

**STATE UNIVERSITIES RETIREMENT SYSTEM OF
ILLINOIS**

INVESTMENT POLICY



Adopted by the Board of Trustees
December 8, 2006



INVESTMENT POLICY

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I. Mission Statement

The Board of Trustees (“Board”) of the State Universities Retirement System (“SURS”, “System”) has a fiduciary responsibility to the Members and Beneficiaries of the System. In recognition of this responsibility, the Board has adopted the following Mission Statement:

The SURS Mission

The mission of the State Universities Retirement System (SURS) is to: (1) provide for SURS annuitants, participants, and their employers, in accordance with State law, the best and most cost-effective benefit administration services in the United States; (2) manage and invest the fund’s assets prudently; and (3) endeavor to achieve and maintain a financially sound retirement system.

The purpose of this Mission Statement is to provide broad operational direction to the Board, Staff, and contractors of SURS.



II. Statement of Purpose of Investment Policy

This document specifically outlines the investment philosophy and practices of SURS and has been developed to serve as a reference point for the management of System assets. In order to assist System participants in achieving their financial security objectives, the Board shall adopt a long-term plan by which the assets of the System will be maintained and enhanced through prudent investments. The Board of Trustees shall at all times have a written Investment Policy that reflects and is consistent with the statutory constraints. In addition, these guidelines shall, among other things, include specification of the investment objectives of the System, the target asset allocations, and the appropriate benchmarks to be used for evaluating the performance of the funds and the asset classes within the funds.

In developing this Investment Policy, the Board and Staff understand and accept their fiduciary obligations to the Members of the System. These obligations are legal in nature, and are outlined in the Illinois Pension Code [40 ILCS 5]. Investments shall satisfy the conditions of the Illinois Compiled Statutes, and in particular, the prudent expert standard of 40 ILCS 5/1-109. In summary form, the provisions specifically referring to the definitions, duties, and responsibilities of a fiduciary are these:

- a fiduciary is anyone who has discretion in managing retirement system assets or in administering the retirement system, or who renders investment advice for direct or indirect compensation. [40 ILCS 5/1-101.2.]
- a fiduciary must discharge its duties to the retirement system for the exclusive purposes of providing benefits to participants and beneficiaries, and defraying administrative expenses of the retirement system. [40 ILCS 5/1-109(a).]
- a fiduciary must discharge its duties to the retirement system with the same care, skill, prudence and diligence that a prudent expert would use in a similar enterprise. [40 ILCS 5/1-109(b).]
- a fiduciary must discharge its duties to the retirement system by diversifying the investments to minimize the risk of large losses, unless prudence dictates otherwise. [40 ILCS 5/1-109(c).]
- a fiduciary must discharge its duties to the retirement system in accordance with Articles 1 and 15 of the Illinois Pension Code. [40 ILCS 5/1-109(d).]
- a fiduciary must not cause the retirement system to engage in prohibited transactions. A fiduciary must not deal with the retirement system's assets for its own interest, or on behalf of any party whose interests are adverse to the retirement system or its participants or beneficiaries. [40ILCS 5/1-110 and 110.5].

These statutes are the foundation for development of SURS' Investment Policy. For brevity and clarity, the Board adopts the following interpretation of the statute as its "Guiding Principles":

Principles Guiding SURS Investment Activity

1. Preserve the long-term principal of the Trust fund.
2. Maximize total return within prudent risk parameters.
3. Act in the exclusive interest of the Members of the System.



These principles, combined with the applicable sections of the Illinois Pension Code [40 ILCS 5], serve as the basic guideline for this Investment Policy.



III. Investment Objectives

The assets of the System will be invested solely for the benefit of participants and beneficiaries within the constraints of applicable Illinois Statutes and the guidelines contained in this document.

In addition, the following investment objectives for the SURS plan have been established:

- Seek annualized investment returns, net of investment management fees, in excess of the market goal (as described later in this document) for 1, 3, 5, and 10 year periods.
- Maintain sufficient liquidity to pay benefits.



IV. Role Definitions

SURS is one of the larger public pension funds in the United States; as such its operational requirements are complex. The Board relies heavily on both Internal Staff and external contractors in order to properly administer the System and implement its investment strategies. Because of the number of parties involved, their roles as fiduciaries must be clearly identified to increase operational efficiency, to ensure clear lines of responsibility, and to reduce or eliminate duplication of effort.

Board of Trustees

The Board has the responsibility of establishing and maintaining broad policies and objectives for all aspects of the System's operation. The Board is responsible for prudent investment and expenditure of the System's funds and assets. Specifically with regard to investments, the Board takes action upon recommendations that come from its Investment Committee. The Board also approves actuarial assumptions, certifies contribution rates and determines policies pertaining to the administration of the plans and benefits under its jurisdiction and responsibility.

Trustees shall carry out their functions solely in the interest of the members and benefit recipients and for the exclusive purpose of providing benefits and defraying reasonable expenses incurred in performing such duties, as required by law. The Trustees shall act in accordance with the provisions of State Statute and with the care, skill, prudence and diligence in light of the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims by diversifying the investments of the association so as to minimize the risk of large losses, unless in light of such circumstances it is clearly prudent not to do so.

Formal Review Schedule

The Board recognizes that even though the System's investments are subject to short-term volatility, it shall maintain a long-term investment focus. This prevents ad-hoc revisions to the philosophy and policies in reaction to either speculation or short-term market fluctuations. In order to preserve this long-term view, the Board has adopted the following formal review schedule:

| <u>Formal Review Agenda Item</u> | <u>Formal Review Schedule</u> |
|---|--------------------------------------|
| Total Fund Performance | At least quarterly |
| Asset Allocation Policy | At least every three to five years |
| Investment Policy | At least annually |
| Investment Manager Performance Evaluation | At least annually |

Investment Committee

The Board establishes an investment committee that will consist of not less than five members of the Board of Trustees. The Committee reviews and makes recommendations to the Board on investment actions including, but not limited to, the following topics:



1. All Board approved policies related to the Investment Program including:
 - The Investment Policy, Exhibits and/or Appendices
 - Rebalancing Policy
 - Manager Selection & Termination Policy
 - Brokerage Policy
 - Corporate Governance Policy
2. The Asset Allocation Policy and Manager Structure
3. Performance Benchmarks
4. The Master Trustee/Custodian (“Custodian”) Relationship
5. The Securities Lending Program
6. Investment Manager Relationships
7. Investment Consulting Relationships(s)

All members of the committee shall be indemnified and held harmless by the System for any reasonable cost or expenses incurred as a result of any actual or threatened litigation or administrative proceeding arising out of the performance of the committee member’s duties in accordance with 40 ILCS 5/1-107. No member of the committee may participate in deliberations or vote on any matter before the panel which will, or is likely to, result in direct, measurable gain to the committee member, or to that committee member's employer.

Executive Director

The Executive Director (“Director”) is appointed by and serves at the pleasure of the Board. Responsibilities delegated by the Board to the Director include, but are not limited to, the following:

- Planning, organizing, and administering the operations of the System under broad policy guidance and direction from the Board. Examples of such duties include:
 - Execution of Investment Management Agreements with Board-approved Investment Managers, with a report provided to the Board at the next regularly scheduled meeting.
 - Execution of contract amendments with existing SURS Investment Managers or other existing service providers, with a report provided to the Board at the next regularly scheduled meeting.
- Monitoring of the performance of the investment portfolio;
- Ensuring that funds are invested in accordance with Board policies;
- Communicating with the Board, its Officers and Committee Chairs;
- Studying, recommending, and implementing policy and operational procedures that will enhance the investment program of SURS;
- Ensuring that proper internal controls are developed to safeguard the assets of the System.

Employees of the System shall be indemnified and held harmless by the System for actions within the scope of their employment, pursuant to 40 ILCS 5/1-107 and 108. This indemnification extends to former employees for actions within the scope of their employment at time of employment.



In fulfilling these investment responsibilities, the Director relies heavily on the Internal Investment Staff and Consultant(s).

Internal Investment Staff

The Internal Investment Staff reports directly to the Chief Investment Officer (“CIO”) who in turn reports to the Director. The Internal Investment Staff provides internal investment management and consulting services to the Board and Director. In the course of the CIO’s normal functions, the CIO will work directly with the Board, Investment Committee and its Chair(s). The frequency and content of reports to the Board are based on the requirements of the Investment Policy Statement as well as directives from the Board and/or its Investment Committee.

The primary functions delegated by the Board to Internal Investment Staff include, but are not limited to:

- Analyzing and rebalancing the overall asset allocation of the System and its portfolio structure;
- Liquidating assets, as necessary, to pay monthly benefits;
- Implementing the decisions of the Board regarding hiring and firing of external managers;
- Providing internal investment management services with regard to the Treasury Inflation Protection Securities (TIPS) portfolio;
- Oversight of the Manager Development Program, including search, selection, monitoring and rebalancing of managers;
- Providing technical advice in the selection and monitoring of the external managers;
- Approving revisions to investment manager guidelines, with agreement from the External Investment Consultant required; and
- Serving as a liaison to the investment community.

The SURS Staff has the responsibility to implement the Board decisions through negotiation, execution and enforcement of the investment management agreement and guidelines. All investment management agreements and amendments thereto must be executed by the Executive Director. In the event that termination of a Manager is warranted under the Investment Manager Termination Guidelines, and prompt termination of the Manager is necessary to protect and preserve System assets, SURS Staff may, with the prior approval of the Executive Director, terminate the Manager prior to Board action. The Board shall be promptly notified of the decision to terminate the Manager, and the decision shall be presented to the Investment Committee for ratification at its next meeting.

The Internal Investment Staff also works closely with the External Investment Consultant(s). Recommendations to the Investment Committee will generally be developed jointly by the Staff and Consultant with advice to the Chair. Once an item is identified as a potential agenda item, Staff and Consultant begin working together on the issue. If one group has more expertise in the particular area than the other, that party may do the majority of the work. In most if not all cases, however, any analysis or recommendation that is made to the Committee will be developed jointly and agreed to or approved by both parties.



External Investment Consultant(s)

The Board shall generally have under contract an investment advisor who is a paid, professional consultant and who is qualified to provide the Board with investment advice by academic and professional training and experience and is considered an expert in the field of investment and finance. The investment consultant's relationship with the Board shall be fiduciary in nature.

The Consultant is hired by and reports directly to the Board of Trustees. The Consultant's duty is to work with the Board, Investment Committee and its Chair(s), and Staff in the management of the investment process. This includes regular meetings with the Board to provide an independent perspective on the Fund's goals, structure, performance and managers. In the course of the Consultant's normal functions, the Consultant will work directly with the Staff to review asset allocations and performance, and make recommendations to the Board as appropriate. The Consultant will assist Staff and the Committee with external investment manager selection and will promptly inform the System and discuss the impact of material changes taking place within any current Manager's organization or investment process. The Board may elect to retain one or more Consultants that specialize in specific areas of asset consulting. Performance of investment consultant(s) will be subject to periodic review by the Investment Committee as well as prior to contract renewal.

The Staff and Consultant will generally develop recommendations to the Investment Committee jointly with advice to the Chair. Once an item is identified as a potential agenda item, Staff and Consultant begin working together on the issue. If one group has more expertise in the particular area than the other, that party may do the majority of the work.

External Investment Managers

The external Investment Managers ("Managers") are selected by, and serve at the pleasure of, the Board. The Staff and Consultant will provide the Managers with explicit written directions detailing their particular assignments. Duties of External Investment Managers include, but may not be limited to, the following:

- The External Investment Managers will select, buy, and sell specific securities or investments within the parameters specified by Staff and Consultant and in adherence to this Investment Policy or to other policies set forth by the Board.
- The External Investment Managers will construct and manage investment portfolios that are consistent with the investment philosophy and disciplines for which the Board hired them. Discretion is delegated to the Managers to carry out these investment actions.
- External Investment Managers will provide performance reporting to the Staff at intervals specified by Staff.
- External Investment Managers will also, on an annual basis, provide to SURS proof of insurance coverage in an amount and type specified in the manager's Investment Management Agreement.



- External Investment Managers will, on an annual basis, certify in writing that they remain a fiduciary to the System and that they have been in compliance with the investment guidelines in the past year.

Specific operational information for each Manager will be addressed at length in the individual manager guidelines.

Custodian

The Custodian is selected by, and serves at the pleasure of, the Board. The Custodian(s) will collect income and safekeep all cash and securities, and will regularly summarize these holdings, along with both their individual and collective performance, for Staff's review. The Custodian will provide data and performance reports to the Staff and Consultant at intervals specified by the System's written policy or contract. In addition, a bank or trust depository arrangement will be utilized to accept and hold cash flow prior to allocating it to the Investment Managers, and to invest such cash in liquid, interest-bearing instruments. The Board shall determine asset allocation guidelines; in order to maintain these targets, Staff will direct the Custodian to allocate cash and/or securities to the System's Investment Managers as necessary. The Custodian may also, at the direction of the Board, engage in a Securities Lending program.

General Counsel's Office

The role of the General Counsel's office is to perform draft document review and provide legal advice on issues, as necessary, to protect the interests of the System. The General Counsel's Office does not review or approve investment decisions. The General Counsel's Office reviews business terms for proper form and legality. However, General Counsel review does not extend to aspects of business terms that require investment or financial expertise. The following documents and issues will be brought to the attention of the General Counsel's Office:

- Any document that the Executive Director is requested to sign.
- New investment management agreements.
- Contracts with investment service providers.
- Letter agreements and side letters with any investment manager or investment service provider.
- Amendments to investment management agreements.
- Amendments to contracts with investment service providers.
- Amendments to letter agreements and side letters.
- Termination letters.
- Any matter that Investment Staff wishes to assign to outside counsel excluding routine matters for which the CIO may directly interact with outside counsel.
- Correspondence to or from any investment manager or investment service provider concerning actual or potential litigation or legal issue.
- Any material violation by an investment manager or investment service provider of any terms or obligations in a contract with the System that comes to the attention of Investment Staff.



V. Asset Allocation and Rebalancing Strategy

A. Purpose

The purpose of the asset allocation policy is to establish an investment policy framework for SURS that has a high likelihood, in the judgment of the Board, of realizing SURS' investment objective.

B. Targets and Ranges

The principal components of the investment policy are target allocation percentages for various areas of investment, known as "asset classes", and minimum and maximum percentages for each asset class. The table below contains SURS' current strategic and interim target allocation percentages.

| ASSET ALLOCATION POLICY MIX (as of 7/1/2006) | STRATEGIC POLICY ALLOCATION | ADJUSTED STRATEGIC TARGET |
|---|------------------------------------|----------------------------------|
| <i>U.S. Equity</i> | 36.5% | 37.5% |
| <i>Private Markets¹</i> | 5.0% | 4.5% |
| <i>Non-U.S. Equity</i> | 18.5% | 18.5% |
| <i>Global Equities</i> | 5.0% | 5.0% |
| <i>Fixed Income</i> | 21.0% | 22.0% |
| <i>TIPS²</i> | 5.0% | 4.0% |
| <i>Real Estate</i> | 6.0% | 6.0% |
| <i>Opportunity Fund³</i> | 3.0% | 2.5% |

The adjusted strategic target may change over time and is derived from the strategic policy allocation to adjust for liquidity constraints. The ranges for all asset classes are equal to the target percentages plus or minus three percentage points.

C. Rebalancing

The investment policy of the State Universities Retirement System (SURS) provides an efficient allocation of assets to achieve overall risk and return objectives. Proper implementation of this guideline requires that a periodic adjustment, or rebalancing, of assets be made to ensure conformance with asset allocation targets. Such rebalancing is necessary to reflect sizable cash flows and performance differentials among asset classes and investment managers. Rebalancing shall automatically occur whenever an asset class is + or – 3% different than the target allocation level. Rebalancing, when required, shall occur as soon as practical.

Rebalancing requirements shall be reviewed on a continual basis. Rebalancing may also occur in the event of a change in the allocation percentages of asset classes by the

¹ Private markets allocation to reach an eventual target of 5%.

² TIPS allocation to reach an eventual target of 5%.

³ The Opportunity Fund shall be no more than 5% of SURS total market value.



Trustees. Rebalancing shall take place as soon as practicable after said change or amendment has been approved.

In conducting rebalancing activities, the Board expects the staff to operate under these guidelines:

1. Whenever asset class allocation percentages fall outside the indicated range for that asset class, the staff shall initiate rebalancing transactions to bring all percentages to values that do not exceed the range limits.⁴
2. At any time and in its discretion, the staff may bring the actual allocation to, or nearer to, the target percentages.
3. At a minimum, the staff will ensure that as a result of a rebalancing review, no asset class allocation is outside the allowable range.
4. To the extent that it is possible to bring the actual allocation nearer to the target percentages without incurring transactions costs, or while incurring transaction costs, which in the judgment of the staff are unusually low, the staff shall do so.

The spirit of this policy is to ensure compliance with the target asset allocation percentages at a reasonable cost, recognizing that overly precise administration of policy targets can result in transaction costs that are not economically justified. Recognizing the complexity of achieving this result with a portfolio the size and complexity of SURS, as well as the vagaries of transacting in investment markets, the Board accords the staff discretion to take those actions, which in the judgment of the staff are within the spirit of these guidelines and in the best interest of SURS. Staff will report the results of rebalancing activity to the Investment Committee at the next regular Investment Committee meeting.

D. Periodic Review

The Board establishes the asset allocation targets and ranges and reviews them periodically. The target allocation will be reviewed annually for reasonableness relative to significant economic and market changes or to changes in the System's long-term goals and objectives. Typically every three to five years the Board will undertake a comprehensive review of the asset allocation policy designed to assess the continuing appropriateness of investment policy. This ordinarily involves an asset-liability study that places the development of investment policy into the context of future benefit payments, liabilities, required funding and the prospective funded status of liabilities.

⁴ When any one of the public market asset classes hits a trigger point, the entire fund may be rebalanced back to asset class target allocations, with the understanding that it may be impractical to return the real estate and private equity asset classes precisely to target in the short term. Accordingly, qualitative considerations (e.g., transaction costs, liquidity needs, investment time horizons, etc.) will be considered in determining the potential timing and extent of rebalancing real estate and private equity portfolios.



VI. Investment Manager Structure

The Board must make certain strategic decisions regarding the portfolio structure. The major types of strategic decisions typically include these:

- The passive vs. active management mix;
- The internal vs. external management mix; and/or
- Any strategic overweights/underweights based on size, style or sector.

At this time, the Board has elected to utilize a combination of active and passive management, to be implemented primarily by external investment managers, and to maintain a neutral investment strategy based on size, styles, and sectors across asset classes.

Equity Structure

- The overall benchmark for the U.S. Equity allocation is the Dow Jones Wilshire 5000 Index representing the broad U.S. stock market.
- The overall benchmark for the Private Markets allocation is the Dow Jones Wilshire 5000 Index plus 500 basis points. A secondary benchmark of the Venture Economics private equity benchmark (peer group) comparison shall also be used.
- The overall benchmark for the Non-U.S. Equity allocation is the Morgan Stanley Capital International All Country World Ex-US benchmark (MSCI ACW Ex-US).
- The overall benchmark for the Global Equity allocation is the Morgan Stanley Capital International World benchmark (MSCI World).
- The indexed proportion of the equity portfolio is not constant and will fluctuate based upon the relative success (or failure) of the actively managed portfolio(s). Cap-weighted and style-oriented index (i.e. extended market, S&P 500, etc.) funds may be used to offset biases in the actively managed portfolios.

Fixed Income Structure

- The overall benchmark for the fixed income portfolio excluding the TIPS allocation is the Lehman Brothers Aggregate Index.
- The overall benchmark for the Treasury Inflation Protected Securities (TIPS) allocation is the Lehman Brothers U.S. TIPS index.
- The TIPS allocation shall be managed by a combination of internal and external investment managers.



- The indexed portion of the fixed income portfolio and TIPS portfolio is not constant and will fluctuate based upon the relative success (or failure) of the actively managed portfolio(s).

Real Estate Structure

- The real estate asset allocation consists of publicly traded Real Estate Investment Trust Securities (REITS) and direct real estate.
- The overall benchmark for the Real Estate Investment Trust Securities (REITS) asset allocation is the Dow Jones Wilshire Real Estate Securities Index.
- The overall benchmark for the direct real estate asset allocation is the NCREIF Open End Index.
- The indexed portion of the real estate portfolio is not constant and will fluctuate based upon the relative success (or failure) of the actively managed portfolio(s).

Opportunity Fund Structure

- The overall benchmark for the Opportunity Fund shall be a weighted average of the underlying investment benchmarks. The Opportunity Fund shall be no more than 5% of the total fund value.
- The indexed portion of the Opportunity Fund, if present, is not constant and will fluctuate based upon the relative success (or failure) of the actively managed portfolio(s).

In order to implement this strategy, it is necessary that the Board retain External Investment Managers in addition to the Internal Investment Managers. Both Internal and External Managers will be given specific tactical roles within the overall strategic investment plan. Depending on their assignments, the Managers may be judged on some or all of the following criteria: (i) consistency of philosophy, style, and key personnel, (ii) performance relative to an appropriate index or proxy group, and (iii) ability to add incremental value after costs. Staff and Consultant will be responsible for implementation of this strategy, supervision of the Managers, performance monitoring and reporting. Updates will be provided to the Board (i) based on the schedule outlined in Section IV, (ii) as requested by the Board, its Investment Committee or its Chair, and (iii) as deemed necessary by Staff and Consultant.



VII. Investment Manager Selection and Retention

Introduction

The Trustees of the State Universities Retirement System (“SURS”) have established the following guidelines for hiring external investment managers. In establishing these guidelines, it is the Board’s intention to assure all interested parties that decisions made in carrying out these actions occur in a full disclosure environment characterized by competitive selection, objective evaluation, and proper documentation. The overriding consideration with respect to all decisions is that they shall be made solely in the best interest of plan participants and beneficiaries.

Manager Selection

Investment managers will be selected to fill investment needs when identified by the staff, consultant, or Board of Trustees. Generally, for each manager search, a comprehensive written plan shall be prepared by staff, reviewed by the investment consultant, and approved by the Board of Trustees prior to its commencement. For searches affiliated with the SURS Manager Development Program (MDP), the investment staff conducts the search process with the investment consultant providing an independent evaluation of the program annually. The criteria used to determine the minimum qualifications of firms to be selected for an assignment is shown below:

| Selection Criteria | |
|---------------------------|---|
| 1. | Registration with the Securities and Exchange Commission (SEC) under the Investment Advisors Act of 1940, or otherwise qualified under Sec. 1-101.4 of the Illinois Pension Code (40 ILCS 5/1-101.4). |
| 2. | Experience of the firm in the management of institutional portfolios operated under prudent person standards, as well as related investment management experience. |
| 3. | Qualifications and/or depth of the professional staff. |
| 4. | Soundness of the firm’s investment philosophy and process. |
| 5. | The investment record of the firm and/or the firm’s principals in former associations where that record is verifiable. |
| 6. | The adequacy of the firm’s trading, back office, accounting and reporting, and client servicing capabilities. |
| 7. | Fees. |

Using the above criteria established by the Board of Trustees, the top firms are selected based upon the experience and qualifications of the firm’s principals, the soundness of the firm’s investment philosophy and process, as well as the strength of the investment



record and organization. SURS does not use any criteria that would be considered a barrier to an emerging manager such as a minimum number of years in business or a minimum asset level under management. As a part of the selection process, SURS utilizes its databases to ensure that qualified emerging managers are included in the pool of eligible candidates. Once these top firms are identified, the staff generally prepares and sends a standardized questionnaire to the firms, typically between five and twenty-five, depending on the nature of the search. Following a review of the responses from interested firms, the field of candidates is narrowed to a smaller list of the most highly qualified firms. At this point, representatives from SURS staff and consultant separately meet with representatives of each firm to obtain its own independent assessment of the firm's capabilities. Following the interview with the selected firm(s), SURS staff, in consultation with the consultant, recommends to the Board one or more managers for engagement. Generally, the finalists appear before the Board to present their firms' qualifications. The Board accepts or modifies the recommendation and approves the engagement, if satisfied with the firm's capabilities. Contracts are then completed, and funding is supplied to commence the investment program.

Investment Advisory Agreements

Upon approval by the Board for the hiring of an investment manager, the investment advisory agreement and other related documents shall be executed prior to funding the account. All investment advisory agreements will be in compliance with the relevant section(s) of the Illinois Compiled Statutes.

Manager Evaluation

An evaluation of each investment manager shall be conducted not less than annually. The evaluation, at a minimum, will take into consideration the firm's organization and performance relative to an agreed upon benchmark as indicated in the individual investment manager's guidelines. The evaluations will contain a formal recommendation from both the investment consultant and the staff. The recommendation presented to the Trustees will generally take one of the following four formats:

- Retention with additional funding
- Retention without additional funding
- Retention with a reduction in funding
- Termination

Reasons for termination include: changes in investment style and discipline, changes in the firm (personnel, structure, or organizational form) which may detract from future performance, changes in the total fund's investment guidelines that eliminate the need for the manager, repeated violations of established investment guidelines, or a loss of confidence that the firm will add value or as evidenced by failure to perform historically above their relative benchmark over a period of 3 to 5 years.

Performance Analysis

Regarding performance, the primary measurement will be the manager's returns (net of fees) vs. the relevant and agreed upon benchmark. Failure of a manager to generate excess returns in a short period of time does not require that the contract with the firm be terminated. However, the firm's returns must be within an acceptable range. A



secondary performance measure is the manager's return vs. the return of a universe of manager returns whose styles are similar. Again, the manager's returns must be within an acceptable range.

Style Analysis

Regarding conformance to style, the quarterly performance measurement will analyze the portfolios of the active managers as well as the aggregate equity portfolio and identify any significant deviations from the individual managers' style benchmarks and the Dow Jones Wilshire 5000 in the case of the aggregate. Significant deviations may lead to the adjustments in asset allocations or to the replacement of a manager whose portfolio deviates significantly from the benchmark.

Manager Transitions

In the event of the need to transfer the management of the assets from one investment firm to another, staff will present a recommended transition plan that will be approved by the Board of Trustees. Transition plans may include, but are not limited to, the following: a transfer of securities to an appropriate index fund, crossing securities with other institutional investors, or a transfer of securities to another approved investment manager.

Board Reporting and Monitoring

After a manager is selected, the Staff and Consultant will regularly monitor the manager's results versus expectations. The System's Staff and Consultant will conduct periodic due diligence meetings with the outside organizations and provide the Board with reports summarizing the assessments made. The Staff and Consultant are responsible for reporting to the Board on any material events regarding an investment manager, along with any recommendation for action to be taken.

Placement Fees

The System requires its investment managers to disclose any and all fees, commissions, or payments of any type that have been or will be paid to any third party in connection with the relationship with SURS.



VIII. Quiet Period Policy

Purpose

The Quiet Period Policy is intended to establish guidelines by which Board Members and staff will communicate with prospective service providers during the search process.

Policy Objectives

The objectives of the policy are to ensure that:

- Prospective service providers competing to become employed by SURS have equal access to information regarding the search parameters;
- Communications related to the selection are consistent and accurate; and
- The process of selecting service providers is efficient, diligent, and fair.

Policy Guidelines

The following guidelines will be instituted during a search process for a service provider:

- A quiet period will commence upon Committee action (or Board action if the selection is not initiated through a Committee) to authorize a search for a service provider and end once a selection has been made by the Board and accepted by the service provider;
- Initiation, continuation and conclusion of the quiet period shall be publicly communicated to prevent inadvertent violations;
- All Board members, and staff not directly involved in the search process, shall refrain from communicating with service provider candidates regarding any product or service related to the search offered by the candidate throughout the quiet period and shall refrain from accepting meals, travel, hotel, or other value from the candidates;
- Throughout the quiet period, if any Board member is contacted by a candidate, the Board member shall refer the candidate to SURS Investment Consultant or staff directly involved in the search process;
- All authority related to the search process shall be exercised solely by the relevant Committee or Board as a whole, and not by individual Board Members;
- All information related to the search process shall be communicated by the SURS Investment Consultant and staff to the relevant Committee or Board as a whole, and not to individual Board Members; and
- The quiet period does not prevent Board approved due diligence or client conference attendance; however, discussions related to the pending selection shall be avoided during those activities.
- The provisions of this policy will apply to service provider candidates throughout the quiet period and shall be communicated to candidates in conjunction with any RFP or RFI;
- A service provider may be disqualified from a search process for a knowing violation of this policy.



IX. Investment Manager Termination Guidelines

Introduction

From time to time it will be necessary for the System to terminate a contractual relationship with an Investment Manager and these actions must be viewed in the context of a business decision. Due to the sensitivity of this issue, the Board has established the following guidelines to assist in making these termination decisions. In establishing these guidelines, it is the Board's intention to assure all interested parties that decisions made in carrying out these actions occur in a full disclosure environment characterized by objective evaluation and proper documentation. The overriding consideration with respect to all decisions is that they shall be made solely in the best interest of plan participants and beneficiaries.

Clearly Defined Objectives

Any action to terminate a manager should be based on one or more of the following primary criteria:

- significant changes in firm ownership and/or structure,
- loss of one or more key personnel,
- significant loss of clients and/or assets under management,
- shifts in the firm's philosophy or process,
- significant and persistent lack of responsiveness to client requests,
- changes in SURS' investment strategy eliminating the need for a particular style or strategy,
- chronic violations of SURS' Investment Policy or Parameters,
- unsatisfactory investment performance,
- identification of a new asset class or approach which has been approved in advance by the Board, or
- a need for diversification of styles within an existing asset class.

Prior to the termination decision, the primary and other relevant considerations shall be identified and described. An evaluation covering the quantitative and qualitative issues to be considered will be developed for each case and the relative importance of each evaluation area will be determined. Documentation regarding any such action should include, but is not limited to, the following items:

- a full description of the reason for the action, including the specific elements serving as the basis for the evaluation and identification of the relevant issues from the System's perspective,
- the assumptions made in the evaluation, if any,
- the results considered and/or qualitative issues upon which the action was based, and
- an objective discussion of the risks, costs, and expected benefits is also to be included if appropriate to the subject matter.



Proper Documentation and Full Disclosure

When reviewing the documentation regarding the termination of an external investment service provider, the primary focus of the Investment Committee shall be on ensuring that the Board will be able to satisfy any interested party that decisions were well reasoned, thoroughly considered, and prudent. Toward this end, the Chair and Committee members will review the written supporting documentation to ensure disclosure of all relevant issues. In evaluating a termination decision, Staff, Consultant and the Committee should review documentation to ensure that the evaluation process was fair and consistently applied. Candidates for termination may, at the pleasure of the Committee or upon the recommendation of Staff and Consultant, be asked to make a formal presentation to the Staff and/or Committee prior to a termination decision, but any such meeting shall not be permitted to delay any action the Board deems appropriate.



X. Performance Measurement and Reporting

Performance Measurement

Marketable Equity, Fixed Income and Real Estate Portfolios

Time weighted returns will be calculated monthly by the Master Trustee to measure the performance of the Fund and managers in comparison with the Fund objectives, appropriate peer groups and managers, and performance benchmarks.

The results of the total fund, individual asset classes and managers are reported to the Board members on a monthly basis.

Private Markets Portfolios

For private equity portfolios, internal rates of return will be calculated quarterly by the investment managers and verified by SURS staff and/or the investment consultant. These returns will be used to measure performance of the portfolios in comparison with the objectives of the fund and appropriate peer groups. Returns are reported quarterly in arrears.

For direct real estate portfolios, time weighted returns will be calculated quarterly by the Master Trustee to measure the performance of the portfolios in comparison with the objectives of the fund and appropriate peer groups. Returns are reported quarterly in arrears.

Performance Reporting

Monthly, the total fund return shall be compared with the market goal and public fund universe for the current month, quarter; fiscal year; rolling 1, 3, 5 and 10-year periods. The Market Goal is a passive representation of the specific asset allocation strategy pursued (as defined by the Adjusted Strategic Target) and is the most objective performance evaluation metric to evaluate the performance of the SURS Total Fund. The return of the Market Goal is a weighted average calculation, multiplying each asset class' adjusted strategic target weighting times the return of the asset class benchmark, as defined in Section VI (Investment Manager Structure). Each individual asset class and manager shall have their returns compared to relevant benchmark returns for the current month, quarter, fiscal year; rolling 1, 3, 5 and 10-year periods.

Quarterly, a detailed performance report will be prepared by the investment consultant retained by the Board. The report will include information on the total fund, individual asset classes and managers. The report will be distributed to the Board of Trustees.

Annually, SURS investment staff in conjunction with the investment consultant will prepare and present a comprehensive review of the fiscal year results at the September Investment Committee Meeting.



Market Values

All investment values shall be revised not less frequently than quarterly to reflect the values at which they could be sold. The fact that they may not be up for sale currently does not affect the continuing need for market value revisions.

A description follows of the process for accomplishing this for each category of investments.

Marketable Securities (Publicly traded)

These constitute stocks, bonds, warrants, options, etc. traded on the public exchanges. The SURS custodial bank, which has access to prices for these securities, establishes their market value.

Non-Marketable Traded Securities (Private Markets and Real Estate)

The investment manager has the responsibility for estimating and publishing the market value of these investments. The valuation and appraisal methods used should be consistent with current AIMR and industry standards.



XI. Safeguard of Assets

- Qualification of Service Providers

Any firm which SURS retains to manage, control or have custody of assets shall be qualified by thorough due diligence. Appropriate agreements with the firms and trust agreements shall minimize any risk of loss of assets or income.

- Asset Limits

There are cost and service advantages in firms managing or having custody of large pools of assets so that in the absence of any statutory provision(s) to the contrary, there shall be no specific limit on the size of assets controlled or held in custody by any one firm within the asset allocation guidelines.

- Monitoring of Service Providers

There shall be continuous monitoring of firms which manage or have custody of assets to assure the firms continue to be stable and financially secure. Instability of any firm or financial weakness shall be reason to transfer custody and/or management of assets from the firm.

- Authorization to Transfer Funds

Transfer of funds between accounts must be evidenced in writing by an authorized staff member and be in compliance with the custodial banks procedures. The following positions have been designated by the Board to have such authorization: Executive Director, Chief Investment Officer, Deputy Chief Investment Officer and Investment Executive Assistant.

- Insurance Requirements

All investment managers shall be required to secure and maintain throughout the term of the investment management relationship with SURS insurance that satisfies the requirements set forth below and that is provided by insurer(s) rated A- or better by A.M. Best & Company. Each investment manager shall be required to provide to the Board: (i) a copy of the requisite insurance policies upon initiation of the contract, (ii) an annual certification that the insurance requirements continue to be satisfied, and (iii) evidence of continued satisfaction of the insurance requirements upon request. With the exception of the Manager Development Program, the minimum insurance required for each investment manager shall include: (i) a bond protecting SURS assets that meets the requirements of and that is in the amount specified under ERISA and the regulations thereunder; (ii) errors and omissions coverage in an amount equal to the greater of: a) \$5 million or, b) 5% of the assets under management, up to \$10 million of coverage. For investment managers in the Manager Development Program, the minimum insurance required for each investment manager shall



include: (i) a bond protecting SURS assets that meets the requirements of and that is in the amount specified under ERISA and the regulations thereunder; (ii) errors and omissions coverage in an amount not less than \$1 million of coverage. The insurance shall protect SURS against losses from the negligent acts, errors or omissions of the investment manager.

- Custodial Credit Risk

Pursuant to the 40 ILCS 5/15-166, the Board of Trustees has statutory authority to be the custodian of all cash and securities belonging to the System created under Article 15 of the Pension Code. Pursuant to 40 ILCS 5/15-167, the Board may deposit SURS trust funds with one or more banks, savings and loan associations, or trust companies. This policy addresses how SURS will handle custodial credit risk.

Credit risk is the risk that an issuer or other counter-party to an investment transaction will not fulfill its obligations. Custodial credit risk is the risk that, in the event of the failure of a financial institution or counter-party to a transaction, SURS would not be able to recover the value of deposits or investments in the possession of an outside party. To minimize this risk, SURS takes the following measures:

1. Performs due diligence for custody financial institutions and advisors with which SURS will do business and appropriately documents business relationships with these service providers.
2. Provides investment parameters for the investment vehicles detailed in the specific Investment Manager Agreements.
3. Monitors the financial condition of the custodian. If there is cause for concern, the Board of Trustees will determine appropriate action.
4. Endeavors to have all investments held in custodial accounts through an agent, in the name of custodian's nominee⁵, or in a corporate depository or federal book entry account system. For those deposits or investment assets held outside of the custodian, SURS will follow the applicable regulatory rules.
5. Requires the custodian to meet the following requirements:
 - The custodian or its subcustodians will provide safekeeping of all SURS securities in segregated accounts that reflect the holdings of SURS; the custodian will not commingle SURS securities with the custodian's own securities.
 - Monthly reports will be provided/made available by the custodian.

⁵ Registered owner of a stock or bond if different from the beneficial owner, who acts as holder of record for securities and other assets. Nominee ownership simplifies the registration and transfer of securities.



XII. Permissible Investments

Listed below are the investment vehicles specifically permitted under this Investment Policy. They are categorized as equity and fixed income to indicate how they are classified for purposes of the Policy Mix:⁶

Equity Investment Vehicles:

- Common Stocks
- Preferred Stocks
- Convertible Preferred Stocks
- Convertible Bonds
- Private Placement Investments
- Rule 144A Securities
- Directly Owned Real Estate
- Commingled Real Estate Funds
- Real Estate Investment Trusts (REITs)
- American Depositary Receipts (ADRs)
- Covered Call and/or Covered Put Options
- Warrants
- Futures
- Swaps

Fixed Income Investment Vehicles:

- Government Bonds
- Corporate Bonds
- Convertible Bonds
- Inflation Indexed Bonds
- Residential and Commercial Mortgages
- Residential and Commercial Mortgage Backed Securities
- Asset Backed Securities
- Commercial Paper
- Short-term investments
- Money Market Funds
- Private Placement Residential and Commercial Mortgages
- Private Placement Debt
- Rule 144A Securities
- Futures
- Covered Call and/or Covered Put Options
- Cash and Cash-Equivalent Securities
- Money Market Funds
- Short-Term Investment Funds (STIF)
- Swaps

⁶ Investments listed here are for general information purposes only. Each manager retained by the Board will be given specific instructions with regard to permissible investments relevant to their role in SURS' investment process.



XIII. General Investment Restrictions and/or Guidelines

- **Leverage**

Leverage used with any investment strategy will be consistent with the discipline for which the Board hired the Manager. Use of leverage will be controlled as appropriate in the Manager's investment guidelines, and will be subject to review by Staff, Consultant, and/or Investment Committee.

- **Account Structure**

Assets may be held in commingled funds and/or privately managed separate accounts. Exposure through commingled funds shall be evaluated on a case-specific basis through analysis of the fund's "offering document." Upon review by the Staff and Consultant, and approval by the Board, the "offering document" becomes the specific investment guidelines for that allocation.

- **Quality and Diversification Restrictions**

All investments made shall be subject to the quality and diversification restrictions established by the Illinois Pension Code [40 ILCS 5].

- **Investment Authorization**

No investment or action pursuant to an investment may be taken unless expressly permitted by this Policy and/or the Investment Manager's guidelines. Exceptions may be made subject to prior review by and express written authorization from the Board. In the event that any exception is discovered which has not been specifically authorized, the Staff will immediately provide to the Board a detailed explanation of the exception and action being taken to remedy the situation.

- **Mini-Tenders**

This guideline applies to all investment managers of SURS. It should be considered as an integral part of the Investment Guidelines applicable to the investment manager.

This guideline applies to tender offers that are exempt from registration requirements imposed by the U.S. Securities and Exchange Commission (such tender offers are generally known as "mini-tenders"; currently where the total amount of the tender offer is limited to five percent (5%) or less of the outstanding shares of the issuer).



Investment managers may tender shares owned by SURS only upon the following terms and conditions:

1. The securities involved in the tender are publicly traded, and the issuer of the shares and the entity making the tender offer are the same, OR
2. The offeror must be included on the List of Approved Counterparties.
3. The investment manager provides three (3) days' advance written notice to SURS that it is going to tender shares pursuant to a mini-tender offer.⁷
4. Each notice must be in writing and must include the following information:
 - a. The identity of the offeror and what due diligence has been performed by the investment manager to satisfy itself as to the creditworthiness of the offeror.
 - b. The identity of the transfer or receiving agent, whether or not the transfer or receiving agent is affiliated with the offeror, and what due diligence has been performed by the investment manager to satisfy itself as to the creditworthiness of the transfer agent.
 - c. The expiration date of the offer, the deadline for settlement of the tender, and whether the terms of the tender offer permit the offeree to revoke the tender if payment is not received by the settlement deadline.
 - d. Whether securities tendered on behalf of SURS will be maintained in trust or escrow pending receipt of payment for the securities, or the other protections that will be in place to ensure the safekeeping of SURS' securities pending receipt of payment.

⁷The sole purpose of the notice requirement is for the investment manager to confirm that it has conducted due diligence adequate to protect the SURS assets involved in the mini-tender, and SURS does not assume responsibility for such due diligence or for the investment decision. The investment manager shall retain full fiduciary responsibility for the investment decision, including a determination that a decision to tender SURS' securities under the terms and circumstances involved in the mini-tender is prudent, is protective of SURS' assets, and is otherwise in accordance with the investment manager's fiduciary duties to SURS, which determinations may involve due diligence and consideration of factors beyond those outlined in this section 3, in the investment manager's sole discretion.



XIV. Corporate Governance

A. Proxy Voting Guidelines

Investment managers shall vote the proxies of shares under their discretion and report the results of those votes not less than annually. Proxies shall be voted for the exclusive benefit of System participants and beneficiaries. In general, proxies should be voted in favor of enhancing shareholders' long-term value.

As a general rule, votes that fall within the context of Routine and Non-Routine Matters should be made in accordance with the following guidelines:

- **Routine Matters:** Routine proxy proposals may be voted in support of company proposals unless doing so would be contrary to the interests of the shareholders. Routine matters include the following, unless a proxy contest is being waged with respect to such matter, in which case it becomes Non-Routine:
 - Election of directors;
 - Selection of auditors;
 - Corporate name change;
 - Amendment of Articles of Incorporation that are required to comply with federal or state regulation; and
 - Change in the date, time or location of annual meeting.
- **Non-Routine Matters:** Non-Routine proposals should be carefully analyzed and considered on a case-by-case basis. Non-Routine proposals that do not eliminate the rights of shareholders, unreasonably dilute or impair the status of securities held, or impair ownership status of the securities may be voted with management. Non-Routine proposals that would or might impair the economic interests of shareholders should be voted against management.

Reporting: Investment managers shall report the results of their votes at least annually. The report shall contain at a minimum the name of the corporation, a brief description of the proposal, the vote cast, and whether the vote cast was with or against management.

B. Securities Litigation Policy

1) Identification Of Potential Claims

- a) In order to weigh the costs and benefits of the various alternatives as specified below, SURS staff will identify potential claims by determining if it bought or sold the securities of a company during applicable periods.
- b) SURS staff will regularly match the SURS portfolios against reports of securities litigation cases obtained from consultants, law firms



engaged for securities litigation, and from other sources deemed reliable by staff such as the Stanford Class Action Clearinghouse and the Council of Institutional Investors.

- c) If SURS did not buy or sell securities of a company during the applicable period, the inquiry will end. If SURS had purchases or sales during the period, evaluation of the potential claim will proceed as specified below.

2) Evaluation Of Potential Claims

- a) If SURS bought or sold securities during an applicable period, evaluation of the alternatives available will be begin with an initial assessment of the size of the potential claim.
- b) Where a potential loss is less than \$1 million, further action will ordinarily be limited to monitoring as specified in Part 3 below to ensure that class member claims are filed if and when there is a right to do so, unless there are extenuating circumstances that warrant further consideration by staff and the Board of Trustees
- c) Where the potential loss is greater than \$1 million, the alternative courses of action available shall be identified by the staff. Alternatives will likely include several different courses of action, such as:
 - i) Monitoring the course of a class action suit and filing a claim at the end to participate in a class payment.
 - ii) Monitoring the course of a class action suit, but objecting to a proposed settlement if there are reasons to object.
 - iii) Seeking to control a class action by seeking designation as lead plaintiff, either singly or with others.
 - iv) Opting out of a class action suit and filing a separate suit, either singly or with others.
- d) The relative merits of each alternative will be weighed and considered by staff.
- e) Staff will make a recommendation to the Executive Committee of any course of action beyond participating in the litigation as a passive member of the class. The Executive Committee will have the authority to approve any course of action beyond monitoring the case.

3) Monitoring

- a) The staff will utilize the services of the system's custodian, as well as the services of any consultants with expertise in this area chosen by staff, to monitor pending cases which involve securities that SURS bought and sold during the relevant periods to evaluate any settlements proposed and to file claims as necessary for SURS to participate in



distributions of funds. To the extent that staff finds a proposed settlement inadequate to protect the interests of the System, the Executive Committee may authorize action to file legal objections.

4) Legal Action

- a) Where the Executive Committee has determined under Part 2 that the interests of the System will be best served by seeking designation as lead plaintiff or by opting out of a class action, staff will choose appropriate counsel from the approved list determined under Part 5 and will negotiate a fee agreement. If the staff determines that appropriate counsel is a firm not on the approved list, the recommendation of such firm shall be made to, and approved by, the Executive Committee.
- b) Any legal action authorized or taken shall be reported to the Board of Trustees, who shall also be provided periodic updates on the status of such actions.

5) Approved Law Firms

- a) SURS staff will interview and select, through a request for proposal process, a roster of no more than five qualified securities litigation firms. This roster will constitute SURS' "approved list".
- b) In cases where the initiation of litigation is a formality designed to provide support for another institutional investor, SURS staff may recommend that the most sensible and cost-effective source of legal representation will be the SURS General Counsel or the legal counsel representing the institutional investor that SURS wishes to support.



XV. Emerging, Minority and Women-Owned (EMW) Firms

The State Universities Retirement System of Illinois (SURS) is committed to providing opportunities for emerging, minority and women-owned (EMW) firms. SURS has taken and is continuing to take important and appropriate actions to provide increased opportunities for EMW managers. This program has been and will continue to be important to the SURS Board of Trustees and has received the highest priority.

The Illinois Pension Code, in 40 ILCS 5/15-167.3, encourages the trustees of the System to use emerging investment managers, minority-owned businesses, female-owned businesses, and businesses owned by persons with disabilities in managing the System's assets to the greatest extent feasible within the bounds of financial and fiduciary prudence, and to take affirmative steps to remove any barriers to the full participation of emerging investment managers, minority-owned businesses, female-owned businesses, and businesses owned by persons with disabilities in investment opportunities afforded by the System.

SURS Board of Trustees adopted the following resolution in 1992 to seek increased participation by EMW investment managers and brokers for SURS investment program. The Trustees reaffirmed the resolution in 2001.

WHEREAS

SURS is a public retirement system with a mandate to invest prudently for the best total return subject to reasonable risks, and

WHEREAS

SURS investment strategy, established by the Board, is designed to achieve excellent long-term results through a well-diversified, multi-asset structure. Investment service providers are engaged to implement the Board's strategy, and

WHEREAS

SURS as a public agency with a diverse membership aspires to assure reasonable access to SURS service provider relationships to minority and women-owned firms, and

WHEREAS

The availability of qualified minority and women-owned firms is not a barrier to their utilization,

THEREFORE

IT SHALL BE THE POLICY OF THE SURS BOARD

To seek to achieve a goal of increased participation of minority and women-owned business enterprises as investment managers of SURS actively managed assets.

To seek to achieve a goal of increased participation of minority and women-owned business enterprises as brokers for security trading of SURS assets.



To request an annual report from each of SURS investment managers regarding its use of minority and women-owned business enterprises as brokers, as well as a report on its work force utilization of the same.

To provide annually to its membership a report of SURS goals and progress toward those goals for utilization of minority and women-owned business enterprises.

A. Minority- and Female-Owned Brokerage Usage Policy

The Board of Trustees of the State Universities Retirement System has an established policy that seeks increased participation of minority and women-owned business enterprise firms. As part of this policy, the Board has adopted minimum expectations for the use of minority- and female-owned brokerage firms by the System's investment managers.

The minimum expectations are established based on the asset class in which the investment manager is utilized.

Domestic Equity Separate Accounts including Real Estate Investment Trust Securities (REITS)

Subject to best execution, domestic equity investment managers for SURS are required to direct 25% of the total commission dollars to minority- and female-owned broker/dealers.

Non-U. S. Equity Separate Accounts

Subject to best execution, Non-U. S. equity investment managers for SURS are required to direct 10% of the total commission dollars to minority- and female-owned broker/dealers.

Fixed Income Separate Accounts

Effective January 1, 2006, subject to best execution, fixed income investment managers for SURS are required to direct 5% of fixed income volume to minority- and female-owned broker/dealers. Expectations will increase to a level of 10% effective July 1, 2006, 15% effective July 1, 2007 and 20% effective July 1, 2008.

Reporting Guidelines

Each manager will submit a compliance report within 30 days after March 31, June 30, September 30 and December 31 of each year. Reporting will be monitored over a rolling twelve-month period.

Consequences of Non-Compliance

SURS continuously monitors managers' compliance with this policy and has established a series of consequences for those managers who continually fail to meet expectations. The investment managers are expected to achieve the desired



levels over rolling twelve-month periods. The following steps will occur if the investment manager continues to fall short of expectations:

- 1) A follow-up letter will be distributed to the investment managers not achieving the minimum level of minority- and female-owned broker/dealer usage. The investment manager will be reminded of the usage expected by SURS. Currently, as stated in the Annual Report to the Governor and General Assembly on the Use of Emerging Investment Managers, prepared as required in Public Act 87-1265, a letter is distributed to all of the investment managers on an annual basis listing the level of expectations.
- 2) Not achieving the desired level of minority- and female-owned broker/dealer usage will be noted in the annual manager review presented to the SURS Board of Trustees. This could impact the evaluation ranking provided to the firm.
- 3) SURS staff will conduct a meeting with the investment manager to discuss the reasons for not achieving the desired level of expectations.
- 4) No increase in funding will be recommended to the investment manager until the expected levels of broker/dealer usage are utilized.
- 5) If a manager fails to comply with the request, they will be invited to appear before the SURS Board of Trustees to explain why they are unable to achieve the desired level of expectations.
- 6) The manager will be subject to a reduction of assets or potential termination should the investment manager consistently fail to achieve the expected levels of minority- and female-owned broker dealer usage over an extended period.

B. Manager Development Program

Objectives and Goals

The State Universities Retirement System (SURS) has implemented the Manager Development Program (MDP) in its proactive efforts to assist minority- and women-owned domestic equity, non-U.S. equity and fixed income investment management firms. The Manager Development Program is an internally managed program that is administered by SURS staff. To qualify, firms must be at least 51% minority- and/or women-owned and controlled.

The primary goal of the MDP is identifying highly successful, minority and female managers that can then be awarded larger allocations and simultaneously integrated into the larger, actively managed portfolio when openings occur or when a need is identified.



The performance objective of the MDP is to seek annualized investment returns, net of investment management fees, in excess of the market goal for 1, 3, 5, and 10 year periods. While individual managers may underperform in any given year, the diversification within the program should limit the underperformance at the program level.

Benchmarks

The Manager Development Program consists of three broad components, each of which is measured by a relevant benchmark. Within the domestic equity component, the active portfolio and the passive portfolio are measured by two distinct benchmarks. The table below identifies the benchmark for each program component. Individual manager benchmarks are identified in the investment guidelines for each manager.

| <u>MDP Component</u> | <u>Benchmark</u> |
|---------------------------------|---|
| Overall Program | Custom based on the benchmarks of the underlying MDP components |
| U.S. Equity – Active Component | Russell 2500 Index |
| U.S. Equity – Passive Component | S&P 500 Index |
| Fixed Income | Lehman Aggregate Index |
| Non-U.S. Equity | MSCI EAFE Index |

Search and Selection Process

For searches affiliated with the SURS Manager Development Program (MDP), the investment staff conducts the search process with the investment consultant providing an independent evaluation of the program annually. The criteria used to determine the minimum qualifications of firms to be selected for an assignment is shown in the table that follows:

| <u>Selection Criteria</u> |
|--|
| 1. Registration with the Securities and Exchange Commission (SEC) under the Investment Advisors Act of 1940, or otherwise qualified under Sec. 1-101.4 of the Illinois Pension Code (40 ILCS 5/1-101.4). |
| 2. Experience of the firm in the management of institutional portfolios operated under prudent person standards, as well as related investment management experience. |
| 3. Qualifications and/or depth of the professional staff. |
| 4. Soundness of the firm's investment philosophy and process. |
| 5. The investment record of the firm and/or the firm's principals in former associations where that record is verifiable. |



| |
|--|
| 6. The adequacy of the firm's trading, back office, accounting and reporting, and client servicing capabilities. |
| 7. Fees. |

Using the above criteria established by the Board of Trustees, the top firms are selected based upon the experience and qualifications of the firm's principals, the soundness of the firm's investment philosophy and process, as well as the strength of the investment record and organization. SURS does not use any criteria that would be considered a barrier to an emerging manager such as a minimum number of years in business or a minimum asset level under management. As a part of the selection process, SURS utilizes its databases to ensure that qualified emerging managers are included in the pool of eligible candidates. Once these top firms are identified, the staff generally prepares and sends a standardized questionnaire to the firms, typically between five and twenty-five, depending on the nature of the search. Following a review of the responses from interested firms, the field of candidates is narrowed to a smaller list of the most highly qualified firms. At this point, representatives from SURS staff meet with representatives of each firm to obtain its own independent assessment of the firm's capabilities. Following the interview with the selected firm(s), SURS staff, in consultation with the consultant, recommends to the Executive Committee of the Board one or more managers for engagement. The Executive Committee accepts or modifies the recommendation and approves the engagement, if satisfied with the firm's capabilities. Upon approval, the investment advisory agreement and other related documents shall be executed prior to funding the account. All investment advisory agreements will be in compliance with the relevant section(s) of the Illinois Compiled Statutes.

Manager Evaluation

Managers in the MDP program will be evaluated in the same manner as that set forth in Section VII (Manager Selection and Retention). Termination decisions will follow the guidelines set forth in Section IX (Investment Manager Termination Guidelines). An evaluation of each investment manager shall be conducted not less than annually.

Staff Authority to Hire/Retain/Terminate Managers

The MDP is an internally managed program. As such, SURS Staff has the responsibility to identify, recruit, monitor and oversee MDP Managers. SURS Staff will make recommendations on the selection, retention and termination of MDP Managers, but the Board (acting through its Executive Committee) reserves the ultimate authority with respect to all Investment Manager hiring, retention and termination decisions. The SURS Staff has the responsibility to implement the Board decisions through negotiation, execution and enforcement of the investment management agreement and guidelines. All investment management agreements and amendments thereto must be executed by the Executive Director. In the event that termination of a Manager is warranted under the Investment



Manager Termination Guidelines, and prompt termination of the Manager is necessary to protect and preserve System assets, SURS Staff may, with the prior approval of the Executive Director, terminate the Manager prior to Board action. The Board shall be promptly notified of the decision to terminate the Manager, and the decision shall be presented to the Investment Committee for ratification at its next meeting.

Retention and termination decisions will be fully documented and will include a full description of the reason for the action, including the specific elements serving as the basis for the evaluation and identification of the relevant issues from the System's perspective.

SURS staff has the authority to rebalance between MDP managers in order to maintain target allocations and style neutrality in each component of the MDP. Staff will report the results of rebalancing activity to the Investment Committee at the next regular Investment Committee meeting.

Graduation from MDP

The following factors are considered in determining when a manager should be graduated from the Manager Development Program into the larger SURS portfolio:

- Stability in Organization
- Growth in Assets under Management
- Confidence in Investment Process
- Strong Investment Performance

In addition to the factors mentioned above, the needs of the overall SURS investment program will be considered. Generally, a manager is initially graduated from the MDP into the Opportunity Fund. Upon further demonstration of stability, firm growth, strong investment process and performance, a manager is eligible for graduation into the larger SURS portfolio.