, Ltd. – Chicago, Illinois

Auditors

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

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

Engineering Services

Henneman Engineering, Inc. – Champaign, Illinois

Master Custodian & Performance Measurement

The Northern Trust Company - Chicago, Illinois

Investment Consultant

Callan Associates Inc. - San Francisco, California

Investment Advisors

Adams Street Partners - Chicago, Illinois
Alinda Capital Partners - New York, New York
BlackRock Institutional Trust Company - San Francisco, California
Calamos Advisors - Naperville, Illinois
CastleArk Management - Chicago, 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
Mondrian Investment Partners - London, England
Muller and Monroe Asset Management - Chicago, Illinois
Neuberger Berman - Chicago, Illinois
Northern Trust Global 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
RREEF - Chicago, Illinois
State Street Global Advisors - Boston, Massachusetts
T. Rowe Price - Baltimore, Maryland
Taplin, Canida & Habacht - Miami, Florida
TCW / Metropolitan West Asset Management - Los Angeles, California
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
New Century Advisors - Chevy Chase, 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

Affinity Investment Advisors - Irvine, California
Ambassador Capital Management - Detroit, Michigan
Brown Capital Management - Baltimore, Maryland
Cheswold Lane Asset Management - West Conshohocken, Pennsylvania
Fortaleza Asset Management - Chicago, Illinois
Garcia Hamilton & Associates - Houston, Texas
Glovista Investments - Jersey City, New Jersey
GW Capital - Bellevue, Washington
Hahn Capital Management - San Francisco, California
Hanoverian Capital - Kennett Square, Pennsylvania
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 - Chevy Chase, Maryland
Piedmont Investment Advisors - Durham, North Carolina
Ramirez Asset Management - New York, New York
Sky Investment Counsel - Toronto, Ontario, Canada
StoneRidge Investment Partners - Malvern, Pennsylvania
Strategic Global Advisors - Newport Beach, California
Vision Capital Management - Portland, Oregon

Self-Managed Plan Service Providers

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

