State Treasurer's Working Group on Investments

January 2011
703 Stratton Office Building
Springfield, Illinois 62706

The State Treasurer's Working Group on Investments (P.A. 96-0006)

Public Act 096-0006 amends the State Treasurer Act to add a new Section titled, "working group; peer cost comparison." The Treasurer shall convene a working group consisting of representatives from the retirement systems, pension funds, and investment board created under the Illinois Pension Code, persons that provide investment services, and members of the financial industry. The working group shall review the performance of investment managers and consultants providing investment services for the retirement systems, pension funds, and investment board created under the Illinois Pension Code. The group shall develop uniform standards for comparing the costs of investment services and make recommendations to the retirement systems, pension funds, and investment board. In performing its functions, the working group shall work in coordination with the Commission on Government Forecasting and Accountability. The working group shall draft a report, and the Treasurer must submit such report, to the Governor and the General Assembly by January 1, 2011.

State Treasurer's Working Group on Investments Members

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I. Fees

- **Report of the Committee on Fee Structure**

Report of the Committee on Fee Structure

I. Introduction

Consistent with Public Act 96-0006 (the "Act"), which amends the State Treasurer Act to create the Treasurer's Working Group on Pensions (the "Working Group"), the Working Group respectfully submits the procedural standards, set forth in the below report, as "Best Practices" regarding the payment of investment fees by Illinois public pension plans.

In the process of creating procedural standards, the Working Group focused on certain broad prudential standards, transparency and process, to help public pension plans meet their fiduciary responsibility of defraying reasonable expense while providing benefits to participants and their beneficiaries.

Further, the Working Group acknowledged the differing needs and capabilities of the plans regulated by Articles 3 and 4 of the Illinois Pension Code ("Article 3 and 4 Plans") and the larger public plans that operate mostly under a prudent person fiduciary standard ("Prudent Person Plans"). As a result, the procedural standards recommended for the two types of plans differ in certain aspects.

II. Transparency

Illinois public pension plans should seek transparency in relation to fees incurred for investment services. At a minimum, applying standards of prudence, all such fees incurred should be discussed in open meetings and made available for public review..

All investment fees should be itemized to reflect the following:

- Investment Management Fees (itemized by manager);
- Brokerage Fees (itemized by manager and broker, and including any soft dollar fees);
- Investment Consulting Fees;
- Custodial Fees (Unbundled), and;
- Other Mutual Fund Fees (such as 12b1 fees, wrap fees, and front or back end sales loads).

III. Illinois Department of Insurance (the "DOI")

Under existing statute, Article 3 and 4 Plans are required to file annual reports with the DOI; therefore, the DOI is in a position to compile and present reports of aggregated data, including fee data. If the DOI could generate regular comparable reports for investments by Article 3 and 4 Plans, such reports would be useful to the Article 3 and 4 Plans in terms of peer comparables.

As a result, the Committee encourages the DOI to consider the feasibility of issuance of such reports, and to the extent possible, make detailed fee data available to Article 3 and 4 Plans. Data should be organized by investment type (separate account management or mutual funds) and by asset class (equities and fixed income) in a useable manner, such as a percentile basis.

IV. Process - Article 3 and 4 Plans

Articles 3 and 4 of the Illinois Pension Code create and regulate municipal police and fire plans. Article 3 and 4 Plans operate under the regulations contained within the applicable provisions of the Illinois Pension Code, but retain prudential responsibility for the assets under their care. At a minimum, such plans should adhere to the aforementioned standards while also applying the procedural standards described below.

Consideration of Fees
When considering the appropriate fee to pay for investment services, plans first and foremost should apply standards of prudence. In doing so, plans should consider the marketplace and the level of fees being proposed by the investment service provider, the anticipated value of the service to be provided, and, if possible, the objective advice of a retained, independent investment consultant.

Whenever possible and practical, plans should seek out an independent fee database against which to compare proposed investment fees. Plans should seek to pay investment fees as low as possible. From a fiduciary duty perspective, certain instances may require payment of a higher fee. In such instances, the plan should fully disclose and memorialize the rationale behind its decision to pay a higher fee.

Mutual Funds
When investing in mutual fund shares, plans should seek to avoid retail fund relationships. Peer group comparisons of mutual fund fees should be implemented in order to seek out the lower fees of institutional shares.

As a general rule, 12b1 fees, wrap fees, and sales loads should be avoided. In instances where a plan determines that such fees must be paid, the rationale behind such decision should be memorialized and fully disclosed.

Insurance Contracts
The standards pertaining to fees paid to mutual funds should also be applied by plans when utilizing insurance contracts. All fees imbedded in an insurance contract should be broken out and fully disclosed in an open meeting.

Consultants
Given the likelihood of there not being independent investment professionals to advise fiduciaries in the selection of a consultant, particular care needs to be given to process and transparency. The selection process should be openly and competitively bid, and consultant relationships should be routinely evaluated and re-bid, at least every five years. All payment to consultants should be per invoice and paid with hard dollars by the plan. In addition, any payments to the consultant by brokers, investment advisers, custodians, or any other plan service provider should be disclosed reflecting the amount of payment and the services rendered. Such relationships should be discouraged and avoided.

V. Process - Prudent Person Plans

The Working Group acknowledges that Prudent Person Plans, those plans created separately under the Illinois Pension Code, which apply a prudent person fiduciary standard, operate in a regulatory space, which differs from Article 3 and 4 Plans. The procedural standards applied to Article 3 and 4 Plans should also be applied to Prudent Person Plans; however, Prudent Person Plans, which tend to be larger and more sophisticated, should take further steps, as described below, to insure reasonable costs and sufficient transparency.

Conventional Asset Classes
Upon procuring the services of investment advisers to oversee conventional assets (i.e. securities), plans should insure that such advisers are bona fide Registered Investment Advisors ("RIAs"). Negotiated fee schedules should be fully disclosed and accessible by the public. Plans, in conjunction with a retained independent investment consultant, should prudently consider the proposed fee against a comparable global product database to accurately compare the proposed fee against the database. From a fiduciary duty perspective, certain instances may require payment of a higher fee. In such instances, the plan should fully disclose and memorialize the rationale behind its decision to pay a higher fee.

Whenever possible, plans should seek to include a Most Favored Nations provision within its investment advisory agreements to insure that no similarly situated client is in receipt of a more favorable fee arrangement.

Alternative Asset Classes
Alternative assets can be described as allocations made to platforms that are not traditional long only managers of conventional securities (stocks and bonds), but rather generally include real estate funds and private equity limited partnerships. However, alternative assets may also include alternative debt or equity strategies, hedge funds, commodities, or other investment strategies that do not fit cleanly within the conventional asset category.

Plans should seek to achieve fee transparency within these strategies; however, plans should be aware of contractual restrictions and statutory exemptions when providing fee transparency. In many, if not all, alternative asset strategies, the extent to which transparency may be achieved is restricted by contract and/or statutory provisions.

Prudent Person Plans should seek to use the fee structure to maximize the alignment of the Plan's interest with that of the investment team; investment professionals should be rewarded for success and incented not to fail. Whenever possible and prudent, the majority of compensation of the investment professional, often the general partner, should come from carried interest earned after the plan has received back their capital commitment plus a preferred return, rather than investment management fees. It's worth noting that in certain instances (e.g. fund-of-funds) only investment management fees are material.

VI. Conclusion

In light of federal financial reform and in accordance with fiduciary duties, public pension plans should adhere to procedural standards for comparing the costs of investment services. The regulatory nature of Article 3 and 4 Plans differs from that of Prudent Person Plans; therefore, the procedural standards for the two plans differ as well. For example, Article 3 and 4 Plans are uniquely positioned to take advantage of comparative database reports, which could be published by the DOI. Such reports, in conjunction with the comparison of fees against global databases, ensure prudent consideration of fees. On the other hand, Prudent Person Plans tend to be larger in size and therefore have greater capacity to seek certain standards such as Most Favored Nations provisions which ensure equal fee arrangements for similarly situated funds.

Both types of plans utilize different tools in order to minimize investment fees; however, both types of plans share similar prudential responsibilities over the assets, which they oversee. In accordance with fiduciary duty, both plans should adopt procedural standards, which promote transparency. Fees for investment services should be publicly disclosed, with higher fee decisions memorialized in order to explain the rationale for the decision.

As a collective unit of institutional investors, public pension plans have the potential to manipulate investment fees in their favor. By taking advantage of their respective positions and adopting procedural standards, which are in line with fiduciary duty, Illinois public pension plans will be able to reduce investment expense within their investment portfolio.

Disclaimer language

Performance Results

Please note: Asset allocation is a principal determinant of performance among other factors. Asset allocation will vary by plan taking into account factors such as plan liabilities, risk tolerance, return objectives, and operational resources for implementation of certain strategies. All factors must be considered when evaluating performance results and fee data. Performance results measured in a single point in time may not be an accurate reflection of the value of plan assets and are best measured over a range of time periods.

Manager Fees

Please note: As different asset classes will respond differently to market characteristics such as volatility, interest rates, time horizon and inception. Likewise investment fees can vary depending on the performance of the asset class as well as the size of mandate, account structure, changes in allocation, and other services provided.

Consulting Fees

Please note: Consulting fees may be determined by the scope of work and term of engagement which can be determined by the operational infrastructure of the sponsor, independent negotiations, etc.

II. Performance

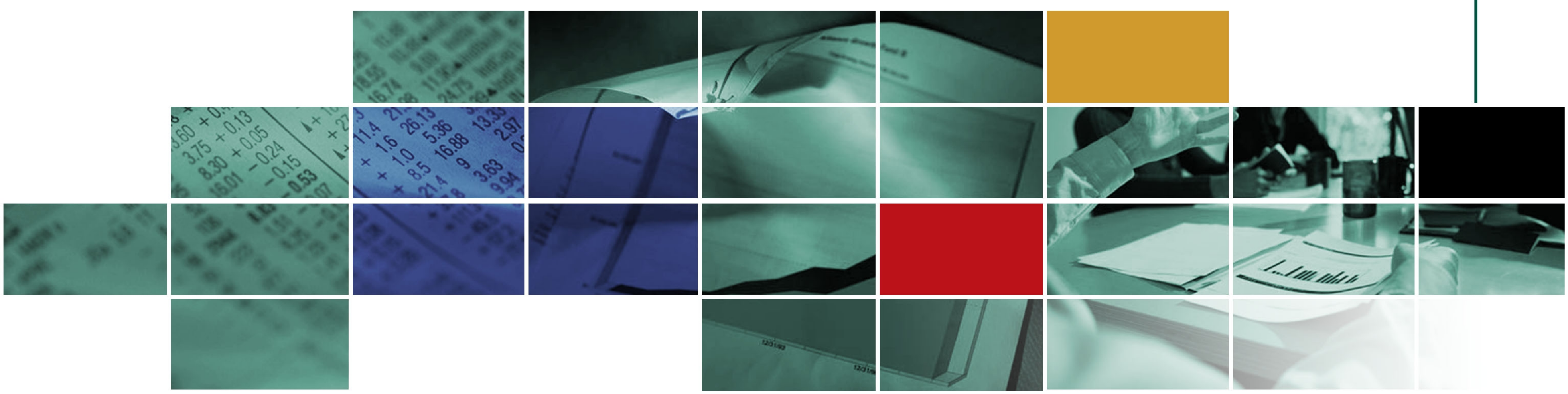
- **Public Funds Universe Analysis Period Ending June 30, 2010**
  Compiled by RVKuhns & Associates, Inc.

RVKuhns & ASSOCIATES, INC.

Illinois Funds

Public Fund Universe Analysis

Period Ending June 30, 2010



Report and Firm Summary

The following report is a compilation of data provided to R.V. Kuhns & Associates, Inc. by 92 public funds from throughout the United States. R.V. Kuhns & Associates, Inc. is a registered investment advisor with the Securities Exchange Commission under the Investment Advisors Act of 1940. Our firm provides investment consulting services to over 275 clients with total assets in excess of $800 billion. The confidentiality of the participants is maintained by revealing the fund name only to the individual fund. For more information about services provided by R.V. Kuhns & Associates, Inc. please visit our website at www.RVKuhns.com.

Participants

As of June 30, 2010

Alameda County Employees' Retirement Association
Big Spring Firemen's Relief & Retirement Fund
California Public Employees' Retirement System
California State Teachers' Retirement System
Chicago Teachers' Pension Fund
City of Fresno Retirement Systems
City of Grand Rapids General Retirement System
City of Grand Rapids Police & Fire Retirement System
City of Philadelphia Board of Pensions and Retirement
City of Phoenix Employees' Retirement System
Civilian Employees' Retirement System of the Police Department of Kansas City, Missouri
Colorado Public Employees' Retirement Association
Commissioners of the Land Office, State of Oklahoma
Contra Costa County Employees' Retirement Association
County Employees' Annuity & Benefit Fund of Cook County
District of Columbia Retirement Board
Educational Employees' Supplementary Retirement System of Fairfax County
Employees Retirement System of Texas
Fire & Police Employees' Retirement System of Baltimore
Fire and Police Pension Association of Colorado
Fire and Police Pension Fund, San Antonio
Firemen's Annuity and Benefit Fund of Chicago
Fort Worth Employees' Retirement Fund
Georgia Division of Investments
Gila River Indian Community Retirement Plan
Illinois Municipal Retirement Fund
Illinois State Board of Investment
Imperial County Employees' Retirement System
Iowa Public Employees' Retirement System
Kansas City Police Employees' Retirement System
Kansas City, Missouri Employees' Retirement System
Kansas City, Missouri Firefighters' Pension System
Kansas Public Employees' Retirement System
Kentucky Retirement Systems
Kentucky Teachers' Retirement System
Kern County Employees' Retirement Association
Laborers' Annuity and Benefit Fund of Chicago
Los Angeles County Employees Retirement Association
Los Angeles Fire and Police Pension System
Los Angeles Water & Power Employees Retirement Plan
Marin County Employees' Retirement Association
Merced County Employees' Retirement Association
Metro Water Reclamation District Retirement Fund
Milwaukee Employes' Retirement System
Montana Public Employees' Retirement System
Montana Teachers' Retirement System

Participants

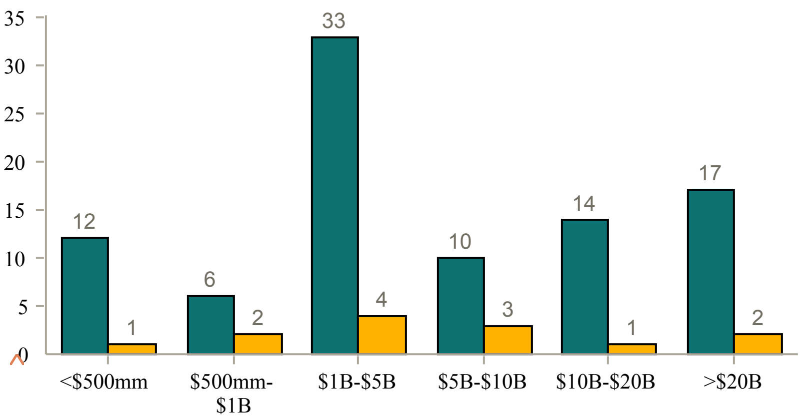
As of June 30, 2010

Montgomery County Employees' Retirement System
Municipal Employees' Annuity and Benefit Fund of Chicago
Navajo Nation Permanent Fund
Navajo Nation Retirement Plan
Nevada Public Employees' Retirement System
New Jersey Division of Investment
New Mexico Educational Retirement Board
New York State Common Retirement Fund
Orange County Employees Retirement System
Park Employees' Annuity & Benefit Fund of Chicago
Pennsylvania Municipal Retirement System
Pennsylvania Public School Employees' Retirement System
Pennsylvania State Employees' Retirement System
Policemen's Annuity and Benefit Fund of Chicago
Public Education Employee Retirement System of Missouri
Public Employee Retirement System of Idaho
Public Employees Retirement Association of New Mexico
Public School Retirement System of Missouri
Retirement Plan of Chicago Transit Authority Employees
Sacramento County Employees' Retirement System
San Bernardino County Employees' Retirement Association
San Diego City Employees' Retirement System
San Diego County Employees Retirement Association
San Mateo County Employees' Retirement Association
Santa Barbara County Employees' Retirement System
Sonoma County Employees' Retirement Association
Stanislaus County Employees' Retirement Association
State Board Administration of Florida
State of Michigan Retirement Systems
State of Wisconsin Investment Board
State Universities Retirement System of Illinois
Teachers' Retirement System of Louisiana
Teachers' Retirement System of Oklahoma
Teachers' Retirement System of the State of Illinois
Texas Municipal Retirement System
Texas Permanent School Fund
Tulare County Employees' Retirement Association
Utah Retirement Systems
Ventura County Employees' Retirement Association
Virginia Retirement System
West Virginia Investment Management Board
Wyoming Common School Permanent Land Fund
Wyoming Permanent Land Trust
Wyoming Permanent Mineral Trust Fund
Wyoming Retirement System
Wyoming University Permanent Land Trust

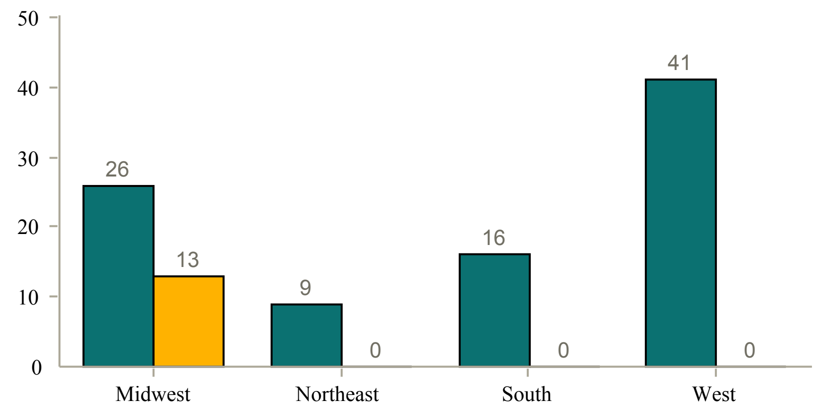
Universe Characteristics

As of June 30, 2010

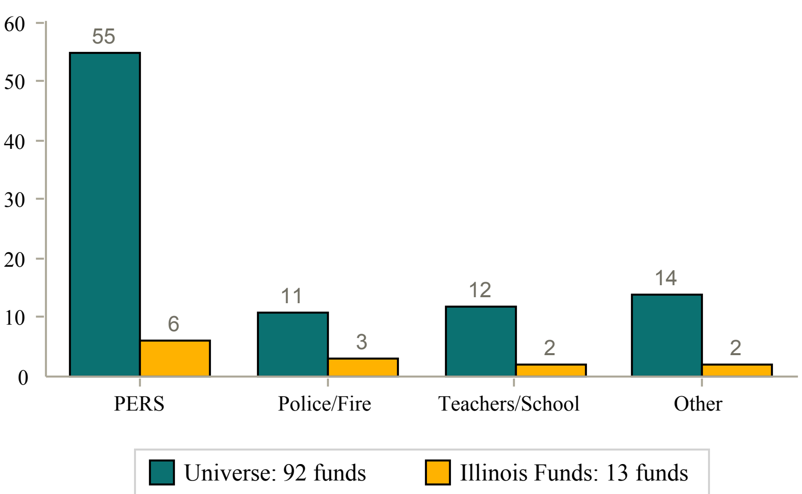
Asset Size



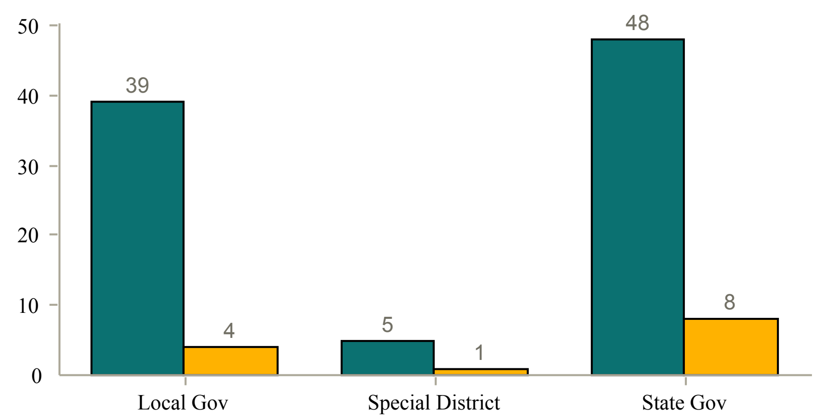
Geographical Distribution



Fund Classification



Fund Type

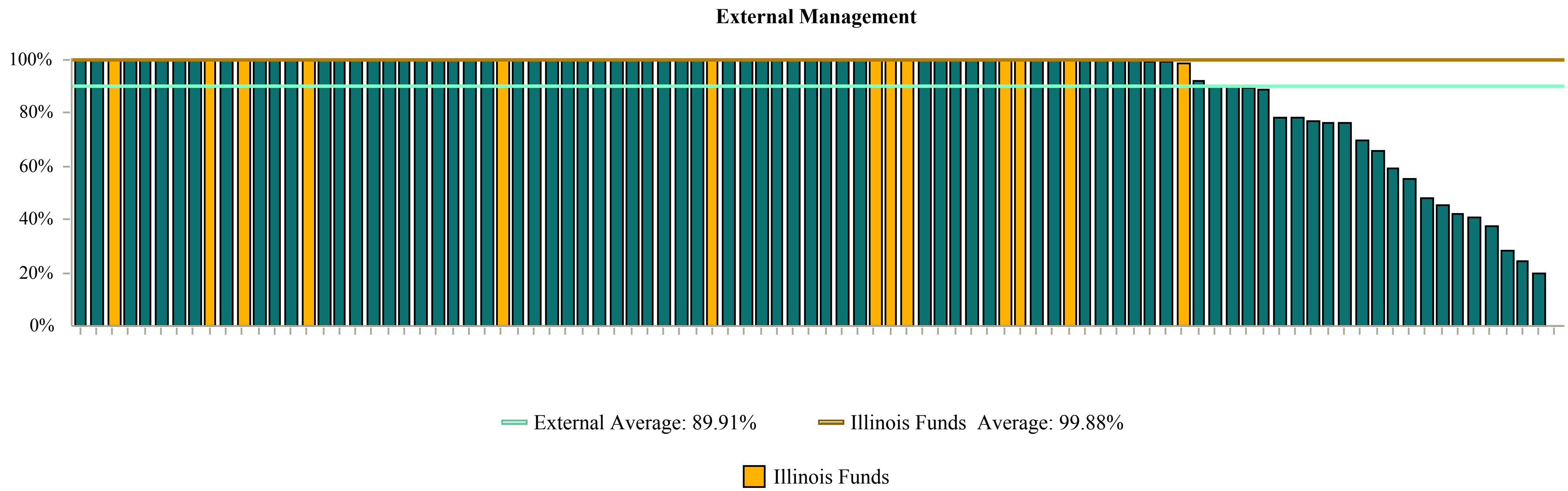


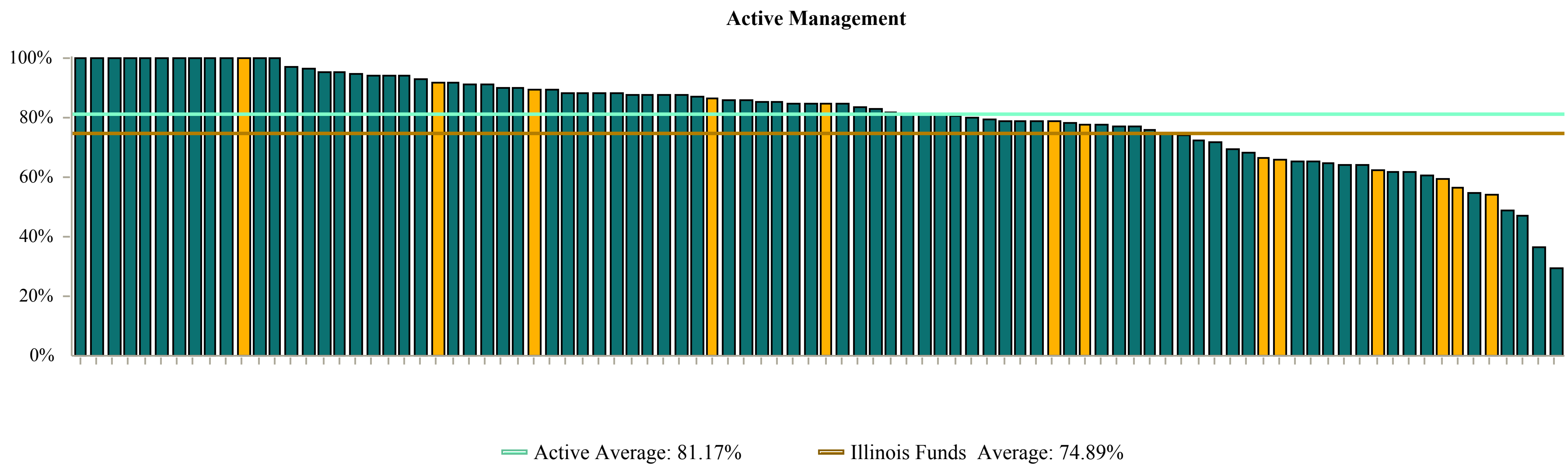
RVKuhns
& ASSOCIATES, INC.

Portfolio Management

Percentage Externally Managed & Percentage Actively Managed

As of June 30, 2010





Portfolio Management Statistics

As of June 30, 2010

Asset Range	Percentage Actively Managed	Percentage Passively Managed	Percentage Externally Managed	Percentage Internally Managed
Over $20B	69.23%	30.77%	66.95%	33.05%
$10B-$20B	78.11%	21.89%	81.82%	18.18%
$5B-$10B	83.38%	16.62%	97.72%	2.28%
$1B-$5B	85.06%	14.94%	97.94%	2.06%
$500mm-$1B	88.93%	11.07%	100.00%	0.00%
Under $500mm	85.19%	14.81%	98.24%	1.76%
Illinois Funds	**74.89%**	**25.11%**	**99.88%**	**0.12%**

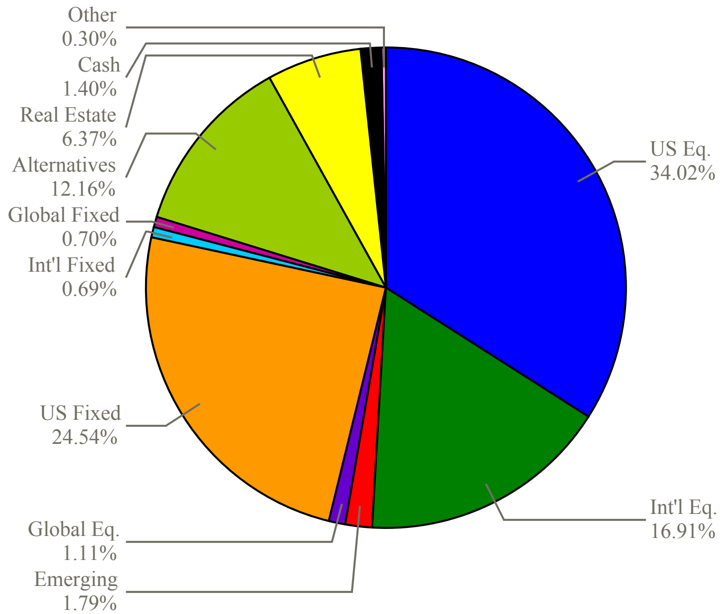
	Active Management		External Management	
Percentage of Portfolio	Public Fund Universe	Illinois Funds	Public Fund Universe	Illinois Funds
90% to 100%	27	2	71	13
50% to 89%	61	11	12	0
10% to 49%	4	0	8	0
Less than 10%	0	0	1	0
Total Funds Reporting	**92**	**13**	**92**	**13**

Asset Allocation

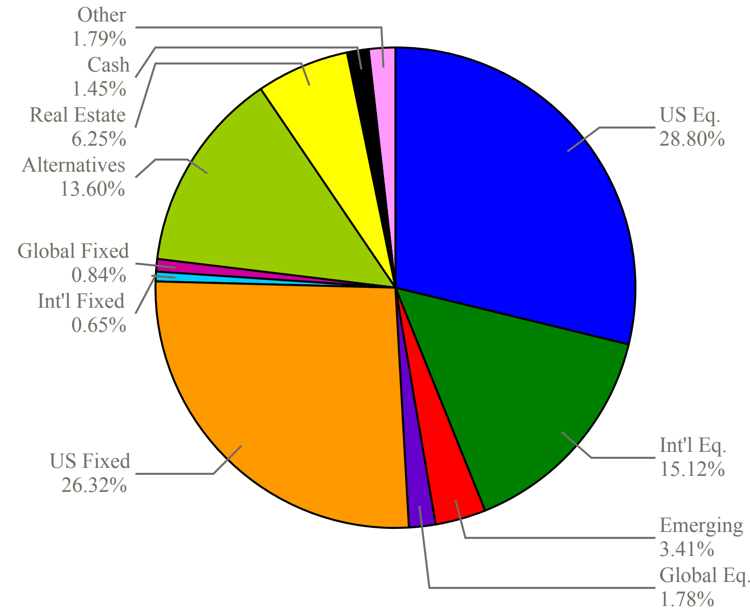
Illinois Funds vs. Weighted Average of All Funds

As of June 30, 2010

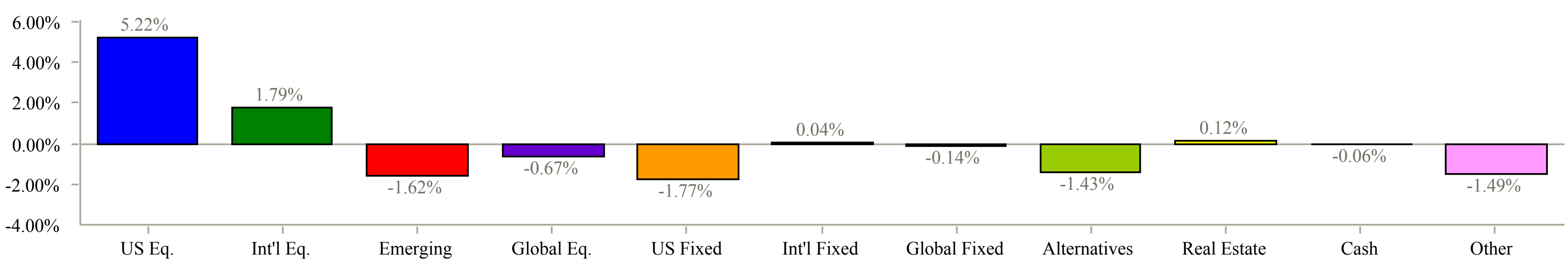
Illinois Funds



All Funds



Variance



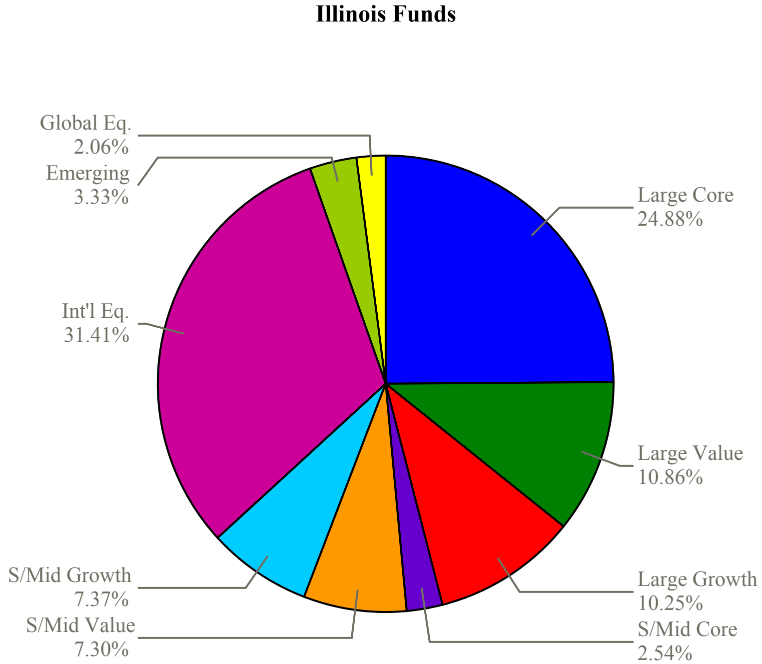
Allocations shown may not sum up to 100% exactly due to rounding.

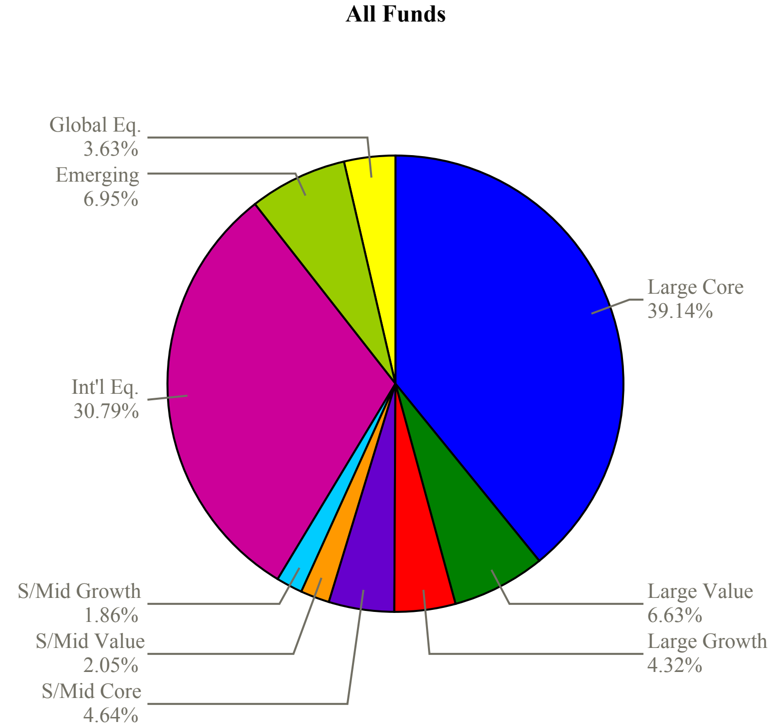
RVKuhns & ASSOCIATES, INC.

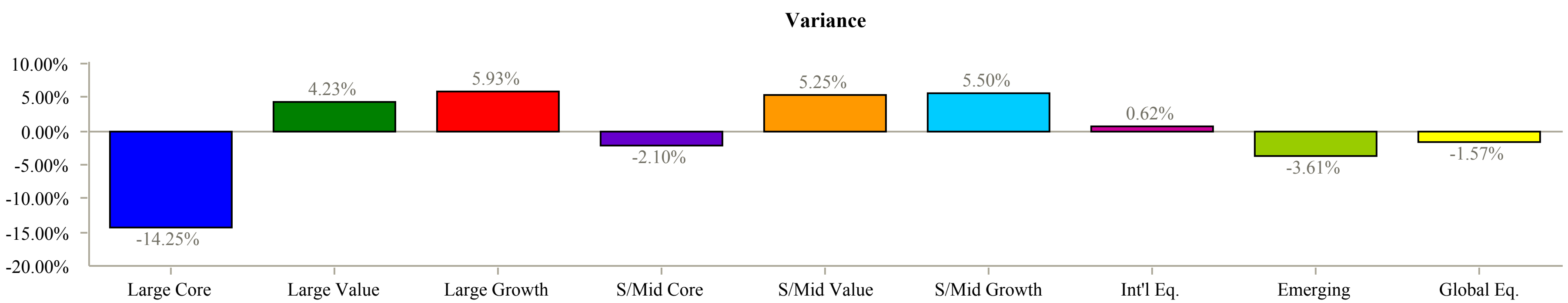
Equity Style Allocation

Illinois Funds vs. Weighted Average of All Funds

As of June 30, 2010





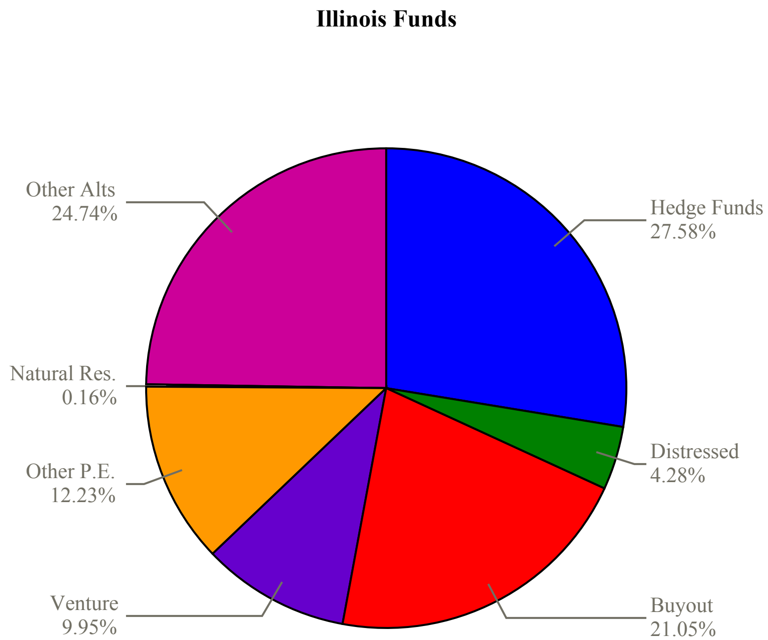


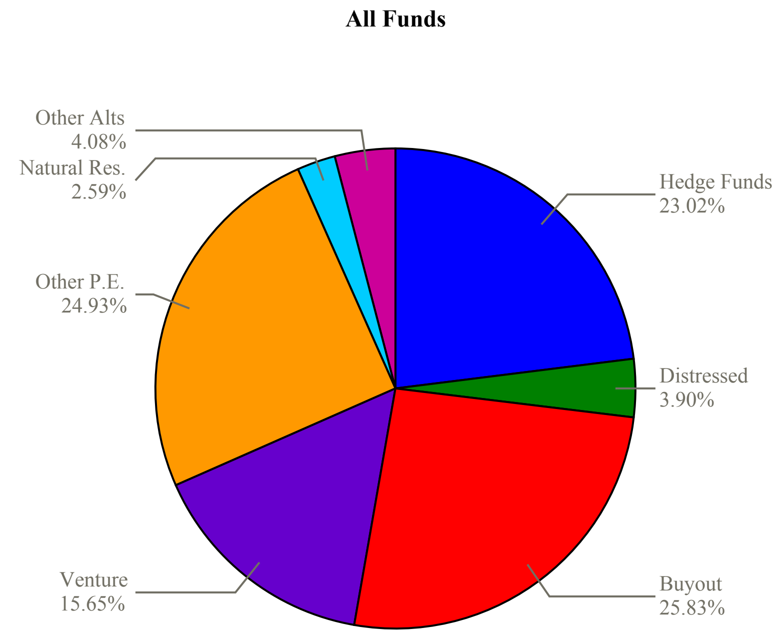
Allocations shown may not sum up to 100% exactly due to rounding.

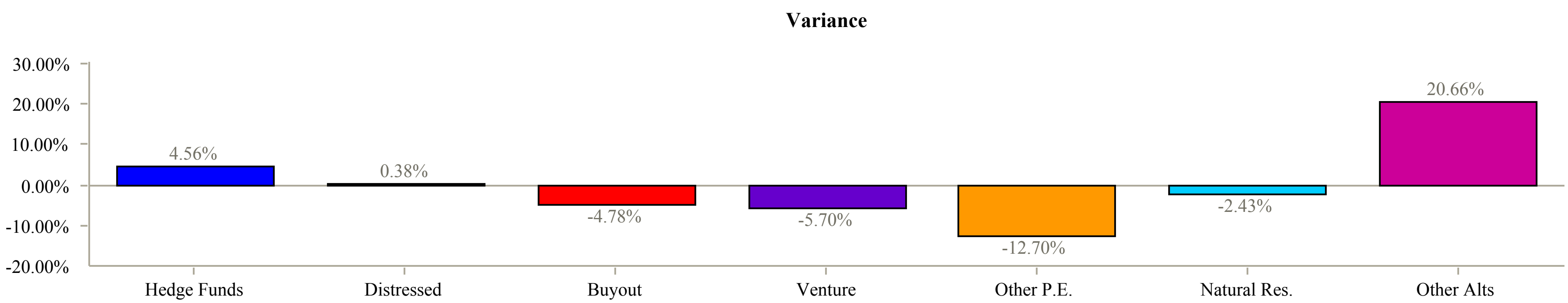
Alternatives Style Allocation

Illinois Funds vs. Weighted Average of All Funds

As of June 30, 2010







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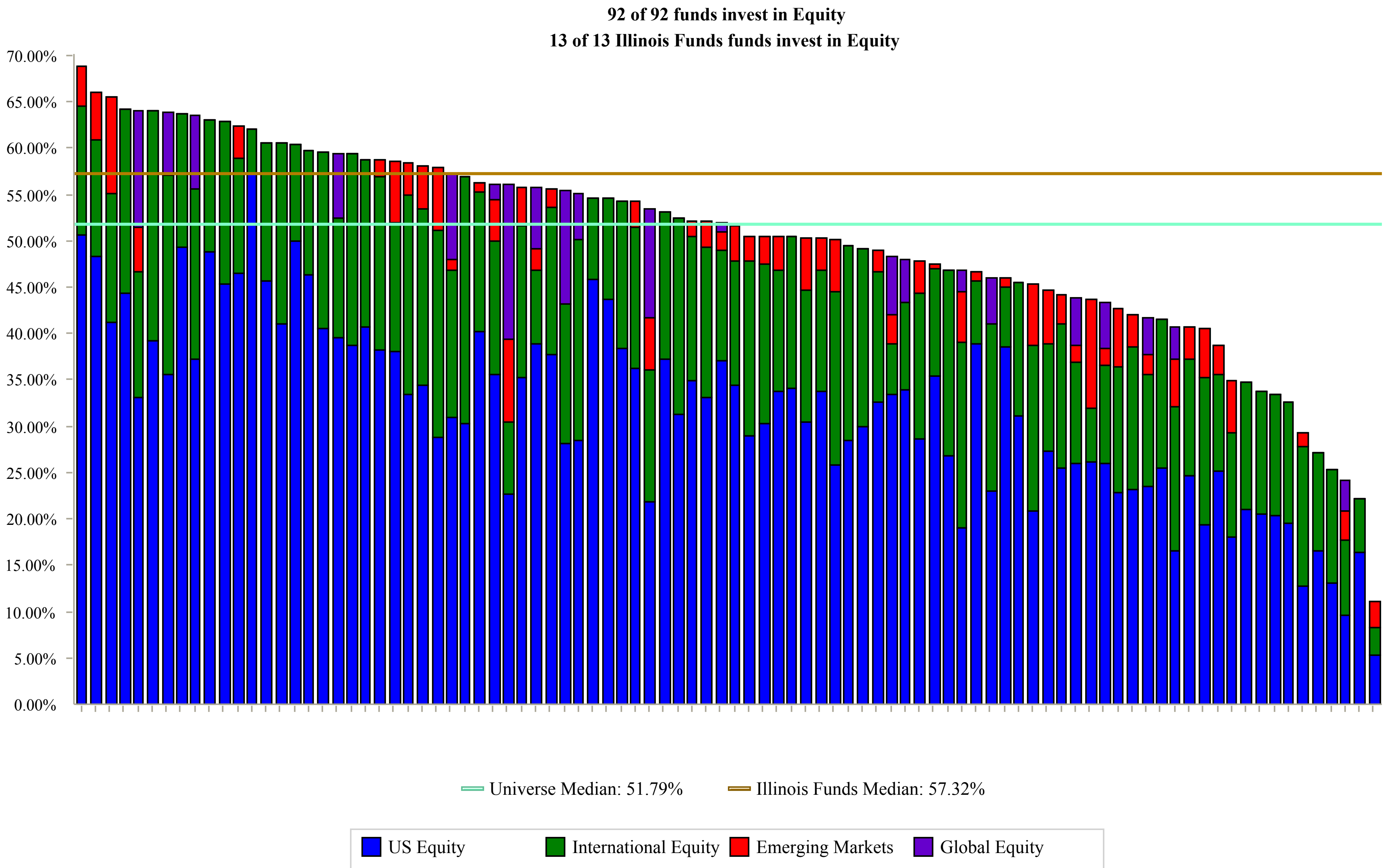
RVKuhns & ASSOCIATES, INC.

Equity Style Allocation

As of June 30, 2010



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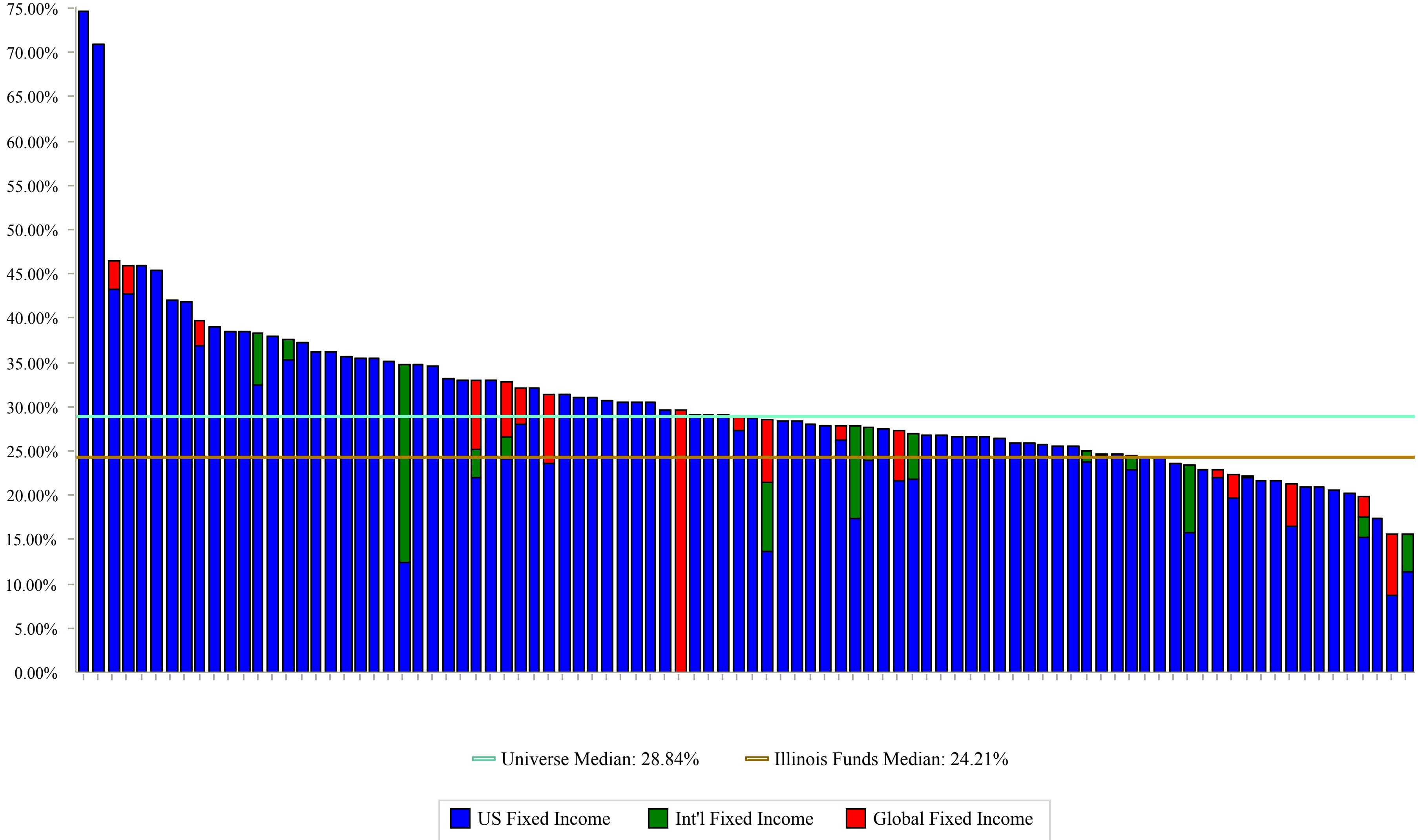
Fixed Income Style Allocation

As of June 30, 2010

92 of 92 funds invest in Fixed Income
13 of 13 Illinois Funds funds invest in Fixed Income



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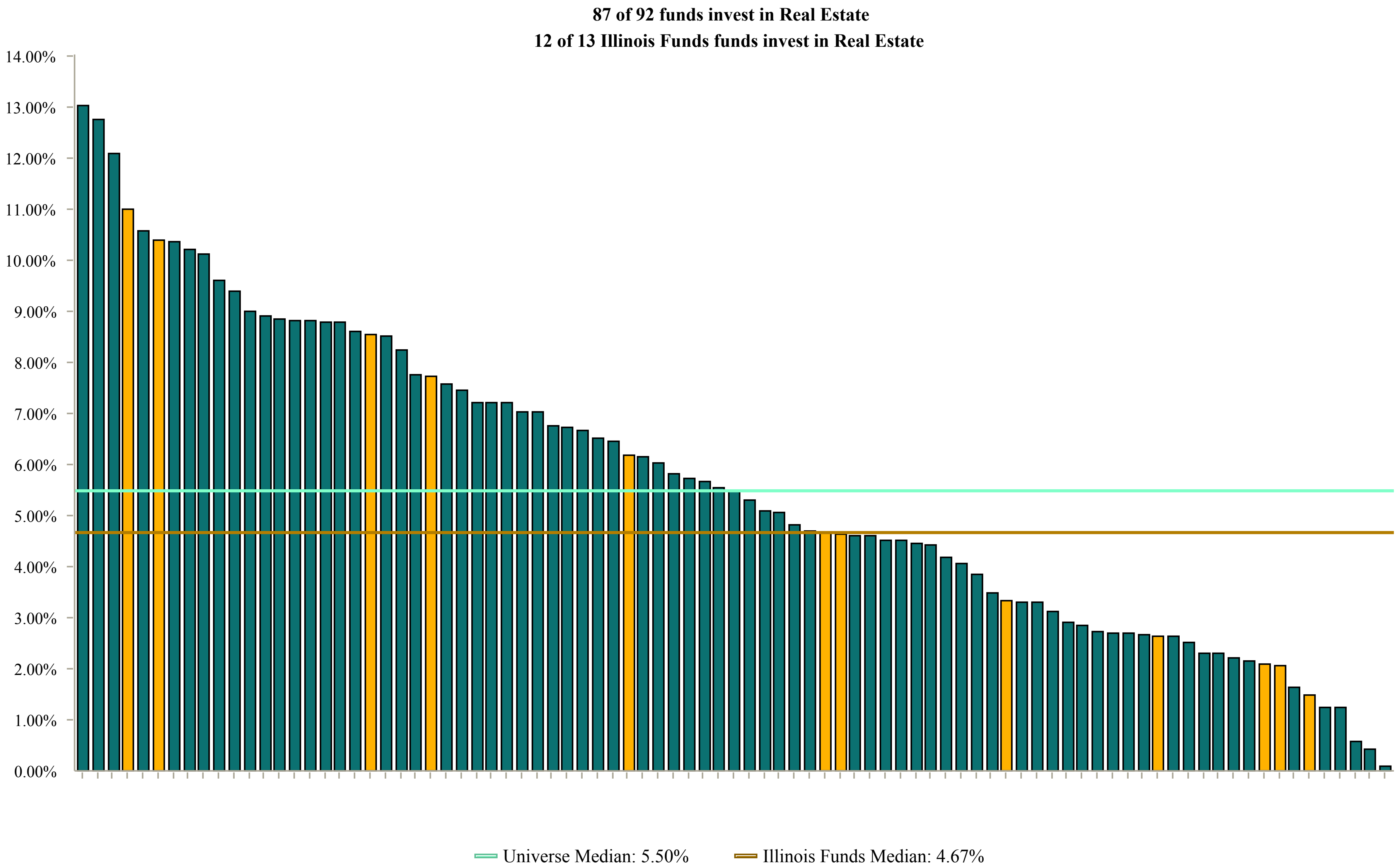
Real Estate Allocation

As of June 30, 2010



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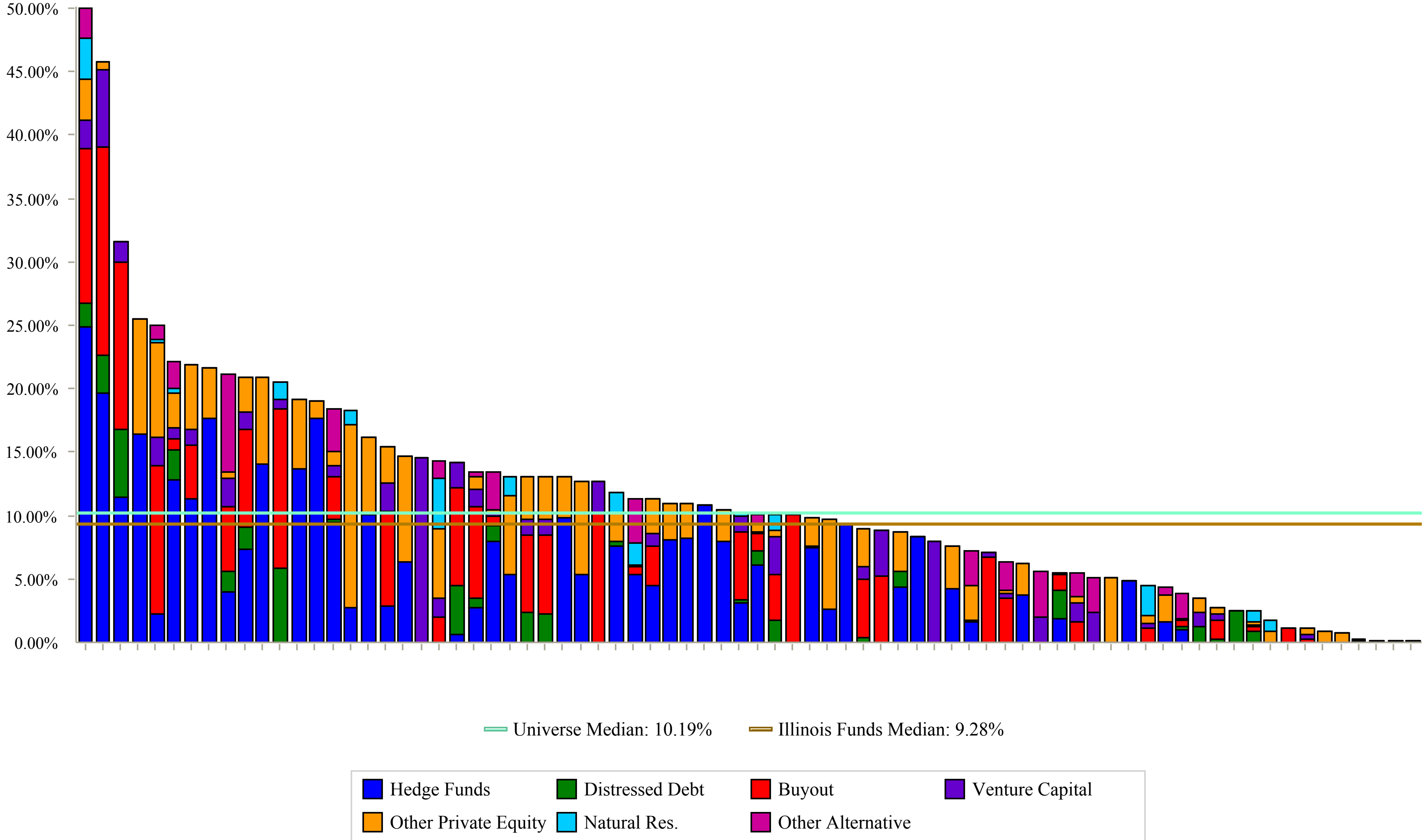
Alternatives Style Allocation

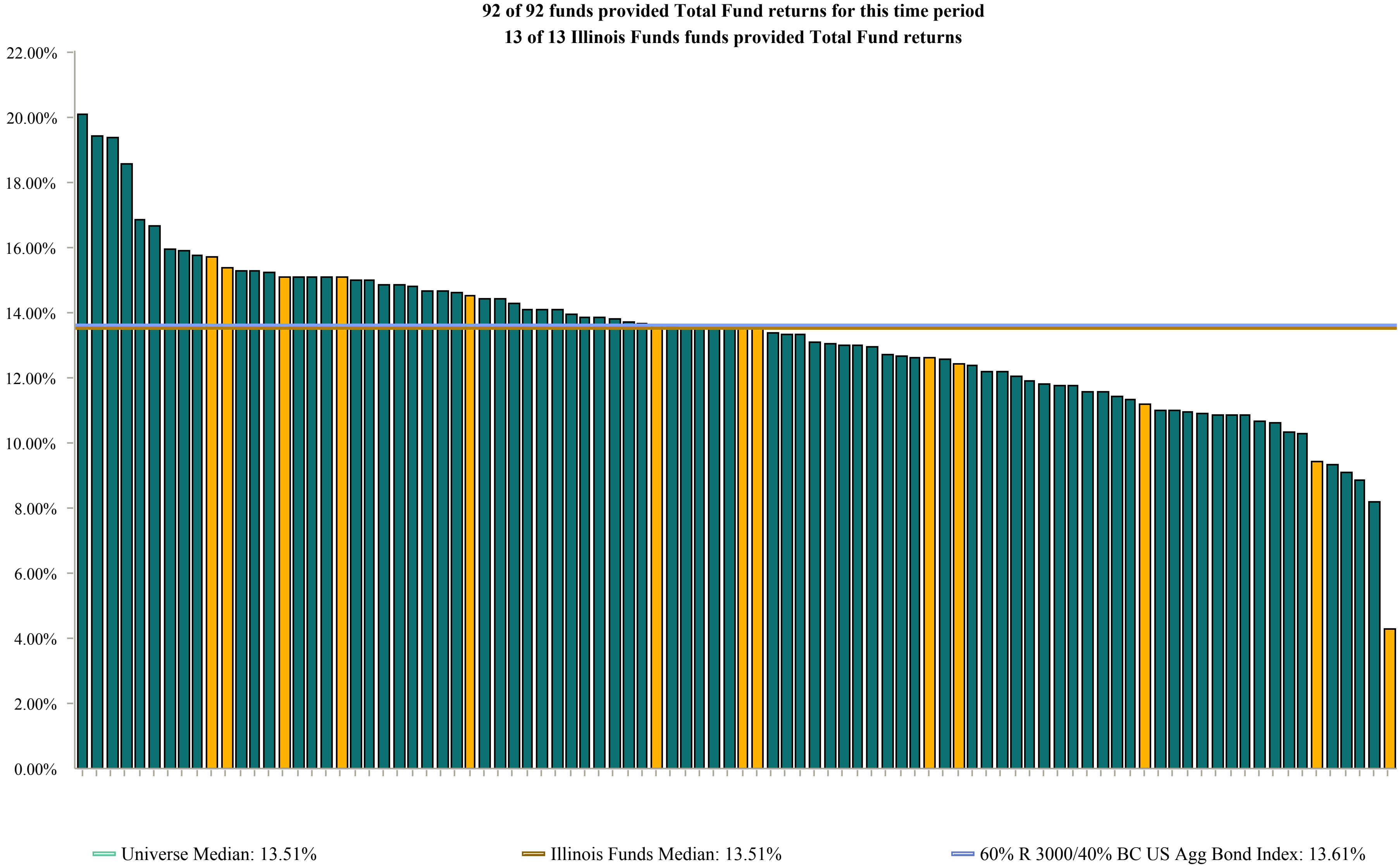
As of June 30, 2010

76 of 92 funds invest in Alternatives
12 of 13 Illinois Funds funds invest in Alternatives



1 Year Annualized Total Fund Returns

As of June 30, 2010

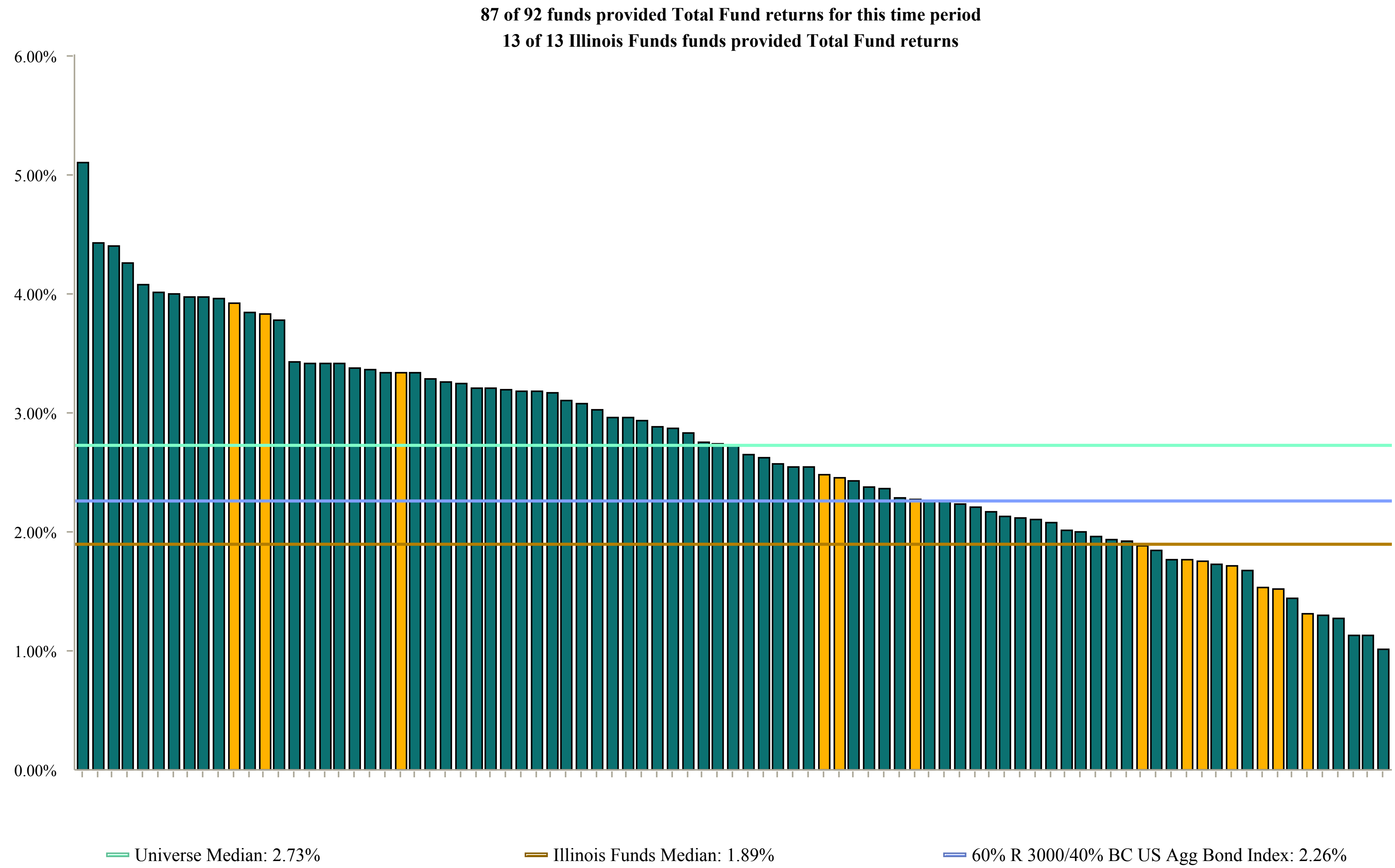


Performance shown is calculated using quarterly performance provided by participating public funds.

RVKuhns & ASSOCIATES, INC.

5 Year Annualized Total Fund Returns

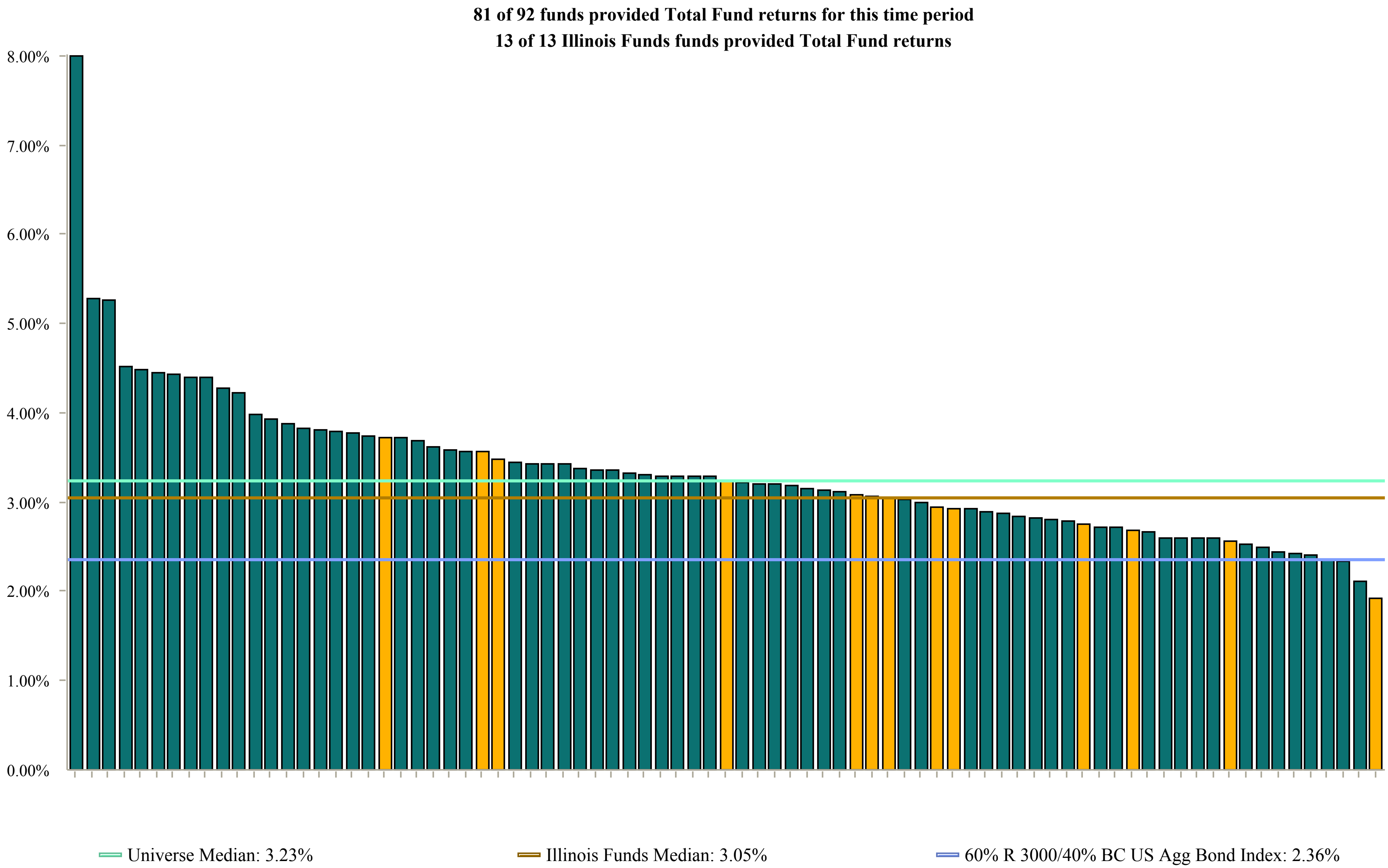
As of June 30, 2010



Performance shown is calculated using quarterly performance provided by participating public funds.

10 Year Annualized Total Fund Returns

As of June 30, 2010



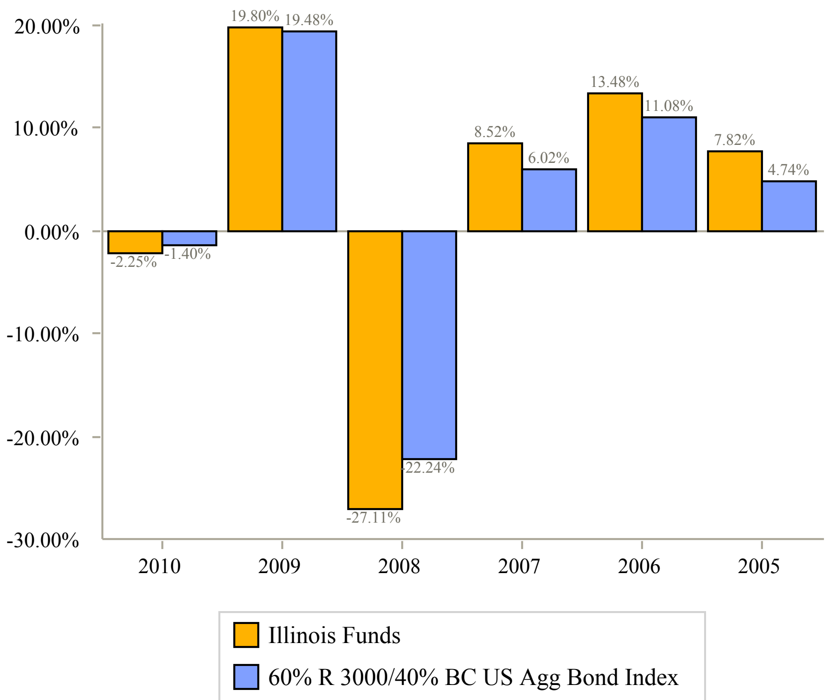
Performance shown is calculated using quarterly performance provided by participating public funds.

Total Return - Total Fund

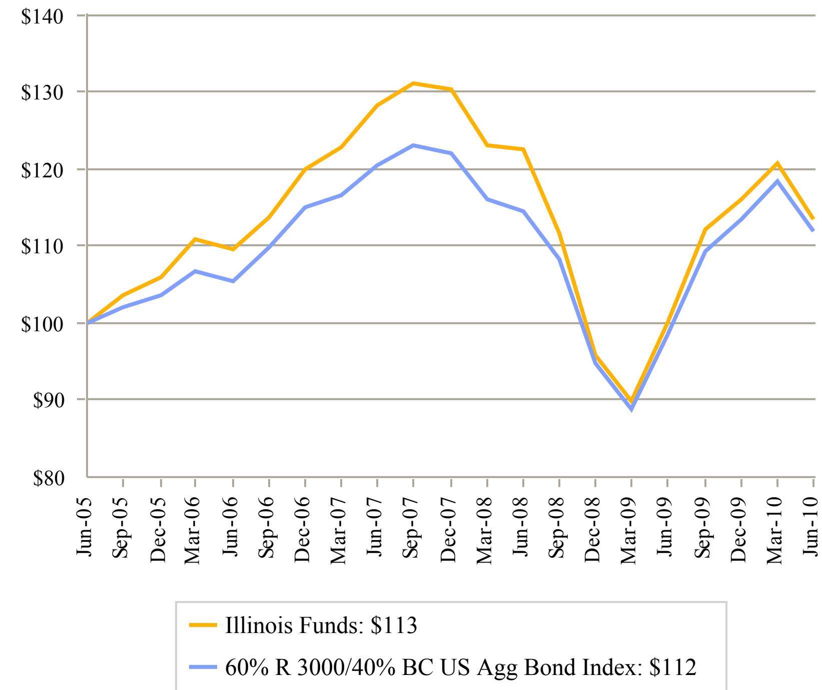
Illinois Funds vs. 60% R 3000/40% BC US Agg Bond Index

As of June 30, 2010

Calendar Year Rates of Return



Cumulative Performance (Growth of $100)



Annualized Returns:	1 Year	2 Years	3 Years	4 Years	5 Years
Illinois Funds	13.51%	-4.66%	-4.19%	0.62%	1.89%
60% R 3000/40% BC US Agg Bond Index	13.61%	-1.19%	-2.47%	1.50%	2.26%
Variance	*-0.10%*	*-3.47%*	*-1.72%*	*-0.88%*	*-0.37%*

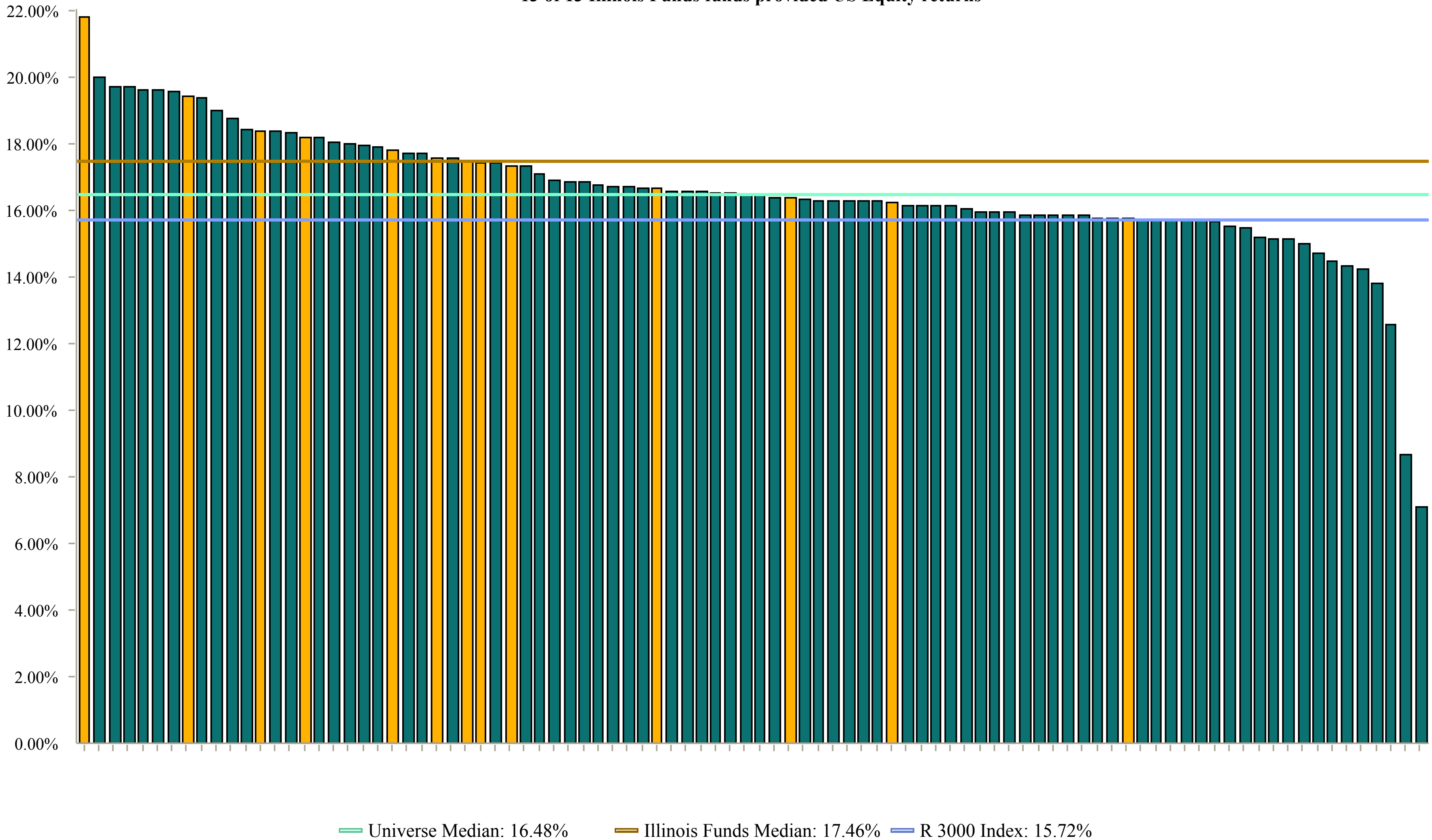
Performance shown is calculated using quarterly performance provided by participating public funds.

RVKuhns & ASSOCIATES, INC.

1 Year Annualized US Equity Returns

As of June 30, 2010

92 of 92 funds provided US Equity returns for this time period
13 of 13 Illinois Funds funds provided US Equity returns



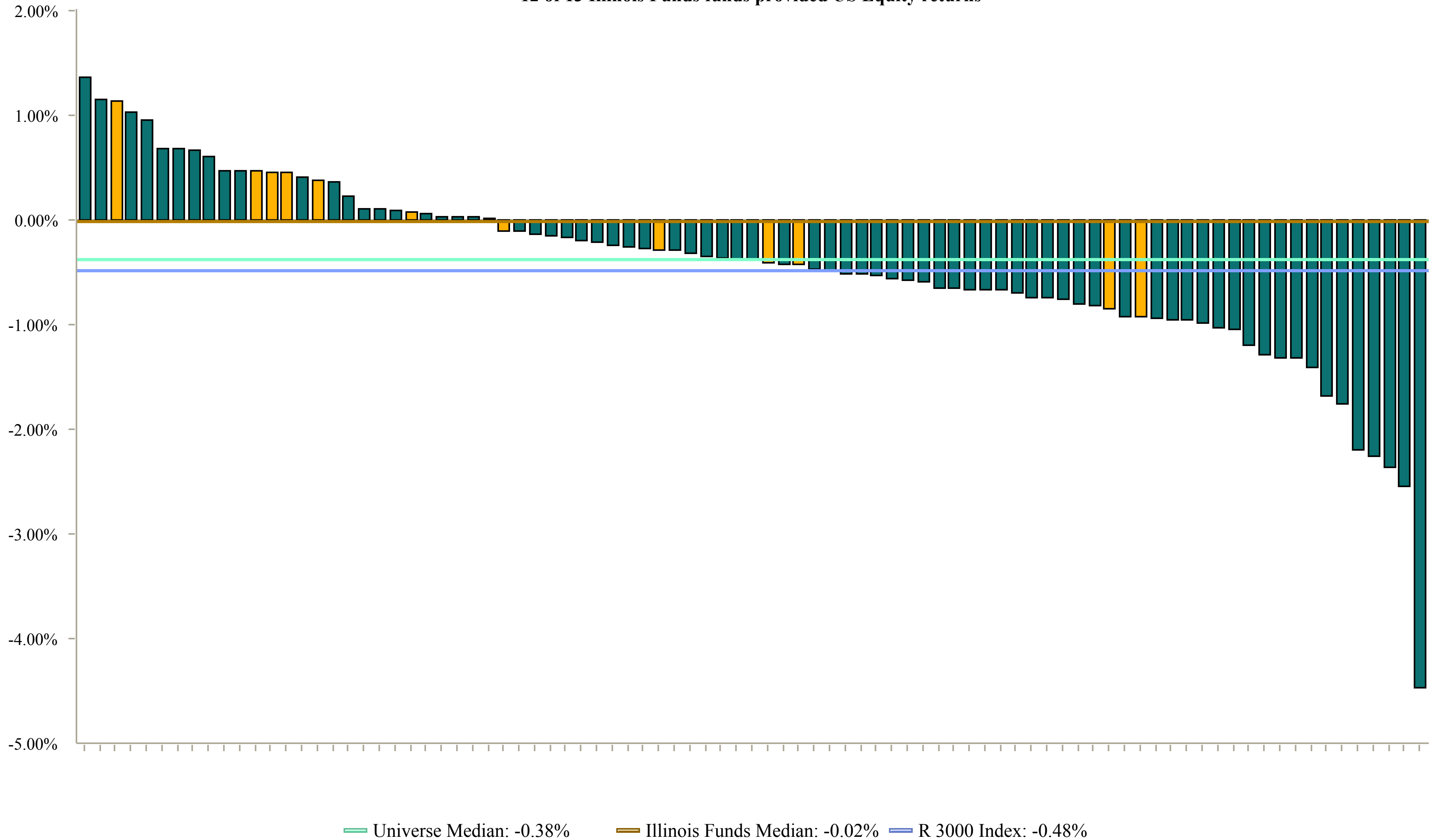
Performance shown is calculated using quarterly performance provided by participating public funds.

RVKuhns & ASSOCIATES, INC.

5 Year Annualized US Equity Returns

As of June 30, 2010

87 of 92 funds provided US Equity returns for this time period
12 of 13 Illinois Funds funds provided US Equity returns



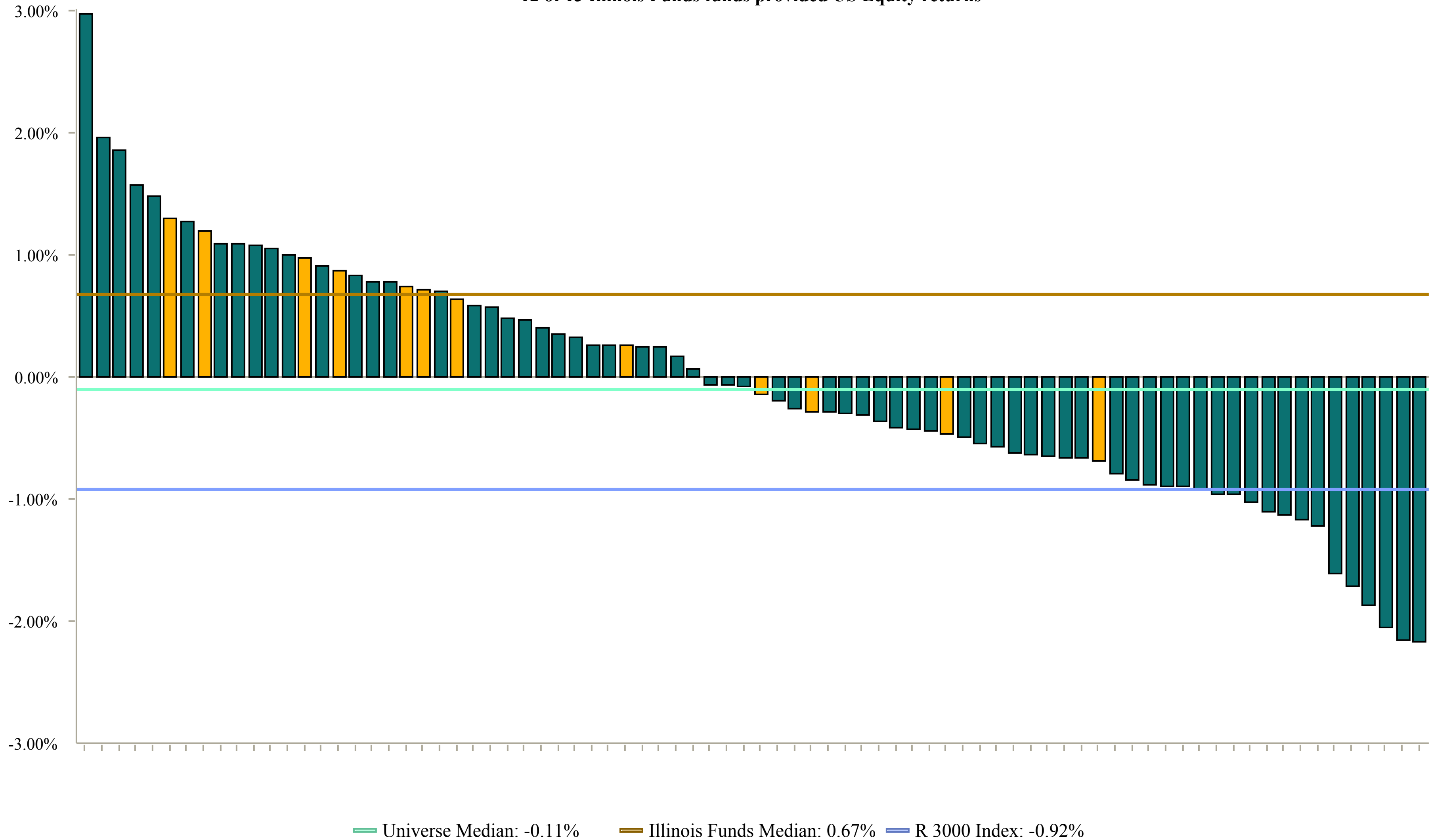
Performance shown is calculated using quarterly performance provided by participating public funds.

RVKuhns & ASSOCIATES, INC.

10 Year Annualized US Equity Returns

As of June 30, 2010

80 of 92 funds provided US Equity returns for this time period
12 of 13 Illinois Funds funds provided US Equity returns



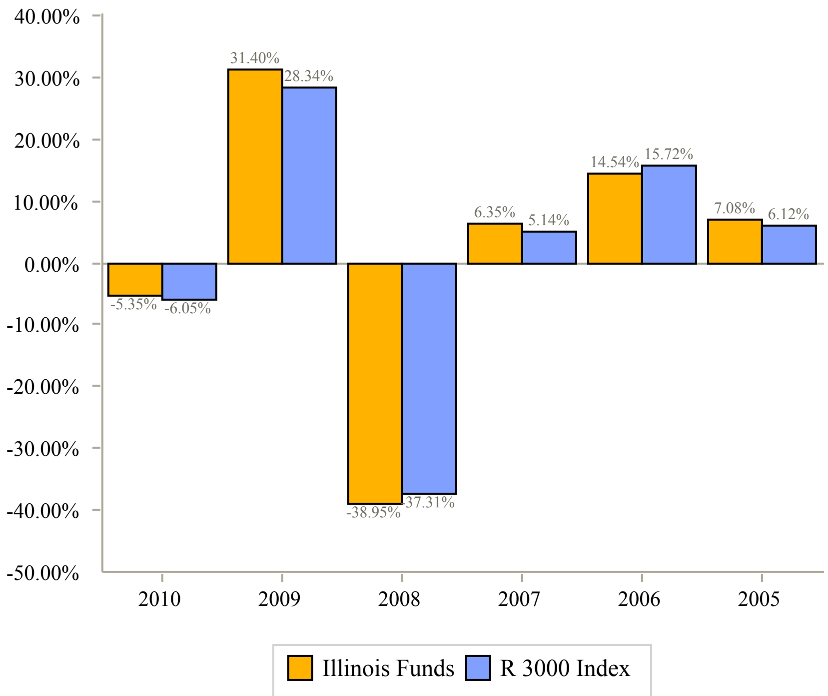
Performance shown is calculated using quarterly performance provided by participating public funds.

Total Return - US Equity

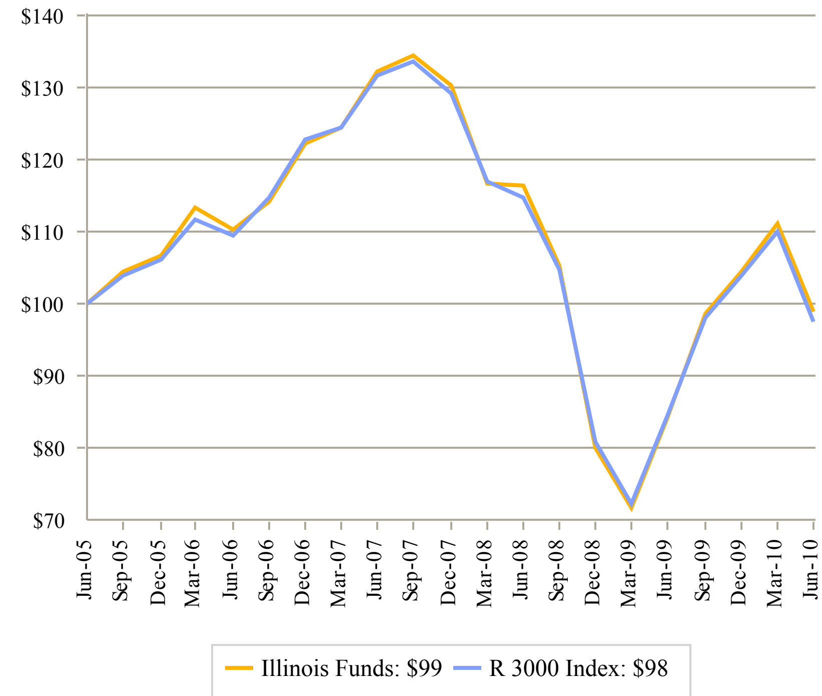
Illinois Funds vs. R 3000 Index

As of June 30, 2010

Calendar Year Rates of Return



Cumulative Performance (Growth of $100)

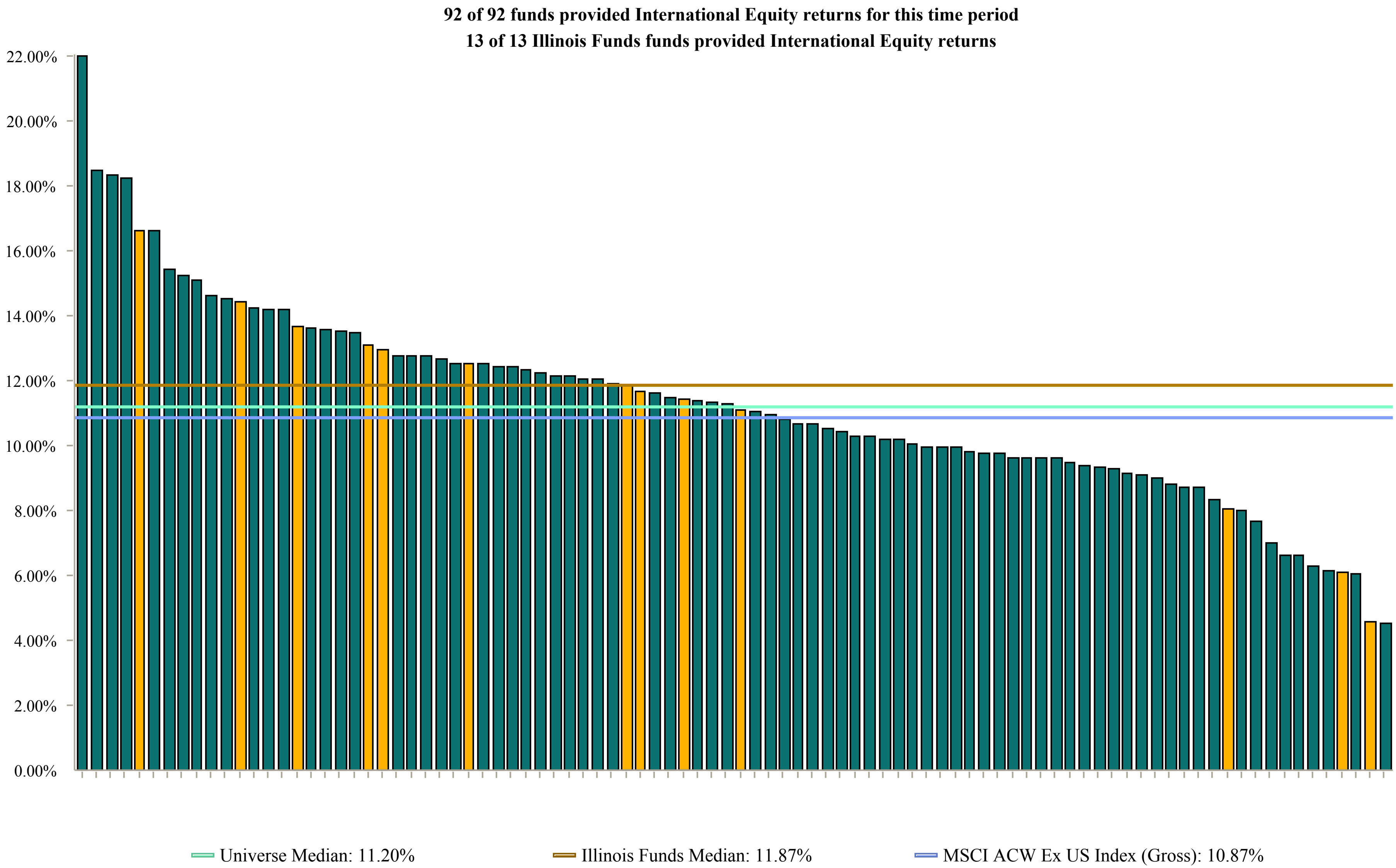


Annualized Returns:	**1 Year**	**2 Years**	**3 Years**	**4 Years**	**5 Years**
Illinois Funds	17.46%	-7.44%	-8.91%	-2.39%	-0.02%
R 3000 Index	15.72%	-7.81%	-9.47%	-2.85%	-0.48%
Variance	*1.74%*	*0.37%*	*0.56%*	*0.46%*	*0.46%*

Performance shown is calculated using quarterly performance provided by participating public funds.

1 Year Annualized International Equity Returns

As of June 30, 2010

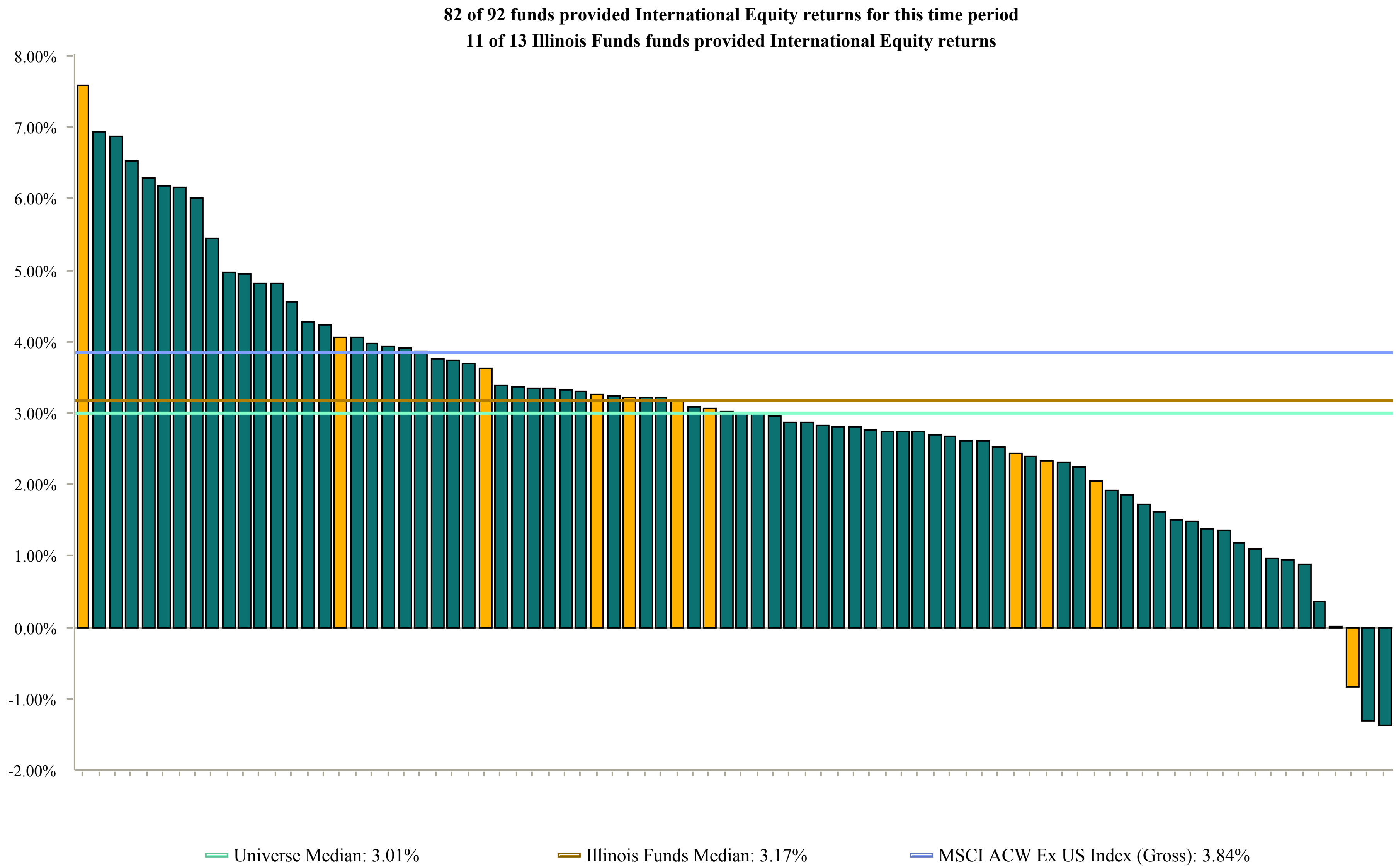


Performance shown is calculated using quarterly performance provided by participating public funds.

RVKuhns & ASSOCIATES, INC.

5 Year Annualized International Equity Returns

As of June 30, 2010



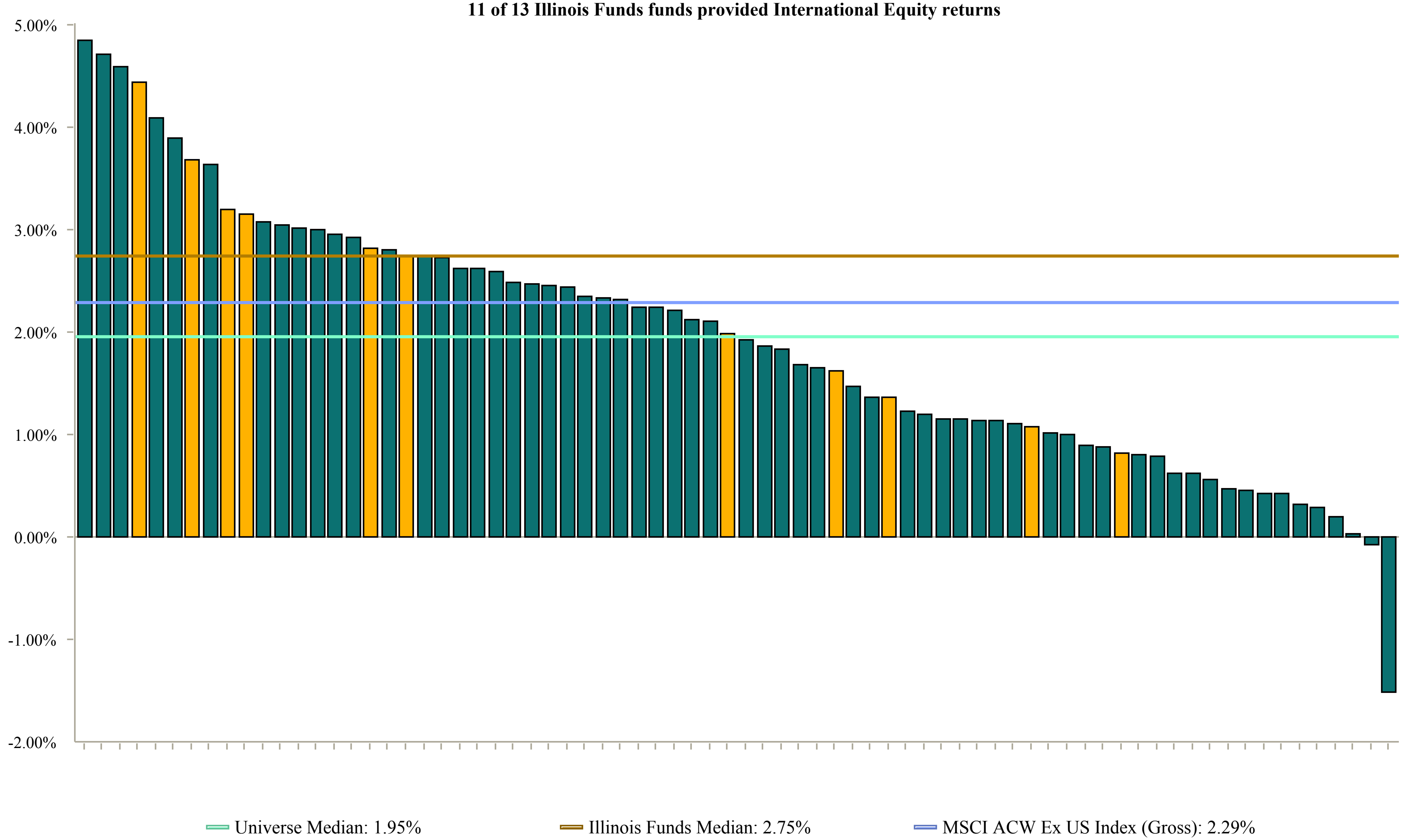
Performance shown is calculated using quarterly performance provided by participating public funds.

RVKuhns & ASSOCIATES, INC.

10 Year Annualized International Equity Returns

As of June 30, 2010

74 of 92 funds provided International Equity returns for this time period
11 of 13 Illinois Funds funds provided International Equity returns



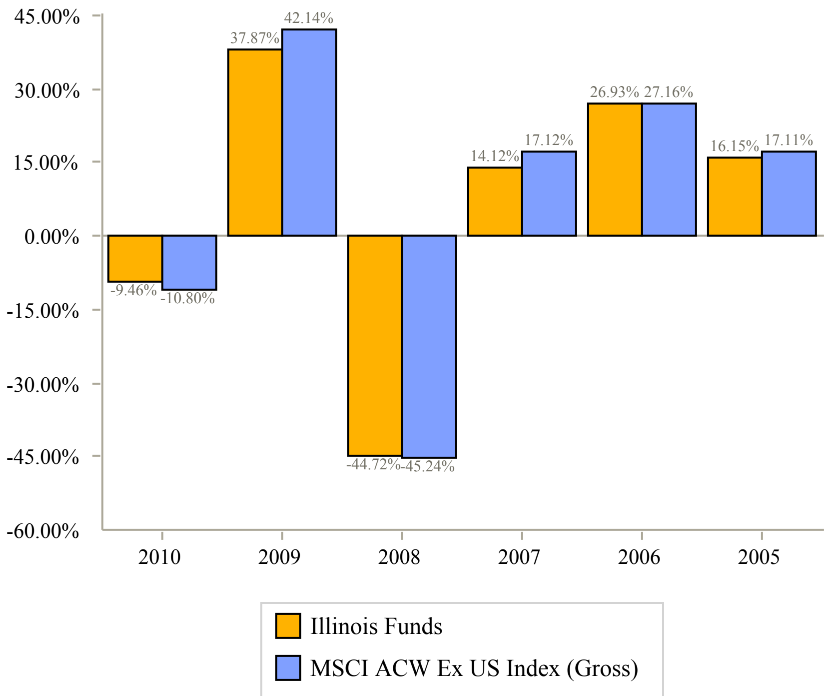
Performance shown is calculated using quarterly performance provided by participating public funds.

Total Return - International Equity

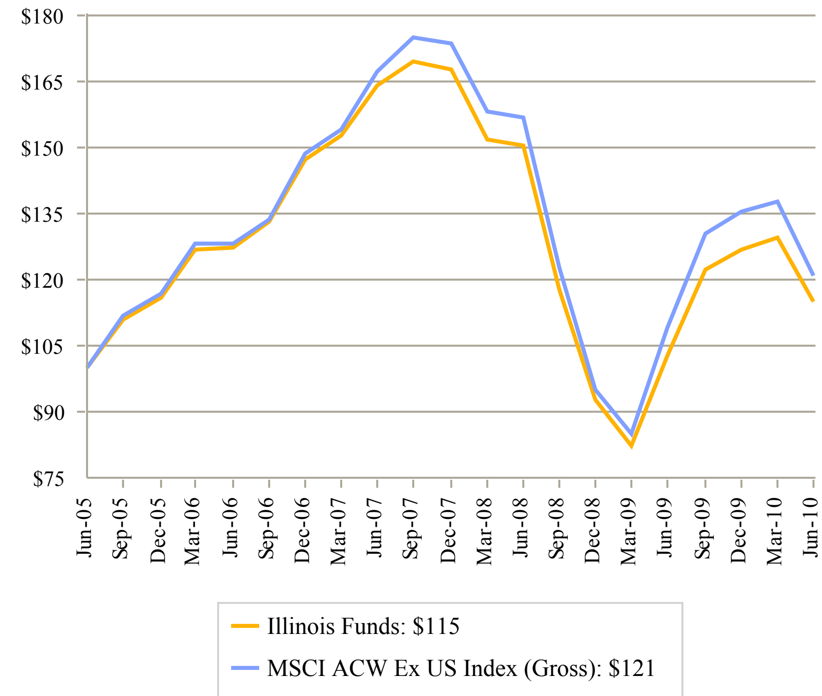
Illinois Funds vs. MSCI ACW Ex US Index (Gross)

As of June 30, 2010

Calendar Year Rates of Return



Cumulative Performance (Growth of $100)



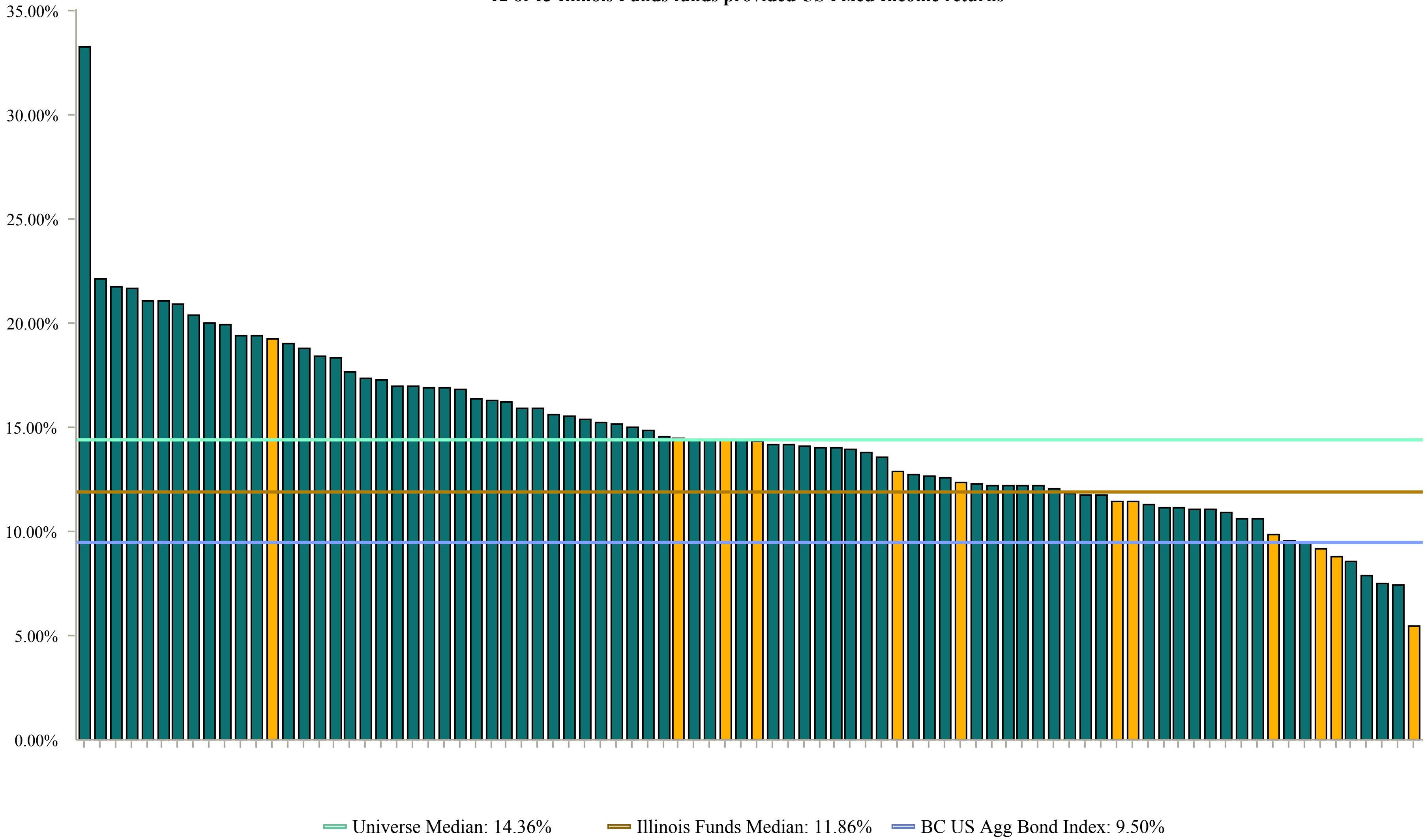
Annualized Returns:	**1 Year**	**2 Years**	**3 Years**	**4 Years**	**5 Years**
Illinois Funds	11.87%	-12.60%	-10.92%	-2.19%	3.17%
MSCI ACW Ex US Index (Gross)	10.87%	-12.25%	-10.28%	-1.53%	3.84%
Variance	*1.00%*	*-0.35%*	*-0.64%*	*-0.66%*	*-0.67%*

Performance shown is calculated using quarterly performance provided by participating public funds.

1 Year Annualized US Fixed Income Returns

As of June 30, 2010

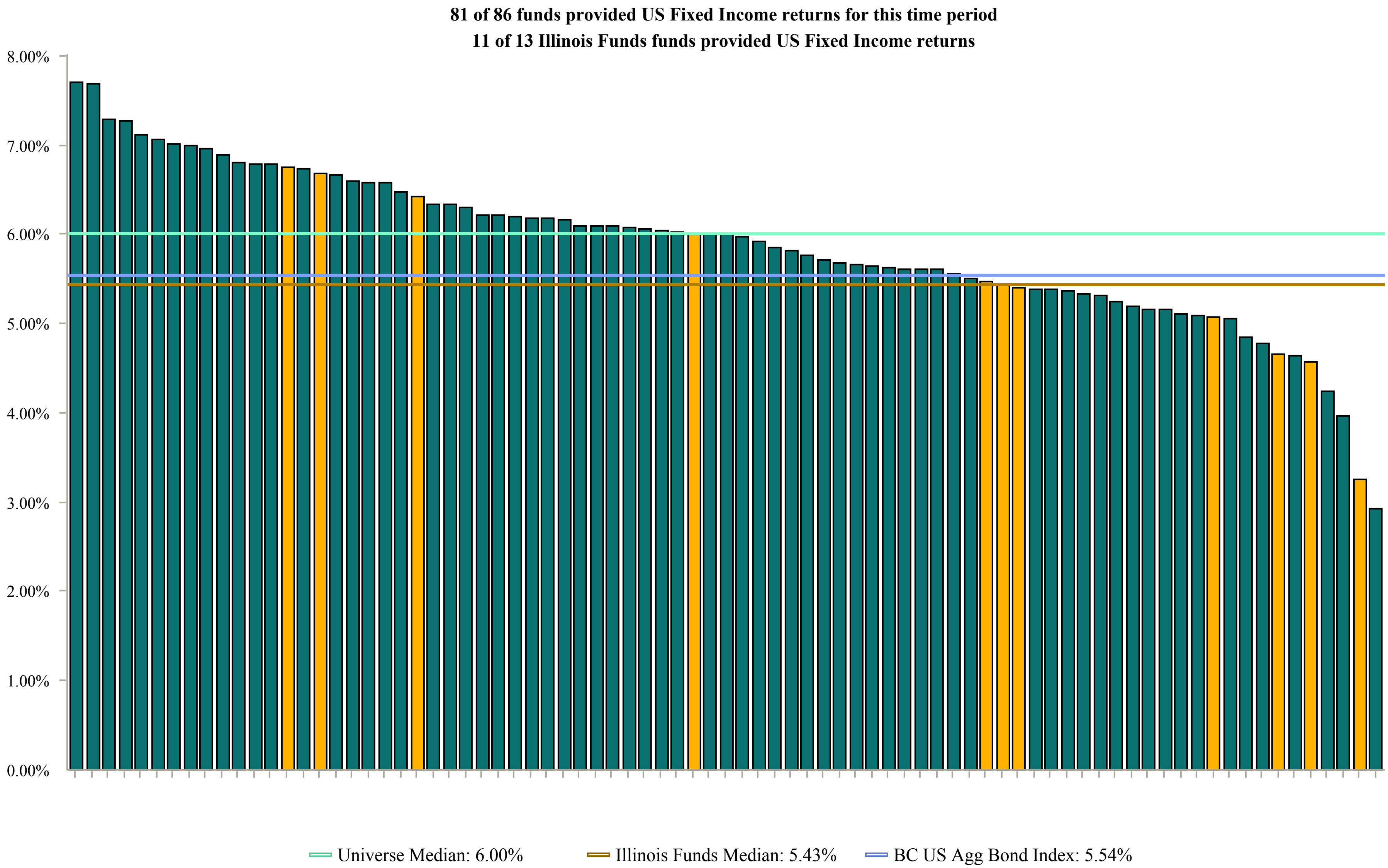
86 of 86 funds provided US Fixed Income returns for this time period
12 of 13 Illinois Funds funds provided US Fixed Income returns



Performance shown is calculated using quarterly performance provided by participating public funds.

5 Year Annualized US Fixed Income Returns

As of June 30, 2010

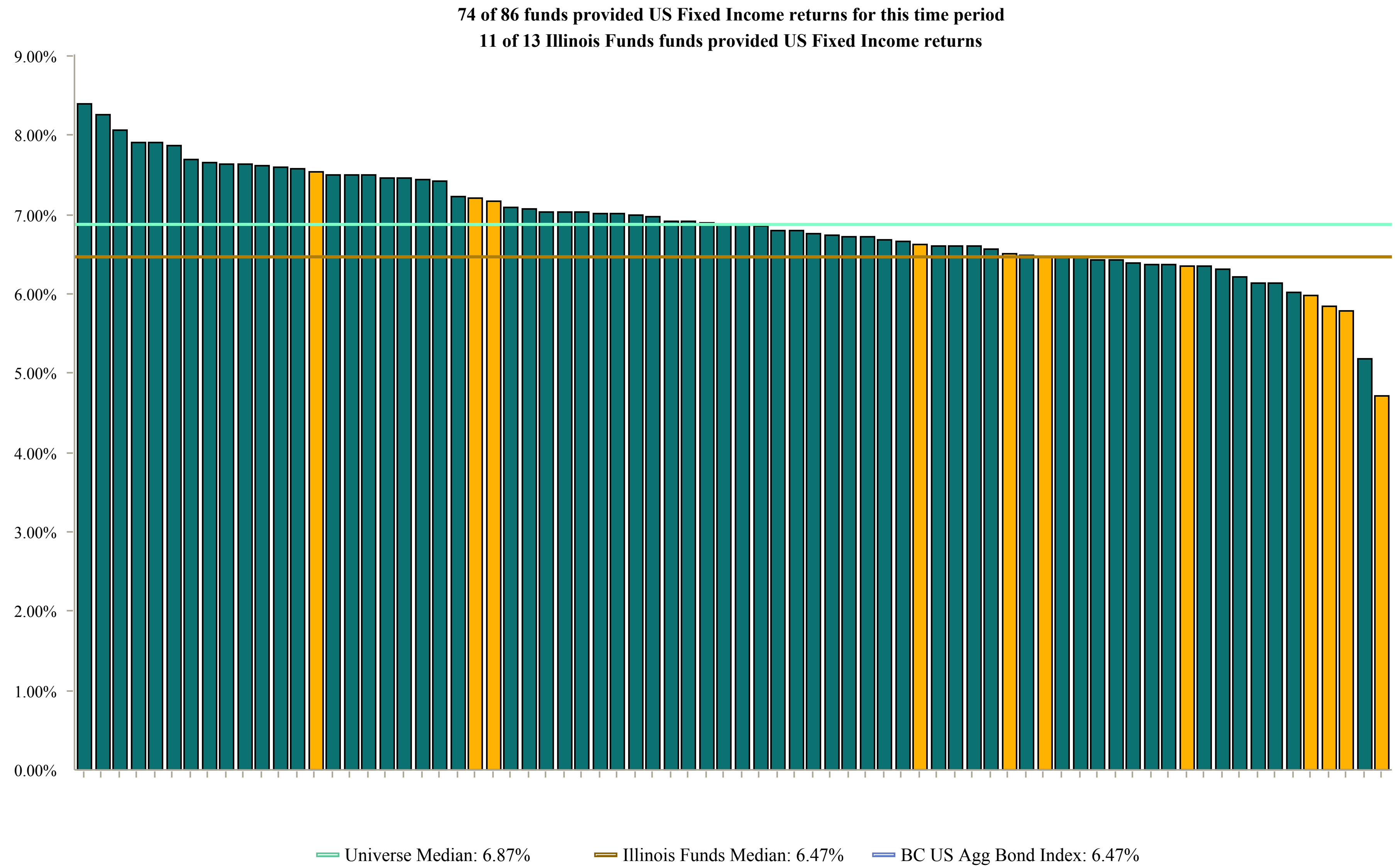


Performance shown is calculated using quarterly performance provided by participating public funds.

RVKuhns & ASSOCIATES, INC.

10 Year Annualized US Fixed Income Returns

As of June 30, 2010



Performance shown is calculated using quarterly performance provided by participating public funds.

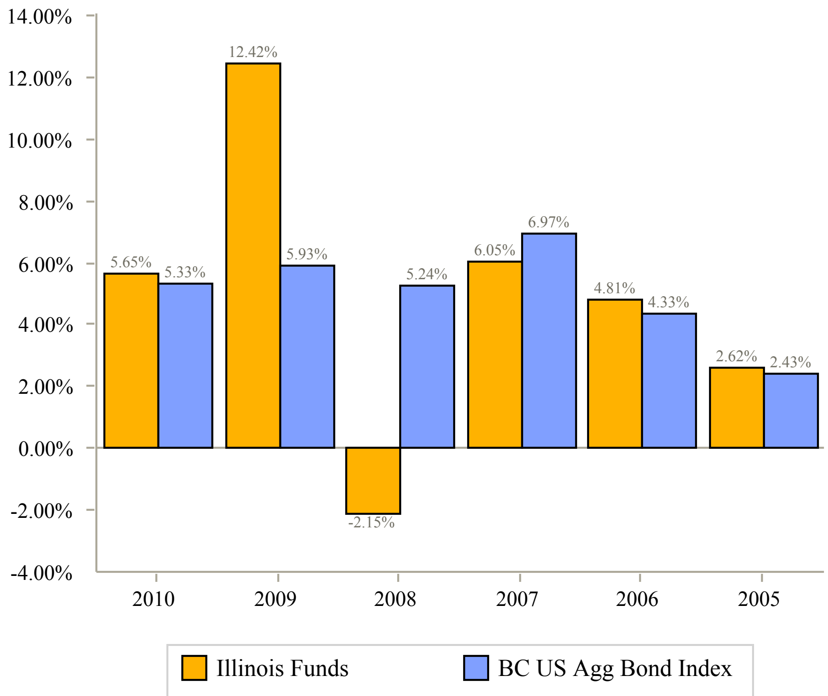
RVKuhns & ASSOCIATES, INC.

Total Return - US Fixed Income

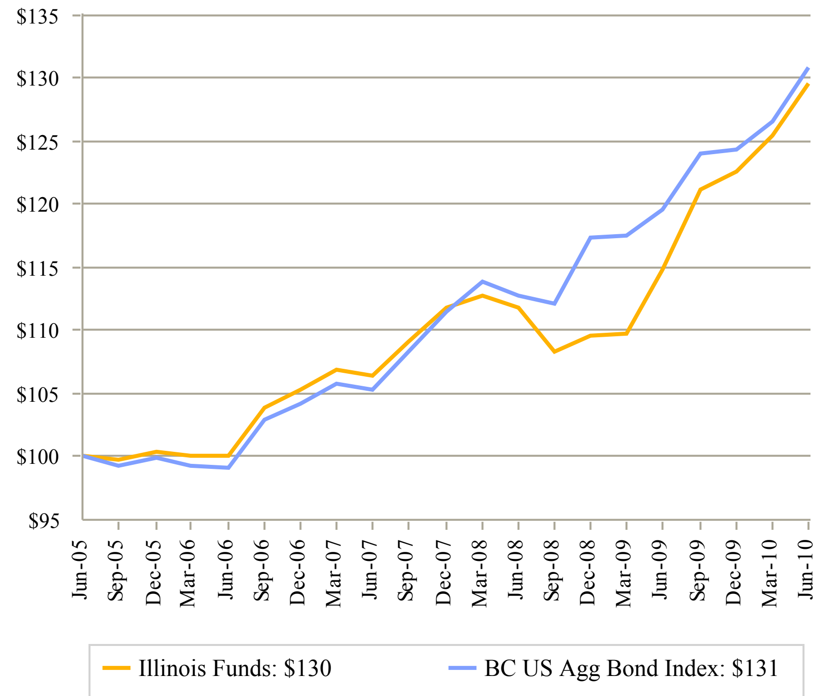
Illinois Funds vs. BC US Agg Bond Index

As of June 30, 2010

Calendar Year Rates of Return



Cumulative Performance (Growth of $100)



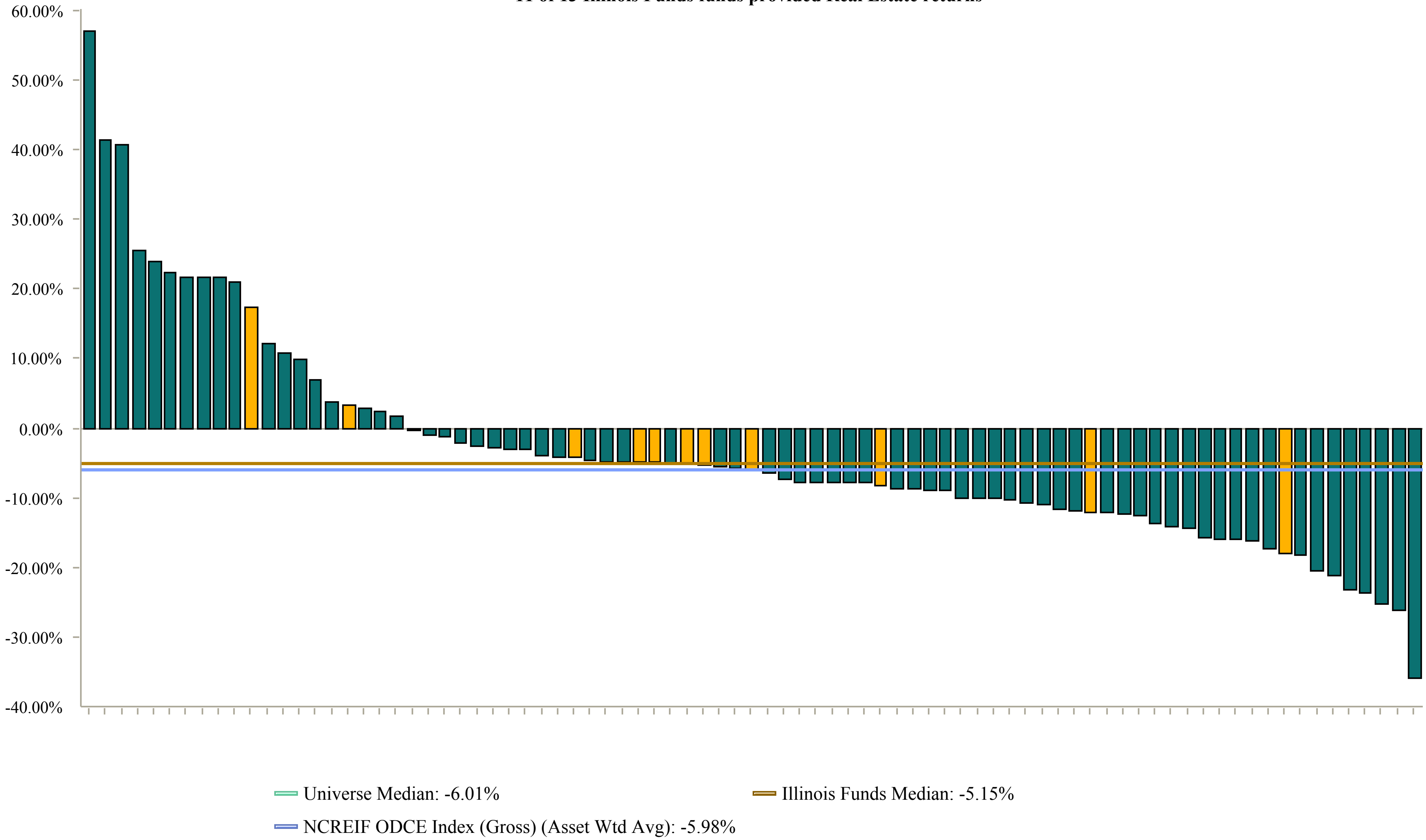
Annualized Returns:	**1 Year**	**2 Years**	**3 Years**	**4 Years**	**5 Years**
Illinois Funds	12.31%	8.12%	7.18%	6.92%	5.45%
BC US Agg Bond Index	9.50%	7.76%	7.55%	7.19%	5.54%
Variance	*2.81%*	*0.36%*	*-0.37%*	*-0.27%*	*-0.09%*

Performance shown is calculated using quarterly performance provided by participating public funds.

1 Year Annualized Real Estate Returns

As of June 30, 2010

83 of 92 funds provided Real Estate returns for this time period
11 of 13 Illinois Funds funds provided Real Estate returns



Performance shown is calculated using quarterly performance provided by participating public funds.

RVKuhns
& ASSOCIATES, INC.

5 Year Annualized Real Estate Returns

As of June 30, 2010

63 of 92 funds provided Real Estate returns for this time period
9 of 13 Illinois Funds funds provided Real Estate returns

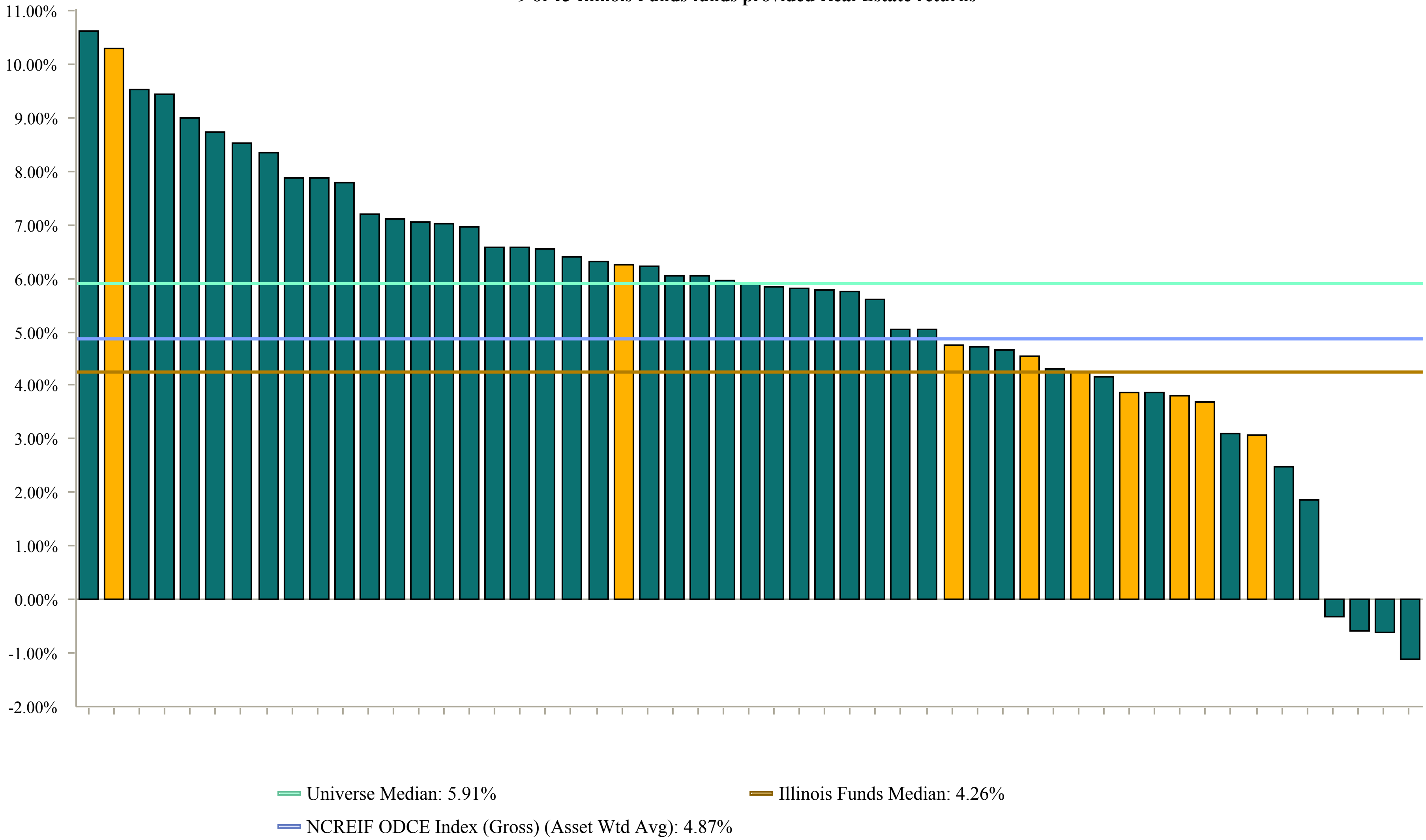
Performance shown is calculated using quarterly performance provided by participating public funds.

RVKuhns & ASSOCIATES, INC.

10 Year Annualized Real Estate Returns

As of June 30, 2010

53 of 92 funds provided Real Estate returns for this time period
9 of 13 Illinois Funds funds provided Real Estate returns



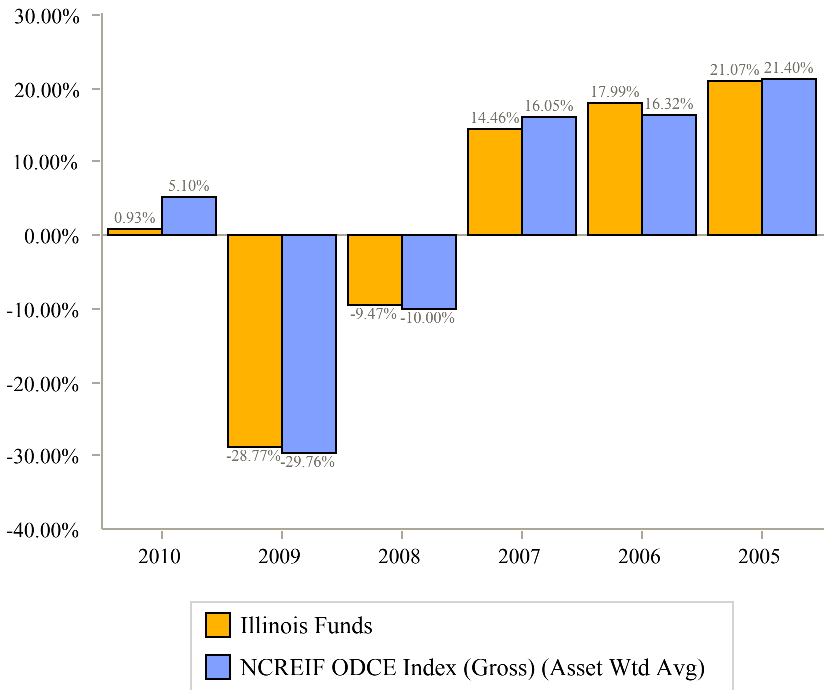
Performance shown is calculated using quarterly performance provided by participating public funds.

Total Return - Real Estate

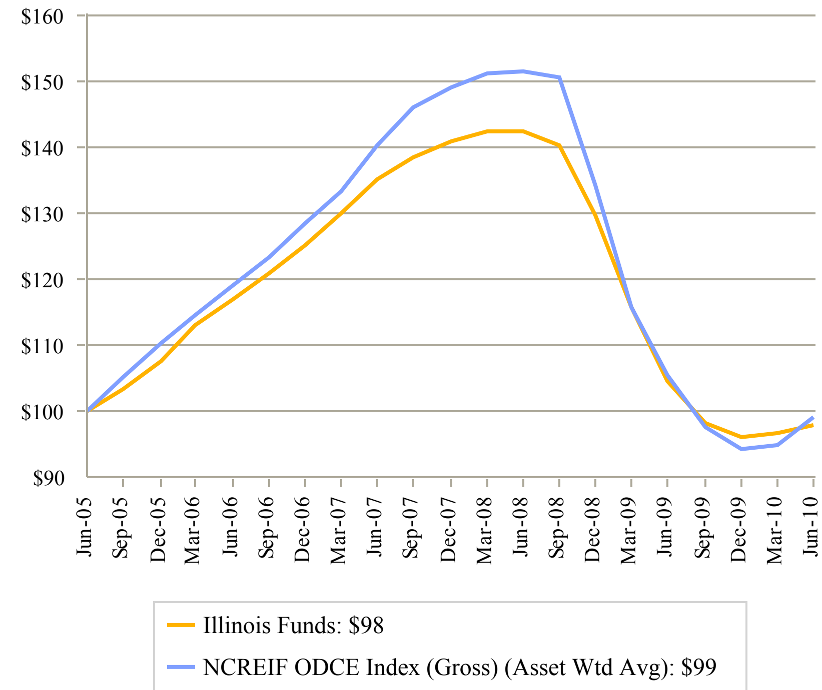
Illinois Funds vs. NCREIF ODCE Index (Gross) (Asset Wtd Avg)

As of June 30, 2010

Calendar Year Rates of Return



Cumulative Performance (Growth of $100)



Annualized Returns:	**1 Year**	**2 Years**	**3 Years**	**4 Years**	**5 Years**
Illinois Funds	-5.15%	-18.12%	-12.88%	-5.94%	-1.15%
NCREIF ODCE Index (Gross) (Asset Wtd Avg)	-5.98%	-19.17%	-10.95%	-4.52%	-0.19%
Variance	*0.83%*	*1.05%*	*-1.93%*	*-1.42%*	*-0.96%*

Performance shown is calculated using quarterly performance provided by participating public funds.

Net Assets Available For Benefits

Expressed as a Percentage of the Pension Benefit Obligation

As of June 30, 2010

63 of 92 funds provided Net Assets Available data

10 of 13 Illinois Funds funds provided Net Assets Available data

III. Consulting

- Consultant Expectations Rankings

CONSULTANT EXPECTATIONS RANKINGS

1) Accept Fiduciary Liability

2) Define/recommend asset allocation

3) Deal with all assets

4) Provide unbiased advice

5) Create/maintain investment policy

6) Education
    a) Rational decision making
    b) Information regarding opportunities, techniques, risk
    c) Provide to Trustees

7) Compliance
    a) Oversee managers
    b) Monitor standards and regulatory requirements

8) Conduct searches and negotiations

9) Knowledge of Illinois specific issues
    a) MFDBE investment managers and broker/dealers
    b) Sudan and terrorist country restrictions
    c) MFDBE outreach

10) Forward thinking capabilities

Summary

In 2005, an investment consultant search was concluded which resulted in the selection of Ennis Knupp & Associates (EK&A) to serve the Board of Trustees. As a requirement of Illinois Public Act 96-0006, as well as prudent fiduciary practice, staff is recommending the Board authorize a search to identify qualified candidates for the critical role of external investment consultant. Finalist interviews are planned to be conducted at the December 9, 2010 Investment Committee meeting.

The SURS Investment Program has assets of approximately $13.3 billion as of March 31, 2010. Since 1982, EK&A has served admirably in the role of investment consultant to the Board. EK&A is encouraged to respond to the Request For Proposal (RFP).

In order to achieve desired risk and long-term investment return expectations, the SURS Investment Program is comprised of a variety of diversified investment mandates, some of which are quite complex. During 2008, an asset/liability study was conducted which resulted in an increased allocation to alternative asset classes, such as private equity and real estate. The intent of this strategy was to increase diversification and reduce overall portfolio risk. New strategies included investing in infrastructure (search completed in 2009) and commodities (future search included in the Work Plan). In addition, an opportunistic investment identified during the past year included a recommendation to participate in the Public Private Investment Program (PPIP). The most recent Work Plan of anticipated projects is included in the Investment Committee section of the Agenda book.

Expectations of the Investment Consulting Relationship

It is anticipated that only a small number of investment consulting firms have the resources and expertise necessary to serve an investment program as complex and large as SURS. Areas of expertise necessary in identifying a premier investment consultant include:

- Commitment and Dedication of Necessary Resources to Support SURS Board and Investment Staff
- Independence of the Firm
- Willingness to Listen and Acceptance of Being Challenged
- Recommendations Regarding Strategy, Investment Policy and Asset Allocation
- Expertise of the Investment Management Industry / Depth of All Asset Classes including Alternative Strategies
- Expertise of the Public Pension Funds Industry
- Awareness of the Illinois Legislative Climate

- Extensive Knowledge of Minority, Female and Persons with a Disability-Owned Investment Firms
- Significant Research Regarding Investment Managers / Ability to Lead Manager Searches for Complex Investment Strategies
- Networking Relationships / Access to the Best Investment Management Firms
- Insight of the Latest Trends, Topical Issues and Access to Best Thinking
- Diversity of the Organization
- Reasonable Fee Structure
- Provide Trustee and Staff Education and Training
- Willingness and Courage to Provide Recommendations Outside of the Norm

Quality Internal Investment Staff

Over the years, SURS has built a strong internal investment staff. In total, the seven investment professionals employed have accumulated over 100 years of experience in the public, corporate and endowment sectors of the investment industry. The investment team is widely recognized throughout the industry and has developed numerous networking relationships. This level of expertise will be helpful to the Board in evaluating the best investment consulting firms that respond to the RFP.

Board Involvement During the Search Process

The selection of a general investment consultant is one of the most important decisions of the Board during their tenure. At the most recent search conducted in 2005, the Board selected a sub-committee to assist Staff in the process. Four semi-finalist investment consulting firms were identified and on site visits to the firms were conducted. At least one Trustee was in attendance at each of the due diligence visits. I would anticipate a similar practice be conducted to assist Staff in the information gathering process.

During the summer, I will contact each of the Trustees to enlist your input and opinions regarding the expectations of the relationship. This information will assist in the identification of semi-finalist candidates. A status report will be provided to the Investment Committee at the September 2, 2010 meeting.

The search will comply with Illinois Public Act 96-0006. Also, as stated in Section VII of the SURS Investment Policy, a Quiet Period Policy will be in effect during the search process.

Proposed Timeline

The proposed timeline for the search is as follows:

Planned Timeline of Events	
Output	*Date*
Development of Request For Proposal (RFP)	June 2010
Release RFP and Include on Web Site and in Industry Publications	July 2010
Staff To Review Responses	Aug 2010
Status Report to the Investment Committee and Recommendation of Semi-Finalist Candidates	Sep 2010
Schedule and Conduct On-Site Visits for Semi-Finalist Candidates (if needed)	Sep - Oct 2010
Status Report to the Board of Trustees and Recommendation of	Oct 2010

Planned Timeline of Events	
Finalist Candidates	
Conduct On-Site Visits of Finalist Candidates	Nov 2010
Finalist Candidate Interviews	Dec 2010

Recommendation

The SURS Investment Program is well respected on a national level. As of March 31, 2010, the annualized investment performance return for the past twenty-five years of the Investment Program was 9.4%. The selection of a premier investment consultant is crucial to assist in dealing with the many financial challenges facing public pension funds in the current financial environment.

SURS staff recommends a search be conducted to identify a qualified investment consultant.

Pension Working Group
Consultant Committee

1. *Accept fiduciary liability*. Plan trustees should be able to rely on their consultants' advice concerning investments. If not, why have them around in the first place? If a plan is so reliant, then a consultant who denies that he or she is a fiduciary is being disingenuous. There is a high legal but no explicit dollar value to this service. Consultants who serve as fiduciaries must (for their own protection, if not the client's) stay on top of their client's investment operations. They also will incur the cost of fiduciary insurance (if available).

2. *Help define/recommend changes in asset allocation*. Given the pace of change in the markets, plans can ill afford to put their strategies and allocation policies on the shelf. Consultants should take the lead in keeping them current. To do this, the consultant must keep up to date with developments in the markets as well as in the plan itself. Further, asset allocation must be congruent with the plan's liabilities and cash flows; the consultant must under stand both assets and liabilities. You should expect your consultant to belong to and participate in industry research groups, be familiar with actuarial procedures and their implications, and be able to model (and explain) the interaction of assets and liabilities.

3. *Create and regulary update investment policy guidelines.*(formerly "*Write account guideline statements*") Account guidelines (especially in bonds) rapidly become obsolete. Even if managers do not change their procedures, from a fiduciary standpoint it is preferable to have more, rather than less, explicit guidelines. Again, the consultant should take the lead in bringing guideline issues to the trustees before problems arise and guidelines should be reviewed at least annually.

4. *Deal with all assets*. Many consultants report only on stocks and bonds. However, many plans also own real estate, invest in GICs, have dedicated bond portfolios, alternatives, etc. A consultant who can't deal with a wide range of assets can't give trustees a full picture of their opportunities.

5. *Oversee the managers*. This goes beyond reporting on their performance. It involves understanding their strategies and their implementation, personnel and organization changes, whether they are complying with your plan guide lines, etc. You cannot assume that the manager will always keep you informed about all these matters (especially if there might be cause for concern). Meetings, conference calls, etc. should be required regularly Historical documentation of the meetings is also important to be able to review your consulting firms work.

6. *Shield trustees from importunate investment managers*. Given the opportunity and the tiniest bit of encouragement, managers will besiege trustees. Though some trustees like the attention, for most, manager meetings are a colossal waste of time. Consultants can shield trustees by fielding calls, reading the endless marketing brochures, etc. By doing so, the consultant can send the message that the board will deal with investment decisions professionally, not on the basis of "relationships." (Of course, this assumes that the consultant doesn't abuse his or her own gatekeeper role to extort favors from the managers).

7. *Inform trustees about investment opportunities, techniques and risks*. Most plans use only a small fraction of the strategies available to them—a list that grows ever longer. While some are inappropriate and some should be avoided at all costs, the consultant should keep the board informed. If he or she doesn't, you may never know what opportunities you have passed up.

8. *Provide trustee education*. Few trustees are investment experts. Most have had to devote the bulk of their time to their businesses, union affairs, etc. At the same time, they are responsible for significant investment decisions. All too often, these are based on recommendations expressed in unintelligible jargon. While publications (such as this one), Foundation meetings, etc., provide some background, they don't (and can't be expected to) go into the depth required to support specific decisions. The consultant should provide such background information and education, whether through seminars, position papers or regular memos**.**

9. *Help put decisions on a rational basis*. Investment decisions are often complex and are always fraught with uncertainty. The consultant should be able to help the board define clear alternatives, identify their key-factors and lay out their potential consequences. While no one can guarantee that all investment decisions will turn out well, making them in the frame work of clear decision analysis reduces the regret when they don't. This is a very important item but it can't really be defined. I believe how consultants communicate is what separates them but how would you require that your consultant communicate clearly?

10. *Produce information and advice tailored to your particular needs*. Many consultants rely on third parties either for reporting software or for producing actual reports. Often, this arrangement produces masses of information irrelevant to trustee decision making. Further, while all boards want certain basic information, no two have precisely the same information needs. Trustees should not have to settle for an off-the-rack or one-size-fits all type of report.

11. *Give unbiased advice, even if unpopular*. This should go without saying. You do not need a consultant who is so responsive to the clients' predilections that he or she is reluctant to give firm advice even when it is called for. If your consultant doesn't give you hard advice when you need it, all the consultant is really providing is window dressing. And this ought to be cheap.

12. *Conduct all searches and negotiate contracts and fees*. Consultants should be able to handle whatever searches are required (i.e., not just those for standard bond or equity managers). Among other things the consultant should have some detailed familiarity with custody, lockbox and cash management operations.

13. *Monitor compliance with "best practice" standards and regulatory requirements*. Plans need to be able to demonstrate that their investment decisions, policies and procedures comply with Department of Labor and other applicable legal requirements. Beyond this, they ought to meet emerging standards of "best practice," e.g., with regard to risk controls and due diligence. Trustees should not rely on counsel or auditors to keep them up to date on investments. (For example, neither is in the position to comment on compliance with such things as DOL Letter 96-1 regarding terminal funding arrangements). Trustees should expect their consultant to make sure that the plan stays current with these developments.

14. *Work collaboratively with other service providers*. Few investment decisions affect only investments. Many have actuarial, legal or administrative implications. You should expect your consultant to be able to work closely with all your other service providers. This is a matter of both temperament and familiarity with other areas of professional competence. For example, your consultant should be able to address cash management issues, to discuss the implications of assumption changes with the actuary and to communicate matters of contract and compliance with counsel.