

# INTRODUCTORY

## The start and early years

Creating the University Retirement System of Illinois (renamed State Universities Retirement System in 1963) started with careful, diligent study that took four years and included surveying every employee at its sponsoring university, the University of Illinois.

The System initially included the faculty and staff of the University of Illinois, Normal School Board, Illinois State Normal University, Northern Illinois State Teachers' College, Southern Illinois State Normal University, Eastern Illinois State Teachers' College, Western Illinois State Teachers' College, State Geological Survey, State Natural History Survey, State Water Survey, and the Board of Trustees of the University Retirement System.

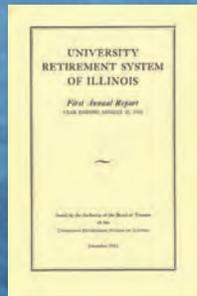


### 1941

Gov. Dwight H. Green signed the law governing the University Retirement System of Illinois.

The System opened its doors in Room 305 of the University of Illinois Administration Building (now known as the David Dodds Henry Administration Building) on Wright Street in Urbana. Ruth Ellen Kunkel served as the first senior administrator.

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## 1942

Three staff members served the System's 3,760 participants.

The average annual salary of a participant was \$2,217.

## 1949

The System expanded to two rooms of the U of I Administration Building.

A legislative amendment to the 1941 law required that all permanent and continuous employees participate regardless of age. Until this time, participation had been optional for employees under 30.

## 1954

The System moved to 1210 W. Oregon, an old 1,300-square-foot two-story house in Urbana.

## LETTER OF TRANSMITTAL



1901 Fox Drive, Champaign, IL 61820-7333  
800-275-7877 • 217-378-8800 • (Fax) 217-378-9800  
[www.surs.org](http://www.surs.org)

December 12, 2016

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

I am pleased to present the 75th 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, 2016.

The System was established in 1941 for the benefit of the employees of the state universities, community colleges, and certain other state educational and scientific agencies, and the survivors, dependents, and other beneficiaries of those employees. Our vision is to continue to be a respected leader among public pension funds. The SURS staff strives to deliver the exceptional service our members expect and prudently manage the System's assets. The knowledge, wealth and civic pride generated by the educational institutions that are part of the SURS system enhance the well-being of the students, the communities and the state.

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.

Management is responsible for establishing and maintaining adequate internal controls over financial reporting. SURS' internal controls over financial reporting are designed to provide reasonable assurance regarding safekeeping of assets and reliability of financial records in accordance with generally accepted accounting principles. These controls include appropriate segregation of duties and responsibilities, and sound practices in the performance of those duties. The cost of a control should not exceed the benefits likely to be derived. The valuation of costs and benefits requires estimates and judgments by management. The objective of internal controls is to provide reasonable, rather than absolute assurance, that the financial statements are free of any material misstatements.

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 use a detailed internal audit program to provide a continuing review of the SURS internal controls and to report audit findings and recommendations for improvements to the SURS Board of Trustees. There are inherent limitations in the effectiveness of any system of internal controls, including the possibility of human error and the circumvention or overriding of controls.

The Illinois Pension Code requires an annual audit of the financial statements of the System by independent public certified accountants selected by the State Auditor General. This requirement has been complied with, and the independent auditor's unqualified report on the System's 2016 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 18 of the report.

## LETTER OF TRANSMITTAL

### 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 employees, survivors and other beneficiaries of those employees of the state universities, community colleges, and certain other state educational and scientific agencies. SURS services 61 employers and approximately 230,000 members and annuitants. The plans administered by SURS include a defined benefit plan established in 1941 and a defined contribution plan established in 1998. SURS is governed by an 11-member board of trustees that includes four members elected, two annuitants elected, and five members appointed by the governor, of which the chairperson is the appointed chair of the Illinois Board of Higher Education.

### Funding

SURS is funded through contributions from non-employer, employer and employee contributions as well as investment earnings. The State of Illinois, a non-employer contributing entity, provides funding from two sources: the General Revenue 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 in accordance with the Illinois Pension Code, which sets forth the manner of calculating the statutory contribution under the Statutory Funding Plan. The Statutory Funding Plan requires the state to contribute annually an amount equal to a constant percent of pensionable (capped) payroll necessary to allow the System to achieve a 90% funded ratio by fiscal year 2045, subject to any revisions necessitated by actuarial gains or losses, or actuarial assumptions. The majority of the \$1.4 billion Statutory Contribution for fiscal year 2016 was received through continuing appropriation based on 40 ILCS 15/1.1(b). The remainder of \$190 million was received based on Public Act 99-0524. As of June 30, 2016, the plan net position as a percentage of the total pension liability was 39.57%. The funding issue confronting SURS continues to represent a challenge to the System. Although the statutory contribution requirement was met in fiscal year 2016, the Statutory Funding policy creates a perpetual contribution variance of underfunding the System in earlier years. In later years, the statutory contribution would exceed a contribution equal to normal cost plus a 30-year open period level percent of pay amortization of the unfunded liability. Further information is presented in the Required Supplementary Information related to employer contributions and the funding of the plan.

### 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 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 decreased to \$17.0 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 0.2%, net of fees, for the year ended June 30, 2016. The SURS investment program has a long-term horizon. The returns, net of fees, are 6.8% over the last three years and 5.9% over the last 10 years. The SURS defined contribution assets increased from \$1.7 billion to \$1.8 billion.

The System has shown a positive return of 2.1% through October 31, 2016, bringing total investments to approximately \$17.0 billion.

### Legislation

- 1) Public Act 99-0128, signed into law on July 23, 2015, prohibits investments in companies that boycott Israel and streamlines the current divestiture policies for Iran and Sudan. It creates the Illinois Investment Policy Board, consisting of four members appointed by the Governor and three members

## LETTER OF TRANSMITTAL

appointed by each of the boards of the State Universities Retirement System, Teachers' Retirement System, and Illinois State Board of Investments, respectively, to develop a list of restricted companies for the retirement systems.

- 2) Public Act 99-0232, signed into law on August 3, 2015, requires an actuarial experience study to occur at least once every three years (instead of at least once every five years) for SURS.
- 3) Public Act 99-0450, signed by the Governor on August 24, 2015, clarifies language allowing technical changes to strengthen the oversight and administration of the System.
- 4) Public Act 99-0462, signed by the Governor on August 25, 2015, establishes an aspirational goal that, beginning January 1, 2016, each retirement system, pension fund, or investment board under the Illinois Pension Code use emerging investment managers for not less than 20% of total funds under management. Additionally, it establishes an aspirational goal that not less than 20% of investment advisors be minorities, females, and persons with disabilities and to utilize businesses owned by minorities, females, and persons with disabilities for not less than 20% of contracts awarded for information technology services, accounting services, insurance brokers, architectural and engineering services, and legal services.
- 5) Public Act 99-0524, signed by the Governor on June 30, 2016, appropriated \$190 million from the State Pensions Fund as part of the annual required State contribution to SURS for fiscal year 2016 and \$190 million from the State Pensions Fund for fiscal year 2017.

### Major Initiatives

In fiscal year 2016, the SURS staff continued to make changes to its technological infrastructure and made significant progress on projects that impact the System, its members, employers and other stakeholders.

- Completed Phase I of a multi-year network backbone project, including an upgrade of the infrastructure that connects all devices on the SURS network. This project will support increased bandwidth requirements; replace "End of Life" equipment; take advantage of enhanced security features of new equipment; and position SURS for meeting the business requirements associated with increased video conferencing and telephony enhancements.
- There were significant changes and improvements made to the defined contribution plan (called Self-Managed Plan/SMP) established in 1998. The administrative fees for members were reduced on a per participant basis. SURS staff also continued to work with the two record keepers for reductions in investment fees across all fund options. A statewide outreach program was launched to improve member communications.
- A self-service counseling appointment scheduling system was implemented in September 2015.
- Facility improvements to SURS nearly 25-year-old facility included parking lot enhancements and the remodeling/conversion of space to accommodate staff growth.
- The new SURS logo was introduced in January 2016 in honor of the 75th anniversary of the System. The logo symbolizes the core beliefs of integrity, professionalism, accountability and a renewed commitment to deliver timely, quality service to our members.
- Public Act 97-0695, which reformed state retiree health insurance, was challenged and deemed unconstitutional. The Sangamon County Circuit Court judge ordered the state to stop deducting the health premiums from annuities. SURS was directed to issue refund checks to those persons, subject to the condition that each check be cashed or otherwise negotiated by the payee(s) no later than June 15, 2016, after which SURS was directed to return the remaining funds to the State of Illinois' Unclaimed Property Trust Fund by June 30, 2016.

## LETTER OF TRANSMITTAL

### Awards and Recognition

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, 2015. This is the thirty-second 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.

The Public Pension Coordinating Council (PPCC), a coalition of three national associations that represents more than 500 of the largest pension plans in the U.S., awarded SURS the *Public Pension Standards Award for Funding and Administration*. Public Pension Standards are a benchmark to measure public defined benefit plans in the areas of retirement system management, administration, and funding.

### 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. We thank all those whose impact in Illinois' universities and colleges guide the future. 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](http://www.surs.org).

Respectfully submitted,



Phyllis L. Walker  
Chief Financial Officer

## BOARD OF TRUSTEES



**Tom Cross**  
Chairperson  
Appointed



**Dorinda Miller**  
Vice Chairperson  
Elected



**John Engstrom**  
Treasurer  
Elected



**Aaron Ammons**  
Elected



**Dennis Cullen**  
Appointed



**J. Fred Giertz**  
Elected



**Francis Idehen Jr.**  
Appointed



**Paul R. T. Johnson Jr.**  
Appointed



**Craig McCrohon**  
Appointed



**Steven Rock**  
Elected



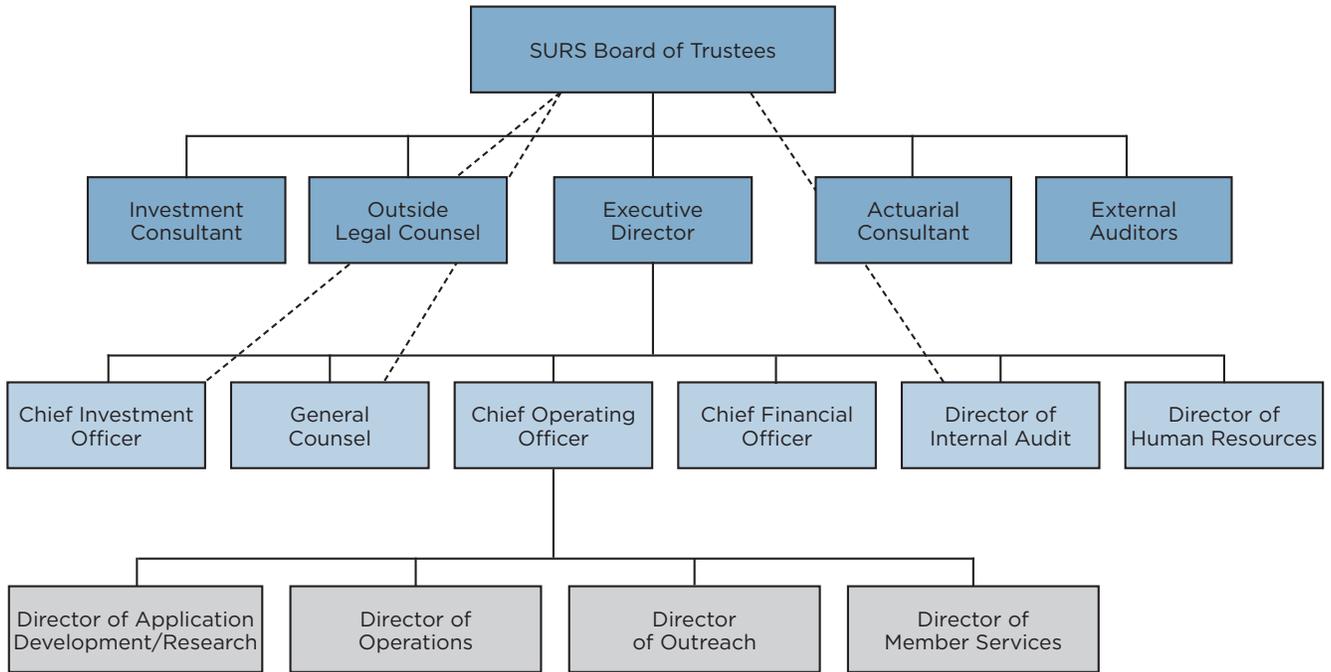
**Antonio Vasquez**  
Elected

## ADMINISTRATIVE STAFF



**Left to right:** Director of Operations Chris Hansen, Interim Chief Investment Officer Douglas Wesley, General Counsel Bianca T. Green, Director of Human Resources Brenda Dunn, Executive Director Martin Noven, Director of Application Development and Research Douglas J. Steele, Chief Financial Officer Phyllis Walker, Director of Outreach Suzanne Mayer, Director of Internal Audit Steven L. Hayward, Chief Operating Officer Andrew Matthews, and Director of Member Services Angie Lieb.

# ORGANIZATIONAL CHART



## CONSULTING AND PROFESSIONAL SERVICES

### Actuary

Gabriel, Roeder, Smith & Co.

### Auditor

BKD, LLP

(Acting as Special Assistant Auditor for the Illinois Office of Auditor General)

### Legal Counsel

Burke, Burns & Pinelli, Ltd.

Jackson Walker L.L.P.

Mayer Brown LLP

### Consultants and Other Vendors

Document Access Systems

Huber & Associates, Inc.

Segal Company

Sirius Computer Solutions

### Master Trustee and Custodian

The Northern Trust Company

### Investment Consultants, Measurement and Counsel

NEPC, LLC

### Investment Advisors

Adams Street Partners

Alinda Capital Partners

BlackRock Institutional Trust Company

BlueBay Asset Management

Blue Vista Capital Management

Brookfield Asset Management

CastleArk Management

CBRE Clarion Real Estate Securities

Chicago Equity Partners

Colchester Global Investors Limited

Courtland Partners

Crow Holdings

Deutsche Bank

Dune Capital Management

Fidelity Institutional Asset Management

Franklin Templeton Real Estate Advisors

Heitman

Invesco

J.P. Morgan Asset Management

KKR Prisma

Macquarie Capital

Mesirow Financial Investment Management

Mondrian Investment Partners

Neuberger Berman

Northern Trust Asset Management

Pacific Alternative Asset Management Company

Pacific Investment Management Company

Pantheon Ventures

Parametric Clifton

Progress Investment Management Company

Prudential Fixed Income

RhumbLine Advisers

RREEF

State Street Global Advisors

T. Rowe Price

TCW

UBS Realty Investors

Wellington Management Company

### Manager Diversity Program Investment Advisors

Ativo Capital Management

Channing Capital Management

EARNEST Partners

Fairview Capital Partners

Franklin Templeton Real Estate Advisors

Garcia Hamilton & Associates

GlobeFlex Capital, L.P.

Holland Capital Management

LM Capital Group

Lombardia Capital Partners

Longfellow Investment Management

Muller and Monroe Asset Management

New Century Advisors

Piedmont Investment Advisors

Pugh Capital Management

Smith Graham & Company

Strategic Global Advisors

### Progress Investment Management Company Emerging Manager Investment Advisors

Affinity Investment Advisors

Apex Capital Management

Brown Capital Management

Garcia Hamilton & Associates

GIA Partners

Glovista Investments

LM Capital Group

Lombardia Capital Partners

New Century Advisors

Piedmont Investment Advisors

Ramirez Asset Management

Strategic Global Advisors

### Self-Managed Plan Service Providers

Fidelity Investments

Teachers Insurance Annuity Association