

Annual financial report summary for the fiscal year ended June 30 / Teachers' Retirement System of the State of Illinois.

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Annual Financial Report Summary

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for the fiscal year ended June 30, 2000



Teachers' Retirement System of the State of Illinois
a component unit of the State of Illinois

Year in Review

Fiscal year 2000 at TRS was brimming with progress. We received high marks in an international benchmarking study, made improvements in technology and investments, and completed the restructuring of a large portion of our investment portfolio. In addition, we published our first *Annual Financial Report Summary* – a synopsis of our *Comprehensive Annual Financial Report* designed specifically for our members. Copies of the *Comprehensive Annual Financial Report* and the *Annual Financial Report Summary* are available on our Web site at www.trs.state.il.us or by calling (800) 877-7896.

Quality Service, Low Costs

An international study of 25 very large pension funds conducted by Cost Effectiveness Measurement, Inc. (CEM) used sophisticated statistical techniques to compare service levels and expenditures while controlling for legitimate differences such as plan size and complexity. Overall, CEM found our service levels to be very high and our costs relatively low. We will use this study in our ongoing efforts to improve member service delivery and to assure administrative expenditures are made wisely.

Telecommunications

In December 1999 we added a toll-free, 24-hour Forms Order Line through which you may order forms or other publications from your telephone. This service has proven to be very popular. In May we added a new telephone feature that gives you the opportunity to wait on the line for the next available member service representative if all of our lines are busy. Your call is momentarily placed on hold during peak calling times and you are asked to leave a message only when, after a brief period, all of the member service representatives continue to be busy.

Web Site

Our Web site continues to grow. We have added downloadable forms and internal search capabilities. Additions also include links to the Illinois State Board of Education (ISBE) and the Coalition to Preserve Retirement Security (CPRS). Future plans include making the site more interactive by providing member and employer data on-line. Progress on this project will be published in the *Topics & Report* newsletter.

Year 2000 Readiness

Our computer systems were functioning properly when business resumed January 3, 2000.

TRS 2000

A complete workflow and computer system reengineering project, TRS 2000 will provide computer support to staff for enhanced member and employer processes. The

project is scheduled to be completed in the second quarter of fiscal year 2002.

Legislative Changes

During the 2000 legislative session, the General Assembly made several administrative changes that benefit TRS members and annuitants. Among those changes were:

- a provision to allow surviving spouses who remarry to remain eligible to receive monthly surviving spouse benefits. Previously, persons who remarried prior to age 55 lost their eligibility and benefits stopped.
- removal of the salary cap for members with low annual earnings. The 20 percent cap on salary increases included in the calculation of pension benefits no longer applies for persons earning less than 50 percent of the statewide average teacher salary (currently about \$22,000 per year).
- an allowance for automatic refunds to surviving spouses of members who die without a valid Nomination of Beneficiary (NOB) form on file.
- reinstatement of an expired provision allowing payments of monthly surviving spouse benefits in cases where a member remarries a former spouse within one year prior to the date of death.

Investment Program

The Board of Trustees adopted a revised asset/liability study in July 1999. Consequently, TRS staff, in conjunction with our external investment consultant, performed an extensive review of the entire public market manager structure in order to implement most efficiently the new asset/liability study. As a result, TRS significantly reduced the number of external investment managers; renegotiated the fees paid to these managers; and restructured, rebalanced and transitioned a major portion of TRS' assets.

This reduction of managers and restructuring of assets has now placed the public markets portfolio in line with the asset allocation targets that were adopted in July 1999. This optimal mix makes the TRS investment portfolio more cost effective and efficient. With the implementation of the new structure, we expect to save nearly \$16 million annually in external manager fees through an increased exposure to indexing, larger average account sizes, and contractual fee renegotiations.

The Board of Trustees also approved a revised investment policy, outlining its investment philosophy and defining roles and responsibilities for the investment operations.

These accomplishments demonstrate our commitment to delivering quality service to our members. Our dedication to this goal will continue in the years ahead.

Board of Trustees



A 10-member Board of Trustees is responsible for the general administration of TRS. Trustees include the Illinois Superintendent of Education, who serves in an ex-officio capacity; four trustees elected by contributing members; four trustees appointed by the governor; and one trustee elected by annuitants. Members of the TRS Board of Trustees are:

Front row: Sharon Leggett; Glenn W. McGee, *president*; James Bruner, *vice president*; Jan Cleveland

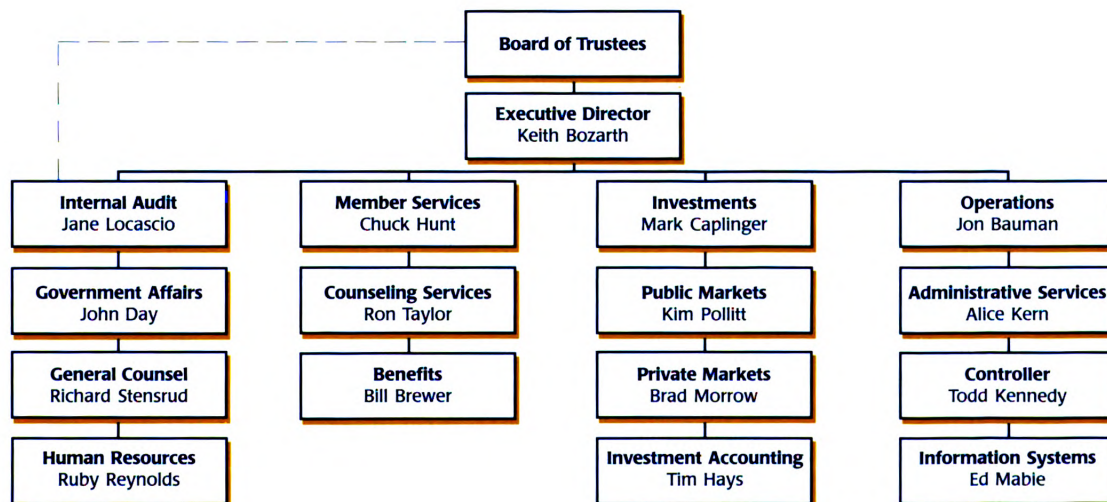
Back row: Scott Eshelman; Molly Phalen; Stuart Levine; John E. Glennon; Cynthia O'Neill; William R. Enlow

Administration

Under the direction of the executive director, the day-to-day administration of TRS is delegated to the TRS staff. The staff is located in two facilities. Springfield, Illinois is home to the main office; a northeastern Illinois regional office is located in Lisle. Members of the executive staff are:

Front row: Alice Kern; Keith Bozarth, *executive director*; Richard Stensrud; Jon Bauman

Back row: Ron Taylor, Ruby Reynolds, Tim Hays, Kim Pollitt, John Day, Todd Kennedy, Jane Locascio, Chuck Hunt, Ed Mabie, Brad Morrow, Mark Caplinger



Financial Statements

TEACHERS' RETIREMENT SYSTEM OF THE STATE OF ILLINOIS STATEMENT OF PLAN NET ASSETS AS OF JUNE 30, 2000, AND 1999

	2000	1999
ASSETS		
Cash	<u>\$3,213,679</u>	<u>\$2,756,183</u>
Receivables and prepaid expenses		
Member payroll deduction	213,579,965	260,963,782
Member contributions	31,263,832	31,749,100
Employer Early Retirement Incentive	679,813	17,007,562
Employer contributions	9,203,574	4,187,757
State of Illinois	412,206	0
Investment income	232,706,956	222,342,888
Prepaid expenses	<u>368,526</u>	<u>449,650</u>
Total receivables and prepaid expenses	<u>488,214,872</u>	<u>536,700,739</u>
Investments, at fair value		
Fixed income	8,845,767,666	9,052,552,366
Equities	11,543,579,021	10,255,950,172
Real estate	2,428,110,937	2,500,511,322
Short-term investments	1,089,576,833	609,197,593
Private equity investments	877,028,687	596,456,656
Foreign currency	<u>39,495,154</u>	<u>39,166,266</u>
Total investments	<u>24,823,558,298</u>	<u>23,053,834,375</u>
Collateral from securities lending	<u>1,952,295,799</u>	<u>1,418,345,349</u>
Property and equipment, at cost, net of accumulated depreciation of \$5,763,526 and \$5,525,309 in 2000 and 1999, respectively	<u>3,420,592</u>	<u>3,339,675</u>
Total assets	<u>27,270,703,240</u>	<u>25,014,976,321</u>
LIABILITIES		
Benefits and refunds payable	6,179,594	3,432,999
Administrative and investment expenses payable	69,959,589	87,060,219
Payable to brokers for unsettled trades, net	760,855,651	1,268,428,755
Securities lending transactions	<u>1,952,295,799</u>	<u>1,418,345,349</u>
Total liabilities	<u>2,789,290,633</u>	<u>2,777,267,322</u>
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS	<u>\$24,481,412,607</u>	<u>\$22,237,708,999</u>

Financial Statements

TEACHERS' RETIREMENT SYSTEM OF THE STATE OF ILLINOIS STATEMENT OF CHANGES IN PLAN NET ASSETS YEARS ENDED JUNE 30, 2000, AND 1999

	2000	1999
ADDITIONS		
Contributions		
Members	\$619,622,840	\$866,375,866
State of Illinois	639,298,949	572,950,673
Employers		
Early retirement	36,751,052	27,110,341
Federal funds	21,425,188	19,844,329
2.2 benefit formula	33,122,050	16,690,590
Total contributions	<u>1,350,220,079</u>	<u>1,502,971,799</u>
Investment income		
Net appreciation in fair value	1,451,074,361	1,249,234,042
Interest	559,584,336	557,162,549
Real estate operating income, net	243,815,891	215,826,235
Dividends	109,959,618	129,304,570
Private equity income	29,631,911	6,152,976
Securities lending income	106,909,999	109,266,864
Other investment income	2,183,038	1,669,537
	<u>2,503,159,154</u>	<u>2,268,616,773</u>
Less investment expense		
Securities lending expense	97,475,237	98,364,242
Investment activity expenses	69,466,794	80,591,562
Net investment income	<u>2,336,217,123</u>	<u>2,089,660,969</u>
Total additions	<u>3,686,437,202</u>	<u>3,592,632,768</u>
DEDUCTIONS		
Retirement benefits	1,317,841,317	1,205,864,868
Survivor benefits	68,797,583	63,585,582
Disability benefits	15,607,144	14,676,166
Refunds	28,797,054	25,858,851
Administrative expenses	11,680,647	10,680,094
Prior service credits and transfers	9,849	145,613
Total deductions	<u>1,442,733,594</u>	<u>1,320,811,174</u>
NET INCREASE	<u>2,243,703,608</u>	<u>2,271,821,594</u>
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS		
Beginning of year	<u>22,237,708,999</u>	<u>19,965,887,405</u>
End of year	<u>\$24,481,412,607</u>	<u>\$22,237,708,999</u>

Investments

Fund's Value Increases

The TRS trust fund is invested by authority of the Illinois General Assembly under the "prudent person rule," requiring investments to be managed solely in the interest of fund participants and beneficiaries. As of June 30, 2000, TRS' total investments, including accrued investment income, at market value totaled \$25,056 billion, an increase of \$1.780 billion over last year.

TRS' investments are guided by the TRS Investment Policy. Investment principles include preserving the long-term principal of the trust fund, maximizing total return within prudent risk parameters, and acting in the exclusive interest of the members of the system.

TRS had a total fund annualized return of 10.9 percent (gross of fees) and 10.6 percent (net of fees) for the one-year period ending June 30, 2000. The one-, three-, five-, and ten-year returns for each asset class are listed in the Performance Summary table.

Portfolio Restructured

TRS restructured the entire public markets portfolio during FY00. Based on the July 1999 adopted asset allocation and liability study, TRS eliminated 42 assignments, added 13 new assignments, and reallocated assets among the public market asset classes and accounts. The asset allocation depicted in the Allocation Targets vs. Total Assets table is in effect as of June 30, 2000.

TRS' investment fund is 100 percent externally managed. At June 30, 2000, TRS employed 48 external investment advisors. The TRS custodian/master trustee is The Northern Trust Company, Chicago, Illinois; the TRS general consultant is Strategic Investment Solutions, Inc., San Francisco, California.

TRS is ranked 47th out of the largest 200 plan sponsor funds in the U.S., including corporate, government and endowment funds according to *Pensions and Investments*, January 22, 2000. (Based on market value of total assets.)

PERFORMANCE SUMMARY (net of fees)

Asset Class/Index	FY 2000	3 Years	5 Years	10 Years
TRS Total Fund	10.6%	12.6%	14.5%	11.7%
TRS Policy Index	9.7	11.9	13.8	12.3
TRS Equity - U.S.	6.5	16.4	19.9	15.7
Russell 3000 Index	9.6	19.2	22.8	17.5
TRS Fixed Income - U.S.	4.4	6.8	6.9	8.4
SSB BIG Index	4.5	6.0	6.2	7.9
TRS Fixed Income - International	(0.7)	2.0	4.1	8.3
SSBNUSWGB Index	2.4	2.7	1.7	8.4
TRS Equity - International	19.9	10.1	15.3	8.7
MSCI ACWI Ex.-U.S. Free Index	18.1	9.5	11.1	8.3
TRS Real Estate Property	8.8	12.3	12.1	7.4
NCREIF Property Index	11.6	13.9	12.1	6.0
TRS Private Equity	137.7	58.0	52.8	31.0
Russell 3000 Index + 300 bps.	12.6	22.2	25.8	20.5

ALLOCATION TARGETS VS. TOTAL ASSETS

	6/30/00 Total Fund \$ Million	Percent of Portfolio	Policy Allocation Target	Band Width	Rebalance Percentage	
					Lower Trigger Point	Upper Trigger Point
U.S. Equities	\$7,343	30.3%	30.0%	+/-2.0%	28.0%	32.0%
U.S. Fixed Income	6,502	26.8	27.0	+/-4.0	23.0	31.0
International Equities	5,024	20.7	20.0	+/-2.0	18.0	22.0
International Fixed Income	1,690	7.0	7.0	+/-2.0	5.0	9.0
Real Estate	2,428	10.0	8.0	+/-2.0	6.0	10.0
Private Equity	1,036	4.3	7.0	+/-2.0	5.0	9.0
Short-Term Investments	221	0.9	1.0	+/-1.0	0.0	2.0
Pending Settlements/Expenses*	812	N/A	N/A			
Total Fund	\$25,056	100.0%	100.0%			

* The liability portions are placed within the Statement of Plan Net Assets.

Actuarial and Statistical Data

Funded Ratio on the Rise

Actuaries estimate the cost of benefits that members and their beneficiaries will receive over their lifetimes and calculate the amount that should be set aside each year to fund the benefits.

Buck Consultants, TRS' actuarial service provider, conducted the annual actuarial valuation and determined that although there was a net increase in the unfunded liability, the funded ratio also increased.

What does this mean?

The **accrued liability** is an estimate of all the benefits that have been earned and will, at some point, be paid to members and their beneficiaries. The **actuarial value of assets** is the amount that is available to pay the accrued liability. The **unfunded liability** is the value of those future payable benefits that are not covered by assets.

The **funded ratio** shows the percentage of the accrued liability that is covered by the assets at market value.

As you can see from the table below, our funded ratio increased by 1.2 percentage points, due mainly to investment returns that were higher than the actuaries' long-term assumption.

ACTUARIAL VALUATION WITH MARKET VALUE ASSETS (\$ thousands)

	Years Ended June 30	
	2000	1999
Total actuarial accrued liability	\$35,886,404	\$33,205,513
Less actuarial value of assets (net assets at market value)	\$24,481,413	\$22,237,709
Unfunded liability	\$11,404,991	\$10,967,804
Funded ratio	68.2%	67.0%

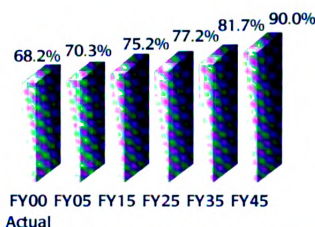
State Maintains Commitment to TRS Funding

State contributions to TRS under Public Act 88-593 began in FY96. The law established the state's commitment to strengthen TRS' financial position through a 35-year funding plan following a 15-year phase-in that ends in FY10. Under the phase-in, contributions are being gradually increased to a level percentage of active member payroll, and that rate (as adjusted annually by the actuaries) will be contributed for the following 35 years. At the end of the funding period in FY45, TRS will reach a 90 percent funded ratio.

Public Act 90-582, the 2.2 legislation, added minimum state contribution rates for FY99 through FY10 with the state's share of the cost of the 2.2 benefit formula change paid as a level percentage of active member payroll. The overall phase-in feature and the 90 percent target funded ratio of Public Act 88-593 are maintained.

Since FY96, state contributions to TRS and the other four state systems have been made through a continuing appropriation, so the required contributions to TRS are made automatically. It is essential that the continuing appropriation feature and the 50-year funding schedule be upheld. The integrity of the funding plan remains a top priority for TRS.

TRS PROJECTED FUNDED RATIO



Benefit Recipient and Member Count Continues to Increase

In FY00, TRS provided monthly benefits to 62,122 individuals, an increase of 1,814 recipients over FY99. Likewise, the number of active members increased by 2,789 during FY00.

BENEFIT RECIPIENTS

	2000	1999
Retirees	54,040	52,430
Disabilitants	1,021	1,008
Survivors	7,061	6,870
Total	62,122	60,308

ACTIVE MEMBERS

	2000	1999
Full and Regular Part-Time	121,459	119,058
Substitutes	23,516	23,128
Total	144,975	142,186

Teachers' Retirement System of the State of Illinois
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Fiscal Year Highlights

	2000	1999
Active contributing members	144,975	142,186
Inactive noncontributing members	66,025	59,271
Benefit recipients	<u>62,122</u>	<u>60,308</u>
Total membership	273,122	261,765
Actuarial accrued liability (AAL)	\$35,886,404,000	\$33,205,513,000
Less net assets held in trust for pension benefits	<u>\$24,481,413,000</u>	<u>\$22,237,709,000</u>
Unfunded actuarial accrued liability (UAAL)	\$11,404,991,000	\$10,967,804,000
Funded ratio (actuarial value of assets/AAL)	68.2%	67.0%
Total fund investment return (net of fees)	10.6%	10.8%
Benefits and refunds paid		
Benefits paid	\$1,402,246,044	\$1,284,126,616
Refunds paid	<u>\$28,797,054</u>	<u>\$25,858,851</u>
Total	\$1,431,043,098	\$1,309,985,467
Income		
Member contributions*	\$619,622,840	\$866,375,866
Employer contributions (includes State of Illinois contributions)	\$730,597,239	\$636,595,933
Net investment income	<u>\$2,336,217,123</u>	<u>\$2,089,660,969</u>
Total	\$3,686,437,202	\$3,592,632,768

* Includes member payments and accounts receivable under the Payroll Deduction Program.

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