



MINUTES

**Meeting of the Investment Committee
of the Board of Trustees of the
State Universities Retirement System
9:00 a.m., Thursday, June 11, 2009
The Northern Trust – London Room B9
50 S. LaSalle Street
Chicago, Illinois**

The following Trustees were present: Mr. Mark Donovan, Mr. Michael Mackey, Dr. Alice Palmer, Mr. Antonio Vasquez, Mr. Mitchell Vogel and Dr. Marva Williams.

Others present were: Ms. Judith A. Parker, Interim Executive Director; Mr. Daniel L. Allen, Chief Investment Officer; Mr. Kelly A. Jenkins, General Counsel; Mr. Douglas C. Wesley, Deputy Chief Investment Officer; Ms. Kimberly Pollitt, Senior Investment Officer; Ms. Lou Ann Fillingham and Mr. Tony Lee, Investment Officers; Ms. Marilyn Branson, Investment Governance and Compliance Officer; Ms. Shelley Porter, Chief Financial Officer; Mr. Steve Hayward, Internal Audit Director; Ms. Angie Lieb, Director of Member Services; Mr. Douglas Steele, Application Development Manager; Mr. Chris Hansen, Information Systems & Building Services Manager; Mr. Terrin Krantz, Director of Human Resources; Mr. Michael Sheppard, Assistant Deputy Director of SMP; Ms. Lori Kern and Ms. Hanea Schluter, Executive Assistants; Ms. Mary Pat Burns, Burke, Burns & Pinelli; Mr. Russell Ivinjack, Ms. Laurel Nicholson, Ms. Heather Christopher, Mr. Mike Comstock, Mr. Dan Kim and Mr. Chris Reel, Ennis Knupp + Associates; Ms. Leslie Thompson and Ms. Amy Williams, Gabriel Roeder Smith & Company; Mr. Don Pollak, Northern Trust Investments; Ms. Amy Bacich, Mr. Dan Hynes and Ms. Amy Sproull, The Northern Trust Company; Ms. Carrie Hightman, Illinois Board of Higher Education; Mr. Thomas Kizziah, Office of the Auditor General; Ms. Linda Brookhart and Mr. Dick Lockhart, SUAA; Mr. Edgar Hernandez, Service Employees International Union; Ms. Janice Gonzalez, Channing Capital Management; Mr. Mike Lazzaro, Policemen's Annuity and Benefit Fund of Chicago; Mr. John Engstrom; Mr. Doug Quoyal.

As Trustee Christine Boardman could not be present, Trustee Mitchell Vogel called the meeting to order at the time and location set forth in the notice of the meeting.

Roll call attendance was taken. Trustee Boardman, absent; Trustee Donovan, present; Trustee Mackey, present; Trustee Palmer, absent (roll call was taken before her arrival);

Trustee Pizzuto, absent; Trustee Vasquez, present; Trustee Vogel, present; Trustee Williams, present.

REPORT FROM THE APRIL 23, 2009 INVESTMENT COMMITTEE MEETING

Mr. Daniel Allen introduced Mr. Thomas Kizziah of the Office of the Auditor General and Mr. Richard Ennis of Ennis Knupp + Associates (EKA). Trustee Vogel also introduced Trustee Alice Palmer who joined the meeting at this point. Mr. Allen remarked on recent events, noting that investment staff and Trustee Vasquez attended the EKA Client Conference, and that staff also attended the Adams Street Partners Client Conference. Mr. Allen participated in the Advisory Committee meeting for the Adams Street Partners Direct Fund and Mr. Douglas Wesley represented SURS at Dune Capital Management's Advisory Committee meeting. Mr. Allen and Mr. Tony Lee also attended Muller and Monroe Asset Management's annual meeting.

Mr. Russell Ivinjack discussed investment returns for the SURS portfolio, which totaled -29.4% for the year ended March 31, 2009. Mr. Ivinjack remarked that January and February 2009 were very difficult; however, subsequent months have shown some improvement, and he noted recent actions taken to rebalance the SURS portfolio within the policy allocation ranges. Mr. Ivinjack noted that portfolio returns were favorable compared to the policy benchmark, but less favorable compared to public pension fund peers due to allocations to Real Estate Investment Trusts (REITS) and Treasury Inflation Protected Securities (TIPS). SURS' portfolio return since inception (1981) is 9.4%, which is above the actuarial expected rate of return. Discussion followed.

Mr. Allen reviewed the funding summary estimated as of May 31, 2009, which is incorporated as a part of these Minutes as [Exhibit 1](#). Mr. Allen advised that the fiscal year to date return as of May 31 is -19.6%, assets total slightly over \$11 billion, liabilities continue to increase, and the funding ratio is estimated at 42.5%. Discussion followed regarding performance comparisons with other Illinois public pension funds.

Mr. Wesley provided an overview of SURS' allocations to U.S. equity, and he advised that the passive allocation has decreased over time from 80%, while the structured active allocation has increased. Mr. Wesley remarked that active management continues to represent about 10% of the total U.S. equity portfolio, and that all of SURS' global equity managers are active managers.

Mr. Allen's Investment Committee Meeting Status Report and his memorandum, entitled "Investment Contracts Approved", dated June 1, 2009, are incorporated as a part of these Minutes as [Exhibit 2](#) and [Exhibit 3](#).

APPROVAL OF MINUTES

Trustee Mark Donovan made the following motion:

- that the Minutes from the April 23, 2009, Investment Committee meeting be approved as presented.

The motion was seconded and the motion carried.

PORTFOLIO REBALANCING STATUS UPDATE

Mr. Wesley presented an update regarding the portfolio rebalancing activity of the past several months. Mr. Wesley noted that the Board was advised in December that the portfolio had moved outside of the approved asset allocation ranges; however, since market liquidity was extremely low, staff requested additional time to take corrective action. After presenting a plan to reduce the tracking error of the portfolio at the March meeting, staff began to implement the rebalancing process. Representatives from Barclays Global Investors reviewed the first phase at the April Investment Committee meeting, and immediately after, the final phase was undertaken, which included liquidating the internal TIPS allocation and moving the funds into the equity markets. Mr. Wesley provided additional details and confirmed that, as of the end of May, the asset allocation for every asset class resides within the approved ranges. Mr. Wesley also noted that the timing was favorable, since due to the rally in the equity markets, the total fund market value is approximately \$46 million greater than it would have been without rebalancing.

Copies of the memorandums by Mr. Allen and Mr. Douglas Wesley, entitled “U.S. Equity Allocation History” and “Portfolio Rebalancing Update”, are incorporated as a part of these Minutes as [Exhibit 4](#) and [Exhibit 5](#).

REVIEW OF ECONOMIC ASSUMPTIONS

Ms. Leslie Thompson presented a report on the validity of an 8.5% return assumption in light of the current economy. According to her analysis, Ms. Thompson advised that 8.5% remains within the range of reasonableness for the expected return of the portfolio. Ms. Thompson remarked that the 2006 actuarial experience study produced an expected return of 8.3%, and after taking into consideration SURS’ current policy allocation and EKA’s capital market assumptions, a return of 8.4% is now expected since the probability that capital markets will rise has increased. Ms. Thompson noted, however, that a survey of the public fund universe indicates that there has been a downward movement, as 72.5% of the funds are at or below an 8% return assumption. Given the long term perspective that is required, Ms. Thompson concluded that, when the next full experience study is conducted, it will be known whether there have been fundamental changes to capital markets that would compel recommendation of a lower return assumption. Discussion surrounding underfunding followed. Mr. Ivinjack also noted that, on a nominal basis, EKA’s return assumptions differ from Gabriel Roeder Smith & Company due to the time horizons used to calculate expected inflation.

Trustee Vogel made the following motion:

- that the results from the Report of the Review of Actuarial Assumptions be approved, maintaining the assumed rate of return at 8.5% pending the outcome of the next experience study.

The motion was seconded and the motion carried.

Trustee Vogel then advised that Trustee Donovan would serve as chair for the remainder of the meeting.

Copies of the memorandum by Mr. Allen, entitled “Economic Assumptions Update Study Recommendation”, and the report by Gabriel Roeder Smith & Company, “The Report of the Review of Actuarial Assumptions”, are incorporated as a part of these Minutes as [Exhibit 6](#) and [Exhibit 7](#).

PRIVATE EQUITY ASSET CLASS OVERVIEW

Mr. Dan Kim provided an overview of the private equity asset class, in which SURS has been invested for nearly 19 years. Since its inception, SURS’ private equity program has achieved an annual internal rate of return of 25.1%. Mr. Kim advised that EKA continues to believe that private equity is an appropriate investment for public funds and that SURS’ policy target allocation of 6% is also appropriate. Mr. Kim noted that Illinois Public Act 96-0006 prohibits payments to placement agents and he also discussed the future outlook for private equity.

Copies of the EKA reports, “Private Equity Asset Class Overview” and “Private Equity Market Overview”, are incorporated as a part of these Minutes as [Exhibit 8](#) and [Exhibit 9](#).

PRIVATE EQUITY ASSET CLASS MANAGER REVIEWS AND UPDATE OF FUNDING PLAN

Ms. Kimberly Pollitt reported that SURS private equity portfolio experienced a -14.9% return for the one-year period ended March 31, 2009, versus the benchmark return of -32.2%. Ms. Pollitt reviewed organizational changes, and she noted that Pantheon Ventures reduced the management fee for the Private Opportunities Fund to 0.75% effective January 1, 2009, which should result in savings of approximately \$187,000 per year. Ms. Pollitt also remarked that staff monitoring of private equity has increased, particularly with respect to the review of valuation methods, and she outlined the efforts in this regard. Ms. Pollitt advised that SURS staff and EKA recommend retention of Adams Street Partners, Pantheon Ventures, Muller & Monroe Asset Management, and Progress Investment Management Company as private equity managers for SURS.

Trustee Donovan made the following motions:

- that Adams Street Partners be retained as a private equity manager.
- that Pantheon Ventures be retained as a private equity manager, which includes the Private Opportunities Fund.

- that Muller and Monroe be retained as a private equity manager.
- that Progress Investment Management be retained as a private equity manager.

During discussion, it was noted that the prohibition on placement agents could impact minority-owned private equity managers as they tend to be smaller in size, and small firms often utilize the services of placement agents. Trustee Palmer recommended that the Board issue comments after examining the legislation, and that consideration be given to other avenues of utilizing minority- and women-owned investment managers.

The motions were then seconded and they carried.

Mr. Allen briefly discussed the three-year private equity funding plan that was approved last June. Mr. Allen noted that private equity has been overweight due to the decline in public equities, but as the markets recover, he anticipates that commitments to private equity will resume later in the year.

A copy of the staff memorandum, “Executive Summary of the Private Equity Asset Class and Manager Reviews”, and the annual reviews of Adams Street Partners, Pantheon Ventures, Muller & Monroe Asset Management, and Progress Investment Management are incorporated as a part of these Minutes as [Exhibit 10](#), [Exhibit 11](#), [Exhibit 12](#), [Exhibit 13](#), and [Exhibit 14](#). A copy of Mr. Allen’s memorandum, entitled “Private Equity Funding Plan for Calendar Years 2009-2011”, is also incorporated as a part of these Minutes as [Exhibit 15](#).

SECURITIES LENDING UPDATE

Mr. Wesley remarked that there are no organizational or staffing issues to report with respect to Credit Suisse. For the first ten months of the fiscal year, securities lending income totaled \$12 million, which exceeds the guarantee that is set to expire at the end of July. Mr. Wesley advised that Credit Suisse has declined to make a further guarantee of revenue, which was offered initially to provide a level of comfort to the Board to move to third party lending. Noting that Credit Suisse has far surpassed the revenue guarantee for the first two years, Mr. Wesley advised that SURS staff and EKA recommend retention of Credit Suisse as a securities lending provider for SURS. Mr. Wesley also commented that the investment guideline changes recommended by EKA are expected to be resolved within the next month. Discussion followed.

Trustee Donovan made the following motion:

- that Credit Suisse be retained as a securities lending provider.

The motion was seconded and the motion carried.

A copy of Mr. Wesley’s memorandum, entitled “Securities Lending Update”, is incorporated as a part of these Minutes as [Exhibit 16](#).

FISCAL YEAR 2010 INVESTMENT DEPARTMENT BUDGET

Ms. Lou Ann Fillingham presented the proposed investment operations budget for fiscal year 2010. The budget reflects an overall decrease of approximately \$1.7 million, or 4.6%, from the previous fiscal year, primarily a result of lower asset values used in the calculation of investment management fees. Investment management fees for the first three quarters of fiscal year 2009 totaled \$20.3 million, versus the \$35 million annual budget amount, due to declining asset values and weaker relative returns over the past year. Ms. Fillingham remarked that SURS' investment management expenses since 1991 compare very favorably with other public pension funds; however, fees are expected to increase as SURS invests in alternative asset classes with higher fee structures. Ms. Fillingham also detailed factors contributing to an expected increase in investment administrative expenses of \$135,300 as compared to the previous fiscal year's approved budget.

Trustee Michael Mackey made the following motion:

- that the Investment Department Operating Budget for Fiscal Year 2010 be approved as presented.

The motion was seconded and the motion carried.

A copy of the memorandum by Mr. Allen and Ms. Fillingham, "Investment Operations Budget – Fiscal Year 2010", is incorporated as a part of these Minutes as [Exhibit 17](#).

REVIEW OF OPPORTUNITY FUND ASSET CLASS

Mr. Allen remarked that, as of March 31, 2009, the sole investment in the opportunity fund asset class is the Private Opportunities Fund, which is currently in liquidation. As the infrastructure search is underway and a commodities search is planned, a 2% allocation in the opportunity fund is anticipated in the near future.

A copy of Mr. Allen's memorandum, entitled "Opportunity Fund Asset Class", is incorporated as a part of these Minutes as [Exhibit 18](#).

STATUS UPDATE OF INFRASTRUCTURE SEARCH PROCESS

Mr. Kim provided an update on the infrastructure manager search that is currently in process. After the request for proposals (RFP) was issued on April 6, thirty responses were received by the May 6 deadline, which are now under review. Mr. Kim noted that the infrastructure RFP requested diversity information from the respondent firms. Over the summer, EKA will work with SURS staff to narrow the pool to six to twelve semi-finalists, from which two to four finalists will be selected to make presentations to the Board in the fall.

A copy of the EKA memorandum, "Infrastructure Search Update", is incorporated as a part of these Minutes as [Exhibit 19](#).

ANNUAL CONSULTANT EVALUATION OF SURS MANAGER DEVELOPMENT PROGRAM

Ms. Laurel Nicholson presented EKA's annual review of the SURS Manager Development Program (MDP), and she remarked that program goals include the identification of minority- and women-owned firms for the program and the allocation of additional funding to successful MDP managers. Ms. Nicholson advised that these primary goals are being met as the MDP currently has thirteen managers and two additional managers will soon be funded, and since, over the past year, an additional \$130 million has been designated to be allocated to managers in the program. Ms. Nicholson remarked that EKA believes the due diligence, monitoring and oversight of the program by staff to be quite adequate. In addition, investment management fees for the MDP are reasonable and performance since inception has matched the benchmark, and U.S. equity and non-U.S. equity MDP managers have outperformed.

A copy of the EKA memorandum, "Annual Manager Development Program Review", is incorporated as a part of these Minutes as [Exhibit 20](#).

PRESENTATION OF SURS INVESTMENT MANAGER WATCH LIST

Mr. Tony Lee presented the investment manager watch list update. Mr. Lee remarked that 2008 was a very difficult year for active investment managers, as relative performance suffered for most asset classes, and especially for the fixed income asset class. Mr. Lee noted that NCM Capital Management was removed from the watch list, and that although Western Asset Management remains on the watch list, their investment performance has improved markedly during 2009. Mr. Lee also discussed the seven managers that were added to the watch list as of March 2009, mainly due to poor investment performance as compared to benchmark.

A copy of the memorandum by Mr. Allen and Mr. Lee, entitled "June 2009 Investment Manager Watch List", is incorporated as a part of these Minutes as [Exhibit 21](#).

UPDATE OF THE AVP REAL ESTATE FUND OF FUNDS RELATIONSHIP

Ms. Heather Christopher provided an update on contract negotiations and due diligence with regard to American Value Partners (AVP). Ms. Christopher confirmed that a contract has not yet been signed with AVP, and she provided details regarding AVP's separation from their relationship with Wetherly Capital, a placement agent that was recently involved in government investigations. Ms. Christopher discussed the additional due diligence now being conducted, which includes ensuring that AVP satisfies the disclosure requirements stipulated by Illinois Public Act 96-0006.

During the following discussion, Trustee Palmer expressed concern regarding the reputational aspect of the situation. Ms. Mary Pat Burns advised that the outgoing Board has fulfilled its fiduciary obligations by securing a certification from AVP, dated June 9, 2009, which certifies officially in the record that they do not pay any placement agent fee to any person that is contingent in whole or in part on the procurement decision.

Copies of the memorandum by Mr. Allen, "Update of the AVP Real Estate Fund of Funds Relationship", and the EKA memorandum, "Status of AVP Negotiations", are incorporated as a part of these Minutes as [Exhibit 22](#) and [Exhibit 23](#).

STATUS UPDATE REGARDING COMPLIANCE ACTIVITIES
PER PUBLIC ACT 96-0006

Ms. Pollitt reported that, in order to comply with Illinois Public Act 96-0006, a revision to the investment policy, which sets forth an investment procurement policy, was approved by the Board on April 23, 2009. Also, letters were sent to SURS' investment consultant and investment managers due to the legislation's requirement that such firms must disclose any fee paid in connection with their relationship with SURS. Ms. Pollitt advised that no contingent or placement fees were found to have been paid to secure the SURS relationship, and that staff is working to comply with other provisions of the law, which include changes to the definition of emerging managers, development of diversity policies, contract requirements, and updates to the SURS website.

A copy of the staff memorandum, "Update on Compliance with New Ethics Legislation (Public Act 96-0006)", is incorporated as a part of these Minutes as [Exhibit 24](#).

APPROVAL OF SCRUTINIZED COMPANIES LISTING
AS DEFINED BY PUBLIC ACT 95-616

Ms. Marilyn Branson remarked that the Board adopted the initial scrutinized companies list compiled by RiskMetrics Group on June 13, 2008, in order to comply with Illinois Public Act 95-616. Staff then corresponded with the 39 companies to notify them of their status and encourage them to cease active operations to avoid divestment, and also with SURS' private market fund investment managers to request that they consider removal of scrutinized companies from the fund or creation of a similar fund without such companies into which SURS could transfer. Although divestment is not required by the legislation if the total market value of scrutinized companies is equal to .5% or less of the total market value of system assets, SURS' indirect holdings of scrutinized companies exceeded this amount. Therefore, SURS investment managers were directed to divest by May 29, 2009, of all direct holdings of companies remaining on the list, with the result that 654,433 shares were sold and a loss of approximately \$12.5 million was incurred. Ms. Branson also presented an updated scrutinized companies list for approval, as required annually by Public Act 95-616.

Trustee Donovan made the following motion:

- that the Board of Trustees adopt the Scrutinized Companies list updated as of June 1, 2009, pursuant to Public Act 95-616, as presented.

The motion was seconded and the motion carried.

A copy of Ms. Branson's memorandum, entitled "Update on Compliance with Public Act 95-616", is incorporated as a part of these Minutes as [Exhibit 25](#).

GOVERNANCE REPORT

Ms. Branson reported that the changes proposed to the corporate governance policies of the Council of Institutional Investors, regarding board diversity and clawbacks, best disclosure practices for institutional investors, stylistic revisions, and endorsement of the Principles for Financial Regulation Reform, were passed. Ms. Branson advised that SURS signed onto letters sent on May 4, 2009, to the chairs of the Senate and House Financial Services Committees and on May 21, 2009, to the Treasury Secretary and the Director of the National Economic Council to advocate for the strengthening of the Securities and Exchange Commission. As SURS has become a signatory to the Principles for Responsible Investment, Ms. Branson noted that an announcement was posted on the SURS website. After presenting the proxy voting report for the first quarter of 2009 from the Marco Consulting Group, Ms. Branson commented on recent proxy activity.

A copy of Ms. Branson's memorandum, entitled "Governance Update", is incorporated as a part of these Minutes as [Exhibit 26](#).

GENERAL DISCUSSION

Mr. Allen advised that a lower fee arrangement, representing approximately \$50,000 in savings per year, was negotiated with Payden & Rygel following the resignation of a co-lead portfolio manager. Mr. Allen noted that Payden & Rygel is presently on the watch list and will continue to be monitored.

Ms. Christopher opened the discussion of RREEF America III, observing that institutional real estate values have been declining and liquidity concerns are prevalent among managers. Mr. Chris Reel reviewed RREEF's recapitalization plan for the fund, which involves various tactics to restructure debt, as well as a contingent equity raise, likely a preferred equity offering. Ms. Christopher noted that SURS would be offered an opportunity to invest its pro rata share of the fund in the equity raise, which is expected to offer very good terms, and she advised that EKA will continue to analyze the situation. Discussion of the investment followed. Mr. Vogel requested that staff review the recording of RREEF's presentation regarding America III to the Investment Committee to ascertain if it contains any grounds for litigation.

Mr. Allen noted that EKA's memorandum regarding Western Asset Management was provided in the agenda materials, as well as Aon Investment Consulting's report to

the Commission on Government Forecasting and Accountability on pension fund consolidation, which indicated that minimal savings would result.

A copy of the funding summary as of April 30, 2009, is incorporated as a part of these Minutes as [Exhibit 27](#). Copies of Mr. Allen's memorandum, "Marco Consulting Group Proxy Voting Summary Reports", and the Marco Consulting Group's quarterly report (1/01/09-3/31/09) are incorporated as a part of these Minutes as [Exhibit 28](#) and [Exhibit 29](#). Copies of Mr. Allen's memorandum, entitled "Payden & Rygel Investment Management Fee Reduction", and Payden & Rygel's letter to Mr. Allen dated April 28, 2009, are incorporated as a part of these Minutes as [Exhibit 30](#) and [Exhibit 31](#). Copies of the EKA memorandums, "RREEF America III Recapitalization Plan" and "Western Asset Management On-Site Update", are incorporated as a part of these Minutes as [Exhibit 32](#) and [Exhibit 33](#). A copy of the report by Aon Investment Consulting, "Analysis of Investment Fee Savings and Transition Costs due to Potential Consolidation into Illinois Public Employees Retirement System (ILPERS)", is incorporated as a part of these Minutes as [Exhibit 34](#).

STANDARD INVESTMENT REPORTS

Ms. Fillingham presented the standard investment reports as of March 31, 2009, and she noted that expenses are significantly below budget for the fiscal year. Ms. Fillingham also advised that the total usage of minority- and women-owned brokerage firms has met or exceeded expected levels for each of the four asset classes. The standard investment reports are incorporated as a part of these Minutes as [Exhibit 35](#).

Mr. Allen thanked the trustees for their service on the Investment Committee and Trustee Palmer also expressed her appreciation to the SURS staff and consultants.

The Investment Compliance Calendar, 2009-2010 Work Plan, the Schedule of Formal Reviews for SURS Investment Managers, and the Schedule of Investment Committee Meetings are incorporated as part of these Minutes as [Exhibit 36](#), [Exhibit 37](#), [Exhibit 38](#), and [Exhibit 39](#).

There being no further business to come before the Committee, the meeting adjourned.

Respectfully submitted,



Ms. Judith A. Parker
Interim Executive Director

JAP:mb