

STATE OF ILLINOIS
STATE UNIVERSITIES RETIREMENT SYSTEM

FINANCIAL REPORT
YEAR ENDED JUNE 30, 2010

PERFORMED AS SPECIAL ASSISTANT AUDITORS
FOR THE AUDITOR GENERAL, STATE OF ILLINOIS

**State of Illinois
State Universities Retirement System**

Financial Audit

For the Year Ended June 30, 2010

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We will issue under a separate cover the Compliance Examination Report for the year ended June 30, 2010.

**State of Illinois
State Universities Retirement System**

**Financial Statement Report
June 30, 2010**

Summary

The audit of the accompanying financial statements of the State of Illinois, State Universities Retirement System (System) was performed by McGladrey & Pullen, LLP.

Based on their audit, the auditors expressed an unqualified opinion on the System's financial statements.



Independent Auditors' Report

Honorable William G. Holland, Auditor General – State of Illinois
Board of Trustees, State Universities Retirement System of Illinois

As Special Assistant Auditors for the Auditor General, we have audited the accompanying Statement of Plan Net Assets of the State Universities Retirement System of Illinois (System), a component unit of the State of Illinois, as of June 30, 2010, and the related Statement of Changes in Plan Net Assets for the year then ended, as listed in the table of contents. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year comparative information has been derived from the System's financial statements as of June 30, 2009 and for the year then ended, on which we expressed an unqualified opinion in our report dated January 21, 2010.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the State Universities Retirement System of Illinois as of June 30, 2010, and the changes in plan net assets for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 13, 2010 on our consideration of the System's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The accompanying management's discussion and analysis and the schedules of funding progress and employer contributions are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the System's basic financial statements. The accompanying supporting schedules, as listed in the table of contents, are presented for purposes of additional analysis and are not a required part of the basic financial statements. The 2010 supporting schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated, in all material respects, in relation to the basic financial statements as of and for the year ended June 30, 2010, taken as a whole. We have also previously audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the System's basic financial statements for the year ended June 30, 2009, which are not presented with the accompanying financial statements. In our report dated January 21, 2010, we expressed an unqualified opinion on those statements. In our opinion, the 2009 supporting schedules are fairly stated, in all material respects, in relation to the basic financial statements for the year ended June 30, 2009, taken as a whole.

McGladrey & Pullen, LLP

Schaumburg, Illinois
December 13, 2010

Management's Discussion and Analysis

This section presents management's discussion and analysis of the State Universities Retirement System's (SURS or the System) financial statements and the major factors affecting the operations and investment performance of the System during the year ended June 30, 2010, with comparative reporting entity totals for the year ended June 30, 2009.

Overview of Financial Statements and Accompanying Information

- The financial statements presented in this report are the Statement of Plan Net Assets as of June 30, 2010 and the Statement of Changes in Plan Net Assets for the year ended June 30, 2010. These statements present separate totals for the defined benefit plan and the self-managed plan, with reporting entity totals for the years ended June 30, 2010 and 2009. The Statement of Plan Net Assets presents the assets on hand as of June 30, 2010 and 2009 and available to be used in the payment of benefits. The Statement of Changes in Plan Net Assets presents the additions to and deductions from the plan net assets during the years ended June 30, 2010 and 2009.
- The notes to the financial statements are an integral part of the financial statements and provide facts and detailed information to assist the reader in understanding the statements. Disclosures include the description of the plan, summary of significant accounting policies, and detailed presentations of major assets and liabilities.
- Required supplementary information presents schedules related to employer contributions and the funding of the plan.
- Other supplementary schedules consist of detailed information supporting administrative and investment expenses, fees paid to consultants, and a summary of cash receipts and disbursements.

General Market Risk

SURS is exposed to general market risk. This general market risk is reflected in asset valuations fluctuating with market volatility. Any impact from market volatility on SURS investment portfolios depends in large measure on how deep the market downturn is, how long it lasts, and how it fits within fiscal year reporting periods. The resulting market risk and associated realized and unrealized gains and losses could significantly impact SURS' financial condition.

Financial Analysis of the System

The State Universities Retirement System serves 193,769 members in its defined benefit plan and 18,467 members in its self-managed plan. The funds needed to finance the benefits provided by SURS are accumulated through the collection of member and employer contributions and through income on investments. The total net assets of the System increased from \$11.6 billion as of June 30, 2009 to \$12.8 billion as of June 30, 2010, chiefly due to investment income.

Plan Net Assets

The summary of plan net assets for the System is presented below:

Condensed Statement of Plan Net Assets

Reporting Entity Total (in millions)	2010	2009	Change	
			Amount	%
Cash and short-term investments	\$ 758.4	\$ 543.6	\$ 214.8	39.5
Receivables and prepaid expenses	57.0	57.0	-	-
Pending investment sales	729.2	606.5	122.7	20.2
Investments and securities lending collateral	14,104.6	12,615.1	1,489.5	11.8
Capital assets, net	6.4	6.6	(0.2)	(3.0)
Total assets	15,655.6	13,828.8	1,826.8	13.2
Payable to brokers-unsettled trades	851.9	878.1	(26.2)	(3.0)
Securities lending collateral	1,935.3	1,323.0	612.3	46.3
Other liabilities	26.9	21.1	5.8	27.5
Total liabilities	2,814.1	2,222.2	591.9	26.6
Total plan net assets	<u>\$ 12,841.5</u>	<u>\$ 11,606.6</u>	<u>\$ 1,234.9</u>	<u>10.6</u>

Management's Discussion and Analysis

Overall, plan net assets increased by \$1.2 billion, or 10.6%, chiefly due to an increase in investments attributable to the positive return on defined benefit plan investments of 15.0%. The investment allocation strategy for the plans making up the reporting entity as of June 30, 2010 and 2009 is as follows:

	2010	2009
Defined Benefit Plan		
Equities	65.0%	66.0%
Opportunity Fund	3.0	2.0
Fixed income	18.0	18.0
TIPS*	4.0	4.0
Real Estate Investment Trusts	4.0	4.0
Real Estate	6.0	6.0
Total	100.0%	100.0%
Self-Managed Plan		
Equities	65.0%	64.0%
Fixed income	34.0	36.0
Real Estate	1.0	0.0
Total	100.0%	100.0%

*TIPS denotes Treasury Inflation Protected Securities

Proper implementation of the investment policy requires that a periodic adjustment, or rebalancing, of assets be made to ensure conformance with policy target levels. Such rebalancing is necessary to reflect sizable cash flows and performance imbalances among investment managers who are hired to manage assets with a specified strategy. SURS' rebalancing policy calls for rebalancing, as soon as practical, if a strategy exceeds or falls below its target allocation by 3%. Ongoing rebalancing of the investment portfolio occurred as needed during the year with the assistance of System cash flows. The allocation of assets within the self-managed plan is totally determined by the individual participants, and also reflects gains or losses over the past year.

Liabilities increased by \$0.6 billion or 26.6%. This was primarily due to an increase in the obligation for securities lending collateral.

Changes in Plan Net Assets

The summary of changes in plan net assets for the System is presented below:

Condensed Statement of Changes in Plan Net Assets

Reporting Entity (in millions)	2010	2009	Change	
			Amount	%
Employer contributions	\$ 739.7	\$ 489.9	\$ 249.8	51.0
Participant contributions	323.6	322.1	1.5	0.5
Net investment income/(loss)	1,725.3	(2,967.1)	4,692.4	158.1
Total additions	2,788.6	(2,155.1)	4,943.7	229.4
Benefits	1,483.7	1,376.7	107.0	7.8
Refunds	57.5	51.4	6.1	11.9
Administrative expense	12.5	12.9	(0.4)	(3.1)
Total deductions	\$ 1,553.7	\$ 1,441.0	112.7	7.8
Net increase/(decrease) in plan net assets	\$ 1,234.9	\$ (3,596.1)	\$ 4,831.0	134.3

Management's Discussion and Analysis

Additions

Additions to plan net assets are in the form of employer and participant contributions and investment income or losses. For fiscal year 2010, employer contributions increased by \$249.8 million due to higher employer contributions from the State of Illinois as required by Public Act 88-0593. Participant contributions remained relatively unchanged from the prior year.

The investment net income for fiscal year 2010 was \$1.7 billion for the System, representing a \$4.7 billion increase from the prior year. For the defined benefit plan, the overall rate of return was 15.0% (net of all investment management fees).

Given the long-term orientation of the SURS defined benefit investment program, it is important to track investment returns over several time periods to correctly assess performance, especially given recent market volatility. The defined benefit plan returns are as follows:

Time Period	1-year	3-year	5-year	10-year	22-year
Annualized Return	15.0%	(4.1%)	3.1%	2.9%	8.1%

The 22-year return corresponds to the average active service term of the System member. At 8.1%, it can be compared to the actuarial rate of return assumption, recently changed from 8.5% to 7.75% and effective as of the June 30, 2010 actuarial valuation. While this assumed rate is normally determined every five years as part of the experience study performed by the System actuaries, the rate can be changed outside of this timetable by the System Board of Trustees, should changes in market conditions or plan demographics call for such an adjustment.

Deductions

The expenses of the Retirement System relate to the provision of retirement annuities and other benefits, refunds to terminated employees, and the cost of administering the System. These expenses for fiscal year 2010 were \$1.55 billion, an increase of \$112.7 million or 7.8% over expenses for 2009. This increase is primarily due to the \$107 million increase in defined benefit plan retirement and survivor annuity payments, and a \$6 million increase in portable lump sum distributions and refunds. Administration expenses decreased by \$0.4 million or 3.1% from fiscal year 2009 to 2010.

Future Outlook

Participant contributions are expected to grow in the future, at least at the pace of wage inflation experienced by the employers. The employer contribution for fiscal year 2011, mainly provided by the State of Illinois, will increase by approximately \$33 million or 3.9%. The employer contributions for fiscal years 2012 and beyond should reach and remain at a level percent of pay of approximately 24% as required by the funding plan set out by Public Act 88-0593. Under this plan, contributions will be at levels sufficient to fund the employer normal cost while amortizing the unfunded accrued actuarial liability for the period of 2011 to 2045, allowing the System to reach a funding ratio of 90%. Of significant concern is the ability of the State of Illinois to overcome the current budget crisis and meet these funding requirements. In fiscal year 2010, the majority of the appropriations paid to the state pension systems was funded with the proceeds of the January 7, 2010 sale of \$3.466 billion in pension obligation notes, as required by Public Act 96-0043. The source for fiscal year 2011 appropriations has not been determined.

Benefit payments are expected to continue to grow at a rate of approximately 7–8% annually as a result of increasing numbers of retirees, the 3% annual increase, and the impact of annual salary increases at the participating agencies. Even with the increase in the employer contributions as discussed above, the projected deficit of contributions over expenditures will continue in future years, forcing the System to continue to liquidate investments by approximately \$500 to \$700 million annually in order to pay current benefits. SURS will continue to structure its portfolio with the objective of maximizing returns over the long term, taking advantage of investment income to help offset the shortages in employer contributions.

Looking further into the future, projected benefits are expected to significantly decrease based on the provisions of Public Act 96-0889 which was signed into law on April 14, 2010. The resulting changes to the Illinois Pension Code will impact benefits for employees first certified as system participants on or after January 1, 2011 and who select the traditional or portable options of the defined benefit plan. Included in these changes are the following:

- Normal retirement age will change from age 62 to age 67 with 10 years
- Early retirement age with reduction will change from age 55 to age 62 with 10 years
- Minimum vesting will change from 5 years to 10 years
- Annual FRE average will be limited to \$106,800 (FY2011), increasing each year by the lesser of 3% or 1/2 of the CPI
- Automatic annual annuity increases will be limited to the lesser of 3% or 1/2 of the CPI
- Survivor benefits will change from 50% to 66 2/3% of earned retirement annuity

Financial Statements

Statement of Plan Net Assets as of June 30, 2010 With Comparative Reporting Entity Totals as of June 30, 2009

	2010			2009
	Defined Benefit Plan	Self-Managed Plan	Total	Total
Assets				
Cash and short-term investments	\$ 758,435,840	\$ -	\$ 758,435,840	\$ 543,659,417
Receivables				
Participants	13,174,337	2,034,293	15,208,630	13,808,147
Federal, trust funds, and other	2,553,537	1,215,308	3,768,845	3,758,588
Pending investment sales	729,180,673	-	729,180,673	606,501,124
Interest and dividends	37,970,185	-	37,970,185	39,454,498
Total receivables	782,878,732	3,249,601	786,128,333	663,522,357
Prepaid expenses	22,480	-	22,480	-
Investments, at fair value				
Equity investments	7,601,044,062	33,315,130	7,634,359,192	6,967,844,154
Fixed income investments	3,580,179,337	16,167,307	3,596,346,644	3,565,341,020
Real estate investments	265,951,229	232,957	266,184,186	228,750,215
Mutual fund and variable annuities	-	667,015,195	667,015,195	530,092,101
Total investments	11,447,174,628	716,730,589	12,163,905,217	11,292,027,490
Securities lending collateral	1,940,729,837	-	1,940,729,837	1,323,035,827
Capital assets, at cost, net of accumulated depreciation \$17,729,535 and \$16,768,688 respectively	6,408,913	-	6,408,913	6,583,663
Total assets	14,935,650,430	719,980,190	15,655,630,620	13,828,828,754
Liabilities				
Benefits payable	6,577,950	-	6,577,950	5,441,147
Refunds payable	3,863,392	-	3,863,392	2,437,930
Securities lending collateral	1,935,311,903	-	1,935,311,903	1,323,035,827
Payable to brokers for unsettled trades	851,863,268	-	851,863,268	878,088,978
Administrative expenses payable	16,491,806	-	16,491,806	13,256,204
Total liabilities	2,814,108,319	-	2,814,108,319	2,222,260,086
Net assets held in trust for pension benefits	\$ 12,121,542,111	\$ 719,980,190	\$ 12,841,522,301	\$ 11,606,568,668

Financial Statements

Statement of Changes in Plan Net Assets For the Year Ended June 30, 2010 With Comparative Reporting Entity Totals For the Year Ended June 30, 2009

	2010			2009
	Defined Benefit Plan	Self-Managed Plan	Total	Total
Additions				
Contributions				
Employer	\$ 696,595,341	\$ 43,116,502	\$ 739,711,843	\$ 489,881,392
Participant	<u>274,999,557</u>	<u>48,570,757</u>	<u>323,570,314</u>	<u>322,117,492</u>
Total Contributions	<u>971,594,898</u>	<u>91,687,259</u>	<u>1,063,282,157</u>	<u>811,998,884</u>
Investment Income				
Net appreciation/(depreciation) in fair value of investments	1,222,989,578	71,482,509	1,294,472,087	(3,290,131,425)
Interest	324,588,475	-	324,588,475	183,668,534
Dividends	153,916,871	-	153,916,871	153,789,636
Securities lending income	<u>6,534,929</u>	<u>-</u>	<u>6,534,929</u>	<u>16,649,099</u>
	<u>1,708,029,853</u>	<u>71,482,509</u>	<u>1,779,512,362</u>	<u>(2,936,024,156)</u>
Less investment expense				
Asset management expense	53,524,481	-	53,524,481	29,430,957
Securities lending expense	<u>652,536</u>	<u>-</u>	<u>652,536</u>	<u>1,664,780</u>
Net investment income/(loss)	<u>1,653,852,836</u>	<u>71,482,509</u>	<u>1,725,335,345</u>	<u>(2,967,119,893)</u>
Total additions	2,625,447,734	163,169,768	2,788,617,502	(2,155,121,009)
Deductions				
Benefits	1,477,486,374	6,254,132	1,483,740,506	1,376,726,389
Refunds of contributions	47,284,471	10,183,308	57,467,779	51,372,312
Administrative expense	<u>12,108,181</u>	<u>347,403</u>	<u>12,455,584</u>	<u>12,922,070</u>
Total deductions	1,536,879,026	16,784,843	1,553,663,869	1,441,020,771
Net increase/(decrease)	1,088,568,708	146,384,925	1,234,953,633	(3,596,141,780)
Net assets held in trust for pension benefits				
Beginning of year	<u>11,032,973,403</u>	<u>573,595,265</u>	<u>11,606,568,668</u>	<u>15,202,710,448</u>
End of Year	\$ <u>12,121,542,111</u>	\$ <u>719,980,190</u>	\$ <u>12,841,522,301</u>	\$ <u>11,606,568,668</u>

The accompanying notes are an integral part of the financial statements.

Notes to the Financial Statements

I. Summary of Significant Accounting Policies

A. Reporting Entity

The System is a component unit of the State of Illinois. As defined by accounting principles generally accepted in the United States of America established by the Governmental Accounting Standards Board (GASB), the financial reporting entity consists of a primary government, as well as its component units, which are legally separate organizations for which the elected officials of the primary government are financially accountable, or for which the nature and significance to the primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or otherwise incomplete. Financial accountability is defined as:

1. Appointment of a voting majority of the component unit's board and either (a) the ability to impose will by the primary government or (b) the possibility that the component unit will provide a financial benefit to or impose a financial burden on the primary government; or
2. Fiscal dependency on the primary government.

Based upon the required criteria, the System has no component units.

B. Measurement Focus and Basis of Accounting

For both the defined benefit plan and the self-managed plan (SMP), the financial transactions are recorded using the economic resources measurement focus and accrual basis of accounting. Member and employer contributions are recognized as revenue when due pursuant to statutory or contractual requirements. Benefits and refunds are recognized as expenses when due and payable in accordance with the terms of the plans.

C. Use of Estimates

The preparation of the System's financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and changes therein, and disclosure of contingent assets and liabilities. Actual results could differ from those estimates and those differences could be material. The System uses an actuary to determine the actuarial accrued liability for the defined benefit plan and to determine the actuarially required contribution.

D. Risks and Uncertainties

The System invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market, and credit risk. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near-term and those such changes could materially affect the amounts reported in the Statement of Plan Net Assets.

E. Description of Plans

Legislation effective January 1, 1998, required State Universities Retirement System (SURS or the System) to introduce a portable benefit package to the existing defined benefit plan and to offer a defined contribution plan. The portable benefit package and the defined contribution plan are available to all participants whose employers elect to make the options available. As of June 30, 2010, the defined benefit plan has two options available. These options are known as the traditional benefit package and the portable benefit package. The defined contribution plan is known as the self-managed plan. The membership, contributions, and benefit provisions related to these plans are presented in the following summary of the provisions of SURS in effect as of June 30, 2010, as defined in the Illinois Compiled Statutes. Interested parties should refer to the SURS Member Guide or the Statutes for more complete information.

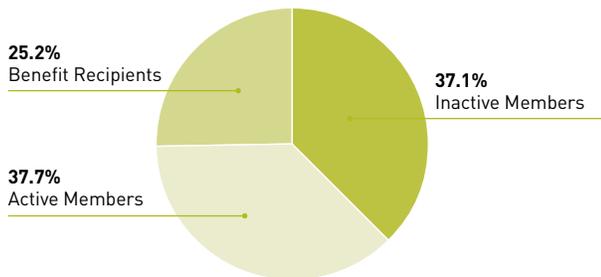
1. Defined Benefit Plan

SURS is the administrator of a cost-sharing, multiple-employer public employee retirement system established July 21, 1941, to provide retirement annuities and other benefits for staff members and employees of the state universities, certain affiliated organizations, and certain other state educational and scientific agencies and for

Notes to the Financial Statements

survivors, dependents, and other beneficiaries of such employees. SURS is included in the State of Illinois' financial reports as a component unit. SURS is governed by Chapter 40, Act 5, Article 15, of the *Illinois Compiled Statutes*. These statutes assign the authority to establish and amend the benefit provisions of the plan to the State Legislature. Operation of the System and the direction of its policies are the responsibility of the Board of Trustees of the System. It is also these statutes that define the scope of SURS' reporting entity. There are no statutory provisions for termination of the System. The Illinois Constitution provides that the pension obligation of the state *shall be an enforceable contractual relationship, the benefits of which shall not be diminished or impaired*.

Defined Benefit Plan



At June 30, 2010 and 2009, the number of participating employers was:

	2010	2009
Universities	9	9
Community Colleges	39	39
Allied Agencies	15	15
State of Illinois	2	2
	65	65

At June 30, 2010 and 2009, defined benefit plan membership consisted of:

	2010	2009
Benefit Recipients	48,903	46,810
Active Members	72,996	73,699
Inactive Members	71,870	71,280
	193,769	191,789

a. Membership

Participation is required as a condition of employment. Employees are ineligible to participate if (a) employed less than full-time and attending classes with an employer; (b) receiving a retirement annuity from SURS; or (c) excluded by subdivision (a)(7)(f) or (a)(19) of Section 210 of the Federal Social Security Act from the definition of employment given in that Section.

b. Benefit Provisions

Public Act 90-448 was enacted effective January 1, 1998, which established an alternative defined benefit program known as the portable benefit package. This option is offered in addition to the existing traditional benefit option. New employees are allowed 6 months from their date of hire to make an irrevocable election. The benefit provisions for these two defined benefit plan packages are as follows:

SURS provides retirement, disability, death and survivor benefits as authorized in Chapter 40, Act 5, Article 15, of the *Illinois Compiled Statutes*.

Retirement benefits are payable to participants meeting minimum vesting requirements of 5 years of service credit at age 62, 8 years of service credit at age 55, or 30 years of service credit regardless of age. Under both defined benefit options, the annuity is the larger of (a) a percentage of the average of the highest 4 consecutive years' earnings, with the percentage based upon total service credit, or (b) an actuarially determined benefit based upon the total employee and employer contributions and the individual's age at time of retirement. Retirement benefits are payable for life and are subject to a 3 percent compounded increase each January 1.

Disability benefits are payable to all participants with at least 2 years of service credit if they are unable to reasonably perform the duties of their assigned position due to a physical or mental impairment as certified by a physician. The benefit becomes payable when sick leave payments are exhausted or after 60 days of the disability, whichever is later. The benefit is payable at a rate of 50% of the monthly rate of compensation on the date the disability began. Disability benefits are reduced by any payments received under the Workers' Compensation or the Occupational Diseases Act. If a participant remains disabled after receiving the maximum benefits due, they may be eligible for a disability retirement annuity equal to 35% of the monthly rate of compensation on the date the disability began.

Upon termination of service, a lump sum refund is available to all members. Under the traditional benefit package, this refund consists of all member contributions and interest at 4-1/2%. Under the portable benefit package, this refund consists of all member contributions and total interest credited, plus for those members with

Notes to the Financial Statements

greater than or equal to 5 years of service credit, an equal amount of employer contributions. Under both defined benefit plan options, a member with 5 or more years of service credit who does not apply for a refund may apply for a normal retirement benefit payable at age 62.

Death benefits are payable to named beneficiaries upon the death of any participant of this System. Under the traditional benefit package, monthly survivor benefits may be paid to eligible survivors if the participant established a minimum of 1.5 years of service credit prior to the date of death. If no qualified survivor exists at the date of retirement, the member is paid a refund of all survivor contributions plus interest. Under the portable benefit package, survivor benefits are available through a reduction of the retirement annuity calculated as described above. No refund of survivor contributions is available if there is no qualified survivor at the time of retirement. These provisions are designed to allow the impact of the portable benefit package's enhanced refund opportunity to be cost neutral.

Upon the death of an annuitant, SURS will pay either a death benefit to a non-survivor beneficiary or a monthly survivor benefit to an eligible survivor. The amount of the monthly survivor benefit will differ depending upon whether the annuitant had selected the traditional benefit package or the portable benefit package.

c. Funded Status and Funding Progress

The funded status of the plan as of June 30, 2010, the most recent actuarial valuation date, is as follows (in millions):

Actuarial Value of Assets	Accrued Actuarial Liabilities	Unfunded Accrued Actuarial Liabilities	Funding Ratio*	Covered Payroll	UAAL as % of Covered Payroll
\$13,966.6	\$30,120.4	\$16,153.8	46.4%	\$3,491.1	462.7%

The schedule of funding progress, presented as required supplementary information (RSI) following the notes to the financial statements, presents multi-year trend information about whether the plan assets are increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

*If calculated using the market value of assets of \$12,121.5, the funding ratio would be 40.2%.

d. Actuarial Value of Assets

The actuarial value of assets is used in determining the funding progress of the System and in establishing the employer contribution rates necessary to adhere to the statutory funding plan. The actuarial value of assets is based on a smoothed investment income rate. Investment income in excess or shortfall of the expected 8.5% rate on fair value is smoothed over a five-year period with 20% of a year's excess or shortfall being recognized each year beginning with the current year. The use of this actuarial method began with the valuation for the period ending June 30, 2009, as required by Public Act 96-0043, which was signed into law on July 15, 2009.

Calculation of Actuarial Value of Assets (in thousands)

Actuarial Value of Assets at July 1, 2009		\$ 14,281,998.1
Total investment income/(loss)	1,653,852.8	
Less: Projected investment income @ 8.5%	914,268.1	
Investment income/(loss) in excess of projected	739,584.7	
Less: Deferral to smooth asset values over 5 years	591,667.8	
Recognized investment income - current year		147,916.9
Projected investment income		914,268.1
Recognized investment loss - prior years		(812,256.2)
Excess of contributions over disbursements		(565,284.1)
Actuarial value of assets at June 30, 2010		\$ 13,966,642.8

Notes to the Financial Statements

e. Additional actuarial valuation information

Valuation date	June 30, 2010
Actuarial cost method	Projected unit credit
Amortization method	Level percent, open
Remaining amortization period	30 years, open
Asset valuation method	5-year smoothed market
Actuarial assumptions:	
Investment rate of return*	7.75%
Projected salary increases**	5.0% - 10.0%
Postretirement benefits	3.0%

*Assumed investment rate of return change from 8.5% in FY2009 to 7.75% in FY2010 by action of the System Board of Trustees.

**Includes inflation and cost-of-living adjustments of 1.25%.

2. Self-Managed Plan

SURS is the plan sponsor and administrator of a defined contribution plan established as of January 1, 1998, by the Illinois General Assembly as an amendment to the Illinois Pension Code through Illinois Public Act 90-448. This plan is referred to as the self-managed plan (SMP) and is offered to employees of all SURS employers who elect to participate. This plan is a qualified money purchase pension plan under Section 401(a) of the Internal Revenue Code. The assets of the SMP are maintained under a trust administered by the SURS Board of Trustees in accordance with the Illinois Pension Code.

At June 30, 2010 and 2009, the number of SMP participating employers was:

	2010	2009
Universities	9	9
Community Colleges	39	39
Allied Agencies	13	13
State of Illinois	1	1
	62	62

At June 30, 2010 and 2009, the SMP membership consisted of:

	2010	2009
Annuity Benefit Recipients	153	110
Active Members	9,746	9,846
Inactive Members	8,568	6,500
	18,467	16,456

a. Membership

A member may elect participation in the SMP if (a) all participation criteria for the defined benefit plan are met; (b) the employer has elected through Board action to offer the self-managed plan; (c) the employee is on active status at the plan offering date; and (d) the employee is not eligible to retire as of the employer plan offering date. The member election is irrevocable. New employees are allowed 6 months from the date of hire in which to make their election. If no election is received, members are considered to be part of the defined benefit plan, under the traditional benefit option.

b. Benefit Provisions

The SMP provides retirement, disability, death, and survivor benefits as authorized in Chapter 40, Act 5, Article 15, of the *Illinois Compiled Statutes*, and amended by Public Act 90-448.

Retirement benefits are payable to participants meeting minimum vesting requirements of 5 years of service credit at age 62, 8 years of service credit at age 55, or 30 years of service credit regardless of age. The distribution options available upon reaching retirement eligibility are the following: a lump sum distribution consisting of all employee and employer contributions and related investment earnings; a single life annuity; a 50% or 100% joint and survivor annuity; a single life annuity with a guaranteed period of 10, 15, or 20 years as elected by the participant; and a 50% or 100% joint and survivor annuity with a guaranteed period of 10, 15, or 20 years as elected by the participant.

Disability benefits are payable to all participants with at least 2 years of service credit if they are unable to reasonably perform the duties of their assigned position due to physical impairment as certified by a physician. The benefit becomes payable when sick leave payments are exhausted or after 60 days of the disability, whichever is later. The benefit is payable at a rate of 50% of the monthly rate of compensation on the date the disability began. Disability benefits are reduced by any payments under the Workers' Compensation or the Occupational Diseases Act.

Notes to the Financial Statements

Upon termination of service with less than 5 years of service credit, a lump sum distribution is available which consists of employee contributions and related investment earnings. The employer contributions and related investment earnings are forfeited. Upon termination of service with greater than 5 years of service credit but where the participant is not yet eligible for retirement, a lump sum distribution is available which consists of employee and employer contributions and related investment earnings.

Death benefits are payable to named beneficiaries upon the death of any participant of this plan. If the participant has less than 1.5 years of service credit, the death benefit payable is the employee contributions and related investment earnings. If the participant has 1.5 or more years of service credit, the death benefit payable is the employee and employer contributions and related investment earnings.

F. Cash and Short-Term Investments

Included in the \$758,435,840 of cash and short-term investments presented in the Statement of Plan Net Assets is \$361,124,491 of short-term investments with less than 90 days maturity. For purposes of the various data tables presented in Note III, this group of short-term investments is included as part of fixed income investments. Short-term investments are generally reported at cost, which approximates fair value.

G. Investments

Investments are governed by Chapter 40, Act 5, Articles 1 and 15, of the *Illinois Compiled Statutes*. The most important aspect of the statutes is the prudent expert rule, which establishes a standard of care for all fiduciaries. (A fiduciary is any person who has authority or control with respect to the management or administration of plan assets.) The prudent expert rule states that fiduciaries must discharge their duties with the care, skill, prudence, and diligence that a prudent person acting in a like capacity and familiar with such matters would use under conditions prevailing at the time. Purchases and sales of securities are recorded on a trade-date basis. Interest income is reported on the accrual basis. Dividends are recorded on the ex-dividend date.

For the defined benefit plan, investments are reported at fair value. Marketable securities (stocks, bonds, warrants, and options) are traded on public exchanges. The Northern Trust Company, SURS' custodial bank, establishes these prices using third-party pricing services. Generally, these values are reported at the last reported sales price. Certain investments that do not have an established market value are reported at estimated fair value obtained from a custodial bank or investment management firm. These investments include commingled investment pools, where the underlying assets are individually marked to market (i.e., estimated fair value) on a daily basis and individually traded on publicly recognized exchanges. The investment manager, using methods approved by the CFA Institute (formerly known as the Association for Investment Management Research) or other industry standards, values non-marketable securities (real estate and venture capital). These methods generally include detailed property level appraisals and discounted cash flow analysis.

For the SMP, investments are reported at fair value by the Service Providers. These investments include both mutual and variable annuity funds where the underlying assets are marked to market (i.e., estimated fair value) on a daily basis and individually traded on publicly recognized exchanges. Generally, the values on the underlying investments are reported at the last reported sales price.

H. Capital Assets

Capital assets are recorded at historical cost and depreciated over the estimated useful life of each asset. Annual depreciation is computed using the straight-line method.

I. Administrative Expenses

System administrative expenses (which include amounts for both the defined benefit and self-managed plans) are budgeted and approved by the System's Board of Trustees. Funding for these expenses is included in the employer contribution as determined by the annual actuarial valuation and appropriated by the State of Illinois.

J. Prior Year Comparative Information

The basic financial statements include certain prior-year summarized comparative information in total but not at the level of detail required for a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the System's financial statements as of and for the year ended June 30, 2009, from which the summarized comparative information was derived.

Notes to the Financial Statements

K. Reclassification

Certain items in the 2009 financial statements have been reclassified to conform to the 2010 presentation.

L. New Accounting Pronouncements

Effective for the year ending June 10, 2010, the System adopted GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, which established accounting and financial reporting for intangible assets. This Statement had no impact on the System's financial statements.

Effective for the year ending June 30, 2010, the System adopted GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, which established the recognition, measurement, and disclosure of information regarding derivative instruments entered into by state and local governments. The disclosures provide a summary of the government's derivative instrument activity and the information necessary to assess the government's objectives for derivative instruments. The System implemented this Statement for the year ended June 30 2010. These disclosures are in Note II.

The Governmental Accounting Standards Board Statement No. 59, *Financial Instruments Omnibus*, has been issued and is effective for all reporting periods beginning after June 15, 2010. The objective of this Statement is to update and improve existing standards regarding financial reporting and disclosure requirements of certain financial instruments and external investment pools for which significant issues have been identified in practice. The requirements of the Statement will improve financial reporting by providing more complete information, by improving consistency of measurements, and by providing clarifications of existing standards. SURS is required to implement this Statement for the year ending June 30, 2011. Management has currently not determined what impact, if any, this Statement may have on its financial statements.

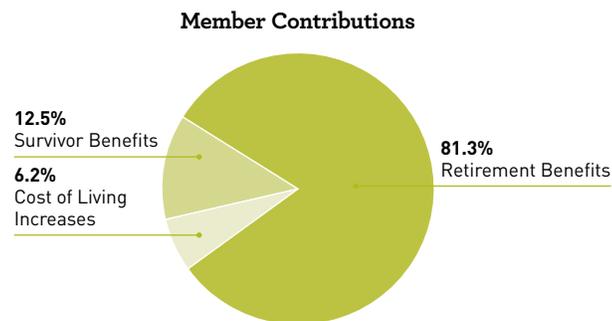
II. Contributions and Net Assets Designations

A. Defined Benefit Plan

1. Membership Contributions

In accordance with Chapter 40, Act 5, Article 15, of the *Illinois Compiled Statutes*, members of the traditional benefit package contribute 8% of their gross earnings; 6-1/2% of those are designated for retirement annuities, 1/2% for post-retirement increases, and 1% for survivor benefits. Police officers and fire fighters contribute 9-1/2% of earnings; the additional 1-1/2% is a normal retirement contribution. Members of the portable benefit package contribute 8% of their gross earnings; 6-1/2% of those are designated for retirement annuities, 1/2% for post-retirement increases, and 1% for enhanced refund benefits. Police officers and fire fighters contribute 9-1/2% of earnings; the additional 1-1/2% is a normal retirement contribution. These statutes assign the authority to establish and amend the contribution provisions of the plan to the State Legislature. The member contributions are picked up by the employer and treated as employer contributions for income tax purposes. Retirement contributions are based on the gross earnings before the employer pick-up and are included in earnings.

All contributions on pre-1981 earnings and service credit payments, plus future other public employment, prior service, refund repayments, leave payments, military service payments, and the employee portion of Early Retirement Option payments are considered as previously taxed, unless qualifying funds are rolled over to SURS to make these purchases, or unless the payments are made in installments through employer deductions from payroll. Previously taxed contributions will be recovered tax-free when distributed to the employee in the form of benefits or payments or to his or her beneficiary as a death and/or survivor benefit.



Notes to the Financial Statements

2. Interest Credited on Member Contributions

For the traditional and portable benefit packages, the interest rate credited is fixed by the Board of Trustees and is 8.0% for the year ended June 30, 2010. As of July 1, 2010, the rate will be 7.5%. For purposes of lump sum refunds to former members, the traditional benefit package offers an interest rate of 4-1/2%, compounded annually, and the portable benefit package offers an interest rate equal to the credited rate, compounded annually. A change brought forth by the enactment of Public Act 94-0004 and effective July 1, 2005, calls for the Comptroller of the State of Illinois to set the interest rate credited to member contribution balances for purposes of the calculation of retirement annuities under the money purchase formula. The Comptroller set that rate at 8.5% for fiscal year 2006, 8.0% for fiscal years 2007 and 2008, 8.5% for fiscal year 2009 and 7.5% for fiscal year 2010. As of July 1, 2010, the rate will be 7.0%. Members certified after July 1, 2005 will not be eligible for the money purchase formula calculation. Rather their retirement annuity will be calculated using the general formula.

3. Employer Contributions

On an annual basis, an actuarial valuation is performed in order to determine the amount of statutorily required contributions from the State of Illinois. An actuarial experience study is performed every 5 years to determine the assumptions to be used in the annual valuation. The actuarial assumptions are also reviewed at least annually by the System. The last actuarial experience study was performed during fiscal year 2007. To determine the funding method, Public Act 88-0593 was passed by the Illinois General Assembly in 1994. This act, which took effect on July 1, 1995, provides a 15-year phase-in to a 35-year plan that requires the state to make continuing appropriations to meet the normal actuarially-determined cost of the System, plus amortize the unfunded accrued liability. Under this plan, the System is expected to be 90% funded by fiscal year 2045.

As required by Public Act 96-0043 the State of Illinois issued \$3.466 billion in pension obligation notes on January 7, 2010 at an interest rate of 3.854%. The proceeds of these debt securities, taxable with a five-year maturity, were used to fund the state's contribution to the five retirement systems, including \$700.2 million paid to SURS.

4. Net Asset Accounts

The System maintains two designated accounts that reflect the assignment of net assets to employee and benefit accounts:

- The Employee Contribution Account records the pension assets contributed by each employee and the interest income earned by those contributions.
- The Benefits from Employee and Employer Contributions Account records the net assets available for annuities in force and available for future retirement, death and disability benefits, the undistributed investment income, the unexpended administrative expense allocation, and the variations in actuarial assumptions.

Balances in these designated accounts as of June 30, 2010 are as follows:

Employee contributions	\$ 5,916,288,541
Benefits from employee and employer contributions	6,205,253,570
Total Net Assets	<u>\$ 12,121,542,111</u>

5. Ownership of Greater than 5 Percent of Net Assets Available for Benefits

There are no significant investments in any one organization that represents 5% or more of net assets available for benefits.

B. Self-Managed Plan

1. Membership Contributions

In accordance with Chapter 40, Act 5, Article 15, of the *Illinois Compiled Statutes*, members contribute 8% of their gross earnings. These statutes assign the authority to establish and amend the contribution provisions of the plan to the State Legislature.

The member contributions are picked up by the employer and treated as employer contributions for income tax purposes. Retirement contributions are based on the gross earnings before the employer pick-up and are included in earnings.

Notes to the Financial Statements

Service credit purchase payments are considered as previously taxed, unless qualifying funds are rolled over to SURS to make these purchases. Previously taxed contributions will be recovered tax-free when distributed to the employee in the form of benefits or refunds or to his or her beneficiary as a death and/or survivor benefit.

2. Employer Contributions

In accordance with Chapter 40, Act 5, Article 15, of the *Illinois Compiled Statutes*, employer contributions credited to the SMP participant are at a rate of 7.6% of the participant's gross earnings, less the amount retained by SURS (currently 0.5%) to provide disability benefits to the participant. The amounts credited are paid into the participant's account. The State of Illinois shall make the employer contribution to SURS on behalf of the SMP participants.

3. Net Asset Accounts

The SMP maintains three designated accounts that reflect the assignment of net assets to employee contributions, disability benefits, and employer forfeiture accounts:

- a. The Employee Contribution Account records the pension assets contributed by each employee and the corresponding employer contribution, and the investment income earned by those contributions.
- b. The Disability Benefits Account reflects the pension assets contributed by the employer and held to fund member disability benefits.
- c. The Employer Forfeiture Account reflects the pension assets contributed by the employer but forfeited from member accounts due to termination prior to reaching 5 years of service. Future employer contributions are reduced by the total forfeitures held by the defined contribution plan.

The assets related to disability benefits and employer forfeitures are commingled with the investment assets of the defined benefit plan. Investment income or loss is credited to these balances based upon the annual investment return or loss of the commingled assets. For fiscal year 2010, the investment income credited to these balances was \$6,142,349.

Balances in these designated accounts as of June 30, 2010 are as follows:

Employee contributions	\$ 670,259,127
Disability benefits	44,490,986
Employer forfeitures	5,230,077
Total Net Assets	<u>\$ 719,980,190</u>

4. Ownership of Greater than 5 Percent of Net Assets Available for Benefits

There are no significant investments in any one organization that represent 5% or more of net assets available for benefits.

III. Deposits and Investments

Custodial Credit Risk for Deposits

Custodial credit risk for deposits is the risk that in the event of a financial institution failure, State Universities Retirement System deposits may not be returned. Cash held in the investment related bank account in excess of \$250,000 is uninsured and uncollateralized. SURS has no deposit policy for custodial credit risk. Deposits are under the custody of The Northern Trust Company which has an AA Long Term Deposit/Debt rating by Standard & Poor's, an Aa3 rating by Moody's and an AA/AA- rating by Fitch. At June 30, 2010, the carrying amount of cash was \$397,311,349 and the bank balance was \$401,662,410, of which \$23,711,170 was foreign currency deposits and was exposed to custodial credit risk. The remaining \$361,124,491 was made up of short-term invested funds which are considered to be investments for the purpose of assessing custodial credit risk.

Notes to the Financial Statements

Investment Policies

Investments are governed by Chapter 40, Act 5, Articles 1 and 15, of the *Illinois Compiled Statutes*. The most important aspect of the statutes is the prudent expert rule, which establishes a standard of care for all fiduciaries. (A fiduciary is any person who has authority or control with respect to the management or administration of plan assets.) The prudent expert rule states that fiduciaries must discharge their duties with the care, skill, prudence, and diligence that a prudent person acting in a like capacity and familiar with such matters would use under conditions prevailing at the time. The SURS Board of Trustees has adopted an Investment Policy that contains general policies for investments. The Investment Section of this report contains a summary of these policies. Within the prudent expert framework, the SURS Board of Trustees establishes specific investment guidelines in the investment management agreement of each individual investment management firm.

Investment Commitments

Alternative investment portfolios consist of passive interests in limited partnerships. The System had outstanding commitments to private equity limited partnerships of approximately \$498.0 million and \$534.2 million as of June 30, 2010 and 2009, respectively. The System had outstanding commitments to real estate partnerships of approximately \$134.4 million, to infrastructure partnerships of approximately \$52.8 million and to Public-Private Investment Program (PPIP) partnerships of approximately \$60.7 million at June 30, 2010.

Investments

The carrying values of investments by type at June 30, 2010 are summarized below:

Equity investments	
U.S. equities	\$ 4,711,502,237
Non-U.S. equities	1,932,289,164
U.S. private equity	1,150,802,647
Non-U.S. private equity	66,068,761
Equity futures	(226,303,617)
Fixed income investments	
U.S. government obligations	1,236,036,920
U.S. agency obligations	291,961,587
U.S. corporate fixed income	1,726,726,250
U.S. fixed income, other	-
Non-U.S. fixed income securities	313,659,375
U.S. fixed income derivatives	110,372,956
Non-U.S. fixed income derivatives	1,036,719
U.S. fixed income futures	(112,037,141)
Non-U.S. fixed income futures	(1,036,719)
U.S. short term investments	615,775,522
Non-U.S. short term investments	33,598,216
U.S. swaps and options	17,129,887
Non-U.S. swaps and options	3,145,042
Real estate investments	
Real estate	266,184,186
Mutual fund and variable annuities	
Self-managed plan mutual funds and variable annuity funds	667,015,195
Total Investments	\$ 12,803,927,187

- (a) Fixed income investments presented in this table include \$361,124,491 of short-term investments with maturities of less than 90 days and \$278,897,479 of investments in the form of cash and cash-equivalents. Both are included in the cash and short-term investments total on the financial statements.
- (b) U.S. short-term investments principally consist of money market funds and options.
- (c) Fixed income investments presented in this table include \$57,986,970 of short-term bills and notes with maturities greater than 90 days.

Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of a failure of the counterparty to a transaction, the System will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. SURS has not adopted a formal policy specific to custodial credit risk. At June 30, 2010, no investments were uninsured and unregistered, with securities held by the counterparty or by its trust department or agent but not in the System's name.

Notes to the Financial Statements

Concentration of Credit Risk

Concentration of credit risk is the risk of loss that may be attributed to the magnitude of the System's investment in a single issue. SURS has not adopted a formal policy specific to concentration of credit risk. However, this area is addressed with each of the relevant investment managers in the Investment Management Agreement between the parties. The System's investment portfolios are managed by professional investment management firms. These firms must maintain diversified portfolios and must comply with risk management guidelines specific to each of their investment management agreements. Excluding U.S. government and agency issues, the portfolios are limited to a 5% allocation in any single investment grade U.S. issuer. Allocation limits also apply to international issuers. At June 30, 2010, SURS had no investments in any one issuer that represented 5% or more of the System's total investments.

Credit Risk of Debt Securities

Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill obligations. SURS has not adopted a formal policy specific to credit risk of debt securities. However, this area is addressed with each of the relevant investment managers in the Investment Management Agreement between the parties. The quality ratings of investments in fixed income securities of the System as described by Standard & Poor's rating agency at June 30, 2010 are as follows:

Quality Rating: Standard & Poor's	Domestic**	International	Total
AAA	\$ 948,612,705	\$ 139,324,920	\$ 1,087,937,625
AA+	87,488,922	34,710,369	122,199,291
AA	49,797,094	46,857,941	96,655,035
AA-	307,234,609	13,483,588	320,718,197
A+	132,609,142	41,505,140	174,114,282
A	232,763,550	29,641,488	262,405,038
A-	75,918,693	29,999,522	105,918,215
BBB+	86,941,980	17,905,047	104,847,027
BBB	95,221,288	18,934,047	114,155,335
BBB-	98,521,577	15,062,771	113,584,348
BB+	29,600,708	1,716,040	31,316,748
BB	44,955,073	1,090,640	46,045,713
BB-	30,597,367	2,534,150	33,131,517
B+	25,621,906	617,160	26,239,066
B	22,492,474	2,124,592	24,617,066
B-	30,728,964	-	30,728,964
CCC+	8,483,850	-	8,483,850
CCC	57,913,319	-	57,913,319
CCC-	250,871	-	250,871
CC	12,471,588	-	12,471,588
C	669,525	916,000	1,585,525
D	2,111,008	-	2,111,008
Not rated	46,151,536	3,128,278	49,279,814
Total credit risk: debt securities	2,427,157,749	399,551,693	2,826,709,442
U.S. government and agencies *	1,251,363,322	-	1,251,363,322
Total debt securities investments	\$ 3,678,521,071	\$ 399,551,693	\$ 4,078,072,764

* Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk.

Includes \$15,326,402 from self-managed plan mutual fund.

** Includes \$75,250,769 from self-managed plan variable annuities and mutual funds.

Notes to the Financial Statements

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The State Universities Retirement System manages its exposure to fair value loss arising from increasing interest rates by diversifying the debt securities portfolio. The System has not adopted a formal policy specific to interest rate risk. However, this area is addressed with each of the relevant investment managers in the Investment Management Agreement between the parties.

At June 30, 2010, the segmented time distribution of the various investment types of debt securities of the System are as follows:

Type	2010 Fair Value	Maturities in Years				
		Less than 1 year	1 to 5 years	6 to 10 years	10 to 20 years	More than 20 years
U.S. Gov't & Agency fixed income *	\$ 1,903,378,705	\$ 371,262,743	\$ 291,041,053	\$ 548,575,384	\$ 289,858,986	\$ 402,640,539
U.S. corporate fixed income **	1,775,142,366	53,887,963	740,314,129	439,765,167	75,827,249	465,347,858
Non-U.S. fixed income	399,551,693	65,223,238	211,464,534	77,421,513	10,655,458	34,786,950
Total	<u>\$ 4,078,072,764</u>	<u>\$ 490,373,944</u>	<u>\$1,242,819,716</u>	<u>\$ 1,065,762,064</u>	<u>\$ 376,341,693</u>	<u>\$ 902,775,347</u>

* Includes \$15,326,402 from self-managed plan mutual fund.

** Includes \$75,250,769 from self-managed plan variable annuities and mutual funds.

Notes to the Financial Statements

Foreign Currency Risk

Foreign currency risk is the risk that changes in currency exchange rates will adversely affect the fair value of an investment or a deposit. SURS has not adopted a formal policy specific to foreign currency risk. However, this area is addressed with each of the relevant investment managers in the Investment Management Agreement between the parties. International investment management firms maintain portfolios with diversified foreign currency risk for SURS. The System's exposure to foreign currency risk derives from its positions in foreign currency and foreign currency-denominated equity and fixed income investments. At June 30, 2010 the System's exposure to foreign currency risk is as follows:

Currency	Equity	Fixed Income*	Total
Australian dollar	\$ 83,059,805	\$ 10,032,996	\$ 93,092,801
Brazilian real	12,257,640	649,154	12,906,794
British pound sterling	249,571,226	8,262,186	257,833,412
Canadian dollar	51,057,280	16,256,732	67,314,012
Chinese yuan renminbi	-	22,049,770	22,049,770
Danish krone	9,512,263	514,326	10,026,589
Euro	350,452,337	7,986,613	358,438,950
Hong Kong dollar	82,636,598	1,572,538	84,209,136
Indonesian rupiah	339,076	1,018,300	1,357,376
Japanese yen	226,079,316	24,366,052	250,445,368
Malaysian ringgit	748,996	1,336,126	2,085,122
Mexican peso	2,036,718	340,216	2,376,934
New Israeli shekel	1,187,854	951	1,188,805
New Taiwan dollar	20,479,508	1,089,974	21,569,482
New Zealand dollar	1,225,640	80,681	1,306,321
Norwegian krone	9,801,400	1,179,620	10,981,020
Philippine peso	171,607	-	171,607
Polish zloty	354,961	-	354,961
Singapore dollar	39,023,715	931,082	39,954,797
South African rand	709,757	32,994	742,751
South Korean won	15,189,469	2,264,775	17,454,244
Swedish krona	12,599,440	2,902,502	15,501,942
Swiss franc	96,483,335	169,920	96,653,255
Thai baht	8,555,069	58,604	8,613,673
Turkish lira	262,297	-	262,297
Total securities subject to foreign currency risk	1,273,795,307	103,096,112	1,376,891,419
Foreign investments denominated in U.S. Dollars	672,116,639	274,141,173	946,257,812
Total foreign investment securities	\$ 1,945,911,946	\$ 377,237,285	\$ 2,323,149,231

* Includes Swaps, Options and Short-Term Investments

Notes to the Financial Statements

Derivative Securities

During the year ended June 30, 2010, the System implemented GASB Statement No. 53 *Accounting and Financial Reporting for Derivative Instruments* with respect to investments held in derivative securities. A derivative security is an investment whose value is derived from other financial instruments such as commodity prices, bond and stock prices, or a market index. The System's derivatives are considered investments. The fair value of all derivative financial instruments is reported in the Statement of Plan Net Assets as either assets or liabilities, and the change in the fair value is recorded in the Statement of Changes in Plan Net Assets as net appreciation in fair value of investments.

In the case of an obligation to purchase (long a financial future or a call option), the full value of the obligation is held in cash or cash equivalents. For obligations to sell (short a financial future or a put option), the reference security is held in the portfolio. Derivative transactions involve, to varying degrees, credit risk and market risk. Credit risk is the possibility that a loss may occur because a party to a transaction fails to perform according to terms. Market risk is the possibility that a change in interest rate risk or foreign currency risk will cause the value of a financial instrument to decrease or become more costly to settle. The market risk associated with derivatives, the prices of which are constantly fluctuating, is regulated by imposing strict limits as to the types, amounts and degree of risk that investment managers may undertake. These limits are approved by the Board of Trustees and senior management, and the risk positions of the investment managers are reviewed on a periodic basis to monitor compliance with the limits. The System has not adopted a formal policy specific to master netting arrangements. As of June 30, 2010, SURS' derivative investments included foreign currency forward contracts, rights and warrants, futures, options, swaps and swaptions.

Foreign currency forward contracts are used to protect against the currency risk in SURS' foreign stock and fixed income security portfolios. A foreign currency forward contract is an agreement to buy or sell a specific amount of a foreign currency at a specified delivery or maturity date for an agreed-upon price. Fluctuations in the market value of foreign currency forward contracts are marked to market on a daily basis. The gain or loss arising from the difference between the original contracts and the closing of such contracts is included in the investment income in the Statement of Changes in Plan Net Assets. At June 30, 2010, SURS' investments in foreign currency forward contracts are as follows:

Currency	Pending Foreign Exchange Purchases	Pending Foreign Exchange Sales	Fair Value 2010	Fair Value 2009
Australian dollar	\$ 7,559,524	\$ (472,666)	\$ 7,086,858	\$ (19,890)
Brazilian real	-	(1,257,046)	(1,257,046)	(25,855)
British pound sterling	11,043,523	(19,070,701)	(8,027,178)	(675,636)
Canadian dollar	15,612,100	(9,497,630)	6,114,470	21
Chinese yuan renminbi	22,049,770	-	22,049,770	(281,300)
Danish krone	503,862	-	503,862	-
Euro	41,545,302	(123,185,564)	(81,640,262)	(666,356)
Hong Kong dollar	3,549,438	(270,577)	3,278,861	(2)
Indian rupee	783,329	(783,329)	-	-
Indonesian rupiah	1,831,034	(813,705)	1,017,329	-
Japanese yen	31,853,036	(17,120,157)	14,732,879	21,778
Malaysian ringgit	1,980,557	(644,895)	1,335,662	-
Mexican peso	2,744,823	(2,627,921)	116,902	(7,844)
New Taiwan dollar	459,826	(1,291,877)	(832,051)	-
New Zealand dollar	-	-	-	(89,896)
Norwegian krone	63,344	(3,504,417)	(3,441,073)	(8,638)
Philippine peso	1,757,191	(1,757,191)	-	-
Singapore dollar	5,051,930	(3,606,148)	1,445,782	(16,868)
South African rand	-	(83,607)	(83,607)	-
South Korean won	12,581,336	(10,505,095)	2,076,241	-
Swedish krona	2,040,519	(290,794)	1,749,725	-
Swiss franc	625,996	(472,303)	153,693	(6,397)
Total securities subject to foreign currency risk	\$ 163,636,440	\$ (197,255,623)	\$ (33,619,183)	\$ (1,776,881)
Foreign investments denominated in U.S. dollars	206,173,742	(165,673,647)	40,500,095	23,494
Total foreign investment securities	\$ 369,810,182	\$ (362,929,270)	\$ 6,880,912	\$ (1,753,387)

Notes to the Financial Statements

SURS investment managers use financial futures to replicate an underlying security they wish to hold (sell) in the portfolio. In certain instances, it may be beneficial to own a futures contract rather than the underlying security (arbitrage). Additionally, SURS investment managers use futures contracts to improve the yield or adjust the duration of the fixed income portfolio. A financial futures contract is an agreement to buy or sell a specific amount at a specified delivery or maturity date for an agreed-upon price. Futures contracts are traded on organized exchanges, thereby minimizing the System's credit risk. The net change in the futures contracts value is settled daily in cash with the exchanges. The cash or securities to fulfill these obligations are held in the investment portfolio. As the market value of the futures contract varies from the original contract price, a gain or loss is paid to or received from the clearinghouse and recognized in the Statement of Changes in Plan Net Assets. At June 30, 2010, the notional future balances of SURS' investments are as follows:

	Notional Value 2010	Notional Value 2009
Equity derivatives futures		
Long	\$ 226,303,617	\$ 161,570,015
Fixed income derivatives futures		
Long	478,109,025	750,702,359
Short	(75,863,453)	(43,459,969)
Total Futures	\$ 628,549,189	\$ 868,812,405

SURS investment managers use options in an attempt to add value to the portfolio (collect premiums) or protect (hedge) a position in the portfolio. Financial options are an agreement that gives one party the right, but not the obligation, to buy or sell a specific amount of an asset for a specified price, called the strike price, on or before a specified expiration date. As a writer of financial options, the System receives a premium at the outset of the agreement and bears the risk of an unfavorable change in the price of the financial instrument underlying the option. All written financial options are recognized as a liability on the System's financial statements. As a purchaser of financial options, the System pays a premium at the outset of the agreement and the counterparty bears the risk of an unfavorable change in the price of the financial instrument underlying the option. At June 30, 2010, SURS' investments had the following option balances:

	Fair Value 2010	Fair Value 2009
Equity options		
Call	\$ (5,288)	\$ -
Put	(364,250)	-
Fixed income options		
Call	(1,642,792)	(165,683)
Put	(56,748)	(114,189)
Cash and cash equivalent options		
Call	(7,950)	300,048
Put	(153,832)	(95,896)
Swaptions		
Call	(4,468,912)	7,438,226
Put	477,104	(2,179,938)
Total Options	\$ (6,222,668)	\$ 5,182,568

SURS fixed income managers invest in swaps and swaptions to manage exposure to credit, currency, inflation and interest rate risks. Swaptions are options on swaps that give the purchaser the right, but not the obligation, to enter into a swap at a specific date in the future. At June 30, 2010, the fair value of swaptions was \$6.2 million. Swap agreements are privately negotiated agreements with a counterparty to exchange or swap investment cash flows, assets, foreign currencies or market-linked returns at specified, future intervals. In connection with swap agreements, securities or cash may be identified as collateral in accordance with the terms of the respective swap agreements to provide assets of value and recourse in the event of default, bankruptcy or insolvency. Swaps are marked to market daily based upon values from third party vendors or quotations from market makers to the extent available and any change in value is recorded as an unrealized gain or loss. SURS investment managers have entered into credit default, inflation-linked, total return and interest rate swap agreements.

	Fair Value 2010	Maturities in Years				
		Less than 1 year	1 to 5 years	6 to 10 years	10 to 20 years	More than 20 years
Swaps						
Credit default	\$ 11,352,930	\$ 31,280	\$ 2,680,872	\$ 7,313,201	\$ -	\$ 1,327,577
Inflation-linked	90,758	71,561	-	19,197	-	-
Interest rate	(9,796,116)	448,681	3,577,963	(5,010,732)	(8,812,028)	-
Total return	(65,222,133)	(65,222,133)	-	-	-	-
Total swaps	<u>\$(63,574,561)</u>	<u>\$(64,670,611)</u>	<u>\$6,258,835</u>	<u>\$2,321,666</u>	<u>\$(8,812,028)</u>	<u>\$1,327,577</u>

Credit default swap agreements involve one party making a stream of payments (the buyer of protection) to another party (the seller of protection) in exchange for the right to receive a specified return in the event of a default or other credit event for the referenced entity, obligation or index. The seller of protection generally receives from the buyer of protection a fixed rate of income throughout the term of the swap provided there is no credit event. The seller effectively adds leverage to its portfolio as it is subject to investment exposure on the notional amount of the swap. At June 30, 2010, the total notional value of written credit default swaps (selling protection) was (\$386.1) million and the notional value of purchased credit default swaps (buying protection) was \$386.1 million. The fair value of credit default swaps at June 30, 2010, was \$11.3 million.

Inflation-linked swap agreements involve a stream of fixed payments in exchange for variable payments linked to an inflation index. These swaps can protect against unfavorable changes in inflation expectations and are utilized to transfer inflation risk from one counterparty to another. At June 30, 2010, the fair value of the inflation-linked swaps was \$0.1 million.

Total return swap agreements involve a stream of payments based on a set rate, either fixed or variable, by one party while the other party makes payments based on the return of an underlying asset, which includes both the income it generates and any capital gains. In total return swaps, the underlying asset (reference asset), usually an equity index, loans, or bonds, is owned by the party receiving the set rate payments. These swaps allow the party receiving the total return to gain exposure and benefit from a reference asset without owning it. The fair value of total return swaps was (\$65.2) million at June 30, 2010.

Interest rate swap agreements involve the exchange of a set of variable and fixed-rate interest payments linked to a referenced interest rate without an exchange of the underlying principal amount. These agreements are used to limit or manage exposure to fluctuations in interest rates or to obtain a marginally lower interest rate than would be available without the swap. Gains and losses on swaps are determined based on market values and are recorded in the Statement of Changes in Plan Net Assets. The fair value of swaps at June 30, 2010, is as follows:

Counterparty	Notional Amount	SURS Rate	Counterparty Rate	Fair Value 2010	Fair Value 2009	Pay Fixed / Receive Fixed
Credit Suisse First Boston	\$ 6,400,000	3.6000%	LIBOR (a)	\$ (361,158)	\$ -	pay fixed
Credit Suisse International	1,700,000	3.8275%	LIBOR (a)	(136,302)	-	pay fixed
Credit Suisse International	5,600,000	1.2425%	LIBOR (a)	(40,316)	-	pay fixed
Credit Suisse International	6,800,000	2.4622%	LIBOR (a)	(186,616)	-	pay fixed
Credit Suisse First Boston	14,500,000	4.5850%	LIBOR (a)	(2,241,831)	(1,334,914)	pay fixed
Deutsche Bank	11,900,000	3.9630%	LIBOR (a)	(1,102,756)	-	pay fixed
Deutsche Bank	3,300,000	4.6800%	LIBOR (a)	(540,885)	(530,233)	pay fixed
Deutsche Bank	3,600,000	3.5000%	LIBOR (a)	(173,158)	-	pay fixed
Deutsche Bank	4,300,000	4.3500%	LIBOR (a)	(516,216)	-	pay fixed
Goldman Sachs & Company	2,400,000	4.4575%	LIBOR (a)	(348,067)	-	pay fixed
Goldman Sachs Bank	6,300,000	2.4875%	LIBOR (a)	(157,955)	-	pay fixed
Goldman Sachs Bank	13,500,000	1.2275%	LIBOR (a)	(92,197)	-	pay fixed
Goldman Sachs Bank	2,700,000	3.8813%	LIBOR (a)	(230,873)	-	pay fixed
Goldman Sachs Bank	3,000,000	3.9450%	LIBOR (a)	(273,201)	-	pay fixed
Bank of America	1,800,000	5.0000%	LIBOR (a)	(364,452)	-	pay fixed
Bank of America	800,000	5.0000%	LIBOR (a)	(161,979)	-	pay fixed
Bank of America	12,000,000	5.0000%	LIBOR (a)	(2,429,681)	-	pay fixed
Bank of America	13,000,000	5.0000%	LIBOR (a)	(2,632,154)	-	pay fixed
Bank of America	6,700,000	5.0000%	LIBOR (a)	(1,356,572)	-	pay fixed
Bank of America	1,200,000	5.0000%	LIBOR (a)	(242,968)	-	pay fixed
Bank of America	2,100,000	5.0000%	LIBOR (a)	(425,194)	-	pay fixed
Barclays Capital Securities	10,100,000	5.0000%	LIBOR (a)	(2,044,981)	(1,071,673)	pay fixed
Barclays Capital Securities	300,000	5.0000%	LIBOR (a)	(60,742)	-	pay fixed
Goldman Sachs Bank	2,700,000	4.0000%	LIBOR (a)	(242,183)	-	pay fixed
Morgan Stanley Capital Services	5,100,000	4.0000%	LIBOR (a)	(457,457)	-	pay fixed
Royal Bank of Scotland	7,600,000	4.0000%	LIBOR (a)	(670,249)	-	pay fixed
Royal Bank of Scotland	3,200,000	4.0000%	LIBOR (a)	(287,032)	-	pay fixed
Royal Bank of Scotland	18,300,000	4.0000%	LIBOR (a)	(1,641,462)	-	pay fixed
Credit Suisse International	5,100,000	LIBOR (a)	2.5700%	157,579	-	receive fixed
Deutsche Bank	10,300,000	LIBOR (a)	3.7530%	731,897	-	receive fixed
Deutsche Bank	3,000,000	LIBOR (a)	3.6690%	183,387	-	receive fixed
Deutsche Bank	12,300,000	LIBOR (a)	3.7530%	874,022	-	receive fixed
Deutsche Bank	6,300,000	LIBOR (a)	2.5031%	148,841	-	receive fixed
Deutsche Bank	12,300,000	LIBOR (a)	1.3650%	119,140	-	receive fixed
Deutsche Bank	1,300,000	LIBOR (a)	3.6730%	79,798	-	receive fixed
Deutsche Bank	2,800,000	LIBOR (a)	3.9350%	281,132	-	receive fixed
Deutsche Bank	3,600,000	LIBOR (a)	2.0000%	105,762	-	receive fixed
Deutsche Bank	9,100,000	LIBOR (a)	3.7530%	646,634	-	receive fixed
Deutsche Bank	8,300,000	LIBOR (a)	2.3450%	122,907	-	receive fixed
Goldman Sachs & Company	12,400,000	LIBOR (a)	5.1580%	289,168	746,319	receive fixed
Goldman Sachs & Company	5,900,000	LIBOR (a)	3.7775%	447,202	294,121	receive fixed
Goldman Sachs & Company	15,600,000	LIBOR (a)	2.3300%	219,773	-	receive fixed
Goldman Sachs & Company	14,500,000	LIBOR (a)	3.5975%	1,100,043	762,802	receive fixed
Goldman Sachs Bank	9,800,000	LIBOR (a)	1.1563%	49,674	-	receive fixed
Goldman Sachs Bank	2,400,000	LIBOR (a)	3.5100%	132,953	-	receive fixed
Goldman Sachs Bank	2,700,000	LIBOR (a)	2.7925%	143,291	-	receive fixed
Bank of America	4,800,000	LIBOR (a)	3.0000%	148,540	-	receive fixed
Barclays Capital Securities	2,600,000	CDI (b)	12.2850%	22,300	-	receive fixed
Barclays Capital Securities	600,000	CDI (b)	10.8350%	1,147	-	receive fixed
Barclays Capital Securities	8,000,000	TIIE (e)	7.3400%	24,134	-	receive fixed
Barclays Capital Securities	1,300,000	LIBOR (a)	3.0000%	40,230	-	receive fixed
Barclays Capital Securities	400,000	LIBOR (a)	4.0000%	37,900	-	receive fixed
Barclays Capital Securities	2,600,000	LIBOR (a)	3.0000%	80,459	-	receive fixed
Barclays Capital Securities	2,000,000	LIBOR (a)	2.1000%	66,829	-	receive fixed
Barclays Capital Securities	3,000,000	CDI (b)	12.5400%	106,905	-	receive fixed
Barclays Capital Securities	1,000,000	LIBOR (a)	2.0900%	32,585	-	receive fixed

Counterparty	Notional Amount	SURS Rate	Counterparty Rate	Fair Value 2010	Fair Value 2009	Pay Fixed / Receive Fixed
Barclays Capital Securities	\$ 3,900,000	LIBOR (a)	3.0000%	\$ 130,317	\$ -	receive fixed
BNP	1,400,000	CDI (b)	11.8800%	2,107	-	receive fixed
Citibank N.A.	27,000,000	TIIE (e)	7.3300%	80,576	-	receive fixed
Citibank N.A.	1,300,000	LIBOR (a)	3.0000%	40,230	-	receive fixed
Citibank N.A.	300,000	LIBOR (a)	4.0000%	28,425	-	receive fixed
Credit Suisse First Boston	7,800,000	CDI (b)	12.4800%	45,884	-	receive fixed
Credit Suisse International	1,100,000	LIBOR (a)	3.0000%	34,040	-	receive fixed
Credit Suisse	200,000	CDI (b)	11.7600%	1,039	-	receive fixed
Deutsche Bank	3,500,000	LIBOR (a)	4.0000%	243,874	-	receive fixed
Deutsche Bank	700,000	LIBOR (a)	4.0000%	48,775	-	receive fixed
Deutsche Bank	24,800,000	BB (d)	4.5000%	(70,218)	(81,794)	receive fixed
Deutsche Bank	1,300,000	LIBOR (a)	3.0000%	40,230	-	receive fixed
Goldman Sachs & Company	1,400,000	CDI (b)	11.6700%	20,800	-	receive fixed
Goldman Sachs & Company	2,200,000	CDI (b)	11.9300%	5,078	-	receive fixed
Goldman Sachs Bank	5,600,000	CDI (b)	11.8900%	11,544	-	receive fixed
Goldman Sachs Bank	3,000,000	CDI (b)	12.6500%	50,591	-	receive fixed
Goldman Sachs Bank	600,000	CDI (b)	10.9900%	954	-	receive fixed
HSBC Bank	300,000	CDI (b)	14.7650%	23,436	11,304	receive fixed
HSBC Bank	1,500,000	CDI (b)	11.8900%	3,092	-	receive fixed
HSBC Bank	6,900,000	CDI (b)	11.3600%	32,818	-	receive fixed
HSBC Bank	1,200,000	CDI (b)	11.6700%	17,829	-	receive fixed
HSBC Bank	200,000	CDI (b)	11.1400%	1,282	-	receive fixed
HSBC Bank	2,800,000	CDI (b)	11.8900%	5,772	-	receive fixed
HSBC Bank	1,800,000	CDI (b)	11.3600%	8,561	-	receive fixed
HSBC Bank	1,200,000	CDI (b)	11.1400%	7,691	-	receive fixed
HSBC Bank	1,000,000	CDI (b)	11.8800%	226	-	receive fixed
HSBC Bank	700,000	CDI (b)	12.3000%	6,275	-	receive fixed
JP Morgan Chase Bank/HSBCSI	500,000	CDI (b)	12.1700%	3,342	-	receive fixed
JP Morgan Chase Bank/HSBCSI	2,900,000	CDI (b)	12.1700%	19,381	-	receive fixed
JP Morgan Chase Bank/HSBCSI	23,000,000	TIIE (e)	7.3300%	68,639	-	receive fixed
JP Morgan Chase Bank/HSBCSI	700,000	LIBOR (a)	3.0000%	21,662	-	receive fixed
JP Morgan Chase Bank/HSBCSI	37,700,000	CDI (b)	11.5700%	184,917	-	receive fixed
JP Morgan Chase Bank/HSBCSI	11,600,000	CBK (c)	5.8000%	147,667	(43,925)	receive fixed
JP Morgan Chase Bank/HSBCSI	4,000,000	CBK (c)	5.8000%	50,919	-	receive fixed
JP Morgan Chase Bank/HSBCSI	5,500,000	CBK (c)	5.8000%	70,014	-	receive fixed
Merrill Lynch Capital Services	8,300,000	CDI (b)	11.9000%	10,408	-	receive fixed
Merrill Lynch Capital Services	2,200,000	CBK (c)	5.8000%	28,006	-	receive fixed
Merrill Lynch International	1,200,000	CDI (b)	10.9900%	1,908	-	receive fixed
Merrill Lynch Pierce Fenner & Smith	5,300,000	CDI (b)	11.9800%	119,580	-	receive fixed
Merrill Lynch Pierce Fenner & Smith	1,000,000	CDI (b)	14.7650%	78,119	37,681	receive fixed
Morgan Stanley Capital Services	1,400,000	CDI (b)	11.9800%	4,460	-	receive fixed
Morgan Stanley Capital Services	7,400,000	CDI (b)	11.6000%	101,524	-	receive fixed
Morgan Stanley Capital Services	4,200,000	CDI (b)	12.5900%	31,151	-	receive fixed
Morgan Stanley Capital Services	3,000,000	CDI (b)	12.5100%	41,673	-	receive fixed
Morgan Stanley Capital Services	1,100,000	CDI (b)	11.6300%	(5,029)	-	receive fixed
Morgan Stanley Capital Services	10,500,000	LIBOR (a)	2.0000%	152,767	-	receive fixed
Morgan Stanley Capital Services	500,000	LIBOR (a)	4.0000%	47,161	-	receive fixed
Morgan Stanley Capital Services	700,000	LIBOR (a)	3.0000%	21,662	-	receive fixed
Morgan Stanley Capital Services	1,300,000	CDI (b)	11.9800%	4,141	-	receive fixed
Morgan Stanley Capital Services	8,000,000	LIBOR (a)	3.0000%	247,567	-	receive fixed
Royal Bank of Canada	9,400,000	CBK (c)	5.8000%	119,661	(75,072)	receive fixed
Royal Bank of Canada	3,000,000	CDI (b)	12.1800%	20,501	-	receive fixed
Royal Bank of Scotland	1,800,000	LIBOR (a)	4.0000%	125,421	-	receive fixed
Royal Bank of Scotland	600,000	LIBOR (a)	4.0000%	41,807	-	receive fixed
Royal Bank of Scotland	1,300,000	CDI (b)	12.0800%	3,386	-	receive fixed

Counterparty	Notional Amount	SURS Rate	Counterparty Rate	Fair Value 2010	Fair Value 2009	Pay Fixed / Receive Fixed
Royal Bank of Scotland	\$ 400,000	LIBOR (a)	4.0000%	\$ 37,027	\$ 89,158	receive fixed
Royal Bank of Scotland	400,000	LIBOR (a)	4.0000%	37,729	-	receive fixed
Royal Bank of Scotland	12,900,000	LIBOR (a)	3.0000%	399,202	-	receive fixed
Royal Bank of Scotland	1,400,000	LIBOR (a)	4.0000%	132,650	-	receive fixed
Royal Bank of Scotland	100,000	LIBOR (a)	4.0000%	9,475	-	receive fixed
Royal Bank of Scotland	2,400,000	CBK (c)	5.8000%	30,552	-	receive fixed
UBS AG	3,100,000	CDI (b)	12.5400%	110,469	-	receive fixed
UBS AG	6,200,000	CDI (b)	10.5750%	(119,893)	-	receive fixed
UBS/Warburg Securities	1,500,000	CDI (b)	12.0700%	7,435	-	receive fixed
Total interest rate swaps	\$ 625,100,000	-	-	\$ (9,796,116)	\$ (1,196,227)	-

(a) Three month London Interbank Offered Rate (LIBOR)

(b) Cetip Interbank Deposit (CDI)

(c) Three month Canadian Offered Dealer Rate (CBK)

(d) Three month Bank Bill Swap Rate (BB)

(e) Three month Tasa de Interes Interbancaria de Equilibrio (TIIE)

Derivatives which are exchange traded are not subject to credit risk. No derivatives held are subject to custodial credit risk. The maximum loss that would be recognized at June 30, 2010, if all counterparties fail to perform as contracted is \$36,760,324. This maximum exposure is reduced by \$46,412,371 in collateral held and \$97,436,762 of liabilities, resulting in no net exposure to credit risk. At June 30, 2010, the counterparties' credit ratings for currency forwards, swaptions and swaps subject to credit risk are as follows:

Quality Rating: Standard & Poor's	Forwards*	Swaptions	Swaps	Total
AA	\$ -	\$ (596,532)	\$ 153,882	\$ (442,650)
AA-	1,889,112	-	393,343	2,282,455
A+	4,105,449	(2,850,582)	(55,577,335)	(54,322,468)
A	895,370	(544,694)	(8,544,451)	(8,193,775)
Total subject to credit risk	\$ 6,889,931	\$(3,991,808)	\$(163,574,561)	\$ (60,676,438)

* Spot currency contracts settle within two days, are equivalent assets that have no counterparty credit ratings, and are not included with forwards on the Quality Ratings table.

Notes to the Financial Statements

Securities Lending

The SURS Board of Trustees policies permit the System to lend its securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. Credit Suisse AG, New York Branch, the System's third party agent lender, lends securities in exchange for cash collateral at 102% for U.S. securities and 105% for international securities. Cash collateral is shown on the System's financial statements. Securities lent are included in the Statement of Plan Net Assets. At year end, the System had no credit risk as a result of its securities lending program as the collateral received exceeded the fair value of the securities loaned. The contract with the System's third party agent lender requires it to indemnify the System if the borrowers fail to return the securities (and if the collateral is inadequate to replace the securities lent) or fail to pay the System for income distributions by the securities' issuers while the securities are out on loan.

All securities loans can be terminated on demand by either the System or the borrower, although the average term of the loans is 1.08 days. Cash collateral is invested in the System's short-term investment pool, which at year end has a weighted average final maturity of 136 days and a weighted average reset of 27.48 days, and with a fair value of \$1,940.7 million.

Collateral as of June 30, 2010 (\$ millions)

Fair value of cash collateral invested	\$ 1,940.7
Fair value of collateral received	\$ 1,935.3
Change in fair value*	\$ 5.4

*Included in net appreciation in fair value of investments in Statement of Changes in Plan Net Assets.

Notes to the Financial Statements

Self-Managed Plan

The SMP participants have the ability to invest their account balances in 51 mutual and variable annuity funds. These funds are offered by two providers: Fidelity Investments and Teachers Insurance and Annuity Association-College Retirement Equities Fund (TIAA-CREF). As of June 30, 2010, the SMP had investments of \$716,730,589. A detailed schedule (unaudited) of the funds and balances at June 30, 2010 is located in the Investment Section of The Comprehensive Annual Financial Report.

IV. Capital Assets

Capital assets activity for the year ended June 30, 2010 was as follows:

	Beginning Balance	Additions	Disposals	Ending Balance
Land	\$ 531,834	\$ -	\$ -	\$ 531,834
Office building	6,362,571	534,219	-	6,896,790
Information system equipment & software	14,336,578	263,205	11,327	14,588,456
Furniture and fixtures	2,121,368	-	-	2,121,368
	<u>23,352,351</u>	<u>797,424</u>	<u>11,327</u>	<u>24,138,448</u>
Less accumulated depreciation:				
Office building	2,016,290	126,000	-	2,142,290
Information system equipment and software	12,834,588	736,171	11,327	13,559,432
Furniture and fixtures	1,917,810	110,003	-	2,027,813
	<u>16,768,688</u>	<u>972,174</u>	<u>11,327</u>	<u>17,729,535</u>
	<u>\$ 6,583,663</u>	<u>\$ (174,750)</u>	<u>\$ -</u>	<u>\$ 6,408,913</u>

The average estimated useful lives for depreciable capital assets are as follows:

Office building	40 years	Information systems equipment	3 years
Information systems software	10 years	Furniture and fixtures	3 years

V. Compensated Absences

The System is obligated to pay employees at termination for unused vacation and sick time. The maximum time for which any individual may be paid is 448 hours of vacation and one-half of unused sick time earned between January 1, 1984 and December 31, 1997. No sick time earned after December 31, 1997 will be compensable at termination. At June 30, 2010, the System had a liability of \$1,099,057 for compensated absences, based upon the vesting method used for calculation of sick leave payable. The liability is included in the administrative expenses payable on the Statement of Plan Net Assets, and the annual increase or decrease in liability is reflected in the financial statements as an increase or decrease in salary expense.

Compensated absences payable for the year ended June 30, 2010 was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Estimate Amount Due Within One Year
Compensated absences payable	<u>\$ 1,084,979</u>	<u>\$ 71,304</u>	<u>\$ 57,226</u>	<u>\$ 1,099,057</u>	<u>\$ 115,000</u>

Notes to the Financial Statements

VI. Insurance Coverage

The System is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The System has minimized the risk of loss through private insurance carriers for commercial, business owners, and automobile policies. The deductible for this insurance coverage ranges from \$250 to \$500 per occurrence. There has been no significant reduction of insurance coverage from the prior year. The System has not had any insurance claims filed or paid in the past five fiscal years.

VII. Post-Employment Benefits

The State provides health, dental, vision, and life insurance benefits for retirees and their dependents in a program administered by the Department of Healthcare and Family Services along with the Department of Central Management Services. Substantially all State employees become eligible for post-employment benefits if they eventually become annuitants of one of the State sponsored pension plans. Health, dental, and vision benefits include basic benefits for annuitants and dependents under the State's self-insurance plan and insurance contracts currently in force. Annuitants may be required to contribute toward health, dental, and vision benefits with the amount based on factors such as date of retirement, years of credited service with the State, whether the annuitant is covered by Medicare, and whether the annuitant has chosen a managed health care plan. Annuitants who retired prior to January 1, 1998, and who are vested in the State Universities Retirement System do not contribute toward health, dental, and vision benefits. For annuitants who retired on or after January 1, 1998, the annuitant's contribution amount is reduced five percent for each year of credited service with the State; therefore, those annuitants with twenty or more years of credited service do not have to contribute toward health, dental, and vision benefits. Annuitants also receive life insurance coverage equal to the annual salary of the last day of employment until age 60, at which time the benefit becomes \$5,000.

The State pays the State Universities Retirement System's portion of employer costs for the benefits provided. The total cost of the State's portion of health, dental, vision, and life insurance benefits of all members, including post-employment health, dental, vision, and life insurance benefits, is recognized as an expenditure by the State in the Illinois Comprehensive Annual Financial Report. The State finances the costs on a pay-as-you-go basis. The total costs incurred for health, dental, vision, and life insurance benefits are not separated by department or component unit for annuitants and their dependents nor active employees and their dependents.

A summary of post-employment benefit provisions, changes in benefit provisions, employee eligibility requirements including eligibility for vesting, and the authority under which benefit provisions are established are included as an integral part of the financial statements of the Department of Healthcare and Family Services. A copy of the financial statements of the Department of Healthcare and Family Services may be obtained by writing to the Department of Healthcare and Family Services, 201 South Grand Ave., Springfield, Illinois, 62763.

VIII. Subsequent Event

On April 14, 2010, Governor Quinn signed Senate Bill 1946 (now Public Act 96-0889) into law. The resulting changes to the Illinois Pension Code made no change to pension benefits for current employees or annuitants, who would be considered Tier 1 members. Any member who elects the self-managed plan is Tier 1, regardless of their date of first employment. Code changes modify SURS benefits for new employees electing to participate in the defined benefit plan on or after January 1, 2011 only, who would be considered Tier 2 members. SURS, in conjunction with other Illinois Reciprocal Retirement Systems, continues to analyze this legislation to ensure consistent interpretation.

SURS has evaluated subsequent events for potential recognition and/or disclosure through December 13, 2010, the date the financial statements were available to be issued.

Required Supplementary Information

Defined Benefit Plan

Schedule of Funding Progress (\$ millions)

Fiscal Year**	Actuarial Value of Assets (A)	Accrued Actuarial Liabilities	Unfunded Accrued Actuarial Liabilities	Funding Ratio	Payroll	UAAL as % of Payroll
2001	\$10,753.3	\$ 14,915.3	\$ 4,162.0	72.1%	\$ 2,474.6	168.2%
2002	9,814.7	16,654.0	6,839.3	58.9%	2,607.2	262.3%
2003	9,714.5	18,025.0	8,310.5	53.9%	2,763.4	300.7%
2004	12,586.3	19,078.6	6,492.3	66.0%	2,814.1	230.7%
2005	13,350.3	20,349.9	6,999.6	65.6%	2,939.1	238.1%
2006	14,175.1	21,688.9	7,513.8	65.4%	3,054.1	246.0%
2007	15,985.7	23,362.1	7,376.4	68.4%	3,181.0	231.9%
2008	14,586.3	24,917.7	10,331.4	58.5%	3,303.2	312.8%
2009	14,282.0	26,316.2	12,034.2	54.3%	3,463.9	347.4%
2010	13,966.6	30,120.4	16,153.8	46.4%	3,491.1	462.7%

(A) Per public Act 96-0043, beginning fiscal year 2009, measures of financial soundness will be calculated using an actuarial value of assets based on a smoothed investment income rate. Investment income in excess or shortfall of the expected 8.5% rate on fair value is smoothed over a five-year period with 20% of a year's excess or shortfall being recognized each year beginning with the current year.

Schedule of Employer Contributions (\$ millions)

Fiscal** Year	Total ARC*	Member Contributions	Net ER/State ARC	Actual ER/State Contribution	State Contributions as % of Net ARC	Total Contributions as % of Total ARC
2001	\$ 548.1	\$ 221.6	\$ 326.5	\$ 247.1	75.7%	85.5%
2002	686.9	250.0	436.9	256.1	58.6%	73.7%
2003	843.8	246.3	597.5	285.3	47.7%	63.0%
2004	934.8	243.8	691.0	1,757.5	254.4%	214.1%
2005	859.7	251.9	607.8	285.4	47.0%	62.5%
2006	914.9	252.9	662.0	180.0	27.2%	47.3%
2007	968.3	262.4	705.9	261.1	37.0%	54.1%
2008	971.6	264.1	707.5	344.9	48.8%	62.7%
2009	1,147.3	273.3	874.0	451.6	51.7%	63.2%
2010	1,278.3	275.0	1,003.3	696.6	69.4%	76.0%

*Annual Required Contribution as defined in GASB Statement No. 25, "Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans."

** The source of these schedules is the annual actuarial valuation which is performed as of June 30 for each fiscal year listed.

Supporting Schedules

Defined Benefit Plan Summary Schedule of Administrative Expenses For the Years Ended June 30, 2010 and 2009

	2010	2009
Personnel services		
Salary and wages	\$ 6,343,007	\$ 6,267,121
Retirement contributions	598,565	607,784
Insurance and payroll taxes	1,573,896	1,570,313
	<u>8,515,468</u>	<u>8,445,218</u>
Professional Services		
Computer services	527,460	547,346
Medical consultation	17,706	23,484
Technical and actuarial	477,612	517,885
Legal services	324,778	483,615
	<u>1,347,556</u>	<u>1,572,330</u>
Communications		
Postage	260,939	416,877
Printing and copying	84,785	122,000
Telephone	94,599	88,921
	<u>440,323</u>	<u>627,798</u>
Other Services		
Equipment repairs, rental and maintenance	76,788	71,760
Building operations and maintenance	228,966	284,790
Surety bonds and insurance	203,873	396,654
Memberships and subscriptions	37,532	47,006
Transportation and travel	147,142	127,768
Education	30,804	18,138
Supplies	107,580	89,834
	<u>832,685</u>	<u>1,035,950</u>
Depreciation and amortization	<u>972,149</u>	<u>877,550</u>
Total administrative expenses - DB Plan	<u>\$ 12,108,181</u>	<u>\$ 12,558,846</u>
Self Managed Plan		
Salary and wages	229,824	240,178
Retirement contributions	21,904	23,538
Insurance and payroll taxes	55,705	56,120
Technical and actuarial	8,000	8,000
Postage	20,564	20,869
Transportation and travel	2,438	1,634
Printing	8,968	12,885
	<u>347,403</u>	<u>363,224</u>
Total administrative expenses - SMP	<u>\$ 347,403</u>	<u>\$ 363,224</u>
Total administrative expenses	<u>\$ 12,455,584</u>	<u>\$ 12,922,070</u>

Supporting Schedules

Defined Benefit Plan

Summary Schedule of Consultant Payments

For the Years Ended June 30, 2010 and 2009

	2010	2009
Defined benefit plan		
Technical and actuarial services:		
Berwyn Group	\$ 4,025	\$ 3,951
Careerbuilders	-	1,400
Centurion	869	33,000
Corley Photography	865	-
Economic Research	4,989	4,578
EFL Associates	80,283	78,392
Alice Faron	-	790
Gabriel, Roeder, Smith & Co.	147,161	166,189
GII of Illinois	19,500	15,000
Governmental Consulting Solutions	36,000	36,000
ICS/Merrill	920	9,394
INFRE	900	1,937
JP Morgan Chase	-	106
McLagan	2,500	2,500
Meador Investigations	1,745	1,915
Miscellaneous	1,140	3,642
Morrill and Associates	48,000	48,000
Open position advertising	4,918	3,613
Recruitment/Relocation	15,893	-
Reed Group	1,185	1,470
Smith Investigations	225	-
SUAA	-	2,043
The Northern Trust	86,150	85,959
University of Illinois	4,500	1,100
Woolard Marketing Consultants	15,844	16,906
	<u>477,612</u>	<u>517,885</u>
Legal services		
Areawide Reporting Services	3,195	1,521
Burke, Burns & Pinelli	151,998	72,746
Investors Responsibility Support Services	25,000	25,000
Mayer Brown LLP	99,141	331,852
Thomas, Mamer & Haughey	22,331	36,936
Winters, Featherstun, et al	23,113	15,560
	<u>324,778</u>	<u>483,615</u>
Self-managed plan		
Technical and actuarial services:		
Ennis, Knupp Investment Consulting	8,000	8,000
	<u>8,000</u>	<u>8,000</u>
Total consultant payments	<u>\$ 810,390</u>	<u>\$ 1,009,500</u>

Supporting Schedules

Defined Benefit Plan

Summary Schedule of Investment Fees, Commissions, and Administrative Expenses

For the Years Ended June 30, 2010 and 2009

	2010	2009
Master trustee & custodian		
The Northern Trust Company	\$ 1,058,006	\$ 996,475
Investment manager		
Aberdeen Asset Management	1,238,663	742,318
Adams Street Partners	4,479,557	3,773,464
Alinda Capital Partners	1,385,616	-
Angelo Gordon GECC	803,056	-
Ariel Capital Management	-	24,802
Barclays Global Investors	387,638	2,442,227
BlackRock Financial Management	4,192,526	732,796
Calamos Advisors	729,877	431,923
Capital Guardian Trust Company	488,562	1,025,284
Dune Capital Management	1,309,574	-
GlobeFlex Capital, L.P.	243,182	226,671
ING Clarion Real Estate Securities	929,511	755,899
Jacobs Levy Equity Management	771,844	579,368
Longfellow Investment Management	12,526	-
Macquarie Capital	1,351,788	-
Manager Development Program	1,619,015	874,703
Martin Currie, Inc.	1,520,079	1,343,404
Metropolitan West Asset Management	1,180,690	205,254
Mondrian Investment Partners	480,394	507,530
Muller and Monroe	405,806	625,000
New Century Advisors	28,648	-
Northern Trust Investments	152,702	133,215
Oaktree Capital Management	2,149	-
Pacific Investment Management Company	14,708,190	2,298,995
Pantheon Ventures	2,575,329	2,798,834
Paradigm Asset Management	58,268	62,088
Payden & Rygel	628,276	451,353
Piedmont Investment Advisors	114,496	169,737
Progress Investment Management Company	1,279,161	753,556
Pyramis Global Advisors Trust Company	344,946	628,798
RhumbLine Advisers	162,732	156,885
RLJ Western Asset Management	162,971	-
RREEF	1,676,528	1,936,953
T. Rowe Price	1,687,422	825,286
Taplin, Canida & Habacht	65,511	58,888
UBS Realty Investors	1,193,020	1,181,688
Wellington Management Company	800,604	820,528
Western Asset Management	1,508,041	408,225
	<u>50,678,898</u>	<u>26,975,672</u>
Investment consultant, measurement & counsel		
EnnisKnupp + Associates, Inc.	383,500	343,668
Mayer, Brown, Rowe & Maw	248,751	135,549
Bryan Cave	25,000	-
	<u>657,251</u>	<u>479,217</u>
Investment administrative expenses		
Personnel	903,288	774,149
Resources, board and travel	131,688	107,894
Performance measurement and database	95,350	97,550
	<u>1,130,326</u>	<u>979,593</u>
Total investment expenses	<u>\$ 53,524,481</u>	<u>\$ 29,430,957</u>

Supporting Schedules

Defined Benefit Plan Summary Schedule of Cash Receipts and Disbursements For the Year Ended June 30, 2010 (\$ millions)

Beginning cash and short-term investments balance	\$ 543.7
Receipts	
Member contributions	\$ 275.8
Employer contributions	695.8
Investment income (loss)	1,693.7
Investments redeemed	65,121.4
Total receipts	<u>\$ 67,786.7</u>
Disbursements	
Benefit payments	\$ 1,474.9
Administrative expenses	12.2
Investment expenses	51.1
Fixed asset purchases	.8
Refunds	46.4
SMP balance transfers	.9
Investments purchased	65,985.7
Total disbursements	<u>\$ 67,572.0</u>
Ending cash and short-term investments balance	<u>\$ 758.4</u>



Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With Government Auditing Standards

Honorable William G. Holland
Auditor General, State of Illinois
Springfield, Illinois

Board of Trustees
State Universities Retirement System
Springfield, Illinois

As Special Assistant Auditors for the Auditor General, we have audited the Statement of Plan Net Assets and Statement of Changes in Plan Net Assets of the State Universities Retirement System of Illinois (System), as of and for the year ended June 30, 2010, and have issued our report thereon dated December 13, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the System's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, and not for the purpose of expressing an opinion on the effectiveness of the System's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the System's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the System's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in the internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the System's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Auditor General, the General Assembly, the Legislative Audit Commission, the Governor, System management, and Board of Trustees, and is not intended to be and should not be used by anyone other than these specified parties.

McGladrey & Pullen, LLP

Schaumburg, Illinois
December 13, 2010

Prior Findings Not Repeated

A. Member Earnings and Contributions

The State Universities Retirement System (System) needed to implement sufficient accounting and reporting processes for verifying the accuracy and completeness of individual member's earnings and contributions. The prior year finding will not be repeated due to the System taking corrective action and the results of current year testing which disclosed no exceptions related to member earnings and contributions. (Finding Code No. 09-1)

B. Valuation of Securities Lending Collateral

The System needed to change the financial reporting process to properly record the securities lending collateral and obligation amounts at fair market value. The prior year finding will not be repeated due to the System taking corrective action by properly recording the aforementioned items at fair market value and the results of the current year investment testing which disclosed no exceptions. (Finding Code No. 09-2)