

Public Act 95-616 (“Iran Act”)

Annual Report

January 1, 2011

Illinois State Board of Investment

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Introduction

On January 1, 2008, Public Act 95-616 (the “Act”) took effect. The Act imposes investment restrictions on retirement systems governed by Article 1 of the Illinois Pension Code. Specifically, new Section 5/1-110.10 of the Illinois Pension Code limits the investment of retirement system assets in certain companies with ties to the Government of Iran and its oil-related and mineral-extraction business sectors.

With respect to actions taken in compliance with the Act, including good faith determinations regarding companies as prescribed by the Act, the Illinois State Board of Investment (the “Board”) is exempt from any conflicting statutory or common law obligations, including any fiduciary duties under Article 1 and any obligations with respect to choice of asset managers, investment funds, or investments for the Board’s securities portfolios. (40 ILCS 5/1-110.10(j)). The Board has developed the Iran Divestment Policy to serve as a guide for implementation of the Act’s specific requirements. This Policy is attached as Exhibit A.

In accordance with the Act, the Board is required to file this annual report with the Public Pension Division, which shall be made available to the public and includes the following:

1. A list of scrutinized companies that have active business operations in Iran.
2. A summary of correspondence between the Board and scrutinized companies.
3. A summary of all investments sold, redeemed, divested, or withdrawn as a result of scrutinized companies continuing to have scrutinized active business operations.
4. A summary of correspondence with private market funds with scrutinized active business operations.

The Board's Scrutinized Companies Identification Methodology

The Board took the following actions to identify all scrutinized companies:

1. Following the Act's passage, Staff contacted the Florida State Board of Administration ("FSBA") to assess how the FSBA responded to the Protecting Florida's Investments Act, an act that restricts the FSBA's investments in scrutinized companies with ties to Sudan and Iran, and reviewed the FSBA's quarterly report, which includes a list of scrutinized companies and details the methodology for FSBA's compliance with the Florida Act.
2. Staff contacted other Illinois state public funds to exchange ideas and receive feedback regarding compilation of the list of scrutinized companies.
3. Staff contacted the American Israel Public Affairs Committee ("AIPAC") to obtain AIPAC's list of companies investing in Iran's energy sector and to discuss the methodology associated with compiling the list of scrutinized companies.
4. Staff contacted Risk Metrics Group ("RMG"), Conflict Securities Advisory Group and Corporate Library, all independent research firms, to request detailed information regarding how the firms could (i) identify scrutinized companies (by tracking the definition of scrutinized company in the Act) and (ii) identify which scrutinized companies have active or inactive business operations. RMG and Conflict Securities Advisory Group submitted proposals to provide the list of scrutinized companies.
5. After evaluation of all resources, the Board chose to retain RMG to provide the list of scrutinized companies.
6. At its July 2009 Board Meeting, the Board authorized Staff to issue a request for competitive proposal ("RFP") for proxy voting advisory and related socially responsible investment ("SRI") services. SRI services include providing the Board with its list of scrutinized companies. Staff carefully reviewed the proposals for content, quality and compliance with proposal document requirements. On December 18, 2009, the Board approved to maintain RMG for proxy voting advisory and related SRI services. RMG's experience and expertise satisfied the scope of work requirements outlined in the RFP and the firm's fee proposal was the most cost effective in relation to the services being provided.
7. On June 1, 2010, RMG was acquired by MSCI Inc. ("MSCI"), a leading global provider of investment decision support tools, including indices and portfolio risk and performance analytics. Staff currently relies upon MSCI for all SRI related issues and services.

On July 11, 2008, the Board adopted an official list of scrutinized companies in accordance with the Act and the Board's Iran Divestment Policy. In accordance with the Act, the Board has continued to review the list on an annual basis. At its meeting on September 24, 2010,

the Board adopted the list set forth in Table 1. Prior to adoption by the Board, the list was revised by RMG/MSCI and includes the deletion of ten companies: Bow Valley, ITOCHU Corporation, KunLun Energy Company Limited, Lukoil, Lundin Petroleum, MITSUI & Co., Ltd., Samsung, Schlumberger N.V., Total S.A., and The Weir Group PLC. The rationale behind each deletion is set forth below:

Deleted Companies:

- Bow Valley- The company is no longer involved with Iran; in 2008, the company's board of directors passed a resolution in which it renounced its previous investments in Iran.
- ITOCHE Corporation- With regards to its investment in Iran, the company no longer reaches the \$10 million threshold established by the Act.
- KunLun Energy Company Limited- The company has not been removed from the list; instead, in February 2010, the company announced its name change to KunLun. The addition of KunLun is reflected later in this report.
- Lukoil- As of June 2010, the company has withdrawn from both direct investment (equity ties) and trade (non-equity ties) with Iran. According to the company, this has been a result of international pressure and the company's increasing exposure in the United States market.
- Lundin Petroleum- The company is no longer involved with Iran.
- MITSUI & Co., Ltd.-Although the company is involved in Iran through a local office in Tehran, the company is no longer involved in the provision of petroleum-related goods or services to Iran and does not plan on expanding its operations in Iran.
- Samsung- The company is no longer present in Iran.
- Schlumberger N.V.- The company's revenues/assets from Iran and its overall investment in the country do not reach the thresholds established by the Act.
- Total S.A.- The company halted its oil supplies to Iran and there is no evidence that the company has a corporate office in Iran.
- The Weir Group- The company no longer has offices in Iran.

Pursuant to research conducted by RMG/MSCI, the list includes the addition of eight companies: Edison Spa, GS Engineering & Construction Corporation,GS Holdings, Hyundai Heavy Industries Co., Ltd., KunLun, Midciti Resources Sdn Bhd , OMV Aktiengesellschaft, and Sinopec.

Table 1: The Board's List of Scrutinized Companies (Prohibited Investments)

Liquefied Natural Gas Ltd
L'Air Liquide SA
Saipem S.p.A.
OMV Aktiengesellschaft
Sasol Limited
Costain Group PLC
Hyundai Heavy Industries Co., Ltd.
Royal Dutch Shell Plc
GS Engineering & Construction Corporation
OAO "Gazprom neft' "
Sinopec Kantons Holdings Ltd.
Aker Solutions ASA
KunLun Energy Company Limited
China Petroleum & Chemical Corporation
DAELIM INDUSTRIAL CO.,LTD.
ENI SpA
Edison SpA
OAO "Gazprom"
Indian Oil Corporation Ltd.
JGC CORPORATION
INPEX CORPORATION
MISC Berhad
Mitsui Engineering & Shipbuilding Co.,Ltd.
Oil and Natural Gas Corporation Limited
PetroChina Company Limited
Petronas Dagangan Bhd
Petronas Gas Berhad
Repsol YPF
Statoil ASA
Snam Rete Gas S.p.A.
Technip
Midciti Resources Sdn Bhd
CNOOC Ltd

Summary of Correspondence with Scrutinized Companies

In accordance with Section 1-110.10 of the Act, the Board determined the companies on the scrutinized companies list in which the Board owns direct or indirect holdings.

The Board did not have investments in scrutinized companies with inactive business operations.

On November 8, 2010, the Board, in accordance with the Act, sent a letter to each newly identified scrutinized company identified as having active business operations in Iran. The letter informed the companies of their scrutinized company status and that they may become subject to divestment by the Board. Furthermore, the letter informed the scrutinized companies of the opportunity to clarify their Iran-related activities and encouraged the

scrutinized companies, within 90 days, to cease their scrutinized business operations or convert such operations to inactive business operations in order to avoid qualifying for divestment by the Board.

Each company's response and classification status is summarized below. Any company that responded to the Board's written correspondence is highlighted in blue text. The newly identified scrutinized companies have until February 6, 2011 to respond in compliance with the Act. If a response warrants a revision to the list, the Board will adopt a revised list at its regularly scheduled meeting in March and will submit such adopted list to its investment advisers.

Table 2: Summary of Responses from Scrutinized Companies

Company	Response	Status
Edison Spa	No response.	
GS Engineering & Construction Corporation	No response.	
GS Holdings	No response.	
Hyundai Heavy Industries Co., Ltd.	No response.	
KunLun	No response.	
Midciti Resources Sdn Bhd	No response.	
OMV Aktiengesellschaft	Responded on 12/21/10 stating that it has ceased or completed many of its business operations in Iran.	OMV is currently contracted with the National Iranian Oil Company; therefore, it will remain a scrutinized company.
Sinopec	No response.	

Summary of Correspondence with Private Market Funds

With respect to indirect holdings in scrutinized companies, the Board, in accordance with the Act, sent a letter to the managers of the private market funds within the Board's portfolio that contain scrutinized companies with active business operations. This letter, sent on November 8, 2010, requested the manager to either (i) consider removing the scrutinized companies from the fund or (ii) create a similar actively managed fund having indirect holdings devoid of the scrutinized companies. The letter also requested feedback on the Board's request. Letters of this nature were sent to the following private market funds: Entrust Capital ("Entrust"), Madison Dearborn Partners, LLC ("MDCP"), Mesirow Advanced Strategies ("Mesirow") and The Rock Creek Group ("Rock Creek"). In the event that the manager creates a similar fund, the Board shall replace all applicable investments with investments in the similar fund in an expedited timeframe consistent with prudent investing standards.

Each private market fund's response is summarized below.

The separately managed account which Entrust manages on behalf of the Board invests in underlying hedge funds which are commingled investment vehicles; any change to the investments in these commingled vehicles would impact all the investors in such vehicles, not just ISBI. Additionally, the total exposure to the scrutinized companies represents approximately 0.10% of the amount invested through the Board's separately managed account. In light of these two issues, Entrust does intend to either request the underlying managers to remove these scrutinized investments from their portfolios or to create an actively managed account devoid of these investments.

Mesirow advised the Board that it was unable to accommodate either of the aforementioned options. According to Mesirow, the underlying hedge fund managers will not agree to be restricted from having holdings in securities of scrutinized companies; these restrictions would have the effect of limiting the exposure of every other investor in an underlying hedge fund manager's fund.

Rock Creek has investments with four managers that have indirect holdings in scrutinized companies: Adage Capital Management, CMT Capital Corporation, Silchester International Investors Limited, and Wellington Hedge Management. Although no redemption action will be taken at this time, Rock Creek will continue to closely monitor these managers. Rock Creek explained that hedge fund managers actively trade their positions and managers with exposure to a scrutinized company in one period may not have a similar exposure in the next period. At the same time, managers without any exposure to a scrutinized company in one period may very well have such exposure in a subsequent period. According to Rock Creek, the sizes of the Board's individual hedge fund investments are too small to justify separate accounts and as such the Board's investments with these managers are through commingled hedge fund vehicles. Moreover, it would be difficult to get these managers to incorporate suitable guidelines in their commingled funds to exclude investments in scrutinized companies. Rock Creek has agreed to continue to monitor the exposure of underlying managers to scrutinized companies and will reduce allocations at the earliest possible date if the exposure is significant.

MDCP is unable to accommodate either of the aforementioned options.

Summary of Investments Sold, Redeemed, Divested, or Withdrawn

On July 11, 2008, the Board sent letters to all external investment managers notifying them of the Act and informing them of the newly adopted list of scrutinized companies.

Beginning in November 2008, the Board informed all affected managers to sell, redeem, divest, or withdraw all publicly traded securities of active scrutinized companies no later than July 11, 2009. The scrutinized companies affected by this direction failed to convert their active scrutinized business operations to inactive.

Specifically, the Board sent letters to Templeton Investment Counsel (Account # NHEB), Fort Washington (NHFS), State Street Global Advisors- ACWI (NHHJ), State Street Global Advisors- EAFE (NHHI), and Vontobel Asset Management (NHHP), stating that the Board must divest itself of all holdings of any scrutinized companies within 12 months of the companies' original appearance on the prohibited investment list. Therefore, complete

divestitures of scrutinized companies (on the original July 11, 2008 list) must be made no later than July 11, 2009. The letters sent to these affected managers also requested that the managers provide the Board with all specific transaction details, including the date of the transaction, the number of shares, total share value and the amount of gain or loss.

Since July 11, 2008, there has been no increase in holdings of scrutinized companies. External managers are contractually responsible for administering investments in accordance with the investment manager guidelines and restrictions set forth by the Board, including the prohibited investments list of the Act.

As of July 11, 2009, ISBI has incurred a gain of \$239,547.07 due to Iran divestments. The total amount divested since July 11, 2009 was \$2,087,994.77.

The table on the follow page presents a summary of all sales of all Prohibited Investments as identified by the Board on July 11, 2008. This summary covers all activity related to Prohibited Investments as of July 11, 2010.

Table 3: Summary of Sales of all Prohibited Investments

Fund	Manager Name	Security Name	Shares/Par Value	Base Security Gain/Loss Amount
NHEG	GLOBEFLEX CAPITAL STATE STREET	LUNDIN PETROLEUM AB	25,700.00	12,281.87
NHEH	GLOBAL ADVISORS STATE STREET	GS ENGINEERING + CONSTRUCT	4,139.00	80,069.77
NHEB	GLOBAL ADVISORS	ELESEWEDY ELECTRONIC CO	124,479.00	12,191.86
NHEH	LSV ASSET MGMT	AKER SOLUTIONS ASA	96,500.00	135,003.57

Exhibit A

IMPLEMENTATION OF PUBLIC ACT 95-616

IRAN DIVESTMENT POLICY

Public Act 95-616 (Act) imposes investment restrictions on retirement systems governed by Article 1 of the Illinois Pension Code. Specifically, new Section 5/1-110.10 of the Illinois Pension Code limits the investment of retirement system assets in certain companies with ties to the Government of Iran and its oil-related and mineral-extraction business sectors.

With respect to actions taken in compliance with the Act, including good faith determinations regarding companies as prescribed by the Act, the Board is exempt from any conflicting statutory or common law obligations, including any fiduciary duties under Article 1 and any obligations with respect to choice of asset managers, investment funds, or investments for the Board's securities portfolios. (40 ILCS 5/1-110.10(j)).

This Iran Divestment Policy shall serve as a guide for implementation of the Act's specific requirements.

In accordance with the Act, the following actions shall be taken:

I. The Board shall use best efforts to identify all *scrutinized companies* in which it has *direct holdings* or *indirect holdings* by March 30, 2008 (90 days after January 1, 2008, the effective date of the Act). In order to identify the *scrutinized companies*, the Board has discretion to use any of the following efforts: A) reviewing and relying on publicly available information regarding *companies* having *business operations* in Iran, including information provided by nonprofit organizations, research firms, international organizations, and government entities; B) contacting asset managers contracted by the Board that invest in *companies* having *business operations* in Iran; C) contacting other institutional investors that have divested from or engaged with *companies* that have *business operations* in Iran; or D) retaining an independent research firm to identify *scrutinized companies* in which the Board has *direct* or *indirect holdings*.

II. The Board shall assemble and adopt an official list of *scrutinized companies* at the June 2008 Board Meeting. The Board shall file the *scrutinized companies* list with the Public Pension Division (Division) of the Department of Financial and Professional Regulation within 30 days of its adoption. The Division shall make the Board's *scrutinized companies* list available to the public. Staff shall supplement the *scrutinized companies* list on an annual basis.

III. In respect of *companies* on the *scrutinized companies* list, the Board shall adhere to the following procedures:

A) The Board must determine which *companies* on the *scrutinized companies* list are *direct* or *indirect holdings*;

B) In respect of a *scrutinized company* with *inactive business operations*, the Board, on a semi-annual basis, must send a written notice informing the *company* of the Act and encouraging the *company* to refrain from initiating *active business operations* in Iran until it is able

to avoid *scrutinized business operations*. This requirement applies to *companies* that are *direct* and *indirect holdings*.

C) In respect of a *scrutinized company* that has *active business operations*, the Board shall send a written notice informing the *company* that it is considered a *scrutinized company* under the Act and that it may become subject to divestment by the Board, due to such status. Further, the notice shall inform the *company* of its opportunity to clarify its Iran-related activities and encourage the *company*, within 90 days, to cease its *scrutinized business operations* or convert such operations to *inactive business operations*, in order to avoid qualifying for divestment by the Board.

1) If the *company* ceases *scrutinized business operations* within 90 days of the Board's first engagement, the Board shall remove the *company* from the *scrutinized companies* list.

2) If the *company* converts its active *scrutinized business operations* to *inactive business operations* within 90 days of the Board's first engagement, the *company* shall receive letters from the Board, as described above in III (B).

3) If the *company* continues to have active *scrutinized business operations* following the 90 day period, the Board shall sell, redeem, divest or withdraw all publicly traded securities of the *company* within 12 months after the *company's* most recent appearance on the *scrutinized companies* list. This requirement does not apply to *indirect holdings* in a *private market fund*. Please note that *companies* that the U.S. Government affirmatively declares are excluded from present and future federal sanctions relating to Iran are not subject to divestment.

IV. Subsequent to the Board's adoption of the *scrutinized companies* list, the Board shall not acquire securities of *companies* on the *scrutinized companies* list that have *active business operations*. This requirement does not apply to *indirect holdings* in a *private market fund*. However, please note that the Board may acquire a *company* that the U.S. Government has affirmatively declared to be excluded from its present or any future federal sanctions relating to Iran. Staff will arrange for the Board's investment managers to have access to the *scrutinized companies* list and provide this Iran Divestment Policy to guide the investment managers' investment of fund assets. If the Board purchases the *scrutinized companies* list from an independent research provider, each of the Board's investment managers will reimburse the Board for their pro rata share of the list's cost.

V. In respect of the Board's *indirect holdings* in *scrutinized companies* with *active business operations* existing within the Board's *private market funds*, the Board shall submit letters to the general partners of the applicable *private market funds*, requesting that the general partner consider removing the *companies* from the fund or create a similar actively managed fund having *indirect holdings* devoid of the *companies*. If the general partner creates such a fund, the Board shall replace all applicable investments with investments in the similar fund in an expedited time frame consistent with prudent investment standards.

VI. The Board shall file an annual report with the Division, which shall be made available to the public, discussing the following information: A) a summary of correspondence with *scrutinized companies* engaged by the Board; B) all investments sold,

redeemed, divested or withdrawn in compliance with the Act; C) all prohibited investments (*companies* on the *scrutinized company* list that have *active business operations*); and D) a summary of correspondence with *private market funds*.

VII. The Board may cease divesting from *scrutinized companies* or reinvest in *scrutinized companies*, if clear and convincing evidence shows that the value of investments in *scrutinized companies* with active *scrutinized business operations* becomes equal to or less than 0.5 % of the market value of all assets under management by the Board. If the Board decides to cease divestment, reinvest, or remain invested in *companies* having active *scrutinized business operations*, the Board must provide a written report to the Division in advance of the action and update the report semiannually thereafter, identifying the reasons and justification (supported by clear and convincing evidence) for the Board's decision to cease divestment, reinvest, or remain invested in the applicable *companies*.

This Iran Divestment Policy shall expire upon the occurrence of any of the following events: A) the U.S. revoking all sanctions imposed against the Government of Iran; B) the Congress or President declaring that the Government of Iran has ceased to acquire weapons of mass destruction and has ceased to support international terrorism; or C) the Congress or the President declaring that mandatory divestment of the type provided for in the Act interferes with the conduct of U.S. foreign policy.

ADOPTED: December 14, 2007

DEFINITIONS:

"*Active business operations*" means all *business operations* that are not *inactive business operations*.

"*Business operations*" means engaging in commerce in any form in Iran, including, but not limited to, acquiring, developing, maintaining, owning, selling, possessing, leasing, or operating equipment, facilities, personnel, products, services, personal property, real property, or any other apparatus of business or commerce.

"*Company*" means any sole proprietorship, organization, association, corporation, partnership, joint venture, limited partnership, limited liability partnership, limited liability company, or other entity or business association, including all wholly owned subsidiaries, majority-owned subsidiaries, parent companies, or affiliates of those entities or business associations, that exists for the purpose of making profit.

"*Direct holdings*" in a *company* means all securities of that

company that are held directly by the *retirement system* or in an account or fund in which the *retirement system* owns all shares or interests.

"*Inactive business operations*" means the mere continued holding or renewal of rights to property previously operated for the purpose of generating revenues but not presently deployed for that purpose.

"*Indirect holdings*" in a *company* means all securities of that *company* which are held in an account or fund, such as a mutual fund, managed by one or more persons not employed by the *retirement system*, in which the *retirement system* owns shares or interests together with other investors not subject to the provisions of this Section.

"*Mineral-extraction activities*" include exploring, extracting, processing, transporting, or wholesale selling or trading of elemental minerals or associated metal alloys or oxides (ore), including gold, copper, chromium, chromite, diamonds, iron, iron ore, silver, tungsten, uranium, and zinc.

"*Oil-related activities*" include, but are not limited to, owning rights to oil blocks; exporting, extracting, producing, refining, processing, exploring for, transporting, selling, or trading of oil; and constructing, maintaining, or operating a pipeline, refinery, or other oil-field infrastructure. The mere retail sale of gasoline and related consumer products is not considered an oil-related activity.

"*Petroleum resources*" means petroleum, petroleum byproducts, or natural gas.

"*Private market fund*" means any private equity fund, private equity fund of funds, venture capital fund, hedge fund, hedge fund of funds, real estate fund, or other investment vehicle that is not publicly traded.

"*Retirement system*" means the State Employees' Retirement System of Illinois, the Judges Retirement System of Illinois,

the General Assembly Retirement System, the State Universities Retirement System, and the Teachers' Retirement System of the State of Illinois.

"*Scrutinized business operations*" means *business operations* that have caused a *company* to become a *scrutinized company*.

"*Scrutinized company*" means the *company* has *business operations* that involve contracts with or provision of supplies or services to the Government of Iran, *companies* in which the Government of Iran has any direct or indirect equity share, consortiums or projects commissioned by the Government of Iran, or *companies* involved in consortiums or projects commissioned by the Government of Iran and:

(1) more than 10% of the *company's* revenues produced in or assets located in Iran involve *oil-related activities* or *mineral-extraction activities*; less than 75% of the *company's* revenues produced in or assets located in Iran involve contracts with or provision of *oil-related* or *mineral-extraction* products or services to the Government of Iran or a project or consortium created exclusively by that government; and the *company* has failed to take substantial action; or

(2) the *company* has, on or after August 5, 1996, made an investment of \$20 million or more, or any combination of investments of at least \$10 million each that in the aggregate equals or exceeds \$20 million in any 12-month period, that directly or significantly contributes to the enhancement of Iran's ability to develop *petroleum resources* of Iran.

For more information, please contact:

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