

COMMONWEALTH OF PENNSYLVANIA

State Employees' Retirement System

A Component Unit of the
Commonwealth of Pennsylvania

COMPREHENSIVE ANNUAL FINANCIAL REPORT

for the year ended December 31, 2000



Including the Independent Auditors' Report of Financial Statements
for the years ended December 31, 2000 and 1999

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for the year ended December 31, 2000



John R. Brosius
Executive Director

Francis J. Donlevy
Director, Office of Management

State Employees' Retirement System
30 North Third Street • P.O. Box 1147
Harrisburg, PA 17108-1147

Including the Independent Auditors' Report of Financial Statements
for the years ended December 31, 2000 and 1999



NICHOLAS J. MAIALE
CHAIRMAN

COMMONWEALTH OF PENNSYLVANIA
STATE EMPLOYEES' RETIREMENT SYSTEM

30 NORTH THIRD STREET
P.O. BOX 1147
HARRISBURG, PENNSYLVANIA 17108-1147
PHONE HARRISBURG: (717) 787-9657



June 2001

Honorable Tom Ridge, Governor
Commonwealth of Pennsylvania

Members, Pennsylvania General Assembly
Members, Pennsylvania State Employees' Retirement System

Dear Governor Ridge, Legislators and Members:

The Board of Trustees of the Pennsylvania State Employees' Retirement System (SERS) is pleased to present our *Comprehensive Annual Financial Report* on the SERS Fund for calendar year 2000.

As chairman of the SERS Board, I am pleased to note that the Fund had a total investment rate of return of 2.2% in 2000 and a total fair value of \$27.9 billion as of December 31, 2000, especially amid turbulent market conditions. By comparison, the Fund's annualized investment rate of return for the past five years was 14.3%, and the annualized investment rate of return for the past 10 years was 13.7%. These substantial returns have enabled SERS to maintain fully-funded status since 1992. They also validate the Board's adherence to two key principles:

- ◆ prudent management of Fund assets, and
- ◆ ensuring payment of benefits promised by the Commonwealth to SERS retirees and beneficiaries.

Also due in part to these substantial returns, the Commonwealth's total employer rate of contribution to the Fund, which was as high as 18.87% of payroll in 1981, was reduced to 1.39% of payroll for fiscal year 2000-2001. Rest assured that the SERS Board, staff and I will continue to pursue prudent investment strategies to assure the solvency of the Fund and the quality of pension-related services to all SERS members.

Sincerely,

Nicholas J. Maiale
SERS Board Chairman

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Board of Trustees

Honorable Nicholas J. Maiale

Chairman



Honorable Gibson E. Armstrong

State Senator



Edward J. Keller

Executive Director, AFSCME Council 13



Honorable Robert A. Bittenbender

State Secretary of the Budget



Honorable Raphael J. Musto

State Senator



Honorable Barbara Hafer

State Treasurer



James E. Nevels

Financial Consultant



Thomas G. Paese, Esq.

Former State Secretary of Administration



Honorable Jere L. Strittmatter

State Representative



Honorable M. Joseph Rocks

Retired Member and Former State Senator



Honorable Michael R. Veon

State Representative



Mission Statement

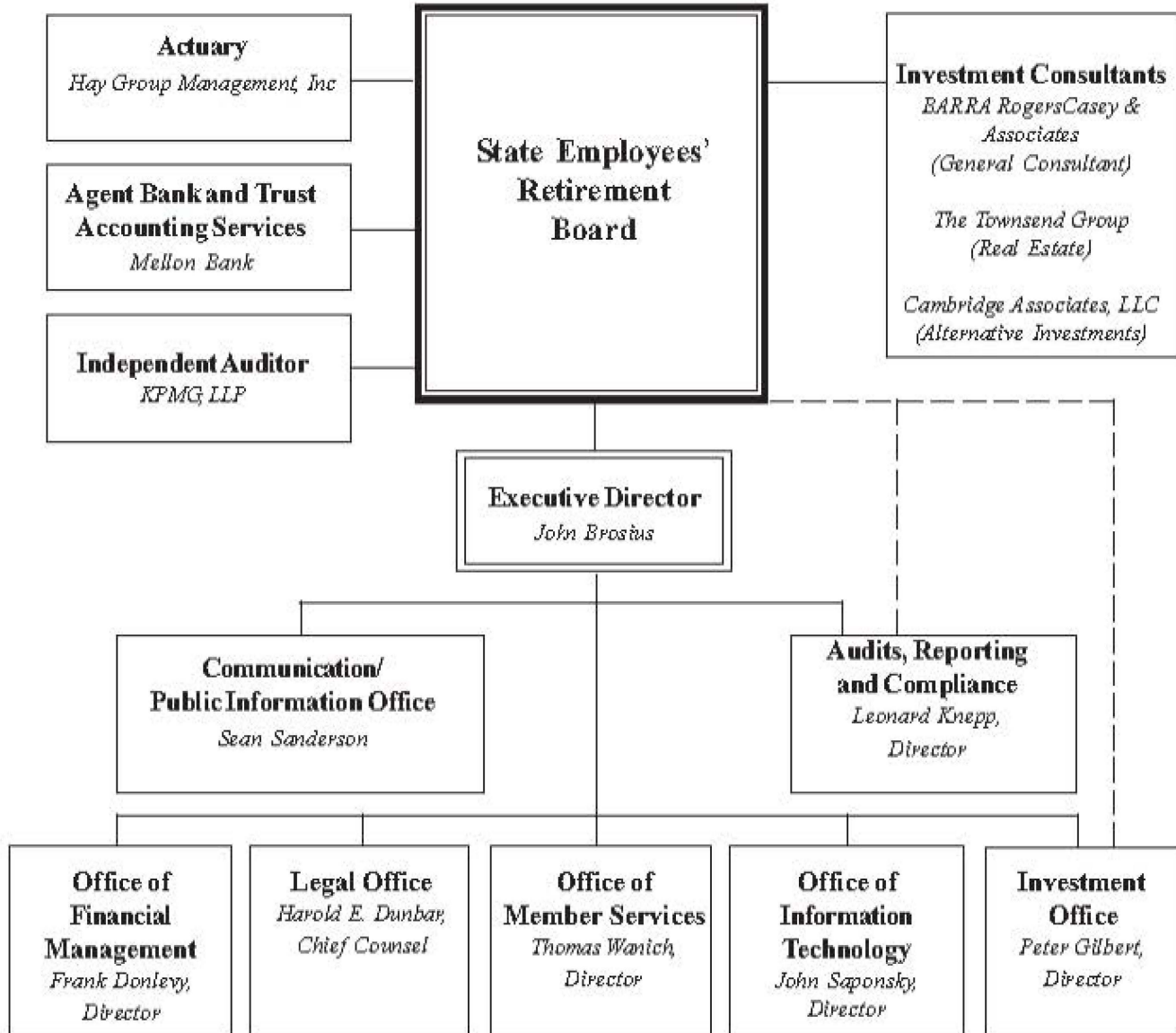
Plan Administration: To administer the retirement benefits plan for state employees and elected officials in accordance with Pennsylvania statutes;

Member Services: To provide effective services to all active and retired members;

Management of Retirement Fund Assets: To accumulate, manage and disburse the retirement Fund assets in accordance with fiduciary standards and at a reasonable cost to Commonwealth taxpayers;

Investment Policy: To maximize investment returns while exercising a prudent person investment policy.

SERS Organizational Chart



Administrative Support

John Brosius
Executive Director

Francis J. Donlevy
Director, Office of Financial Management

Peter M. Gilbert
Chief Investment Officer

Harold E. Dunbar
Chief Counsel

Andrew Deitch
Bruce Feldman
David J. Kalman

Leonard M. Knepp
Director, Audits, Reporting and Compliance

Mark McGrath
Karen N. Nicely
Adam Tosh

Sean Sanderson
Director of Communications

John C. Winchester
Investment Office Directors

Investment Consultants

BARRA RogersCasey
General Consultant

The Townsend Group
Real Estate Consultant

Cambridge Associates
Alternative Investments Consultant

General Service Providers

Hay/Huggins Company, Inc.
Actuary

Mellon Bank
*Agent Bank and
Trust Accounting Services*

KPMG LLP
Independent Auditor

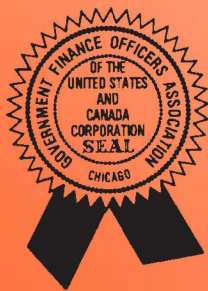
Certificate of Achievement for Excellence in Financial Reporting

Presented to

Commonwealth of
Pennsylvania State Employees'
Retirement System

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
December 31, 1999

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.

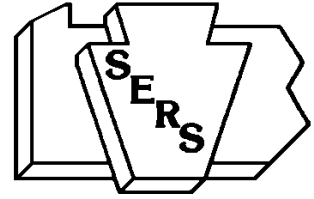


Anne Spray Kinney
President

Jeffrey L. Eselle
Executive Director



COMMONWEALTH OF PENNSYLVANIA
STATE EMPLOYEES' RETIREMENT SYSTEM
30 NORTH THIRD STREET - P.O. BOX 1147
HARRISBURG, PENNSYLVANIA 17108-1147
TELEPHONE: 717-787-6293



May 4, 2000

The Board of Trustees
Pennsylvania State Employees' Retirement System
Harrisburg, PA 17108-1147

Dear Mr. Chairman and Members of the Board:

It is my pleasure to present you with the Comprehensive Annual Financial Report of the Pennsylvania State Employees' Retirement System (the "System") for the calendar year ended December 31, 2000. The System continued its track record of maintaining fully funded status and implementing new concepts to enhance service delivery to its members. During the year 2000, we saw the value of a sound, well-diversified asset allocation program. The System's successful asset allocation is the work product of our annual 5-year Investment Plan. While most indexes were in negative territory, and many of our peer plans were reporting negative returns, the System earned a 2.2% return on assets during the year. Although not nearly as stellar as returns from recent years, it was nevertheless reassuring to see the Fund hold up so well under what can best be described as a "challenging environment."

The System continues to adopt new technology solutions and implement best practices in order to enhance workplace productivity, management decision-making, and customer service delivery. One of the key projects identified by our IT governance process was to establish the Investment Data Warehouse as a top priority. Partnering with Eagle Investment Systems and Deloitte Consulting, we began to develop, design, test and implement the system during the latter part of the year 2000. Our new data warehouse will serve as a repository for historical data on holdings, transactions and performance returns; assist the Fund in monitoring the collection of class action proceeds, and provide continuity of analytical tools in the event of consultant or custodian bank changes.

Another key effort we embarked upon in 2000 was our Customer Care Project (CCP). Our members' needs continue to change and evolve, and the System is working hard to keep up with that pace. Accordingly, during the past year we sent out a customer survey to over 4,500 members. While the responses indicated that the overwhelming majority of members are satisfied with the current delivery of services, there are areas we can improve upon. Specifically, members want improved phone access and service, reduced paperwork, and better education tools to assist in the planning, enjoyment, and preparation for retired life. As a response to those concerns, we have undertaken the CCP to benchmark current procedures against best practices and identify any "gaps" for improvement. These "gaps" are being measured and prioritized to develop a practical and effective 5-year implementation plan. As part of this significant effort, we have begun to analyze the processing of death benefits.

Report Content and Structure

The 2000 CAFR consists of five sections:

- The Introductory Section contains this letter of transmittal and general information on the administrative organization of the System and its mission;
- The Financial Section contains the audited financial statements, required supplementary information and other supporting financial schedules;
- The Investment Section contains a summary of the System's investment management approach and reports on asset allocation and investment performance;
- The Actuarial Section contains the Actuary's Certification Letter and summarized results of the latest annual actuarial valuation; and
- The Statistical Section, which contains general statistical information and trend data regarding SERS participants and finances.

Financial Information

The System's management is responsible for the preparation, accuracy and objectivity of the financial information included in this report. SERS maintains an effective system of internal controls designed to provide reasonable assurance that assets are properly safeguarded, transactions are properly executed, and that the financial statements conform to generally accepted accounting principles. The System's Internal Audits, Reporting and Compliance department provides a continuing review of the adequacy and effectiveness of the System's internal control structure. Also, our independent external auditors, KPMG, conduct an annual audit of the financial statements in accordance with generally accepted auditing standards. Their audit includes tests and procedures designed to provide reasonable assurance the financial statements are fairly presented. The external auditors have full and unrestricted access to the SERS Board of Trustees to discuss their audit and related findings regarding the integrity of financial reporting and adequacy of the internal control structure.

Awards

We are very pleased to note that The Government Finance Officers Association of the United States and Canada (GFOA) again awarded the Certificate of Achievement for Excellence in Financial Reporting to the Pennsylvania State Employees' Retirement System for the year ended December 31, 1999. The Certificate of Achievement is a national award, recognizing conformance with the highest standards for preparation of a State and local government financial report.

In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements, and we are submitting it to the GFOA to determine its eligibility for another certificate.

Income and Contributions

Additions to plan net assets include net income from investment activities and employer and member contributions. During 2000, investment income totaled approximately \$586 million versus \$4.7 billion in 1999, resulting in returns of 2.2% and 19.9% respectively. For the 10-year period ended December 31, 2000, the System earned a compounded rate of return of 13.7%. These rates of return placed the System in the top quartile of government sponsored pension plans for the one, five, and ten-year periods. The most significant deduction from income is the payment of investment manager fees. The System's assets are managed 100% by experts hired by the Board of Trustees. Most of these managers are paid a fee based on the assets under management. However, as is industry standard, the general partners in our limited partnership holdings are paid based on commitments to the partnership. Last year, our commitments to Alternative Investments increased by almost \$1.7 billion. Due to these increased commitments to the Alternative Investment asset class, Investment Expenses increased almost \$25 million from the prior year.

Member contributions amounted to approximately \$232 million and \$225 million for the years ended December 31, 2000 and 1999 respectively. The member rate is set by statute at 5.0% of the gross salary for most employees. Employer contributions decreased to approximately \$168 million versus \$271 million in the prior year. The decrease was due to the latest actuarial valuation that reduced the employer composite rate from 5.0% to 1.39% of reported payroll. Prudent investment of the System's assets has enabled us to achieve and maintain fully funded status, while decreasing the employer contribution rate. The employer rate had been almost 10% as recently as 1990 and has dropped to 1.39% last year. This has resulted in employer contributions decreasing from over \$418 million in 1990 to less than \$170 million in 2000. This is even more impressive when considering the state payroll has grown from \$3.2 billion in 1990 to almost \$4.5 billion last year. The benefits of this investment performance pass directly back to the participating Commonwealth agencies and the taxpayers of Pennsylvania.

Benefits and Expenses

Deductions to Plan Net Assets are primarily benefit payments. During 2000 and 1999, the System paid out approximately \$1.2 billion. Administrative expenses are presented in the annual budget to the state Legislature and are financed through

investment earnings. The system incurred total administrative expenses of approximately \$21.3 million in 2000 representing less than 0.075% of average fund net assets.

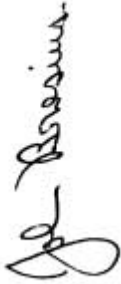
Because a mature plan generally pays more in benefits than is received in contributions, the funding ratio of the plan is very important. The funding ratio reflects whether there are adequate assets available to satisfy the actuarial determined liabilities of the fund, and is an excellent indicator of the health of any retirement plan. We are pleased to report the latest available funding ratio for the year ended December 31, 1999 was 123.7%, as determined by our actuarial consultant. This means the plan has the necessary resources to weather periodic downturns in the investment markets while still keeping contribution rates at historically low levels.

Acknowledgements

This report reflects the dedicated efforts of the SERS staff under the direction of the SERS Board of Trustees. We would like to take this opportunity to express our gratitude to you, the staff, our advisors and others who have worked diligently to administer the plan, enhance delivery of member services, and maximize the returns of the plan's assets in a prudent fashion.

Our pledge to the Board, members and taxpayers of Pennsylvania is to continue to administer the System in an effective and prudent fashion, and set goals which, when realized, will enhance service delivery and customer satisfaction.

Respectfully submitted,



John R. Brosius
Executive Director



Francis J. Donlevy
Director, Office of Financial Management

FINANCIAL



Independent Auditors' Report



225 Market Street
Suite 300
P.O. Box 1190
Harrisburg, PA 17108-1190

Independent Auditors' Report

The Board of Trustees
Commonwealth of Pennsylvania
State Employees' Retirement System:

We have audited the accompanying statements of plan net assets of the Commonwealth of Pennsylvania State Employees' Retirement System (a component unit of the Commonwealth of Pennsylvania) as of December 31, 2000 and 1999, and the related statements of changes in plan net assets for the years then ended. 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 audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 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 significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide 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 Commonwealth of Pennsylvania State Employees' Retirement System as of December 31, 2000 and 1999, and its changes in plan net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The information included in Required Supplemental Schedules 1 and 2 and the notes thereto is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information included in Supplemental Schedules 1 and 2 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

KPMG LLP

April 13, 2001

Financial Statements

COMMONWEALTH OF PENNSYLVANIA
STATE EMPLOYEES' RETIREMENT SYSTEM
(a component unit of the Commonwealth of Pennsylvania)

Statements of Plan Net Assets

December 31, 2000 and 1999

(Amounts in thousands)

Assets:	<u>2000</u>	<u>1999</u>
Receivables:		
Plan members	\$ 1,551	3,201
Employers	15,384	10,908
Investment income	132,435	98,656
Investment proceeds	170,341	79,104
Miscellaneous	<u>1,208</u>	<u>1,028</u>
Total receivables	<u>320,919</u>	<u>192,897</u>
Investments:		
Short-term investment fund	649,559	672,158
United States government securities	2,188,923	2,329,584
Corporate and foreign bonds and notes	3,312,265	3,163,233
Common and preferred stocks	7,189,853	10,416,259
Collective trust funds	9,460,886	7,914,062
Real estate	2,627,710	2,335,028
Alternative investments	<u>2,954,833</u>	<u>1,900,359</u>
Total investments	28,384,029	28,730,683
Securities lending collateral pool	<u>940,558</u>	<u>1,083,831</u>
Total assets	<u>29,645,506</u>	<u>30,007,411</u>
Liabilities:		
Accounts payable and accrued expenses	42,290	40,289
Investment purchases	782,190	790,110
Obligations under securities lending	<u>940,558</u>	<u>1,083,831</u>
Total liabilities	<u>1,765,038</u>	<u>1,914,230</u>
Net assets held in trust for pension benefits	<u>\$ 27,880,468</u>	<u>28,093,181</u>

(A Schedule of Funding Progress is presented on page 15.)

See accompanying notes to financial statements.

COMMONWEALTH OF PENNSYLVANIA
STATE EMPLOYEES' RETIREMENT SYSTEM
(a component unit of the Commonwealth of Pennsylvania)
Statements of Changes in Plan Net Assets
Years ended December 31, 2000 and 1999
(Amounts in thousands)

	2000	1999
Additions:		
Contributions:		
Plan members	\$ 231,667	224,928
Employers	168,002	270,718
Total contributions	399,669	495,646
Investment income:		
Net appreciation in fair value of investments	774,998	2,676,745
Collective trust fund (depreciation) appreciation and income	(825,600)	1,453,724
Interest	412,933	371,062
Dividends	113,293	127,330
Real estate	203,308	164,893
Miscellaneous	37,377	35,981
Investment expenses	716,309 (140,526)	4,829,735 (115,538)
Net income from investing activities	575,783	4,714,197
From securities lending activities:		
Securities lending income	87,874	54,530
Securities lending expenses	(77,945)	(46,056)
Net income from securities lending activities	9,929	8,474
Total net investment income	585,712	4,722,671
Total additions	985,381	5,218,317
Deductions:		
Benefits	1,166,897	1,218,133
Refunds of contributions	9,888	11,215
Administrative expenses	21,309	19,146
Total deductions	1,198,094	1,248,494
Net increase (decrease)	(212,713)	3,969,823
Net assets held in trust for pension benefits:		
Balance, beginning of year	28,093,181	24,123,358
Balance, end of year	\$ 27,880,468	28,093,181

See accompanying notes to financial statements.

COMMONWEALTH OF PENNSYLVANIA
STATE EMPLOYEES' RETIREMENT SYSTEM
(a component unit of the Commonwealth of Pennsylvania)

Notes to Financial Statements

December 31, 2000 and 1999

(Dollar amounts in thousands)

(1) Organization and Description of the System

(a) Organization

The Commonwealth of Pennsylvania State Employees' Retirement System (the System) was established as of June 27, 1923, under the provisions of Public Law 858, No. 331. The System was developed as an independent administrative board of the Commonwealth and is directed by a governing board that exercises control and management of the System, including the investment of its assets. The System's board has eleven members including the State Treasurer, ex officio, two Senators or former Senators, two members or former members of the House of Representatives, and six members appointed by the Governor, one of whom is an annuitant of the System. At least five board members are active members of the System and at least two have ten or more years of credited service. The Treasurer of the Commonwealth of Pennsylvania is the custodian of the State Employees' Retirement System's fund.

The System is the administrator of a cost-sharing multiple-employer defined benefit retirement system established by the Commonwealth of Pennsylvania to provide pension benefits for employees of state government and certain independent agencies. The System is a component unit of the Commonwealth of Pennsylvania and is included in the Commonwealth's financial report as a pension trust fund.

Membership in the System is mandatory for most state employees. Members and employees of the General Assembly, certain elected or appointed officials in the executive branch, department heads, and certain employees in the field of education are not required, but are given the option, to participate. At December 31, 2000 and 1999, System membership consisted of:

	2000	1999
Retirees and beneficiaries currently receiving benefits	88,392	88,043
Terminated employees entitled to benefits but not yet receiving them	3,777	3,664
Current active employees	109,470	108,035
Total members	201,639	199,742
Number of participating agencies	106	106

(Continued)

COMMONWEALTH OF PENNSYLVANIA
STATE EMPLOYEES' RETIREMENT SYSTEM
(a component unit of the Commonwealth of Pennsylvania)

Notes to Financial Statements

December 31, 2000 and 1999

(Dollar amounts in thousands)

(b) Pension Benefits

The System provides retirement, death, and disability benefits. Generally, retirement benefits vest after 10 years of credited service. Cost-of-living adjustments (COLAs) are provided at the discretion of the General Assembly. Article II of the Commonwealth of Pennsylvania's Constitution assigns the authority to establish and amend the benefit provisions of the plan to the General Assembly. Employees, who retire at age 60 with 3 years of service, or with 35 years of service if under age 60, are entitled to a normal annual retirement benefit. Members of the General Assembly and certain employees classified in hazardous duty positions can retire with full benefits at age 50, with at least 3 years of service.

On April 2, 1998, Act 41 was signed into law, which permitted certain participants with at least 30 years of credited service to retire without a reduction in benefits from July 1, 1998, to June 30, 1999. This early retirement window did not require a minimum age in conjunction with length of service for a member to be eligible for full benefits.

The general annual benefit is 2% of the member's highest three-year average salary times years of service. State police are entitled to a benefit equal to a percentage of their highest annual salary, excluding their year of retirement. The benefit is 75% of salary for 25 or more years of service and 50% of salary for 20-24 years of service. Judges are entitled to a benefit of 4% of final average salary for each of the first 10 years of service and 3% for subsequent years. District Justices are entitled to a benefit of 3% of final average salary for each year of service.

According to the Retirement Code, all obligations of the System will be assumed by the Commonwealth should the System terminate.

(Continued)

COMMONWEALTH OF PENNSYLVANIA
STATE EMPLOYEES' RETIREMENT SYSTEM
(a component unit of the Commonwealth of Pennsylvania)

Notes to Financial Statements

December 31, 2000 and 1999

(Dollar amounts in thousands)

(c) Contributions

The System's funding policy, as set by the System's Board, provides for periodic active member contributions at statutory rates. The System's funding policy also provides for periodic employer contributions at actuarially determined rates, expressed as a percentage of annual covered payroll, such that they, along with employee contributions and an actuarially determined rate of investment return, are adequate to accumulate assets to pay benefits when due. Employer contribution rates are determined using a variation of the entry age normal actuarial funding method. A variation of the entry-age normal actuarial cost method is used to determine the liabilities and costs related to all of the System's benefits including superannuation, withdrawal, death, and disability benefits. The significant difference between the method used for the System and the typical entry-age normal actuarial cost method is that the normal cost is based on the benefits and contributions for new employees rather than for all current employees from their date of entry. This variation should produce approximately the same results as the typical method over the long run. These rates are computed based upon actuarial valuations on the System's fiscal year end of December 31 and applied to the Commonwealth based on its fiscal year end June 30; therefore, the employer contribution rates in effect for the System's year end of December 31 reflect a blended average of calculated rates. The blended contribution rates were as follows:

	2000		1999	
Employer normal cost	8.99	%	8.98	%
Amortization of unfunded actuarial assets	(8.22)		(5.52)	
Amortization of supplemental annuities	2.42		2.38	
Total employer cost	3.19	%	5.84	%

Generally, employees are required to contribute to the System at a rate of 5% of their gross pay. Judges and district justices have the option of electing special membership classes requiring a contribution of 10% and 7.5%, respectively. All employee contributions are recorded in an individually identified account which also is credited with interest, calculated at 4% per annum, as mandated by statute. Accumulated employee contributions and credited interest vest immediately, and are returned to the employee upon termination of service if the employee is not eligible for other benefits.

(Continued)

COMMONWEALTH OF PENNSYLVANIA
STATE EMPLOYEES' RETIREMENT SYSTEM
(a component unit of the Commonwealth of Pennsylvania)

Notes to Financial Statements

December 31, 2000 and 1999

(Dollar amounts in thousands)

(2) Summary of Significant Accounting Policies

(a) Basis of Accounting

The financial statements of the System are prepared on the accrual basis of accounting under which expenses are recorded when the liability is incurred, revenues are recorded in the accounting period in which they are earned and become measurable, and investment purchases and sales are recorded as of their trade date. Member and employer contributions are recognized in the period in which employees' salaries are reported. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

The System follows GASB guidance as applicable to proprietary funds and applies only those applicable Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins issued on or before November 30, 1989, that do not conflict with or contradict GASB pronouncements.

(b) Use of Estimates

Management of the System has made certain estimates and assumptions relating to the reporting of assets and liabilities, and the disclosure of contingent assets and liabilities, to prepare these financial statements in conformity with generally accepted accounting principles. Actual results could differ from those estimates.

(c) Investments

The System's investments are reported at fair value. Fair value is the amount that a plan can reasonably expect to receive for an investment in a current sale between a willing buyer and a willing seller – that is, other than in a forced or liquidation sale. The investment in the short-term investment fund, which is a fund operated by the Treasurer of the Commonwealth of Pennsylvania, is reported at cost plus allocated interest, which approximates fair value. The security lending collateral pool, which is a fund operated by the securities lending agent, also is accounted for at cost plus accrued interest which approximates fair value. U.S. government obligations, corporate and foreign bonds and notes, and common and preferred stocks, are generally valued based on published market prices and quotations from national security exchanges and securities pricing services. Securities that are not traded on a national security exchange are valued by the asset manager or third parties based on similar sales. Mortgage loans are valued by the asset manager using the present value of future cash flows. Real estate is primarily valued based on appraisals performed by independent appraisers or, for properties not appraised, at the present value of the projected future net income stream. Alternative investments, which include venture capital, leveraged buyouts, international private equities, and other investments are valued based on amounts established by valuation committees. The values for real estate and alternative investments are reported on a one-quarter lag (September 30), adjusted for cash flows through December 31, 2000. Foreign exchange and futures contracts are marked-to-market daily with changes in fair value recognized as part of investments and investment income.

(Continued)

COMMONWEALTH OF PENNSYLVANIA
STATE EMPLOYEES' RETIREMENT SYSTEM
(a component unit of the Commonwealth of Pennsylvania)

Notes to Financial Statements

December 31, 2000 and 1999

(Dollar amounts in thousands)

The Collective Trust Funds (CTF) consist primarily of domestic and international institutional mutual and index funds. The funds do not pay interest or dividends to shareholders, and reinvest all income earned on securities held by the fund. The fair value of CTF is based on the reported share value of the respective fund. The CTF are principally managed by Barclays Global Investors, N.A. for which the United States Office of the Comptroller of the Currency has regulatory oversight.

Unsettled investment sales are reported as investment proceeds receivable and unsettled investment purchases are reported as investment purchases payable. Investment expenses consist of investment managers' fees and those administrative expenses directly related to the System's investment operations.

(d) Commitments

As of December 31, 2000 and 1999, the System had contractual commitments totaling approximately \$2,503 million and \$1,933 million, respectively, to fund future alternative investments and \$266 million and \$254 million to fund future real estate investments.

(e) Compensated Absences

The System accrues a liability for vacation leave as the benefits are earned by the employees to the extent the System will compensate the employee for the benefits through paid time off or some other means, such as cash payments at termination or retirement. Vacation leave vests 100% at the time it is earned up to 45 days, which are carried over to the next year at December 31. The System also accrues a liability for sick leave as the benefits are earned by the employees to the extent the System will compensate the employee for the benefits through cash payments at termination or retirement. Retiring employees of the System that meet service, age, or disability requirements are paid between 30% and 100% of sick days available at retirement, up to 163 maximum days. As of December 31, 2000 and 1999, \$1,847 and \$1,769, respectively, was accrued for unused vacation and sick leave for the System's employees.

(f) Administrative Expenses

Administrative expenses are financed through investment earnings.

(g) Federal Income Taxes

Management believes the System meets the definition of a Governmental Plan; in the System's communications with the Internal Revenue Service (IRS), it has been treated as a qualified plan, and is therefore considered exempt from federal income taxes. Therefore, the System has not requested a determination letter from the IRS relating to the status of the System under the Internal Revenue Code.

(Continued)

COMMONWEALTH OF PENNSYLVANIA
STATE EMPLOYEES' RETIREMENT SYSTEM
(a component unit of the Commonwealth of Pennsylvania)

Notes to Financial Statements

December 31, 2000 and 1999

(Dollar amounts in thousands)

(h) Risk Management

The System is exposed to various liabilities and risks of loss related to theft or destruction of assets, injuries to employees, and court challenges to fiduciary decisions. To cover such risks, the System carries directors and officers' liability insurance, and fiduciary liability insurance. It also requires asset managers to carry appropriate insurance coverages. As an administrative agency of the Commonwealth, the System is accorded sovereign immunity, and it participates in a state property insurance program. As Commonwealth employees, the System's employees receive health insurance benefits, disability retirement benefits, and workers' compensation benefits. During the past three fiscal years, insurance settlements did not exceed insurance coverage.

(3) Description of Funds

The Retirement Code requires the System to maintain the following funds representing the reserves held for future and current benefit payments:

The *0 HPEHU 6DIQJV \$FFRXQW* accumulates contributions and interest earnings of active employees. Member balances are transferred to the Annuity Reserve Accounts as members retire.

The *6VHHS FFXP XDMRQ \$FFRXQW* accumulates contributions of the employer and the earnings of the fund. Funds are transferred to the Annuity Reserve Accounts as members retire and as determined actuarially.

The *6XSSOP HJYDS QXIW \$FFRXQW* accumulates contributions for supplemental annuities. The negative balances represent the liability for past cost-of-living adjustments that are being amortized to actuarial required contributions over a period of 20 years from the effective date of each supplement. The balance in this account is actuarially determined.

The *\$QXIW 5 HLYH \$FFRXQW* are the accounts from which all death and retirement benefits and supplemental annuities are paid. The balance in this account is actuarially determined.

The *,QFHWS HLYH \$FFRXQW* accumulates all income earned by the fund and from which all administrative and investment expenses incurred by the fund and the Board necessary for operation of the System are paid. Any balance in this reserve is transferred to the State Accumulation Account at year end.

(Continued)

COMMONWEALTH OF PENNSYLVANIA
STATE EMPLOYEES' RETIREMENT SYSTEM
(a component unit of the Commonwealth of Pennsylvania)

Notes to Financial Statements

December 31, 2000 and 1999

(Dollar amounts in thousands)

Fund balances as of December 31, 2000 and 1999 are as follows:

	2000	1999
Members Savings Account	\$ 3,182,776	2,989,489
State Accumulation Account	17,918,667	18,349,480
Supplemental Annuity Account	(1,161,627)	(1,173,067)
Annuity Reserve Accounts:		
Annuitants and Beneficiaries	6,774,913	6,766,411
State Police	1,142,535	1,139,067
Enforcement Officers	23,204	21,801
Total	\$ 27,880,468	28,093,181

(4) Investments

As provided by statute, the System's Board of Trustees (Board) has exclusive control and management responsibility of System funds and full power to invest the funds. In exercising its fiduciary responsibility to System membership, the Board is governed by the "prudent person" rule, which requires the exercise of due care in establishing investment policy, and has adopted its Statement of Investment Policy to formally document investment objectives and responsibilities. This policy, as well as applicable state law, establishes guidelines for permissible investments of the System, including all investment types held in the portfolio at December 31, 2000 and 1999, and at all times during those years.

The System's investments are categorized below to give an indication of the level of custodial credit (counterparty) risk assumed by the System at December 31, 2000 and 1999. In accordance with a contractual relationship between the Commonwealth's Treasury Department and its custodial agent, substantially all investments subject to categorization are held in book-entry form. Therefore, all such investments are in Category 1, which is defined as insured or registered investments for which the securities are held by the System or its agent in the System's name.

(Continued)

COMMONWEALTH OF PENNSYLVANIA
STATE EMPLOYEES' RETIREMENT SYSTEM
(a component unit of the Commonwealth of Pennsylvania)

Notes to Financial Statements

December 31, 2000 and 1999

(Dollar amounts in thousands)

Investments may also be categorized as Category 2, which is defined as uninsured or unregistered investments for which the securities are held by the counterparty's trust department or agent in the System's name, and Category 3, which is defined as uninsured or unregistered investments for which the securities are held by the broker or dealer or by its agent, but not in the System's name. Additionally, the System has investments that are not in any of the three defined categories because securities are not used as evidence of the investment. Such investments are separately identified.

	2000	1999
Investments – Category 1:		
United States government securities	\$ 1,713,041	1,827,273
Corporate and foreign bonds and notes	2,959,058	2,903,670
Common and preferred stocks	6,933,472	9,967,347
Total Category 1 investments	11,605,571	14,698,290
Investments – not categorized:		
Investments held by broker/dealers under securities lending agreement:		
United States government securities	475,882	502,311
Corporate and foreign bonds and notes	273,128	152,363
Common and preferred stocks	256,381	448,912
Short-term investment fund	649,559	672,158
Collective trust funds	9,460,886	7,914,062
Mortgage loans	80,079	107,200
Real estate	2,627,710	2,335,028
Alternative investments	2,954,833	1,900,359
Total not-categorized investments	16,778,458	14,032,393
Total investments	\$ 28,384,029	28,730,683

The System is generally required to invest its excess cash, on a daily basis, in the Pennsylvania Department of Treasury's short-term investment fund, which is not subject to any regulatory oversight.

The System's real estate holdings that are located in the Commonwealth of Pennsylvania total approximately \$491 million and \$425 million or 18.7% and 18.2% of the real estate portfolio at December 31, 2000 and 1999, respectively. Concentrations of investments in a particular geographic area have certain risks and uncertainties associated with the concentration. The System's remaining real estate investments are not concentrated in any one geographic area or industry.

(Continued)

COMMONWEALTH OF PENNSYLVANIA
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(a component unit of the Commonwealth of Pennsylvania)

Notes to Financial Statements

December 31, 2000 and 1999

(Dollar amounts in thousands)

The System's investments in corporate and foreign bonds and notes include approximately \$1,049 million and \$920 million of high-yield bonds at December 31, 2000 and 1999, respectively.

(5) Securities Lending

In accordance with a contract between the Commonwealth's Treasurer and its custodian, the System participates in a securities lending program. State statutes neither specifically authorize nor prohibit the lending of the System's securities.

The custodian, acting as lending agent, lends the System's equity, debt, and money market securities for cash, securities, or letter-of-credit collateral. Collateral is required at 102% of the fair value of the securities loaned except for the equity securities of non-U.S. corporations, for which collateral of 105% is required. Collateral is marked-to-market daily. If the collateral falls below guidelines for the fair value of the securities loaned, additional collateral is obtained. Cash collateral is invested by the lending agent in accordance with investment guidelines approved by the Board. The lending agent cannot pledge or sell securities collateral unless the borrower defaults.

As of December 31, 2000 and 1999, the System's credit exposure to individual borrowers was limited because the amounts the System owed the borrowers exceeded the amounts the borrowers owed the System. The Treasurer's contract with the lending agent requires the agent to indemnify the System if the borrowers fail to return the underlying securities and the collateral is inadequate to replace the loaned securities or if the borrowers fail to pay income distributions on the loaned securities.

All securities loans at December 31, 2000 and 1999 could be terminated on demand by either the lending agent or the borrower. Cash collateral is invested, together with the cash collateral on securities loans of other Commonwealth entities, in a short-term collective investment pool. The duration of the investments in the pool at December 31, 2000 and 1999, was 24 days and 27 days, respectively. The relationship between the average maturities of the investment pool and the System's loans is affected by the maturities of the loans made by other entities in the investment pool. In addition, the interest rate risk posed by mismatched maturities is affected by other program features, such as the lending agent's ability to reallocate securities loans among all of its lending customers.

(Continued)

COMMONWEALTH OF PENNSYLVANIA
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(a component unit of the Commonwealth of Pennsylvania)

Notes to Financial Statements

December 31, 2000 and 1999

(Dollar amounts in thousands)

As of December 31, 2000 and 1999, respectively, the fair value of loaned securities was \$1,005,392 and \$1,103,586; the fair value of the associated collateral was \$1,032,005 and \$1,133,722 of which \$940,558 and \$1,083,831 was cash. The securities lending collateral pool is not categorized because securities are not used as evidence of the investment.

(6) Derivative and Structured Financial Instruments and Restricted Assets

The System enters into certain derivative and structured financial instruments primarily to enhance the performance and reduce the volatility of its portfolio. It enters into foreign exchange contracts to hedge foreign currency exposure, futures contracts to gain or hedge exposure to certain equity markets and to manage interest rate risk, and collateralized mortgage obligation (CMO) investments as part of its overall fixed income portfolio.

Foreign exchange contracts are agreements to exchange the currency of one country for the currency of another country at an agreed-upon price and settlement date. At December 31, 2000 and 1999, the System's contracts to purchase and sell foreign currencies totaled \$8,140,454 and \$7,414,864, with net unrealized (losses) gains of approximately (\$33.8) million and \$38.1 million. To reduce the risk of counterparty nonperformance, the System generally enters into these contracts with institutions regarded as meeting high standards of credit worthiness.

Futures contracts are standardized, exchange-traded contracts to purchase or sell a specific financial instrument at a predetermined price. Gains and losses on futures contracts are settled daily based on a notional (underlying) principal value and do not involve an actual transfer of the specific instrument. The System's futures contracts notional value at December 31, 2000 and 1999 was \$1,006 million and \$428 million. The exchange on which the futures are traded assumes the counterparty risk and generally requires margin payments to minimize such risk. The System pledges investment securities to provide the initial margin requirements on the futures contracts it buys. In addition to that collateral, the System also pledges securities on sales of securities that it does not presently own (short sales). The System enters into those short sales to neutralize the market risk of certain equity positions. The securities the System pledged as collateral on futures purchases and short sales at December 31, 2000 and 1999 represent restricted assets.

The fair value of the System's CMOs at December 31, 2000 and 1999 was approximately \$213 million and \$198 million. The System's CMOs were principally planned amortization class securities that have defined cash flow characteristics in a volatile interest rate environment. Other CMOs (interest-only strips, principal only strips, and inverse floaters) behave less predictably but offer value in certain market conditions. CMOs pose no greater credit risk than any other investment grade holding, but credit risk exists to the extent that the underlying collateral does not perform according to the contracted terms. CMOs have well-defined rules on remitting reserved amounts on defaulted collateral.

(Continued)

COMMONWEALTH OF PENNSYLVANIA
STATE EMPLOYEES' RETIREMENT SYSTEM
(a component unit of the Commonwealth of Pennsylvania)
Notes to Financial Statements (continued)
December 31, 2000 and 1999
(Dollar amounts in thousands)

The System mitigates its legal risk on investment holdings, including the previously discussed instruments, by carefully selecting portfolio managers and extensively reviewing their documentation. It manages its exposure to market risk within risk limits set by management.

The System also indirectly holds foreign exchange contracts, futures contracts; and certain swap contracts through its investments in collective trust funds. Those collective trust funds directly and indirectly (through a securities lending collateral pool) invest in those instruments to hedge foreign exchange exposure, to synthetically create equity returns, and to manage interest rate risk by altering the average life of the portfolio. Swap agreements provide for periodic payments between parties based on the net difference in the cash flows of underlying assets, indexes, or rates.

(7) Commission Recapture Program

The System has commission recapture contracts with several brokers. These contracts generally stipulate that the brokers rebate a percentage of commissions earned on investments directly to the System. During the years ended December 31, 2000 and 1999, the System earned \$928 and \$1,571 of benefits resulting from a commission recapture program, respectively. The System used the program to pay approximately \$1,130 and \$788 on consulting, advisory, and other expenditures for the years ended December 31, 2000 and 1999, respectively. At December 31, 2000 and 1999, the System has accumulated \$3,068 and \$3,270, respectively, of benefits that are available for future expenditures.

(8) Pension Plan for Employees of the System

The System also makes employer contributions. The System's employees' contribution requirements and benefits are described in note 1 to these financial statements. The System's contributions for the years ended December 31, 2000, 1999 and 1998 were \$198, \$395 and \$486, respectively, which were equal to the required contributions each year.

(9) Litigation and Contingencies

The System is involved in various individual lawsuits, generally related to benefit payments, which, if settled adversely, could increase estimated actuarial liabilities by up to one billion dollars. The individual cases involve legal issues that, if extended to the entire membership, may result in significant costs to the System. If such an event were to occur, the additional costs would be recovered by the System through adjustments to the employer contribution rate.

(Continued)

Required Supplementary Information

**COMMONWEALTH OF PENNSYLVANIA
STATE EMPLOYEES' RETIREMENT SYSTEM**
(a component unit of the Commonwealth of Pennsylvania)

Required Supplemental Schedule 1 – Schedule of Funding Progress
(Unaudited – see accompanying auditors' notes)
(Dollar amounts in millions)

Actuarial valuation year	Actuarial value of assets	Actuarial accrued liabilities (AAL)	Unfunded actuarial accrued liabilities (UAAL)	Ratio of assets to AAL	Covered payroll	UAAL as a percentage of covered payroll
1999	\$ 23,624	\$ 19,092	\$ (4,532)	123.7%	\$ 4,519	(100.3)%
1998	20,671	18,358	(2,313)	112.6	4,446	(52.0)
1997	18,565	17,288	(1,277)	107.4	4,219	(30.3)
1996	16,841	15,937	(904)	105.7	4,164	(21.7)
1995	15,510	15,067	(443)	102.9	4,022	(11.0)
1994	13,992	13,742	(250)	101.8	3,990	(6.3)

Required Supplemental Schedule 2 – Schedule of Employer Contributions
(Dollar amounts in thousands)

Year ended December 31	Annual required contributions	Percentage contributed
1999	\$269,869	100.3%
1998	310,501	100.0
1997	324,093	100.0
1996	373,903	100.0
1995	376,692	102.1
1994	342,158	100.2

See accompanying notes to required supplemental schedules of funding progress and employer contributions.

COMMONWEALTH OF PENNSYLVANIA
STATE EMPLOYEES' RETIREMENT SYSTEM
(a component unit of the Commonwealth of Pennsylvania)
Notes to Schedules of Funding Progress and Employer Contributions
(Unaudited – see accompanying auditors' report)

Actuarial information as of the latest actuarial valuation:

Valuation date	December 31, 1999
Actuarial cost method (a)	Variation of entry-age actuarial cost method
Amortization method	Increasing (5% annually)
Remaining amortization period	11 to 19 years, closed
Asset valuation method	5-year smoothed market
Actuarial assumptions:	
Investments rates of return (b)	8.5%
Projected salary increases (b)	5.16% - 8.98%
Cost-of-living adjustments (c)	As described below

(a) A variation of the entry-age normal actuarial cost method is used to determine the liabilities and costs related to all of the System's benefits including superannuation, withdrawal, death and disability benefits. The significant difference between the method used for the System and the typical entry-age normal actuarial cost method is that the normal cost is based on the benefits and contributions for new employees rather than for all current employees from their date of entry. This variation should produce approximately the same results as the typical method over the long run.

(b) Includes inflation at 3%.

(c) Information presented in the required supplementary schedules was determined as part of the actuarial valuation at the dates indicated. The December 31, 1997 valuation includes the effect of a cost of living adjustment to annuitants with an effective date of retirement on or prior to June 30, 1997. The adjustment ranged from 1.86% to 25%, depending on the date of retirement, was effective July 1, 1998, and increased actuarial accrued liabilities by \$478 million.

(Continued)

COMMONWEALTH OF PENNSYLVANIA
STATE EMPLOYEES' RETIREMENT SYSTEM
(a component unit of the Commonwealth of Pennsylvania)
Notes to Schedules of Funding Progress and Employer Contributions (continued)
(Unaudited – see accompanying auditors' report)

Significant Changes in Prior Years

Certain changes have been made in the plan or in actuarial assumptions that affect the trends in the amounts reported in the schedule of funding progress. Those changes also affected the trend in the annual required contributions reported in the schedule of employer contributions. Those changes were effective for the actuarial valuation report dated as of December 31, 1995.

For actuarial valuations through December 31, 1994, actuarial assumptions were as follows:

Actuarial assumptions:	
Investments rates of return	9.25%
Projected salary increases	6.70%

In addition, the demographic assumption was changed from the 1971 Group Annuity Mortality Table (GAM - 71) to the 1983 Group Annuity Mortality Table (GAM - 83) for current and future employees to reflect continuing mortality improvement. The GAM - 71 continues to apply for current retirees.

Also, in 1994, the actuarial assumption changed to reflect the adoption of a new pay scale that became effective January 1, 1994, and compressed the previous schedule of 35 steps to 20 steps. The new scale provides longevity increases for members who have at least one year of service. In addition, Act 1994-29 provided for a cost-of-living adjustment to annuitants with an effective date of retirement on or prior to June 30, 1992.

In the valuation years ended December 31, 1999, 1998, 1997, 1996 and 1995, actual investment earnings exceeded the expected rates of return, thereby causing an increase in the valuation years' actuarial value of assets reported in the schedule of funding progress and reduction in the following years' annual required contribution reported in the schedule of employer contributions.

Additional Financial Information

**COMMONWEALTH OF PENNSYLVANIA
STATE EMPLOYEES' RETIREMENT SYSTEM**

(a component unit of the Commonwealth of Pennsylvania)

Supplemental Schedule 1 - Administrative Expenses

Year Ended December 31, 2000

(Dollar amounts in thousands)

Personnel services:			
Salaries	\$	8,501	
Benefits		2,822	
Temporary personnel wages, overtime, and outservice training		<u>247</u>	
Total personnel services	\$		11,570
Professional services:			
Consultant fees		2,525	
EDP contractual services vendor provided		1,819	
Treasury Department services		676	
Commonwealth Central services		442	
Legal fees		<u>119</u>	
Total professional services			5,581
Rentals:			
Rent of real estate		1,176	
Other equipment rental		<u>215</u>	
Total rentals			1,391
Communication:			
Telephone		343	
Postage		247	
Printing and advertising		<u>103</u>	
Total communication			693
Other expenses:			
EDP and office equipment		809	
EDP software		439	
Supplies		405	
Travel and conferences		191	
Maintenance		174	
Subscriptions and memberships		<u>56</u>	
Total other expenses			2,074
Total administrative expenses			<u>\$ 21,309</u>

COMMONWEALTH OF PENNSYLVANIA
STATE EMPLOYEES' RETIREMENT SYSTEM
(a component unit of the Commonwealth of Pennsylvania)
Supplemental Schedule 2 – Investment Expenses and Consultant Fees
Year Ended December 31, 2000
(Dollar amounts in thousands)

Investment Expenses

Investment manager fees:			
Stocks		\$	42,171
Venture capital			28,192
Private equity			27,947
Real estate			23,226
Fixed income			12,505
TAA			4,891
			138,932
Total investment manager fees			
Investment related expenses:			
Alternative investments		\$	639
Real estate			414
Custodial			255
Legal			150
Fixed income			120
Other			16
			1,594
Total other fees			
Total investment expenses		\$	140,526

Consulting Fees

Firm	Category		
Cambridge Associates Inc.	Private Equity	\$	796
DoxSys. Inc.	EDP		425
BARRA RogersCasey, Inc.	General Investment		369
HayHuggins Company Inc.	Actuary		327
The Townsend Group	Real Estate		194
Unisys Corporations	EDP		112
Deloitte Consulting	EDP		95
Other			207
			2,525
Total consulting fees		\$	2,525

INVESTMENT



Report on Investment Activity

*Peter M. Gilbert
Chief Investment Officer*

May 2001

Dear Members:

As of year-end 2000, the net assets of your pension fund exceeded \$27 billion. According to the January 22, 2001 Pension & Investments survey, this places the State Employees' Retirement System (SERS) as the 37th largest employee benefit fund in the United States and the 26th largest public fund. During the year, net assets decreased by \$213 million with the total fund producing a return of 2.2% after fees and benefit payments. The longer-term results remain impressive with annualized returns of 12.5% over the past three years, 14.3% over the trailing five years and 13.7% over the past ten years. As a result of this record, the Fund enjoys a fully funded status and declining contributions to meet ever-increasing benefit obligations. We have been very fortunate that the performance of financial markets over the past five years has been very good. This compares very favorably with the actuarial assumed rate of return of 8.5%.

Most importantly, these returns have been earned in accordance with the investment policy and objectives set out by the Board of Trustees operating as fiduciaries in the sole interest of the beneficiaries and members of the Fund. The primary investment objective is to assure the adequate accumulation of reserves in the Fund at the least cost to the citizens of the Commonwealth while preserving the principal of the Fund against erosion from inflation. The objectives further state that the Board of Trustees seeks to meet these objectives within acceptable risk parameters through adherence to a policy of diversification of investments by type, industry, investment manager style and geographic location. As a long-term investor, this concept of diversification is key, as it allows the Fund to achieve its return objectives while at the same time reducing risk.

The SERS Investment Office, in conjunction with the Fund's three consultants, performs a review of the asset allocation annually, recommending any modifications to asset classes and future allocations. The results are reviewed and adopted by the Board of Trustees. The asset allocation decisions are among the most important decisions the Board of Trustees make in striving to achieve the Fund's investment objectives. Enabled by the passage of the Prudent Person legislation in 1994, the Fund has successfully broadened the range of diversification of asset classes in which we are able to invest. Perusal of the Investment Summary in the following pages will reveal the diversification of the asset classes and investment manager styles. In addition, the structure has been implemented in such a manner as to ensure broad diversification by industry and geographic location within, and across asset classes. Commensurate with the diversification is the reduction of risk the Fund has been able to achieve. In more colloquial terms, we are not trying to hit a home run or take one large bet; rather, we attempt to hit a lot of singles and spread our bets over a broad range of opportunities so that the odds are in our favor of achieving the Fund's long-term investment objectives.

The overall strong investment performance results over the past decade have been driven most notably by the recent extended bull market in U.S. stocks and a record-breaking ten-year expansion of the U.S. economy. During this period of rising markets and economic expansion, we have experienced historically low economic and financial volatility. Most of the surprises during this time have been positive and on the upside with exception to very near-term events. We have been blessed with both low inflation and low unemployment at the same time that growth has persisted. Because things have been so good, there is a tendency to underestimate risk going forward.

In 1999 the U.S. stock market saw higher levels of volatility and concerns over potential increases in inflation prompting the Federal Reserve Board to raise interest rates a total of ¾% in three tranches. During the first half of 2000, the Federal Reserve Board raised interest rates three more times for a total increase of 1% in response to continued inflationary concerns. Stock market volatility continued into 2000 with significantly sharper volatility arising from the 'technology bubble' which peaked in March. Corporate earnings began to decline and the economy faltered setting off a stock market correction around the globe. The so-called "new economy" technology and telecommunications companies that drove equities worldwide in 1999 led the correction in 2000. Consequently, negative stock market performance offset positive gains in the fixed income, real estate and alternative asset classes.

- ✓ The Board employs an investment staff and also contracts with investment advisors and consultants to provide expert, professional judgment in all investment decisions;
 - ✓ An annual Investment Plan is prepared to control the allocation of funds during the year among investment advisors and categories of assets;
 - ✓ Guidelines are established for each category of assets used by the Fund's investment advisors to provide a framework for monitoring quality, diversification and liquidity; and
 - ✓ Where investment characteristics, including yield, risk and liquidity, are equivalent, the Board's policy favors investments that have a positive impact on the economy of Pennsylvania.
- ✓ The Fund's overall investment objective is to provide a total rate of return, over full economic cycles, which exceeds the return of a fully diversified market portfolio within each asset class. The Board seeks to meet this objective within acceptable risk parameters through adherence to a policy of diversification of investments by type, industry, quality and geographic location;
- ✓ As fiduciaries, the Board will exercise that degree of judgment, skill and care under the circumstances then prevailing which persons of prudence, discretion and intelligence, who are familiar with such matters, exercise in the management of their own affairs in investment matters;
- ✓ The State Employees' Retirement Board adopted a formal Statement of Investment Policy in 1979. It has been revised periodically, principally to reflect and incorporate legislative changes governing investments. The purpose of the statement is to formalize the Board's investment objectives, policies, and procedures, to establish guidelines for the investment of Fund assets and to define the duties and responsibilities of the various entities involved in the investment process. The major elements of the statement are:

Investment Policies



Sincerely,

It is for these reasons that the Investment Office continuously monitors economic and market events and works to position the Fund through broad diversification to be in a position to address a variety of different economic scenarios. Consistent with this strategy, investments were expanded last year in the equity and alternative investment asset classes to further diversify investment styles and geographic exposures. In addition, we continue to rebalance the Fund on an ongoing basis toward our long-term asset allocation objectives in combination with both new investments and the need to provide capital to meet benefit obligations. Outside of this activity, you will notice that structurally relatively little has changed from the prior year. Under the supervision and guidance of the Board of Trustees, we believe the Fund structure is sound and has the ability to endure under a variety of market environments. We believe the Fund is well positioned to ensure the members receive the financial security that they have earned and that is due them.

Investment Objectives

To assure an adequate accumulation of reserves in the Fund at the least cost to the citizens of the Commonwealth and to provide some protection against the erosion of principal by inflation, the long-term investment objectives of the Fund, are:

- ✓ Achieve and maintain the State Employees' Retirement Fund in excess of the Actuarial Accrued Benefit Liability;
- ✓ Over the long run, achieve a positive real total rate of return (with inflation measured by the GDP Implicit Price Deflator);
- ✓ Over the long run, achieve an absolute total rate of return not less than the actuarial investment return assumption;
- ✓ Achieve in Domestic Stocks a total return that exceeds the total return of the Russell 3000 Index;
- ✓ Achieve in International Stocks a total return that exceeds the total return of the SERS Custom International Stock Index;
- ✓ Achieve in the Fixed Income asset class a total return that exceeds the total return of the SERS Custom Fixed Income Index;
- ✓ Achieve in the Equity Real Estate asset class a total return that exceeds the total return of the NCREIF Index;
- ✓ Achieve in the Cash asset class a total return that exceeds the total return on U.S. Treasury Bills (90 days);
- ✓ Achieve in the Venture Capital asset class a total return that exceeds either the Venture Economics' relevant Vintage Year Median Returns or relevant returns furnished for benchmark purposes by SERS's Venture Capital/Alternative Investments consultant;
- ✓ Achieve in the Alternative Investments asset class a total return that exceeds either market returns for similar types of alternative investments or relevant returns furnished for benchmark purposes by SERS's Venture Capital/Alternative Investments consultant.

Total return includes income and both realized and unrealized gains and losses and is computed on fair value. The Board seeks to meet these objectives within acceptable risk parameters through adherence to a policy of diversification of investments by type, industry, investment manager style and geographic location.

Investment Results

Schedule of Portfolio Returns* After Fees For the period ending December 31, 2000

<u>Asset Class</u>	<u>1 Year Total Return</u>	<u>3 Year Total Return</u>	<u>5 Year Total Return</u>	<u>10 year Total Return</u>
Domestic Stocks	-6.5%	11.0%	16.6%	17.0%
<i>Russell 3000 Index</i> ^{1/}	-7.5%	11.4%	17.1%	17.2%
International Stocks	-6.8%	13.2%	11.8%	11.1%
<i>MSCI World ex US Index through 12/93; thereafter, SERS Custom International Stock Benchmark (26% Hedged)</i> ^{2/}	-12.8%	8.0%	6.4%	7.3%
Fixed Income	7.6%	5.5%	6.7%	9.0%
<i>SERS Custom Fixed Income Benchmark</i> ^{3/}	11.2%	6.3%	6.4%	8.4%
Cash	6.3%	5.7%	5.6%	6.4%
<i>90 day U.S. T-bills</i>	6.2%	5.5%	5.4%	5.0%
Tactical Asset Allocation	-1.5%	12.8%	15.5%	15.7%
<i>70% stocks/30% bonds</i>	-0.5%	11.3%	15.3%	15.4%
Real Estate ^{4/}	13.0%	12.5%	12.9%	6.3%
<i>NCREIF</i>	11.8%	13.8%	12.3%	6.2%
Private Equity ^{4/}	28.2%	30.8%	28.2%	16.8%
Venture Capital ^{4/}	92.7%	52.1%	40.6%	26.4%
Total Fund	2.2%	12.5%	14.3%	13.7%

*Returns for periods longer than one year are annualized.

Note: The performance calculations were prepared using a time-weighted rate of return based on the market rate of return in accordance with AIMR's Performance Presentation Standards.

^{1/} The Domestic Stocks Benchmark is the Wilshire 5000 Index through 12/31/98, and the Russell 3000 thereafter.

^{2/} The SERS Custom International Index is constructed by combining developed and emerging markets outside of the United States.

^{3/} The SERS Custom Bond Index is constructed using the following indices: 20% Lehman Brothers Intermediate Government Bond Index; 30% Lehman Brothers Long Term Government Bond Index; 25% Lehman Brothers Corporate Bond Index; and 25% Lehman Brothers Mortgage Backed Securities Index.

^{4/} Results for the Real Estate, Private Equity, and Venture Capital are lagged one quarter.

Asset Allocation

**COMMONWEALTH OF PENNSYLVANIA
STATE EMPLOYEES' RETIREMENT SYSTEM
Asset Allocation Report
December 31, 2000
(Unaudited)**

**Total Fund Summary
(in millions)**

	Fair Value	% of Total Fund	2000 Plan Policy Target
Domestic Stocks	\$ 9,523.1	34.2%	39.6%
International Stocks	5,997.9	21.5%	21.0%
Currency Overlay	(11.8)	0.0%	0.0%
Fixed Income	5,368.2	19.3%	18.5%
Cash	155.4	0.6%	0.0%
Tactical Asset Allocation	1,319.5	4.7%	5.0%
Real Estate	2,639.6	9.5%	8.5%
Alternative Investments			
Venture Capital	1,170.5	4.2%	
Private Equity	1,714.6	6.2%	
Total Alternative Investments	2,885.1	10.4%	7.4%
Total Fund	\$ 27,877.0	100.0%	100.0%

Numbers in this report may not add due to rounding.

Asset Allocation Report (continued)
Dec 31, 2000
Unaudited

Domestic Stocks	(\$ in millions)	% Domestic	% of Total	% of Total
Passively Managed Portfolios	Fair Value	Stocks	Stocks	Fund
Barclays - Equity Index Fund (S&P 500)	\$ 6,692.9	70.3%	43.1%	24.01%
<i>Actively Managed Portfolios</i>				
AIM Cash Equitization Account **	(28.7)	-0.3%	-0.2%	-0.10%
AXA Rosenberg Investment Mgmt. – Mkt Neutral	92.3	1.0%	0.6%	0.33%
AXA Rosenberg Investment Management LLC	302.4	3.2%	1.9%	1.08%
Artemis Investment Management	118.4	1.2%	0.8%	0.42%
Emerald Advisers - PA Portfolio	107.5	1.1%	0.7%	0.39%
Fidelity Management Trust Company	215.4	2.3%	1.4%	0.77%
First Quadrant - Mkt Neutral	94.6	1.0%	0.6%	0.34%
Iridian Asset Management	412.3	4.3%	2.7%	1.48%
J.P. Morgan Investment Management	238.6	2.5%	1.5%	0.86%
Martingale - Mkt Neutral	86.5	0.9%	0.6%	0.31%
Mellon Equity Associates - PA Portfolio	134.1	1.4%	0.9%	0.48%
Mellon Equity Associates - Special Equity	358.8	3.8%	2.3%	1.29%
Provident Investment Counsel	196.5	2.1%	1.3%	0.70%
Provident Investment Counsel - Stellar Fund	206.1	2.2%	1.3%	0.74%
Standish, Ayer & Wood - Mkt Neutral	104.7	1.1%	0.7%	0.38%
Trinity Small Cap Value	107.1	1.1%	0.7%	0.38%
Warburg Pincus Distribution Account	83.6	0.9%	0.5%	0.30%
<i>Domestic Active Stocks Total</i>	2,830.2	29.7%	18.2%	10.15%
<i>Domestic Stocks Total</i>	\$ 9,523.1	100.0%	61.4%	34.16%

** The \$(28.7) million negative balance reflected in the AIM account is not a liability of the fund. AIM margins are settled on a daily basis. This balance represents the valuation adjustment resulting from the effect of the equitization of cash in our active domestic stock manager accounts. In 2000, the S&P 500 Index under-performed cash resulting in the negative balance.

International Stocks	(\$ in millions)	% of Int'l	% of Total	% of Total
Passively Managed Portfolios	Fair Value	Stocks	Stocks	Fund
Barclays - Europe Funds	\$ 742.0	12.4%	4.8%	2.66%
Barclays - Australia/New Zealand Funds	27.4	0.5%	0.2%	0.10%
<i>International Passive Stocks Total</i>	769.4	12.8%	5.0%	2.76%
<i>Actively Managed Portfolios</i>				
Credit Suisse Asset Management - Core	664.8	11.1%	4.3%	2.39%
Emerging Markets Growth Fund	137.0	2.3%	0.9%	0.49%
GAM Int'l Management - Pacific Basin ex Japan	110.4	1.8%	0.7%	0.40%
J.P. Morgan Investment Management - Japan	481.5	8.0%	3.1%	1.73%
Marathon Asset Management - Europe	402.9	6.7%	2.6%	1.45%
Marvin and Palmer	75.3	1.3%	0.5%	0.27%

Asset Allocation Report (continued)
Dec 31, 2000
Unaudited

	(\$ in millions)	% of Int'l	% of Total	% of Total
	Fair Value	Stocks	Stocks	Fund
Merrill Lynch Investment Managers	535.9	8.9%	3.5%	1.92%
Morgan Stanley - EAFE	819.1	13.7%	5.3%	2.94%
Morgan Stanley - Asia ex Japan	72.0	1.2%	0.5%	0.26%
OCM Emerging Markets	51.8	0.9%	0.3%	0.19%
Pictet Int'l Management - Small Cap	273.3	4.6%	1.8%	0.98%
Pictet Int'l Management - Emerging Markets	104.2	1.7%	0.7%	0.37%
Scottish Widows Investment Ptnship Ltd - Europe	356.2	5.9%	2.3%	1.28%
Henderson North American Partners	260.4	4.3%	1.7%	0.93%
Templeton Investment Counsel - Core	784.2	13.1%	5.1%	2.81%
TIFI - Emerging Markets	95.2	1.6%	0.6%	0.34%
Templeton - TGRP	4.5	0.1%	0.0%	0.02%
<i>International Active Stocks Total</i>	\$ 5,228.6	87.2%	33.7%	18.76%
<i>International Stocks Total</i>	\$ 5,997.9	100.0%	38.6%	21.52%
<i>Domestic and International Stocks Total</i>	\$ 15,521.0		100.0%	55.68%

	(\$ in millions)	% of Total	% of Total
	Fair Value	Currency Overlay	Fund
Currency Overlay			
Pareto Partners	\$ (28.6)	242.5%	-0.10%
Record Treasury	16.8	-142.5%	0.06%
<i>Overlay Total</i>	\$ (11.8)	100.0%	-0.04%

	(\$ in millions)	% of Total	% of Total
	Fair Value	Fixed Income	Fund
Fixed Income			
Passively Managed Core Portfolios			
Mellon Bond Associates	\$ 612.5	11.4%	2.20%
Actively Managed Core Portfolios			
Fischer Francis Trees & Watts - International	460.4	8.6%	1.65%
J. P. Morgan Investment Management	694.4	12.9%	2.49%
John Hancock	211.7	3.9%	0.76%
Legg Mason Real Estate Advisors	81.6	1.5%	0.29%
MDL Capital Management	74.5	1.4%	0.27%
Miller, Anderson & Sherrerd - Domestic	917.1	17.1%	3.29%
Miller, Anderson & Sherrerd - Global	849.2	15.8%	3.05%
Taplin Canada	50.5	0.9%	0.18%
<i>Active Core Fixed Income Port. Total</i>	3,339.4	62.2%	11.98%
<i>Core Fixed Income Portfolios Total</i>	\$ 3,951.9	73.6%	14.18%

Asset Allocation Report (continued)
Dec 31, 2000
Unaudited

	(\$ in millions)	% of Total	% of Total
<u>Actively Managed High Yield Portfolios</u>	<u>Fair Value</u>	<u>Fixed Income</u>	<u>Fund</u>
Berwind - PA Capital Fund	4.6	0.1%	0.01%
Fidelity Management Trust Company - CMBS	155.9	2.9%	0.56%
PNC Equity - PA Capital Fund	13.9	0.2%	0.05%
Salomon Brothers	435.4	8.1%	1.56%
Trust Company of the West - Funds III	0.1	0.0%	0.00%
W. R. Huff Asset Management	806.4	15.0%	2.89%
<i>Active Specialty Fixed Income Port. Total</i>	\$ 1,416.3	26.4%	5.07%
<i>Fixed Income Total</i>	\$ 5,368.2	100.0%	19.25%

	(\$ in millions)	% of Total	% of Total
<u>Cash</u>	<u>Fair Value</u>	<u>Cash</u>	<u>Fund</u>
PA State Treasury - STIF *	\$ 155.4	100.0%	0.56%

* SERS investment advisors' cash balances are reflected within their own fair values but in fact are invested in the PA Treasury Short Term Investment Fund (STIF). The total STIF balance reported by the Master Trust Custodian was \$655 million at the end of the month.

	(\$ in millions)	Allocation	% of Total
<u>Tactical Asset Allocation</u>	<u>Fair Value</u>	<u>(Stocks / Bonds/ Cash)</u>	<u>Fund</u>
Barclays - Enhanced US 70/30 TAA Fund	\$ 1,319.5	85% / 10% / 5%	4.73%

	(\$ in millions)	% of Total	% of Total
<u>Real Estate</u>	<u>Fair Value**</u>	<u>Real Estate</u>	<u>Fund</u>
<u>Separate Account Portfolios</u>			
CRA Real Estate Securities	\$ 357.5	13.5%	1.28%
Forest Investment Associates	155.6	5.9%	0.56%
Heitman/JMB	299.1	11.3%	1.07%
LaSalle Investment Management	230.5	8.7%	0.83%
Lowe Enterprises	424.3	16.1%	1.52%
Legg Mason / RAI Real Estate Advisors	215.4	8.2%	0.77%
<i>Separate Account Portfolios Total</i>	1,682.5	63.7%	6.04%

Asset Allocation Report (continued)	Dec 31, 2000	Unaudited	
	(\$ in millions)	% of Total	% of Total
	Fair Value**	Real Estate	Fund
Pooled Fund Portfolios			
Allegis - 4 pooled funds	\$ 143.1	5.4%	0.51%
Apollo III	53.4	2.0%	0.19%
Berwind Property Group IV	21.2	0.8%	0.08%
Berwind Property Group V	6.7	0.3%	0.02%
Blackstone II	46.1	1.7%	0.17%
Blackstone III	23.8	0.9%	0.09%
AEW CIIF-II	5.9	0.2%	0.02%
Cliffwood Select	24.8	0.9%	0.09%
Eastern Retail Holdings	45.8	1.7%	0.16%
Goldman Sachs - Whitehall	62.8	2.4%	0.23%
JMB Group Trust III	5.9	0.2%	0.02%
Lubert Adler Real Estate II	26.2	1.0%	0.09%
Lubert Adler Real Estate III	3.3	0.1%	0.01%
Miller Global III	17.5	0.7%	0.06%
SSR Realty (MIAF I & MIAF II)	10.4	0.4%	0.04%
Oxford Real Estate	56.9	2.2%	0.20%
Prudential	17.2	0.7%	0.06%
Sentinel Corporation	59.8	2.3%	0.21%
Starwood Capital IV	59.1	2.2%	0.21%
Starwood Capital V	49.7	1.9%	0.18%
Westbrook II	42.6	1.6%	0.15%
Westbrook III	76.3	2.9%	0.27%
TCW VI/OCM Opportunity Fund A & B	98.6	3.7%	0.35%
<i>Pooled Fund Portfolios Total</i>	957.1	36.3%	3.43%
<i>Real Estate Total</i>	\$ 2,639.6	100.0%	9.47%

** Fair Values represent September 30, 2000 values as reported by the investment managers adjusted for allocations and distributions. Values for publicly traded REITs represent values reported as of December 31, 2000

	(\$ in millions)	% of Total	% of Total
	Fair Value**	Venture Capital	Fund
Alternative Investments - Venture Capital			
Adams Cap Mgt II	\$ 19.6	1.7%	0.07%
Adams Cap Mgt III	1.5	0.1%	0.01%
Advent VII	7.3	0.6%	0.03%
Advent VIII	27.7	2.4%	0.10%
Advent IX	4.0	0.3%	0.01%
Advanced Tech Ventures	4.3	0.4%	0.02%

Asset Allocation Report (continued)
Dec 31, 2000
Unaudited

	(\$ in millions) Fair Value**	% of Total Venture Capital	% of Total Fund
Alloy Ventures 2000	3.8	0.3%	0.01%
APA/Fostin - Fund I	1.2	0.1%	0.00%
APAX/Excelsoir VI	7.2	0.6%	0.03%
Apex Fund IV	22.6	1.9%	0.08%
Atlas Ventures IV	29.6	2.5%	0.11%
Atlas Ventures V	18.1	1.5%	0.06%
Audax	5.1	0.4%	0.02%
Bachow III	25.8	2.2%	0.09%
CEO Venture Fund II	3.5	0.3%	0.01%
Cross Atlantic Tech Fund	17.3	1.5%	0.06%
Draper Fisher VI	4.2	0.4%	0.01%
Draper Fisher VII	2.1	0.2%	0.01%
Draper Triangle	6.2	0.5%	0.02%
Edison III	7.4	0.6%	0.03%
Fairview Capital I	6.4	0.5%	0.02%
Fairview Capital II	3.9	0.3%	0.01%
Fostin Capital II	1.6	0.1%	0.01%
Frazier Healthcare III	15.6	1.3%	0.06%
Grotech Partners III	0.8	0.1%	0.00%
Grotech Partners IV	14.2	1.2%	0.05%
Grotech Partners V	22.8	1.9%	0.08%
Halpern & Denny II	21.8	1.9%	0.08%
Halpern & Denny III	4.0	0.3%	0.01%
Harbourvest VI	62.2	5.3%	0.22%
Healthcare Ventures III	23.9	2.0%	0.09%
Healthcare Ventures V	30.4	2.6%	0.11%
Healthcare Ventures VI	7.8	0.7%	0.03%
Interwest Partners VIII	2.4	0.2%	0.01%
JP Morgan	67.8	5.8%	0.24%
JP Morgan II	2.5	0.2%	0.01%
Keystone IV	12.3	1.1%	0.04%
Keystone V	25.8	2.2%	0.09%
Keystone VI	0.5	0.0%	0.00%
Kline Hawkes Pacific	2.4	0.2%	0.01%
NEA VI	15.4	1.3%	0.06%
NEA VII	60.0	5.1%	0.22%
NEA IX	16.3	1.4%	0.06%
NEA X	3.5	0.3%	0.01%
NEPA Venture I	15.0	1.3%	0.05%
NEPA Venture II	6.9	0.6%	0.02%

Asset Allocation Report (continued)
Dec 31, 2000
Unaudited

	(\$ in millions) Fair Value**	% of Total Venture Capital	% of Total Fund
NEPA – Mid Atlantic Venture III	27.6	2.4%	0.10%
NEPA – Mid Atlantic Venture IV	9.4	0.6%	0.03%
PA Fund I	38.4	3.3%	0.14%
PA Fund III	121.0	10.3%	0.43%
PNC Equity Fund	0.0	0.0%	0.00%
Point Venture II	0.2	0.0%	0.00%
Polaris Venture Capital	40.6	3.5%	0.15%
Polaris Venture Capital II	45.4	3.9%	0.16%
Polaris Venture Capital III	17.5	1.5%	0.06%
SCP Private Equity II	12.0	1.0%	0.04%
Sprout VII	23.7	2.0%	0.09%
Summit Venture IV	10.8	0.9%	0.04%
Summit Venture V	27.4	2.3%	0.10%
Summit Acclerator	3.7	0.3%	0.01%
Technology Leaders III	14.9	1.3%	0.05%
Technology Leaders IV	26.7	2.3%	0.10%
Technology Leaders V	4.0	0.3%	0.01%
Three Arch Capital	1.2	0.1%	0.00%
US Venture Fund VII	7.5	0.6%	0.03%
Weston Presidio II	9.9	0.8%	0.04%
Weston Presidio III	18.5	1.6%	0.07%
Weston Presidio IV	1.6	0.1%	0.01%
Whitney Equity Partners III	27.1	2.3%	0.10%
Whitney Equity Partners IV	16.5	1.4%	0.06%
<i>Venture Capital Total</i>	\$ 1,170.5	100.0%	4.20%

** Fair Values represent September 30, 2000 values as reported by the investment managers adjusted for allocations and distributions. Pennsylvania law imposes a 2% venture capital ceiling based on book value. This report reflects fair value, which is higher than the book value.

	(\$ in millions) Fair Value**	% of Total Private Equity	% of Total Fund
Alternative Investments - Private Equity			
Abacus Fund	\$ 13.9	0.8%	0.05%
ABRY Broadcast Partners III	16.7	1.0%	0.06%
ABS Capital III	25.4	1.5%	0.09%
APAX Partners - France	2.9	0.2%	0.01%
APAX Partners - Germany	0.3	0.0%	0.00%

	(\$ in millions)	% of Total	
	Fair Value**	Private	% of Total
		Equity	Fund
APAX Partners - Germany II	11.2	0.7%	0.04%
APAX Partners - Germany IV	14.2	0.8%	0.05%
APAX Partners - UK VI	7.7	0.5%	0.03%
Apollo Advisors IV	68.3	4.0%	0.24%
Asia Pacific III	10.8	0.6%	0.04%
Bain Capital Fund	2.7	0.2%	0.01%
BC European Cap VII	8.5	0.5%	0.03%
B III Capital Partners (DDJ)	38.9	2.3%	0.14%
Blackstone II	21.6	1.3%	0.08%
Blackstone III	52.8	3.1%	0.19%
Blackstone Communications I	1.7	0.1%	0.01%
Cerberus	40.1	2.3%	0.14%
Charterhouse II	16.2	0.9%	0.06%
Charterhouse III	34.4	2.0%	0.12%
Clayton, Dubilier & Rice V	42.1	2.5%	0.15%
Clayton, Dubilier & Rice VI	16.9	1.0%	0.06%
Code, Hennesy & Simmons I	0.4	0.0%	0.00%
Code, Hennesy & Simmons II	13.2	0.8%	0.05%
Code, Hennesy & Simmons III	36.4	2.1%	0.13%
Code, Hennesy & Simmons IV	27.8	1.6%	0.10%
DLJ Merchant Banking Fund II	97.5	5.7%	0.35%
Frontenac VII	42.7	2.5%	0.15%
Francisco Partners	12.2	0.7%	0.04%
Golder, Thoma, Cressey & Rauner V	13.7	0.8%	0.05%
Golder, Thoma, Cressey & Rauner VI	39.7	2.3%	0.14%
Golder, Thoma, Cressey & Rauner VII	14.0	0.8%	0.05%
Great Hill	33.1	1.9%	0.12%
Gryphon Partners II	2.8	0.2%	0.01%
Harborvest II	18.5	1.1%	0.07%
Harborvest III	12.1	0.7%	0.04%
Hellman & Friedman II	0.0	0.0%	0.00%
Hellman & Friedman III	18.0	1.0%	0.06%
Hellman & Friedman IV	6.1	0.4%	0.02%
Invemed Fund	7.1	0.4%	0.03%
Kelso V	53.8	3.1%	0.19%
Kelso VI	29.6	1.7%	0.11%
Landmark IV	5.9	0.3%	0.02%
Landmark V	14.2	0.8%	0.05%
Lexington II	14.9	0.9%	0.05%

Asset Allocation Report (continued)
Dec 31, 2000
Unaudited

	(\$ in millions) Fair Value**	% of Total Private Equity	% of Total Fund
Lexington III	20.2	1.2%	0.07%
LLR Equity Partners	5.7	0.3%	0.02%
Madison Dearborn I	13.9	0.8%	0.05%
Madison Dearborn II	72.1	4.2%	0.26%
Madison Dearborn III	62.4	3.6%	0.22%
Media Communications Partners III	56.9	3.3%	0.20%
Media Communications Partners IV	20.4	1.2%	0.07%
Media Communication Partners V	3.5	0.2%	0.01%
Murphy & Partners	0.9	0.1%	0.00%
Newbridge Asia II	12.0	0.7%	0.04%
Oakhill	31.6	1.8%	0.11%
Oaktree Opportunities	15.3	0.9%	0.05%
Oaktree Opportunities II	45.2	2.6%	0.16%
Oaktree Opportunities III	52.1	3.0%	0.19%
Oaktree Principal Opportunities	30.4	1.8%	0.11%
Palamon Partners	6.7	0.4%	0.02%
Providence Equity Partners V	0.1	0.0%	0.00%
RRZ Private Equity Fund	41.1	2.4%	0.15%
Schroder Ventures UK III	0.9	0.1%	0.00%
Schroder Ventures UK IV	11.0	0.6%	0.04%
Schroder European I	17.6	1.0%	0.06%
Schroder European II	12.6	0.7%	0.05%
TCW - Fund V	10.9	0.6%	0.04%
Thomas Lee Equity Fund IV	87.4	5.1%	0.31%
TPG Partners II	69.4	4.0%	0.25%
TPG Partners III	20.0	1.2%	0.07%
Vestar Capital III	18.2	1.1%	0.07%
Vestar Capital IV	14.5	0.8%	0.05%
<i>Private Equity Total</i>	\$ 1,714.6	100.0%	6.15%

** Fair Values represent September, 2000 values as reported by the investment managers adjusted for allocations and distributions.

Numbers may not add due to rounding.

Largest Assets Held

Presented in the tables below are the largest domestic and international equity holdings and largest fixed income holdings as of December 31, 2000.

As of December 31, 2000 SERS held units in the following index funds:

Holding	Fair Value
Barclays Global Investors Equity Index (S&P 500)	\$6,692,906,790
Barclays Global Investors Tactical Asset Allocation Fund (70% S&P 500 / 30% Lehman bond at December 31, 2000)	1,319,469,709
Barclays Global Investors Europe Index	741,941,655

Top 10 Domestic and International Equity holdings At December 31, 2000

Domestic Equity		International Equity	
Holding	Fair Value	Holding	Fair Value
General Elec Co Com	\$ 304,423,262.25	Total Fina ELF EURIO	\$ 67,389,027
Exxon Mobil Corp	191,854,599.67	Vodafone Group	56,535,259
Pfizer Inc Com	185,889,193.18	Nippon Tel & Tel Corp	55,240,989
Cisco Sys Inc Com	177,920,593.54	ING Groep NV CVA	50,687,770
Citigroup Inc Com	167,907,080.26	GlaxoSmithKline	45,257,381
Walmart Stores Inc Com	148,585,569.83	E. ON AG NPV	41,386,892
Microsoft Corp Com	146,348,342.13	Shell Trans & Trdg	40,419,911
American Intl Group Inc Com	143,525,013.38	Aventis Eur 3.82	37,120,752
Merck & Co Inc Com	138,705,011.02	Akzo Nobel	36,015,799
Intel Corp Calif Com	127,586,219.18	Koninklijke Philips	33,093,385

Top 10 Fixed Income holdings in actively managed accounts at December 31, 2000

Holding	Fair Value
US Treasury Bonds, 5.25%, Feb 15, 2029	\$ 89,498,347
Japan Bonds, 0.9%, Dec 22, 2008	77,083,983
FNMA Debentures, 6.25%, May 15, 2029	58,021,653
FHLMC Debentures, 6.625%, Sep 15, 2009	51,903,699
Germany Fed Rep Bonds, 4.25%, Feb 18, 2005	48,364,448
Italy Rep Bonds, 4.25%, Nov 1, 2009	47,229,396
US Treasury Bond, Stripped Prin Pmt, 8.75%, August 15, 2020	38,111,288
International Cabletel, Inc, 11.5%, Feb 1, 2006	34,295,713
Japan Bonds, 3.4%, June 20, 2005	33,902,235
United States Treasury Bonds, 6.25%, May 15, 2030	33,490,912

Schedule of Broker Commissions

Year Ended December 31, 2000

<u>BROKER</u>	<u>COMMISSIONS</u>	<u>BROKER</u>	<u>COMMISSIONS</u>
MERRILL LYNCH	\$ 1,781,442	CARNEGIE	\$ 134,947
BEAR STEARNS	1,610,481	SK INTERNATIONAL SECURITIES	134,409
C S FIRST BOSTON	1,263,313	SG COWEN SECURITIES	132,746
SALOMON SMITH BARNEY	1,143,947	SPEAR LEEDS & KELLOGG	132,650
MORGAN STANLEY	1,041,672	MONTGOMERY SECURITIES	127,648
GOLDMAN SACHS	931,068	SCHROEDER SECURITIES	124,588
WARBURG DILLON READ, LLC	736,551	PRUDENTIAL SECURITIES	122,681
LEHMAN BROS	716,050	B TRADE SERVICES	121,188
PAINE WEBBER	588,287	DAIWA BANK	113,657
BNP CAPITAL MARKETS	560,943	BANK OF NEW YORK	106,151
INVESTMENT TECHNOLOGY GROUP	543,283	WEEDEN & COMPANY	99,083
INSTINET	460,454	VICKERS BALLAS	93,681
KLEINWORT BENSON	435,279	THE EUROPE COMPANY	90,816
JAMES CAPEL	409,443	CHEUVREUX DE VIRIEU	86,560
CREDIT LYONNAIS	405,054	COLLINS STEWART	86,455
LYNCH JONES & RYAN	394,344	WILLIAMS CAPITAL GROUP	81,113
DEUTSCHE MORGAN GRENFELL	390,357	PETERCAM	78,274
ABN AMRO	384,738	CANTOR FITZGERALD	77,180
ROBERT FLEMING	352,567	J B WERE & SON	76,513
ING BANK	348,277	COMMERZBANK	76,418
UNION BANK SWITZERLAND	331,370	PCS SECURITIES	72,994
DEUTSCHE BANK	328,127	JONES & ASSOCIATES	72,719
DONALDSON, LUFKIN, & JENRETTE	306,254	LG SECURITIES	71,409
ROCHDALE SECURTIES	305,476	JULIUS BAER SECURITIES	69,389
HSBC SECURITIES	293,984	AUTRANET	67,456
J P MORGAN	267,619	EXECUTION SERVICES	66,072
CAZENOVE	243,265	HEFLIN & CO LLC	65,695
JARDINE FLEMING BROKERING	235,253	FOX-PITT KELTON	64,013
HOARE GOVETT	226,650	SG SECURITIES	60,926
CI NORDIC SECURITIES	225,075	KEMPEN	60,881
U.B.S. SECURITIES	222,432	LEGG MASON	60,038
D E SHAW SECURITIES	218,655	STANDARD AND POORS SEC	58,559
DB CLEARING SERVICES	217,262	MORGAN GRENFELL	56,719
NOMURA BANK INTERNATIONAL	213,752	GREEN STREET ADVISORS	56,455
W I CARR	193,892	SAL OPPENHEIM JR & CIE	53,161
OPPENHEIMER	182,681	BRIDGE TRADING COMPANY	51,483
JEFFERIES & COMPANY	176,134	J VONTOBEL	49,546
MORGAN GUARANTY TRUST	172,230	ENSKILDA SECURITIES	49,014
ROBERTSON STEPHENS	171,841	A B ASESORES	46,421
SOCIETE GENERALE	159,532	ERNST & COMPANY	45,971
EXANE	148,675	SCHWAB CHARLES	45,622

Schedule of Broker Commissions
(Continued)

<u>BROKER</u>	<u>COMMISSIONS</u>	<u>BROKER</u>	<u>COMMISSIONS</u>
NUTMEG SECURITIES	44,493	M M WARBURG BRINCKMANN	17,812
THOMAS & WEISEL	42,453	LASKER STONE & STERN	17,633
TROSTER SINGER	42,179	DAIN RAUSCHER	17,476
JAVELIN SECS	42,127	CREDIT AGRICOLE	17,168
DAVY STOCKBROKERS	41,885	EWING CAPITAL	17,019
ROSENBLATT	41,268	GK GOH SECURITIES	16,780
SCANDINAVIAN BK GROUP PLC	41,097	KOKUSAI EUROPE	16,555
CHINA EVERBRIGHT SECURITIES	41,032	CROSBY CUSTODIAL SERVICES	16,306
LEWCO SECURITIES	36,765	QUAKER SECURITIES	16,086
SANFORD C BERNSTEIN & CO	36,136	WESTLB PANMURE	15,393
SOUNDVIEW FINANCIAL GROUP	35,365	MORGAN KEEGAN	15,291
LATINVEST SECS INC	34,004	RABO SECURITIES	15,260
ABG SECURITIES	33,325	STERNE AGEE & LEACH	15,106
C L GLOBAL PARTNERS	31,766	PERSHING	14,938
ICHIYOSHI SECURITIES	31,279	DEAN WITTER REYNOLDS	14,865
FIDELITY CAPITAL MARKETS	30,669	SIGMA SECURITIES	14,627
CITATION GROUP	29,152	DEVETOGLOU	14,545
PRINCETON SECURITIES GROUP	29,096	MAYER & SCHWEITZER	14,195
TSUBASU SECURITIES TOKYO	28,866	LOEB PARTNERS	14,106
ELKINS MCSHERRY	28,214	NATIONAL FINANCIAL SERVICES	13,834
FIRST UNION CAP MKTS	27,556	MONNESS	13,780
DEN DANSKE BANK	25,209	BBV LATINVEST SECURITIES LTD	13,563
BROOKS SECURITIES INC	24,493	ORD MINNETT	13,357
HAMBRECHT & QUIST	24,086	BLACKFORD SECURITIES	13,290
KNIGHT SECURITIES BROADCORT	24,081	FIRST ALBANY	13,104
JANNEY MONTGOMERY SCOTT	23,958	HENDERSON CROTHWAITE	12,902
SCOTIA MCLEOD (USA)	23,948	KIM ENG SEC LTD	12,785
BROWN BROTHERS HARRIMAN	23,684	TORONTO DOMINION BK	12,403
LAZARD FRERES	22,839	MAXUS	12,177
THOMSON INST. SERVICES	22,764	SVENSKA HANDELSBANKEN	12,135
WESTLB SECS	22,718	SEIDLER COMPANY	11,994
WESTMINSTER RESEARCH ASSOC	22,555	ALLEN & COMPANY	11,599
UTENDAHL CAPITAL PARTNERS	21,938	DEUTSCHE SECURITIES	11,445
RAYMOND JAMES & ASSOC INC	21,595	WILLIAM BLAIR & COMPANY	11,355
MAGNA SEC CORP	20,435	FANO SECURITIES	11,140
BCI	20,005	ROBINSON & HUMPHREY	10,916
PEREIRE-TOD LTD	19,928	BANQUE PARIBAS	10,788
CAPITAL INST. INVESTORS	18,990	WILSHIRE SANTA MONICA	10,746
WAKO INTL EUROPE	18,748	HAAS BROKER	10,456
A G EDWARDS & SONS INC	18,447	NEUBERGER & BERMAN	10,301
BARNARD JACOBS MELLET	18,020	PIPER JAFFRAY & HOPWOOD	10,027
THEODOOR GILISSEN	17,912	Other Brokers (169)	505,852
		Total Commissions	<u><u>\$ 24,955,200</u></u>

Investment Summary

The assets of the State Employees' Retirement System (SERS) are administered by the SERS Board of Trustees (Board). The Board has adopted an Investment Policy (Policy) that incorporates the provisions of the Retirement Code which govern the investment of SERS' assets. The Policy provides investment objectives and guidelines. An Investment Plan is reviewed and updated annually for strategic asset allocation purposes, as well as for diversification needs within each asset class.

Fair Value as of December 31, 2000: SERS' assets had an unaudited fair value of approximately \$27,877.0 million on December 31, 2000.

SERS Asset Allocation (\$ in millions)

Asset Class	Market Value		2000
	\$	%	Target Allocation
Domestic Stocks	\$9,523.1	34.2%	39.6%
International Stocks	5,997.9	21.5%	21.0%
Currency Overlay	(11.8)	0.0%	0.0%
Fixed Income	5,368.2	19.3%	18.5%
Cash	155.4	0.6%	0.0%
Tactical Asset Allocation	1,319.5	4.7%	5.0%
Real Estate	2,639.6	9.5%	8.5%
Alternative Investments	2,885.1	10.4%	7.4%
Total	\$27,877.0	100.0%	100.0%

Number of Investment Advisors: SERS had 132 external investment advisory firms managing portfolios. There were 47 advisors in the Public Markets domain and 103 covered private equity and real estate. Some of these advisors managed portfolios across asset classes.

- 15 U.S. Stock investment advisors
- 14 International Stock investment advisors
- 2 Currency overlay investment advisors
- 14 Fixed Income investment advisors
- 1 Cash investment advisor
- 1 Tactical Asset Allocation investment advisor
- 22 Real Estate investment advisors
- 37 Venture Capital general partners managing limited partnerships
- 44 Private Equity general partners managing limited partnerships

In addition, the Board approved the hiring of three venture capital partnerships.

Number of Investment Portfolios: SERS had 245 investment portfolios/accounts. Fifty-six of these accounts were public market investments, while 189 covered venture capital, private equity, and real estate.

- 18 U.S. Stock portfolios
- 19 International Stock portfolios
- 2 Currency overlay investment advisors
- 15 Fixed Income portfolios
- 1 Cash portfolio
- 1 Tactical Asset Allocation portfolio
- 35 Real Estate portfolios
- 71 Venture Capital limited partnership interests
- 83 Private Equity limited partnership interests

In addition, Board appointments included four venture capital partnerships. Sixty-one investment advisors manage multiple portfolios within and across asset classes for SERS.

Summary of U.S. Stock Investments

U.S. and International Stocks comprise the Stock asset class. Stocks are one of eight major asset classes, which SERS uses to diversify the investments of the Fund. SERS' investment plan diversifies stock investments and balances stock management styles. SERS contracts with external investment advisors to manage portfolios.

Policy: Stock investments are employed by the Fund primarily because their expected large return premiums versus inflation will help preserve and enhance the real value of the Fund over long periods of time. The Stock asset class is to be managed on a total return basis.

SERS' long term investment objective in the U.S. Stock component of the Stock asset class is to achieve a total return, net of fees, that exceeds the total return of the Russell 3000 Index.

Stock investments shall emphasize, but not be limited to, publicly traded securities, which provide SERS with an equity interest in private sector concerns (e.g., common stock, preferred stock, convertible preferred stock, convertible bonds, etc.).

SERS' 2001 Investment Plan targets an allocation of 37.5% of assets to U.S. Stocks. It targets the investment of a market weight in large, medium, and small capitalization stocks, and also provides for a market weight in value and growth investment styles. The 2001 plan targets 65% of U.S. Stocks to be indexed.

Fair Value as of December 31, 2000: U.S. Stocks had a \$9,523.1 million fair value, 34.2% of the total Fund's \$27,877.0 million fair value on December 31, 2000.

Number of Investment Advisors: SERS had contracts with 15 external investment advisors to manage U.S. Stock portfolios.

Number of Investment Portfolios: SERS had 18 U.S. Stock portfolios managed by the 15 investment advisors.

Type of Investment Portfolios: As of December 31, 2000, 78.8% of SERS U.S. Stock allocation was in large capitalization stock strategies and 21.2% was in medium/small capitalization stock strategies. The portfolios within the U.S. Stock area can be classified by investment style: value at 5.5%; growth at 7.5%; and core at 87.1%. SERS had 15 actively managed portfolios (29.7% of U.S. Stocks) and one indexed portfolio (70.3% of U.S. Stocks). The active managers search out superior investment opportunities, while the indexed portfolio provides broad core diversification and is designed to provide market performance at a low cost. Additionally, SERS employs one cash equitization manager, which uses the active manager's excess cash to maintain exposure to the S&P 500. SERS also utilizes one manager to manage the stock distributions that originate in the private equity portfolio.

<i>U.S. Stock</i>		*Fair Value Of Portfolio As of 12/31/00 (\$ in millions)
Investment Advisor	Investment Style	
1. Barclays Global Investors	S&P 500 Index	\$6,692.9
2. AXA Rosenberg Investment Management	Russell 2500, risk controlled	302.4
AXA Rosenberg Investment Management	Equitized long/short U.S. market neutral	92.3
3. Advanced Investment Management	Cash equitization manager	-28.7 ^{1/}
4. Artemis	Small cap relative value stocks	118.4
5. Emerald	PA stocks	107.5
6. Fidelity Management Trust Company	S&P 500, risk controlled	215.4
7. First Quadrant	Equitized long/short U.S. market neutral	94.6
8. Iridian Asset Management	Mid cap private business value	412.3
9. J.P. Morgan Investment Management	S&P 500, risk controlled	238.6
10. Martingale Asset Management	Equitized long/short U.S. market neutral	86.5
11. Mellon Equity Associates	PA stocks	134.1
Mellon Equity Associates - Special Equity	Russell 2500, risk controlled	358.8
12. Provident Investment Counsel (PIC)	Mid cap aggressive growth stocks	196.5
PIC Stellar Fund	Small cap growth stocks	206.1
13. Standish, Ayer & Wood	Equitized long/short U.S. market neutral	104.7
14. Trinity Investment Management	Small cap low p/e stocks	107.1
15. Warburg-Pincus	Stock distribution manager	83.6
Total		\$9,523.1

**Includes stocks and cash which the manager had available for investment. Numbers may not add due to rounding.*

^{1/}The \$(28.7) million negative balance reflected in the AIM account is not a liability of the fund. AIM margins are settled on a daily basis. This balance represents the valuation adjustment resulting from the effect of the equitization of cash in our active domestic stock manager accounts. In 2000, the S&P 500 Index under-performed cash resulting in the negative balance.

Summary of International Stock Investments

International and U.S. Stocks comprise the Stock asset class. Stocks are one of eight major asset classes that SERS uses to diversify the investments of the Fund. SERS' investment plan diversifies stock investments and balances stock management styles. SERS contracts with external investment advisors to manage portfolios.

Policy: Stock investments are employed by the Fund primarily because their expected large return premiums versus inflation will help preserve and enhance the real value of the Fund over long periods of time. The Stock asset class is to be managed on a total return basis.

SERS' long term investment objective for the International Stock component of the Stock asset class is to achieve a total return, net of fees, that exceeds the total return from: 69% MSCI EAFE Free Index, a proxy for large cap stocks in developed markets; and 17% Salomon Smith Barney World Equity - Extended Market Index Europe and Pacific, a proxy for small cap stocks in developed markets; and 14% MSCI Emerging Markets Free Index.

SERS' 2001 Investment Plan targeted an allocation of 21% of assets to International Stocks. It targeted the investment of: 69% of International Stocks to large cap stocks in developed markets; 17% to small cap stocks in developed markets; and 14% to all size stocks in emerging markets.

Fair Value as of December 31, 2000: International Stocks had a \$5,997.9 million fair value, 21.5% of the total Fund's \$27,877.0 million fair value on December 31, 2000. The fair value of forward exchange contracts in the currency overlay program amounted to \$ (11.8) million.

Number of Investment Advisors: SERS had contracts with 14 external investment advisors to manage International Stock portfolios. In addition, SERS had contracts with 2 external advisors to manage a currency overlay program.

Number of Investment Portfolios: SERS had 19 stock portfolios managed by the 14 investment advisors and 2 accounts for the currency overlay program.

Type of Investment Portfolios: As of December 31, 2000, 70% was allocated to large cap stocks in developed markets; 18% was allocated to small cap stocks in developed markets; and 12% was allocated to emerging markets. SERS had 17 actively managed international portfolios and two indexed portfolios.

<i>International Stock</i> Investment Advisor	Investment Style	*Fair Value of Portfolio as of 12/31/00 (\$ in millions)
1. Barclays Global Investors, N.A. Europe funds Australia and New Zealand funds	Europe - index Australia and New Zealand - index	\$742.0 27.4
2. Capital International, Inc. Emerging Markets Growth Fund, Inc.	emerging markets - value	137.0
3. Credit Suisse Asset Management, LLC	developed & emerging markets - growth	664.8
4. GAM International Management Ltd	Pacific Basin ex Japan	110.4
5. Henderson North American Partners	small cap developed markets - UK growth, other countries value	260.4
6. Marathon Asset Management	Europe – contrarian sector	402.9
7. Marvin & Palmer Emerging Markets Equity, L.P.	emerging markets - growth	75.3
8. Merrill Lynch Investment Managers	small cap developed markets - growth	535.9
9. J.P. Morgan Fleming Inv. Management Inc.	Japan - benchmark risk control	481.5
10. Morgan Stanley Investment Mgt (London team)	developed markets - value	819.1
Morgan Stanley Investment Mgt (Singapore team)	Asia ex Japan	72.0
11. Oaktree Capital Management, LLC OCM Emerging Markets Feeder Fund II, L.P.	emerging markets - hedge fund	51.8
12. Pictet International Management Limited International small cap equity portfolio Emerging markets equity portfolio	small cap developed markets emerging markets	273.3 104.2
13. Scottish Widows Investment Partnership Ltd	Europe - growth and value	356.2
14. Templeton Investment Counsel, Inc. International equity portfolio Templeton Global Restructuring Fund, L.P. TIFI Emerging Markets Series	developed & emerging markets - value emerging markets - value emerging markets - value	784.2 4.5 95.2
Total International Stocks		\$5,997.9
1. Pareto Partners	currency overlay	(28.6)
2. Record Treasury	currency overlay	16.8
Total Currency Overlay		(11.8)
Total International and Currency Overlay		\$5,986.1

**Includes stocks and cash which the manager had available for investment. Numbers may not add due to rounding.*

Summary of Fixed Income Investments

Fixed Income is one of eight major asset classes that SERS uses to diversify the investments of the Fund. The SERS' Investment Plan diversifies Fixed Income investments and balances Fixed Income management styles. SERS contracts with external investment advisors to manage portfolios.

Policy: The Fixed Income asset class is employed by the Fund because of its ability to generate current income from interest payments, increase the value of the Fund through the reinvestment of those interest payments, serve as a Benefit Payment Reserve during periods of financial stress, serve as a hedge against disinflation and/or deflation and help diversify the overall Fund. The Fixed Income asset class is managed on a total return basis.

In the Fixed Income asset class, SERS' long-term investment objective is to achieve a total return, net of fees, that exceeds the total return of the SERS Custom Fixed Income Index.

SERS' 2001 Investment Plan targets an eventual allocation of 18.5% of assets to the Fixed Income asset class. Of this amount, 55% is targeted to the core domestic strategies, 15% to core international/global strategies, 25% to specialty strategies and 5% to inflation-linked bonds. Since inflation-linked bonds are currently being researched, the other three strategies are slightly higher than the Investment Plan targets.

As a result of the evolving nature of the fixed income market and the purpose of the fixed income asset class, specialty strategies represent 27% of fixed income. The specialty strategies consist of two corporate high yield portfolios and one commercial mortgage-backed securities portfolio. In addition, emerging market debt, a growing and important part of the global fixed income universe, is used opportunistically within the corporate high yield portfolios—up to 20% of each portfolio.

Fair Value as of December 31, 2000: Fixed Income had a \$5,368.2 million fair value, 19.3% of the total Fund's \$27,877.0 million fair value, on December 31, 2000.

Number of Investment Advisors: SERS had contracts with 14 external investment advisors to manage portfolios within the Fixed Income asset class as of December 31, 2000.

Number of Investment Portfolios: SERS had a total of 15 portfolios within the Fixed Income asset class.

Type of Investment Portfolios: The Fixed Income asset class is divided into core and high yield segments. Core portfolios invest in relatively liquid, higher quality, fixed income securities that meet return, disinflation/deflation, benefit payment reserve and diversification needs of the Fund. High yield portfolios focus on debt instruments offering higher return premiums and different risk characteristics than traditional fixed income securities.

Core: SERS had eight actively managed core bond portfolios with a fair value of \$3,339.4 million and one passively managed core bond portfolio with a fair value of \$612.5 million. The combination of core portfolios represented 73.6% of the asset class. The core portfolio segment of the asset class includes exposure to both international and global fixed income.

Specialty: SERS had two corporate high yield portfolios with a fair value of \$1,241.8 million, one high yield commercial mortgage-backed securities portfolio with a fair value of \$155.9 million, and two subordinated debt portfolios with a fair value of \$18.5 million that invests in profitable Pennsylvania companies. In addition, there is a special credits portfolio with a value of \$0.1 million that is winding down. The combination of specialty portfolios represented 26.4% of the asset class.

<i>Fixed Income</i>			*Fair Value of Portfolio as of 12/31/00 (\$ in millions)
Investment Advisor	Investment Style		
<u>Core</u>			
1. Fischer Francis Trees & Watts (Int'l)	active international		\$460.4
2. John Hancock Mutual Life Insurance Company	private placements		211.7
3. J.P. Morgan Investment Management	active domestic fixed income		694.4
4. Legg Mason Real Estate Advisors	whole-loan mortgages		81.6
5. MDL Capital Management	active domestic fixed income		74.5
6. Mellon Bond Associates	domestic – index		612.5
7. Miller, Anderson & Sherrerd	active domestic fixed income		917.1
Miller, Anderson & Sherrerd	active global fixed income		849.2
8. Taplin, Canida & Habacht	active domestic fixed income		50.5
<u>Specialty</u>			
9. Berwind Financial Group	PA Capital Fund		4.6
10. Fidelity Management Trust Company	commercial mortgage backed securities		155.9
11. PNC Equity Management	PA Capital Fund		13.9
12. Salomon Brothers Asset Management	high yield bonds		435.4
13. Trust Company of the West Special Credits Fund III	special credits		0.1
14. W. R. Huff Asset Management	high yield bonds		806.4
Total			<u>\$5,368.2</u>

**Includes securities and cash that the manager had available for investment. Numbers may not add due to rounding.*

Summary of Cash Investments

Cash is one of eight major asset classes, which SERS uses for investments of the Fund. The SERS' Investment Plan calls for minimizing cash balances while meeting cash flow requirements.

Policy: Cash Investments are employed by the Fund to provide for SERS' liquidity needs and to accumulate funds for future permanent investment. The Cash asset class is to be managed on a total return basis, with the exception that temporary investments may alternatively be evaluated on a yield-to-maturity basis given their extremely short maturities.

In the Cash asset class, SERS' long term investment objective is to achieve a total return, net of fees, that exceeds the total return on 90 day U.S. Treasury Bills. Since 1997, SERS' Investment Plans have targeted an allocation of 0% of assets to the Cash asset class.

Fair Value as of December 31, 2000: Cash had a \$155.4 million fair value, 0.6% of the total Fund's \$27,877.0 million fair value on December 31, 2000.

Number of Investment Advisors: In accordance with SERS' 2000 Investment Plan, SERS utilizes the Pennsylvania State Treasury Department to manage its cash accounts.

Number of Investment Portfolios: SERS' cash portfolio is managed by the Pennsylvania State Treasury Department.

Type of Investment Portfolios: SERS' cash asset class currently employs a money market short-term investment strategy; the State Treasury manages the portfolio. The portfolio also contains the uninvested cash balances held by other SERS investment advisors in other asset classes.

In the aggregate, State Treasury managed \$655 million on behalf of SERS and SERS' external investment advisors as of December 31, 2000.

Summary of Tactical Asset Allocation Investments

Tactical Asset Allocation (TAA) is one of eight major asset classes, which SERS uses to diversify the investments of the Fund. It is SERS practice to contract with external investment advisors to manage portfolios.

Currently, the TAA asset class contains one investment strategy – the Enhanced US 70/30 Tactical Asset Allocation Fund (“Enhanced 70/30 TAA”). The Enhanced 70/30 TAA strategy shifts assets among stocks, bonds and cash. SERS contracts with an external investment advisor, Barclays Global Investors (“Barclays”), to manage the portfolio.

Policy: SERS’ 2001 Investment Plan targets an allocation of 5.0% of assets to the TAA asset class.

Fair Value as of December 31, 2000: SERS’ investment in the Barclays Enhanced 70/30 TAA Fund had a \$1,319.5 million fair value, 4.7% of SERS total fund’s \$27,877.0 million fair value on December 31, 2000.

Number of Investment Advisors: SERS had a contract with one external investment advisor to manage a TAA portfolio as of December 31, 2000.

Number of Investment Portfolios: SERS had one TAA portfolio managed by the one investment advisor.

Type of Investment Portfolio: The Barclay’s Enhanced 70/30 TAA Fund is designed to offer an efficient, low cost means of seeking above–market returns from a portfolio diversified among the U.S. stock, fixed income and cash markets.

The Barclays TAA Fund utilizes three of Barclay’s collective funds (Equity Index Fund, Long–Term Fixed Income Fund, and the Short–Term Asset Allocation Cash Fund). Proprietary technology is used to establish the optimal asset mix among these funds, and adjust the mix of these funds. The mix will vary as economic and capital market conditions change. Under equilibrium conditions, the Enhanced 70/30 TAA Fund will have 70% of assets invested in the Equity Index Fund, 30% of assets invested in the Long–Term Fixed Income Fund, and 0% in the Cash Fund. As of December 31, 2000, the actual asset mix of the Fund was 85% stock, 10% bonds and 5% cash.

Summary of Real Estate Investments

Equity Real Estate is one of eight major asset classes that SERS uses to diversify the investment of the Fund. SERS' investment plan diversifies Real Estate investments and balances real estate management styles. In accordance with the plan, SERS contracts with external investment advisors to manage portfolios.

Policy: Equity Real Estate investments are generally long-term, illiquid investments that due to their high correlation with inflation provide an inflation hedge and, due to their low correlation with stocks and bonds, provide diversification within the total portfolio. It is expected that the long-term total return (income and appreciation) for real estate will fall between that of stocks and bonds. The Equity Real Estate asset class is to be managed on a total return basis.

In the Equity Real Estate asset class, SERS' long-term investment objective is to achieve a total return that exceeds the total return of the NCREIF Index. SERS' 2001 Investment Plan targeted an eventual allocation of 8% of assets to the Equity Real Estate asset class.

Investments are made through commingled fund investments, limited partnerships, REITs and separate account portfolios where SERS owns the properties directly or with other co-investors. SERS' Equity Real Estate portfolio guidelines provide for diversification by:

- Transaction structure;
- Property type;
- Geographic location; and
- Development phase.

Fair Value as of December 31, 2000: Real Estate had an estimated \$2,639.6 million fair value, approximately 9.5% of the total Fund's December 31, 2000 fair value. This fair value represents September 30, 2000 actual numbers adjusted for cash flows, which occurred in the fourth quarter 2000.

Number of Investment Advisors: SERS had contracts with 22 external investment advisors to manage real estate portfolios as of December 31, 2000.

Number of Investment Portfolios: SERS had investments in 35 real estate portfolios managed by the 22 investment advisors.

Type of Investment Portfolios: As of September 30, 2000, the composition of the real estate portfolio was:

37% pooled funds, 63% separate accounts;
35% office, 8% industrial, 15% retail, 12% residential, 13% hotel/motel, 6% timber, 12% other;
19% Pennsylvania, 21% East excl. PA, 25% West, 16% South, 13% Midwest, 4% International, 2% Unclassified; and
16.8% of the fair value of the separate accounts was invested in twenty investments located in Pennsylvania.

<i>Real Estate</i> <u>Investment Advisor</u>	<u>SERS</u> <u>Initial</u> <u>Funding</u>	<u>Property</u> <u>Type</u>	<u>Transaction</u> <u>Structure</u>	<u>Fair Value</u> <u>of Portfolio</u> <u>as of 9/30/00</u> <u>(\$ in millions)</u>
1. AEW CIIF-II	08/08/88	Industrial, other	equity ownership	\$ 5.9
2. Apollo – AREF III	06/26/98	Opportunistic	equity and debt	58.0
3. Berwind – BPG Fund IV	04/20/98	Opportunistic	equity and debt	21.4
BPG Fund V	11/29/99	Opportunistic	equity and debt	6.4
4. Blackstone - BREP II	02/26/97	Opportunistic	equity and debt	61.5
BREP III	10/22/99	Opportunistic	equity and debt	20.3
5. Cliffwood Select Equity Fund	08/04/00	Long/Short REITs	public securities	24.8
6. CRA Securities	01/31/96	REITs	public securities	344.8
7. Forest Investment Assoc.	10/30/92	Timber	equity ownership	155.6
8. Heitman Capital Mgmt:				
Separate account	12/28/87	Diversified	equity ownership	316.3
JMB Group Trust III	12/31/84	Office, retail	equity ownership	5.9
9. LaSalle Partners:	10/01/93	Diversified	equity ownership	229.4
10. Legg Mason Real Estate Adv.	10/01/93	PA diversified	equity ownership	218.3
Eastern Retail Holdings	01/07/99	Retail	equity and debt	45.8
11. Lowe Enterprises	10/01/93	Diversified	equity ownership	359.1
12. Lubert-Adler Fund II	10/30/98	Diversified	equity and debt	28.7
13. Miller Global Fund III	01/19/99	Diversified	equity and debt	3.1
14. Oaktree Capital Management:				
TCW Fund VI	04/20/94	Opportunistic	equity and debt	19.6
OCM Opportunity Fund A	05/09/96	Opportunistic	equity and debt	42.5
OCM Opportunity Fund II	12/15/98	Opportunistic	equity and debt	36.5
15. Oxford Development	01/09/97	Industrial	equity ownership	56.9
16. Prudential Senior Housing	12/22/98	Senior housing	equity and debt	16.7
17. SSR Realty Advisors:				
MIAF	09/05/89	Residential	equity ownership	0.6
MIAF II	12/07/92	Residential	equity ownership	12.5
18. Sentinel Corp.	07/31/84	Diversified	equity ownership	59.8
19. Starwood :				
SOFI IV	03/24/97	Opportunistic	equity and debt	59.1
SOFI V	05/14/99	Opportunistic	equity and debt	49.7
20. UBS-Brinson:				
PMSA	09/30/83	Diversified	equity mortgages	55.3
RESA	06/3//84	Diversified	equity ownership	60.3
Multifamily Trust	08/02/99	Residential	equity ownership	23.4
21. Westbrook Partners:				
WREF II	06/16/97	Opportunistic	equity and debt	47.7
WREF III	9/01/98	Opportunistic	equity and debt	75.7
22. Goldman Sachs:				
Whitehall V & VI	04/20/94	Opportunistic	equity and debt	33.2
Whitehall V-S & VI-S	12/11/95	Opportunistic	equity and debt	6.4
Whitehall VII & VIII	05/28/96	Opportunistic	equity and debt	25.1
September 30, 2000 Total				\$2,586.3
4 th Quarter 2000 Net Cash Flow Adjustments				53.3
December 31, 2000 Total				\$2,639.6

Numbers may not add due to rounding.

Summary of Alternative Investments

Alternative Investments includes two of the eight major asset classes SERS uses to diversify the investments of the Fund: Venture Capital and Private Equity. Investments in these areas are accomplished by means of limited partnerships. The partnerships are established by individual management groups, called general partners, for the purpose of investing in and managing private equity and non-marketable subordinated debt positions on behalf of SERS and other limited partners. Sub-asset class definitions are as follows:

Venture Capital is the financing of young, rapidly growing companies that lack access to public equity or debt-oriented institutional funding. Venture Capital strategies are typically classified as follows:

Seed Stage—This form of venture capital supports companies that are still in the conceptual phase, i.e., a product and market are identified; however, the company itself has yet to be formed. The seed investment is used to finance development of the concept or business plan.

Early Stage— This investment phase emphasizes companies that have been formed; however, revenues have not yet been realized. The product has been developed and may have been shipped to a friendly user for testing. Management positions have been filled and the team is in place.

Late Stage— At this stage, venture capitalists fund companies with proven revenues that are in the process of expanding. Typically, these companies, if substantially profitable, are nearing a strategic sale to another company or an initial public offering. In other cases, a “bridge” financing may be used to supply needed capital for operations or expansion.

Private Equity represents forms of private investment other than conventional venture capital investing as previously described. The term primarily refers to investments in the equity and subordinated debt of established companies, but may also include other forms of non-traditional investing such as investments in oil and gas interests and in hedge funds. Distinct strategies currently used by SERS are as follows:

Leveraged buyout (“LBO”) financing enables companies to be acquired through the use of borrowed funds, or a combination of debt and equity capital. Typically, the assets of target companies serve as collateral for loans originated in the transaction. The loans are subsequently repaid from the acquired company’s cash flows. SERS invests as an equity partner in LBO partnerships. As such, SERS participates in potential profits resulting when LBO exits occur, typically reaping higher rewards than company debt holders.

Distressed debt investing involves the identification of opportunities in the de-leveraging of debt-laden companies. Investments are usually made in successful companies, which, over time, have accumulated heavy debt loads. Distressed debt investors assist companies in reducing debt and even avoiding bankruptcy by providing patient capital. The new capital carries renewed terms that usually include an equity stake in the restructured firm.

Secondary partnerships acquire interests in established private equity funds from the original limited partners of such funds. Such interests become available when an investor needs liquidity or desires to realign or rebalance its investment portfolio, often for non-financial reasons. Secondary investing can be lucrative in two ways: 1) the partnership interests are often purchased at significant discounts to net asset value and 2) the purchase frequently occurs as the acquired partnerships begin to realize profits, thereby reducing risk in the asset class.

Policy: SERS’ long term investment objective for Alternative Investments is to achieve a risk-adjusted total return, net of fees, that exceeds market returns for similar types of alternative investments, or benchmark return data furnished by SERS’ Alternative Investments Consultant. SERS’ 2001 Investment Plan targets an eventual allocation of 15% to Alternative Investments, including both Venture Capital and Private Equity. The allocation to Venture Capital is guided by the State Employees’ Retirement Code which, after amendment by Act 23 of 1991, provides:

Venture capital investments shall be limited to not more than 2% of the book value of the total assets of the fund as determined for financial statement purposes as of December 31 next preceding the date of investment. A venture capital investment may be made only if, in the judgment of the board, the investment is reasonably likely to enhance the general welfare of this Commonwealth and its citizens and meets the standard of prudence set forth in subsection (a) [the so-called “prudent person investment standard”].

Legislation intended to eliminate this 2% ceiling on venture capital investments and treat venture capital under the same prudent person standard as all other investments was introduced during the 2000 legislative session. It progressed through the General Assembly, only to stall at the end of the session in November, 2000. A comparable bill was introduced early in the legislative session this year.

Fair Value as of December 31, 2000: The asset class total fair value stood at \$2,885.1 million, representing 10.4% of the Fund. Sub-asset class fair values and fund percentages were as follows:

	Total Commitments (millions)	Fair Value (millions)	Percent Allocation to Total Fund
Venture Capital	\$2,118.0	\$1,170.5 ^{1/}	4.2% ^{2/}
<u>Private Equity</u>	<u>\$3,251.6</u>	<u>\$1,714.6</u>	<u>6.1%</u>
Total			
Alternative Investments	\$5,369.6	\$2,885.1	10.3%

Number of Limited Partnerships: As of December 31, 2000, SERS had made commitments to 154 Alternative Investments limited partnerships; 71 commitments were made to Venture Capital partnerships and 83 to Private Equity partnerships. (This does not include nine partnerships - seven Venture Capital and two Private Equity - that are now “inactive,” i.e., in the liquidation phase.)

^{1/} The Venture Capital market value does not include the stock distribution account which is classified as a domestic equity account.

^{2/} Compliance with the statutory limit on venture capital investments is assessed quarterly. The Fund remains compliant since the book value of the current venture capital portfolio, defined as the present cost of the portfolio, remains well below the investment ceiling established as of December 31, 1999.

Alternative Investment Program

Venture Capital

SERS Venture Capital program includes commitments to 71 venture capital limited partnerships. Twenty-two of these active and six of these inactive partnerships are committed to invest in Pennsylvania-based companies as a part of their investment focus. These partnerships use their best efforts to make venture capital investments in companies headquartered in Pennsylvania or in companies that provide employment for Pennsylvania citizens.

Of the total venture portfolio, venture capital investments have been made in companies located in Pennsylvania and companies based elsewhere that employ in-state residents. According to the PricewaterhouseCoopers MoneyTree Survey in partnership with VentureOne, for calendar year 2000, Pennsylvania ranked 7th in the nation in the number of portfolio company transactions financed, and 10th in terms of dollars applied to venture financing.

The Venture Capital program seeks to diversify company investments across industries. Though many venture capital partnerships are formed to invest in high technology companies, venture partnerships offer varying industry focus exposure. As of September 30, 2000, based on invested capital, SERS' Venture Capital program was invested across industry categories as follows:

31.8% Communications	2.7% Financial Services	0.4% Transportation
19.2% Healthcare/Biotech	2.3% Manufacturing	0.2% Environmental
18.0% Software	2.3% Diversified	0.2% Healthcare Services
8.0% Fund of Funds	1.7% Chemical/Materials	0.2% Other
7.5% Consumer/Retail/Services	1.2% Electronics	0.1% Biotechnology
3.4% Hardware	0.6% Industrial	0.1% Secondary
		0.1% Healthcare Software

The Venture Capital partnerships also invest at different points in company life cycles. SERS' investments are grouped to reflect varying financing stage exposures, including seed/start-up stage, early stage and later/expansion stage financing. As with industry diversification, diversification of venture fund investment by financing stage is an important portfolio construction objective. As of September 30, 2000, based on invested capital, the Venture program consisted of approximately 55.1% in seed/start-up and early stage investments and 22.9% in later/expansion stage investments.

Finally, fund-of-funds investments represent investments with managers who, in turn, invest in selected venture funds of diversified industry and stage focus. Venture Capital funds of funds investments offer SERS diversified exposure to Venture Capital limited partnerships of varied industry foci and stages. They also provide SERS with valuable entrée into many top-performing Venture Capital partnerships to which access would otherwise be difficult. As of December 31, 2000, there were five Venture Capital fund of funds investments approved by the Board.

Private Equity

The Private Equity program has commitments to 83 buyout-oriented partnerships, which are well-diversified by size of investment and geographic focus. Non-hostile acquisitions are pursued. Most transactions are privately negotiated rather than auctioned, and are usually completed with present management in place.

SERS' fifteen non-U.S. private equity investments are comprised of twelve funds investing in companies based in the U.K. and Europe, and three funds investing in Asian companies. The U.K./Europe funds plan to take advantage of dynamic changes occurring within Europe, including the formation of the European Economic Union and currency harmonization. The Asian partnership investments, the first two investments were made in 1999, focus on expanded opportunities in the region created by attractive valuations, favorable demographics, and changing attitudes on behalf of local businesspeople regarding foreign investment.

The international fund-of-funds category is comprised of partnerships specializing in late stage venture and buy-out investing. The partnerships are located throughout the world, with a geographic emphasis on developed countries. These funds offer SERS immediate and diversified exposure to limited partnerships internationally and provide guidance for SERS in forming its own core investment portfolio of non-U.S. private equity partnerships.

SERS has ownership interest in six partnerships specializing in distressed debt instruments. Many of these partnerships, national in geographic coverage, deal in debt obligations of financially troubled companies; the distressed debt is ultimately converted into equity in order to produce an equity-like return. Alternatively, some distressed debt investments anticipate gains from the appreciation of the debt instrument itself and do not rely on converting the debt into an equity position.

SERS also has an interest in four partnerships that invest in secondary purchases. These partnerships have a national focus and specialize in secondary purchases of interests in established buyout and venture capital partnerships. The benefits of secondary purchases are two-fold: 1) the partnerships are normally acquired from motivated sellers at substantial discounts to net asset value; and 2) secondaries often provide earlier distribution of profits compared to initial investments made in new funds, thereby "smoothing" over time the aggregate returns and cash flow contributed by the alternative investments portfolio.

SERS Venture Capital Committed, Drawn and Distributed

As of December 31, 2000

The Capital Committed column represents total dollars allocated from SERS to each limited partnership. Capital Drawn is the portion of SERS' capital commitments drawn by the General Partner to be placed with underlying portfolio companies. The Distributions column shows the value of original capital and profits returned to SERS.

<u>Limited Partnership</u>	<u>Financing Stage Focus</u>	<u>SERS Initial Funding</u>	<u>Capital Committed (\$millions)</u>	<u>Capital^{1/2} Drawn (\$millions)</u>	<u>Distributions^{1/2} (\$millions)</u>
1. Adams Capital Management II	Early Stage	10/1/99	\$30.0	\$18.0	\$0.0
2. Adams Capital Management III	Early Stage	11/21/00	30.0	1.5	0.0
3. Advanced Technology Venture VI	Early Stage	3/9/00	10.0	4.5	0.0
4. Advanced Technology Venture VII	Diversified	*	25.0	0.0	0.0
5. Alloy Ventures 2000	Seed/Early	5/19/00	20.0	4.0	0.0
6. APA/Fostin – Fund I	Diversified	9/30/87	20.0	20.0	76.1
7. APA/Excelsior VI	Diversified	7/3/00	35.0	7.3	0.0
8. Apex Ventures IV	Early/Later	9/17/99	25.0	16.3	0.0
9. Atlas Ventures IV	Early/Later	3/23/99	26.0	18.7	2.4
10. Atlas Ventures V	Early/Later	2/7/00	40.0	15.8	0.0
11. Bachow Investments III	Diversified	11/9/94	25.0	25.0	23.4
12. CEO Venture Fund II	Diversified	7/14/89	7.5	7.5	3.6
13. Cross Atlantic Technology Fund	Early Stage	2/14/00	20.0	11.0	0.0
14. Draper Fisher Jurvetson VI	Early Stage	8/13/99	8.0	4.0	0.0
15. Draper Fisher Jurvetson VII	Seed/Early	9/22/00	20.0	2.0	0.0
16. Draper Triangle	Early Stage	12/20/99	20.0	5.6	0.0
17. Edison Ventures III	Diversified	3/1/94	25.0	25.0	37.5
18. Fairview Capital I	Minority	9/28/94	10.0	9.0	3.0
19. Fairview Capital II	Minority	3/1/98	10.0	4.5	0.1
20. Fostin Capital II	Diversified	10/5/89	8.0	7.5	11.2
21. Frazier Healthcare III	Later Stage	2/4/99	30.0	15.9	0.0
22. Grotech Partners III	Diversified	6/29/90	3.0	3.0	1.9
23. Grotech Partners IV	Diversified	11/1/93	25.0	25.0	33.6
24. Grotech Partners V	Diversified	9/18/98	25.0	21.1	10.6
25. Halpern & Denny II	Early Stage	4/28/98	25.0	21.7	0.3
26. Halpern & Denny III	Early Stage	4/26/00	25.0	4.4	0.0
27. HarbourVest Partnership Fund VI	Fund-of-funds	5/7/99	200.0	50.0	3.4
28. Healthcare Ventures III	Diversified	7/9/92	15.0	15.0	20.4
29. Healthcare Ventures V	Diversified	10/17/97	25.0	21.3	28.8
30. Healthcare Ventures VI	Diversified	6/19/00	35.0	6.3	0.0
31. Highland Capital VI	Early Stage	*	25.0	0.0	0.0
32. InterWest Partners VIII	Early/Later	8/25/00	25.0	2.5	0.0
33. JP Morgan Pooled Venture Capital	Fund-of-funds	7/8/99	100.0	52.7	1.2

<u>Limited Partnership</u>	<u>Financing Stage Focus</u>	<u>SERS Initial Funding</u>	<u>Capital Committed (\$Millions)</u>	<u>Capital^{1/2/} Drawn (\$Millions)</u>	<u>Distributions^{1/} (\$Millions)</u>
34. JP Morgan Pooled Venture Cap. II	Fund-of-funds	10/10/00	\$100.0	\$5.2	\$0.0
35. Keystone Ventures IV	Middle/Later	7/21/93	15.0	15.0	9.7
36. Keystone Ventures V	Middle/Later	12/29/97	25.0	24.5	0.0
37. Keystone Ventures VI	Middle/Later	12/26/00	25.0	0.5	0.0
38. Kline Hawkes Pacific II	Diversified	8/30/00	15.0	2.6	0.0
39. NEA IX	Seed/Early	11/15/99	20.0	15.0	0.4
40. NEA VI	Early/Later	3/2/94	25.0	25.0	188.0
41. NEA VII	Early/Later	4/1/97	30.0	30.0	75.8
42. NEA X	Seed/Early	12/11/00	35.0	3.5	0.0
43. NEPA – MidAtlantic Ventures III	Seed/Early	4/1/97	20.0	18.6	1.0
44. NEPA - Mid-Atlantic Ventures IV	Early Stage	5/4/00	30.0	9.9	0.1
45. NEPA Venture I	Seed/Early	8/29/85	2.0	2.0	7.2
46. NEPA Venture II	Seed/Early	7/24/92	8.0	7.5	27.8
47. PA Fund I (APA/Fostin II)	Diversified	6/2/93	30.0	30.0	30.2
48. PA Fund III	Diversified	4/1/97	100.0	92.9	100.9
49. Point Ventures II	Diversified	10/2/90	1.0	1.0	1.3
50. Polaris Venture Partners	Early Stage	6/4/96	15.0	14.6	36.4
51. Polaris Venture Partners II	Early Stage	9/8/98	25.0	23.3	21.1
52. Polaris Venture Partners III	Early Stage	1/21/00	50.0	17.0	0.5
53. Sprout VII	Diversified	2/24/95	18.0	18.0	25.8
54. Summit Accelerator	Early Stage	11/15/99	8.0	3.6	0.0
55. Summit Ventures IV	Later Stage	6/27/95	25.0	23.8	172.9
56. Summit Ventures V	Later Stage	3/9/98	37.5	27.2	6.2
57. TA Associates - Advent VII	Diversified	7/30/93	25.0	25.0	82.6
58. TA Associates - Advent VIII	Diversified	2/1/97	30.0	27.3	21.3
59. TA Associates - Advent IX	Diversified	9/20/00	75.0	4.1	0.0
60. Technology Leaders III	Diversified	1/3/97	15.0	13.5	15.4
61. Technology Leaders IV	Diversified	5/13/99	35.0	21.0	4.4
62. Technology Leaders V	Diversified	10/18/00	40.0	4.0	0.0
63. Three Arch Capital	Later Stage	12/20/00	20.0	1.2	0.0
64. U.S. Venture Partners VII	Early/Later	2/18/00	15.0	6.5	0.0
65. U.S. Venture Partners VIII	Early Stage	*	35.0	0.0	0.0
66. Whitney Equity Partners III	Early Stage	3/12/98	20.0	18.2	21.2
67. Whitney Equity Partners IV	Early Stage	2/1/00	20.0	14.8	0.0
68. Whitney Equity Partners V	Early/Later	*	20.0	0.0	0.0
69. Weston Presidio II	Diversified	11/27/95	20.0	16.0	25.6
70. Weston Presidio III	Diversified	3/31/99	35.0	19.3	0.0
71. Weston Presidio IV	Diversified	6/21/00	35.0	1.8	0.0
Total**			\$2,072.0	\$1,029.5	\$1,133.3

<i>Inactive Funds</i>	Financing Stage Focus	SERS Initial Funding	Capital Committed (\$Millions)	Capital Drawn (\$Millions)	Distributions (\$Millions)
<u>Limited Partnership</u>					
1. CEO Ventures S	Diversified	7/1/87	\$ 8.0	\$ 1.0	\$ 1.2
2. Fostin Capital	Diversified	11/25/85	10.0	10.0	10.5
3. Keystone II	Middle/Later	11/1/85	10.0	10.0	22.4
4. PNC Ventures	Diversified	11/25/85	5.0	5.0	12.0
5. Pittsburgh Seed	Seed	1/13/87	2.0	2.0	1.0
6. TDH II	Diversified	11/25/85	9.0	9.0	16.0
7. Zero Stage II	Seed	4/30/87	2.0	2.0	0.6
Total**			\$46.0	\$39.0	\$63.7

1/ Actual amount drawn and distributed as of 12/31/00.

2/ Capital Drawn does not include total management fees.

* Not funded as of December, 2000.

** Numbers may not add due to rounding.

SERS Private Equity Investments Committed, Drawn and Distributed

As of December 31, 2000

The Capital Committed column represents total dollars allocated from SERS to each limited partnership. Capital Drawn is the portion of SERS' capital commitments drawn by the General Partner to be placed with underlying portfolio companies. The Distributions column shows the value of original capital and profits returned to SERS.

<u>Limited Partnership</u>	<u>Focus</u>	<u>SERS Initial Funding</u>	<u>Capital Committed (\$millions)</u>	<u>Capital^{1/2/} Drawn (\$millions)</u>	<u>Distributions^{1/} (\$millions)</u>
1. APAX France III	France	11/29/90	\$5.0	\$5.1	\$7.2
2. APAX Germany	Germany	1/30/91	5.2	5.2	11.9
3. APAX Germany II	Germany	7/15/97	6.0	8.5	13.7
4. APAX UK VI	U.K.	12/9/97	9.0	6.6	6.6
5. APAX Europe IV	Pan-Europe	3/31/99	35.0	17.3	4.5
6. APAX Europe V	Pan-Europe	*	60.0	0.0	0.0
7. ABACUS Fund	National Hedge	4/24/00	15.0	15.0	0.0
8. ABRY Broadcast Partners III	Telecom Buyouts	4/1/97	25.0	20.8	12.9
9. ABRY Broadcast Partners IV	Telecom Buyouts	*	35.0	0.0	0.0
10. ABS Capital III	National Buyouts	1/26/99	35.0	23.5	0.8
11. ABS Capital IV	National Buyouts	10/13/00	35.0	1.4	0.0
12. Apollo Advisors	National Buyouts	8/3/98	75.0	61.3	0.2
13. Asia Pacific III	Global Situations	9/28/99	15.0	11.3	0.5
14. Audax Private Equity Fund	Mid-Mkt Buyouts	5/25/00	35.0	4.9	0.0
15. B III Capital Partners (DDJ)	Distressed Debt	8/1/97	35.0	34.4	0.1
16. BC European Capital VII	Pan-Europe	7/28/00	45.0	8.6	0.0
17. Bain Capital Fund VII	National Buyouts	7/6/00	25.0	2.9	0.0
18. Blackstone II	Global Buyouts	8/26/94	40.0	42.3	60.5
19. Blackstone III	Global Buyouts	11/3/97	75.0	41.7	12.6
20. Blackstone Communications	Global Buyouts	8/29/00	25.0	1.7	0.0
21. Cerberus Institutional Partners	Distressed Debt	3/5/99	35.0	35.0	0.0
22. Charterhouse II	National Buyouts	3/30/94	40.0	42.8	81.2
23. Charterhouse III	National Buyouts	11/19/97	50.0	30.4	0.0
24. Clayton, Dubilier & Rice V	Global Buyout	5/3/95	50.0	48.9	0.0
25. Clayton, Dubilier & Rice VI	Global Buyouts	1/4/99	50.0	17.8	0.0
26. Code, H. & Simmons I	Midwest Buyouts	9/28/89	10.0	9.7	29.2
27. Code, H. & Simmons II	Midwest Buyouts	7/12/94	20.0	20.0	29.6
28. Code, H. & Simmons III	Midwest Buyouts	8/1/97	40.0	32.4	0.8
29. Code, H. & Simmons IV	Midwest Buyouts	9/16/99	100.0	27.7	0.0
30. DLJ Merch. Banking Fund II	Global Buyouts	5/22/97	75.0	68.2	10.9
31. Francisco Partners	National Buyouts	7/27/00	50.0	12.5	0.0
32. Frontenac VII	Midwest	8/1/97	40.0	40.0	26.6
33. Great Hill	National Buyouts	4/12/99	30.0	17.3	0.0
34. Great Hill II	National Buyouts	*	35.0	3.0	0.0
35. Gryphon Partners II	National Buyouts	11/3/99	35.0	0.0	0.0
36. GTCR V	National Buyouts	4/25/97	11.4	11.4	3.1
37. GTCR VI	National Buyouts	6/25/98	50.0	45.1	28.2
38. Golder Rauner VII	National Buyouts	3/15/00	41.3	14.4	0.0
39. HarborVest International II	Intl Fund of Funds	4/1/97	25.0	21.6	11.9
40. HarborVest International III	Intl Fund of Funds	6/22/98	40.0	14.0	1.1

Limited Partnership		Focus	SERS Initial Funding	Capital Committed (\$millions)	Capital^{1/2/} Drawn (\$millions)	Distributions^{1/} (\$millions)
41.	HarborVest International IV	Intl Fund of Funds	*	\$40.0	\$0.0	\$0.0
42.	Hellman & Friedman II	Global Situations	1/7/92	21.1	23.2	39.8
43.	Hellman & Friedman III	Global Situations	6/14/95	50.0	40.3	67.1
44.	Hellman & Friedman IV	Global Situations	2/14/00	75.0	16.0	17.1
45.	Invemed Fund	Mid-Mkt Buyouts	10/19/99	25.0	6.2	0.0
46.	Kelso V	National Buyouts	1/26/94	40.0	53.8	67.9
47.	Kelso VI	National Buyouts	7/7/98	75.0	32.8	4.6
48.	LLR Equity Partners	Mid-Mkt Buyouts	2/4/00	25.0	6.2	0.0
49.	Landmark IV	Secondaries	2/28/95	14.9	12.5	12.5
50.	Landmark V	Secondaries	1/27/96	20.0	19.4	15.6
51.	Lexington II	Secondaries	4/1/98	40.0	19.8	6.6
52.	Lexington III	Secondaries	1/26/99	35.0	18.3	12.0
53.	M/C Partners III	Telecom. Buyouts	6/2/97	25.0	21.3	10.4
54.	M/C Partners IV	Telecom Buyouts	3/31/99	25.0	16.3	0.0
55.	M/C Partners V	Telecom Buyouts	9/29/00	35.0	3.5	0.0
56.	Madison Dearborn I	National Buyouts	2/23/93	15.0	14.5	28.7
57.	Madison Dearborn II	National Buyouts	1/3/97	40.0	39.5	21.9
58.	Madison Dearborn III	National Buyouts	4/6/99	75.0	47.7	0.0
59.	Madison Dearborn IV	National Buyouts	*	90.0	0.0	0.0
60.	Murphy & Partners	National Buyouts	10/11/88	5.2	5.2	7.9
61.	Newbridge Asia II	Global Situations	9/3/99	15.0	13.3	2.4
62.	Newbridge Asia III	Global Situations	*	15.0	0.0	0.0
63.	Oakhill	National Buyouts	5/17/99	50.0	31.8	0.0
64.	OCM Opportunities	Distressed Debt	1/12/96	24.0	24.0	20.4
65.	OCM Opportunities II	Distressed Debt	2/5/98	40.0	40.0	0.0
66.	OCM Opportunities III	Distressed Debt	1/20/00	60.0	51.0	0.0
67.	OCM Principal Opportunities	Distressed Debt	11/12/96	25.0	25.0	0.0
68.	Palamon Equity Partners	Pan-European	7/23/99	30.0	6.4	0.0
69.	Providence Equity IV	National	11/27/00	25.0	0.1	0.0
70.	RRZ Private Equity Fund	PA Buyouts	11/7/96	20.0	18.9	0.0
71.	Schroder Ventures UK III	UK	8/29/89	10.0	8.9	24.7
72.	Schroder Ventures UK IV	UK	4/2/96	15.0	14.9	10.0
73.	Schroder European I	Pan-European	7/1/97	36.0	27.2	48.9
74.	Schroder European II	Pan-European	6/7/00	50.0	12.6	0.0
75.	SCP Private Equity II	National Buyouts	6/15/00	25.0	12.2	0.0
76.	Summit Ventures VI	National	*	75.0	0.0	0.0
77.	Thomas Lee Equity Fund V	National Buyouts	*	100.0	0.0	0.0
78.	Thomas Lee Equity Fund IV	National Buyouts	4/24/98	70.0	58.8	2.3
79.	TPG Partners II	National Situations	5/2/97	75.0	67.5	18.0
80.	TPG Partners III	National Situations	1/13/00	75.0	21.5	0.0
81.	TCW V	National Situations	8/25/94	35.0	35.0	48.4
82.	Vestar Capital III	National Situations	5/7/97	25.0	19.9	5.3
83.	Vestar Capital IV	Mid-Mkt Buyout	1/25/00	100.0	14.3	0.0
Total**				\$3,229.1	\$1,724.5	\$846.6

^{1/} Actual amount drawn and distributed as of 12/31/00.

^{2/} Capital Drawn does not include total management fees.

* Not funded as of December 31, 2000.

**Numbers may not add due to rounding.

Inactive Funds

	Financing Stage Focus	SERS Initial Funding	Capital Committed (\$millions)	Capital Drawn (\$millions)	Distributions (\$millions)	
1.	Brentwood Buyout Fund	National Buyouts	12/88	\$12.5	\$12.5	\$22.0
2.	RRZ PA Fund #1	PA Buyouts	3/88	10.0	10.0	19.6
	Total			\$22.5	\$22.5	\$41.6

ACTUARIAL



Actuary's Certification

HayGroup, Inc.
Actuarial and Benefits Consultants
4301 North Fairfax Drive
Suite 500
Arlington, VA 22203
(703) 841-3100
Fax: (703) 908-3005

April 23, 2001

Mr. John Brosius
Executive Director
State Employees' Retirement System
30 North Third Street
Harrisburg, PA 17108-1147

Dear Mr. Brosius:

The purpose of this letter is to certify the actuarial adequacy of the contributions being made by the State of Pennsylvania and other participating agencies to the Pennsylvania State Employees' Retirement System (SERS), and to discuss the approach currently being taken toward meeting the financing objectives of the plan.

The funding objective of the plan is set forth in the SERS code. The annual employer contribution is equal to the sum of the following:

- (1) The employer share of the normal cost.
- (2) The amortization of the unfunded liabilities as of December 31, 1990 over a twenty-year period ending on June 30, 2011.
- (2) The amortization of changes in liability after 1990 over twenty-year periods typically beginning with the July first following the effective date of the change. Changes include actuarial gains and losses and plan amendments.

The amortization payments increase 5% a year. The employer cost is determined as a percent of payroll, and the employer contributes that percent of the payroll of all covered members during each fiscal year. The employer cost is the total of (1) the employer normal cost percent and (2) the amortization payment on the outstanding liabilities. The employer contribution rate is based on the results of the actuarial valuation which is performed annually. The most recent valuation was performed as of December 31, 1999.

All costs and liabilities have been determined in conformance with generally accepted actuarial principles and procedures in accordance with the principles of practice prescribed by the Actuarial Standards Board. The calculations were performed on the basis of actuarial assumptions and methods which are internally consistent and reasonable (taking into account past experience under the SERS and reasonable expectations) and which in combination represent the best estimate of anticipated experience under the plan.

The actuarial valuation is based on financial and participant data, which is prepared by SERS staff. The data are reviewed for internal and year-to-year consistency as well as general reasonableness prior to its use in the actuarial valuation. The data are also summarized and tabulated for the purpose of analyzing trends.

The actuarial valuation uses assumptions regarding future rates of investment return and rates of retirement, withdrawal, death, and disability among SERS members and their beneficiaries. The current set of assumptions used in the December 31, 1999 actuarial valuation were adopted by the Board and were based on actual experience of SERS during the years 1991 through 1995. The rate of inflation is not a direct assumption because the SERS plan does not include automatic cost-of-living adjustments. The implicit inflation assumption is 3% a year.

The actuarial value of assets is developed by recognizing the difference between the expected actuarial value of assets and the market value of assets over a five-year period. The expected actuarial value is last year's actuarial value brought forward to reflect actual contributions, benefit payments and expenses, and assumed investment income. Each year 20% of the difference between this expected value and the market value is recognized in determining the current actuarial value of assets with the remaining 80 percent to be recognized over the next four years.

Government Accounting Standards Board (GASB) Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contributions Plans* establishes the range of funding methods for the Unfunded Actuarial Accrued Liability. The minimum funding can be over a 40-year period with payments increasing by the assumed increase in payroll. The SERS contributions increase at 5%, which is greater than the 3.3% salary growth assumption. However, the use of a 20-year amortization period results in payments that are greater than the minimum required under GASB #25.

The Schedule of Funding Progress and Schedule of Employer Contributions included in the Financial Section are provided as part of the accounting disclosure statements in accordance with GASB #25.

The attached schedules are derived from the December 31, 1999 actuarial valuation and data provided by SERS.

Based upon the valuation results, it is our opinion that the Pennsylvania State Employees' Retirement System continues in sound condition in accordance with generally accepted actuarial principles and procedures.

Respectfully submitted,
Hay Group



By
Edwin C. Husted, F.S.A.
Member American Academy of Actuaries
Enrolled Actuary No. 99-1499



Brent M. Mowery, F.S.A.
Member American Academy of Actuaries
Enrolled Actuary No. 99-3885

Summary of Actuarial Assumptions and Methods

- ◆ The investment rate of return is 8.5% per year based on an underlying rate of inflation of 3.0% per year.
- ◆ The Plan uses a five-year smoothed market approach to value plan assets for actuarial purposes
- ◆ Actuarial methods are specified by statute. Actuarial assumptions are suggested by the plan's actuary and approved by the SERS Board of Trustees
- ◆ For current retirees, beneficiaries and survivors the plan uses the 1971 Group Annuity Mortality Table set back no years for males and six years for females. For current active employees, the plan uses the 1983 Group Annuity Mortality Table for both males and females.
- ◆ The rates for probability of retirement and the probabilities of withdrawal from active service, including death, before age and service retirements are presented in the Schedule of Active Member Valuation Data.
- ◆ The projected average salary increase is 6.8% with a range of 5.16% to 8.98%. This increase includes an underlying assumption of 3.0% for inflation. The annual rate of salary increase for promotions and longevity for members is presented in the Schedule of Active Member Valuation Data.
- ◆ The plan uses a variation of the entry-normal age actuarial cost method to determine the liabilities and costs related to the System's benefits. The method is based on the benefits and contributions for new employees rather than for all current employees from their date of entry. This variation should produce approximately the same results as the typical method over the long run. The Plan uses an amortization period of 20 years for both unfunded liabilities and subsequent changes in the liability, including those arising from plan amendments and actuarial gains and losses.
- ◆ The Plan does not use an assumption for cost-of-living adjustments in the determination of actuarial valuations.
- ◆ The Plan periodically prepares a study using actual experience in order to develop assumptions to be used in its actuarial valuations. The latest study was completed March 20, 1996, for the period January 1, 1991, through December 31, 1995.
- ◆ Effective for the actuarial valuation for the year ended December 31, 1995, the Board approved changing the investment rate of return from 9.25% to 8.5% and changing the projected salary increases from 6.7% to a range of 5.16% to 8.98%. In addition, the Board approved the change from the 1971 Group Annuity Mortality Table (GAM 71) to the 1983 Group Annuity Mortality Table for current and future employees. GAM 71 continues to apply to current retirees. In 1998, the Legislature enacted a cost-of-living adjustment. This adjustment had the effect of increasing the actuarial accrued liabilities by approximately \$478 million.
- ◆ The valuation was based on members of the Plan as of December 31, 1999. All census data was supplied by the Plan and was subject to reasonable consistency checks. Asset data was also supplied by the Plan.
- ◆ The actuarial computations were prepared by, or made under the supervision, of a Member of the American Academy of Actuaries (M.A.A.A.).

Schedule of Active Member Valuation Data

Withdrawal From Active Employment Before Age and Service Retirement Annual Rate of Active Members Separating Within the Next Year As of December 31, 1999

Table A*

Sample Age	Male						Female					
	Withdrawal Years of Service				Death	Disability	Withdrawal Years of Service				Death	Disability
	0	1	5	> 9			0	1	5	> 9		
20	12.04%	8.40%	3.50%	0.48%	-	-	9.51%	5.07%	5.88%	0.98%	-	-
25	12.04	8.40	3.78	0.48	0.05%	0.03%	10.57	9.10	5.88	0.98	0.04%	0.05%
30	9.05	7.48	3.75	0.48	0.06	0.07	10.59	10.12	5.75	0.98	0.04	0.13
35	8.70	5.23	3.15	0.48	0.07	0.14	8.90	7.31	4.49	0.78	0.05	0.20
40	7.67	4.49	2.63	0.37	0.10	0.21	7.52	4.90	3.41	0.61	0.08	0.29
45	7.25	5.57	2.05	0.34	0.17	0.38	6.40	4.41	3.06	0.51	0.09	0.46
50	7.07	3.58	1.52	0.32	0.26	0.53	7.75	4.35	2.73	0.60	0.17	0.69
55	5.99	3.01	1.33	0.30	0.44	0.70	6.45	5.65	2.56	0.56	0.28	0.87
60	-	-	-	-	0.68	0.80	-	-	-	-	0.32	1.02

Annual Rate of Retirement
Table B*

Sample Age	Full Benefits	
	Male	Female
50-58	13.0%	3.0%
59	13.0	13.0
60	17.0	26.0
61	19.0	21.0
62	51.0	43.0
63	26.0	28.0
64	26.0	28.0
65	51.0	50.0
66	34.0	35.0
67	26.0	33.0
68-79	24.0	24.0
80	100.0	100.0

Annual Rate of Salary Increase
Table C

Age	Increase
20	5.5%
25	5.5
30	5.3
35	4.6
40	4.0
45	3.5
50	2.8
55	2.1
60	1.8

Reduced Benefits

	Male	Female
	30	1.0%
35	1.0	1.0
40	1.0	1.0
45	1.0	1.0
50	1.1	1.0
55	1.6	1.0

* The assumptions presented in Table A and Table B on this page were based on a review of SERS's experience from 1991 through 1995. The rates are the probabilities that an event will occur in the year after the valuation. For instance, the male retirement rate of 17% at age 60 means that 170 of every 1,000 male employees age 60 and eligible for full benefits are expected to retire before they reach age 61.

Active Members by Age and Years of Service

Years of Service

Age Group	0 - 4	5 - 9	10 - 14	15 - 19	20 - 24	25 - 29	30 Plus	Total	Average Salary
Male									
< 20	15	-	-	-	-	-	-	15	\$20,167
20 - 24	610	4	-	-	-	-	-	614	23,829
25 - 29	2,712	765	14	-	-	-	-	3,491	30,900
30 - 34	2,458	3,426	694	13	-	-	-	6,591	37,537
35 - 39	1,759	2,508	2,393	842	72	-	-	7,574	39,378
40 - 44	1,644	1,903	2,203	2,188	1,059	94	-	9,091	40,760
45 - 49	1,471	1,813	1,851	1,885	2,346	1,770	66	11,202	43,302
50 - 54	1,354	1,621	1,639	1,406	1,819	3,431	1,177	12,447	46,748
55 - 59	747	919	940	769	792	1,437	1,535	7,139	48,441
60 - 64	344	557	530	443	340	429	783	3,426	49,782
> 65	192	227	225	126	143	124	288	1,325	53,113
	13,306	13,743	10,489	7,672	6,571	7,285	3,849	62,915	\$42,799

Average Age: 45.55
Average Service: 13.38

Years of Service

Age Group	0 - 4	5 - 9	10 - 14	15 - 19	20 - 24	25 - 29	30 Plus	Total	Average Salary
Female									
< 20	45	-	-	-	-	-	-	45	\$20,265
20 - 24	741	33	-	-	-	-	-	774	22,538
25 - 29	1,609	716	65	-	-	-	-	2,390	26,697
30 - 34	1,386	1,368	829	51	-	-	-	3,634	29,841
35 - 39	1,394	1,330	1,334	1,057	115	-	-	5,230	32,622
40 - 44	1,372	1,497	1,456	1,496	1,353	225	-	7,399	35,115
45 - 49	1,209	1,423	1,465	1,373	1,711	2,256	199	9,636	37,618
50 - 54	817	1,137	1,314	1,072	1,157	1,661	854	8,012	38,508
55 - 59	416	651	847	826	861	853	517	4,971	38,245
60 - 64	175	308	425	407	373	311	257	2,256	37,881
> 65	68	144	150	113	101	82	115	773	36,837
	9,232	8,607	7,885	6,395	5,671	5,388	1,942	45,120	\$35,374

Average Age: 45.41
Average Service: 13.54

Active Member Valuation Data

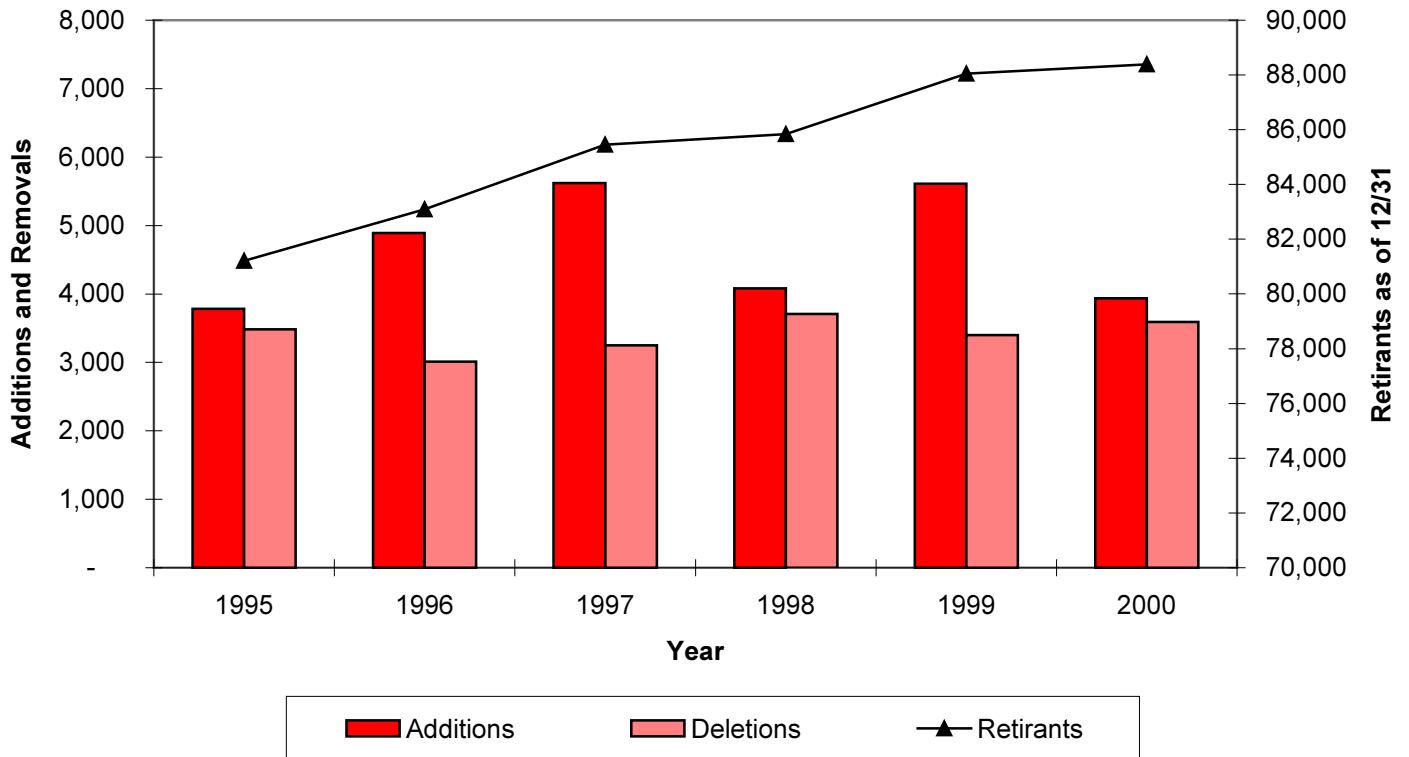
Valuation Date	Number Employers	Number Active Members	Annual Payroll	Annual Average Pay	% Increase in Average Pay
31-Dec-99	106	108,035	\$ 4,519,000,000	\$ 39,698	2.1%
31-Dec-98	107	108,893	4,446,000,000	38,898	5.3
31-Dec-97	107	108,684	4,219,000,000	36,926	3.0
31-Dec-96	108	110,922	4,164,000,000	35,839	4.6
31-Dec-95	109	112,637	4,022,000,000	34,268	4.0
31-Dec-94	110	114,120	3,990,000,000	32,960	4.1

Schedule of Retirants and Beneficiaries Added to and Removed from Rolls

Years Ended December 31, 2000 through 1995

Year	Number on Rolls		End of Year	Percentage Change in Annuitants	Annual Annuities	Percentage Change Annuities
	Additions	Deletions				
2000	3,939	3,590	88,392	0.40%	\$983,432,700	2.54%
1999	5,610	3,401	88,043	2.57%	959,067,216	7.40
1998	4,084	3,707	85,834	0.44%	892,981,308	11.38
1997	5,622	3,251	85,457	2.85%	801,778,597	7.01
1996	4,893	3,011	83,086	2.32%	749,274,115	6.50
1995	3,783	3,482	81,204	0.37%	703,568,068	5.03

Retirant Rolls



Solvency Test

Valua- tion Date	Aggregate Accrued Liabilities For			Total Actuarial Accrued Liability (AAL)	Actuarial Valuation of Assets	Portion of Accrued Liabilities Covered by Reported Assets			Funded Ratio
	(1) Active Member Contri- butions	(2) Retirants & Bene- ficiaries	(3) Active Members (Employer Financed Portion)			(1)	(2)	(3)	
(Amounts in thousands)									
31-Dec-99	\$2,989,489	7,779,993	8,322,358	19,091,840	23,624,467	100.0%	100.0%	100.0%	123.7%
31-Dec-98	2,904,232	7,200,000	8,253,667	18,357,899	20,670,711	100.0	100.0	100.0	112.6
31-Dec-97	2,748,177	6,951,411	7,588,825	17,288,413	18,565,136	100.0	100.0	100.0	107.4
31-Dec-96	2,646,630	6,027,333	7,262,653	15,936,616	16,841,069	100.0	100.0	100.0	105.7
31-Dec-95	2,499,485	5,649,454	6,918,266	15,067,205	15,510,309	100.0	100.0	100.0	102.9
31-Dec-94	2,352,731	5,039,221	6,350,104	13,742,056	13,991,485	100.0	100.0	100.0	101.8

Analysis of Financial Experience

Gains & Losses in Accrued Liabilities Resulting from Differences Between Assumed Experience and Actual Experience

Type of Activity	1999	1998	1997	1996
Gain(Loss) from Investment Earnings	\$1,971,870	\$ 1,099,095	\$814,468	\$396,986
Demographic Assumptions	29,667	(14,752)	23,754	190,630
Pay Increases	165,852	(193,945)	83,253	(196,568)
Contribution Income	-	-	-	23,676
Other	31,499	133,685	(22,670)	41,010
Gain(Loss) During Year From Financial Experience	2,198,888	1,024,083	898,805	455,734
Non Recurring Items:				
Inclusion of Step Rate Bonuses in Retirement Pay	-	-	(58,597)	-
Supplemental Annuities	-	-	(478,000)	-
Composite Gain (Loss)	\$2,198,888	\$1,024,083	\$362,208	\$455,734

Summary of Plan Provisions

Benefit and Contribution Provisions as of December 31, 2000

The State Employees' Retirement System makes provision for retirement, disability, and death benefits for all State employees and certain other eligible groups. The major provisions may be summarized as follows:

Eligible Employees

Class A All regular State employees as well as employees of certain Commissions and Authorities and all employees of state-owned educational institutions and the Pennsylvania State University (unless such employees have joined the Public School Employees' Retirement System or TIAA-CREF). All employees who become members (or who rejoin the Retirement System) on and after March 1, 1974, except Judges and District Justices.

Class C Liquor Law enforcement officers and other officers and certain employees of the State Police who have been members and employees continuously since prior to March 1, 1974.

Class D-3 Members of the General Assembly who have been members and employees continuously since prior to March 1, 1974.

Class E-1 Judges

Class E-2 District Justices

Age and Service Requirements for Superannuation (full formula benefits)

Class A Age 60, with three years of service, except for members of the General Assembly, enforcement officers, correction officers, psychiatric security aides, and officers of the Delaware River Port Authority; for whom the requirement is age 50 with three years of service. Members of Class A with 35 or more years of credited service are entitled to full formula benefits regardless of age. State Police Officers can retire on full benefits after age 50 or with 20 years of service. Capitol Police and Park Rangers can retire on full benefits at age 50 with 20 years of Capitol Police or Park Ranger service.

Class C Age 50, with three years of service.

Class D-3 Age 50, with three years of service.

Class E-1 Age 60, with three years of service; or 35 or more years of credited service, regardless of age.

Class E-2 Age 60, with three years of service; or 35 or more years of credited service, regardless of age.

(Continued)

Formula for Superannuation Annuity

The standard single-life annuity applicable to members of Class A and Class C is equal to 2% of the high three-year average salary of the member multiplied by the years and fractions of credited service.

The applicable single-life annuity for Class C State Police and Class A State Police is a minimum of 50% of highest annual salary if the member has over 20 but less than 25 years of service. With more than 25 years of service the benefit is a minimum of 75% of highest annual salary.

The annuity paid to a member shall not exceed the member's highest salary during any period of 12 consecutive months of creditable service.

The annuity for other classes of members is obtained by multiplying the standard single-life annuity by a class multiplier as follows:

<u>Class</u>	<u>Multiplier</u>	
D-3	3.75	
E-1	2.0	for each of the first 10 years of judicial service dropping to 1.5 for each subsequent year of judicial service.
E-2	1.5	for each year of judicial service.

NOTE: There are conditions under which long-service members or members retiring at advanced ages may receive somewhat larger benefits than those described above. Further, benefit limitations exist for most members of Class D-3.

STATISTICAL



*Trend Data**

	2000	1999	1998	1997	1996	1995	1994
Employer Contribution Rate	N/A	1.39%	5.00%	6.70%	7.28%	7.69%	10.27%
Member Contribution Rate	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%
Employer Contributions	\$168,002	270,718	310,501	324,093	373,903	384,506	342,927
Member Contributions	\$231,667	224,928	221,618	212,556	209,581	201,719	193,204
Average Annual Compensation	N/A	\$39,698	38,898	36,926	35,839	34,268	32,960
Fair Value of Assets	\$27,880,468	28,093,181	24,123,358	21,311,771	18,492,216	16,342,809	13,330,276
Actuarial Value of Assets	N/A	\$23,624,267	20,670,711	18,565,136	16,841,069	15,510,309	13,991,485
Accrued Actuarial Liability	N/A	\$19,091,840	18,357,899	17,288,413	15,936,617	15,067,205	13,742,056
Funded Ratio	N/A	123.7%	112.6%	107.4%	105.7%	102.9%	101.8%
Total Benefits and Refunds	\$1,176,785	1,229,348	1,062,155	1,021,721	928,344	879,717	796,371
Average Pension	\$12,935	12,520	12,027	10,555	10,150	9,801	9,456
Annuitants and Beneficiaries	88,392	88,043	85,834	85,457	83,086	81,204	80,835
Active Employees	109,470	108,035	108,893	108,684	110,922	112,637	114,120

**All Dollar amounts are in thousands, except Average Pension and Average Annual Compensation*

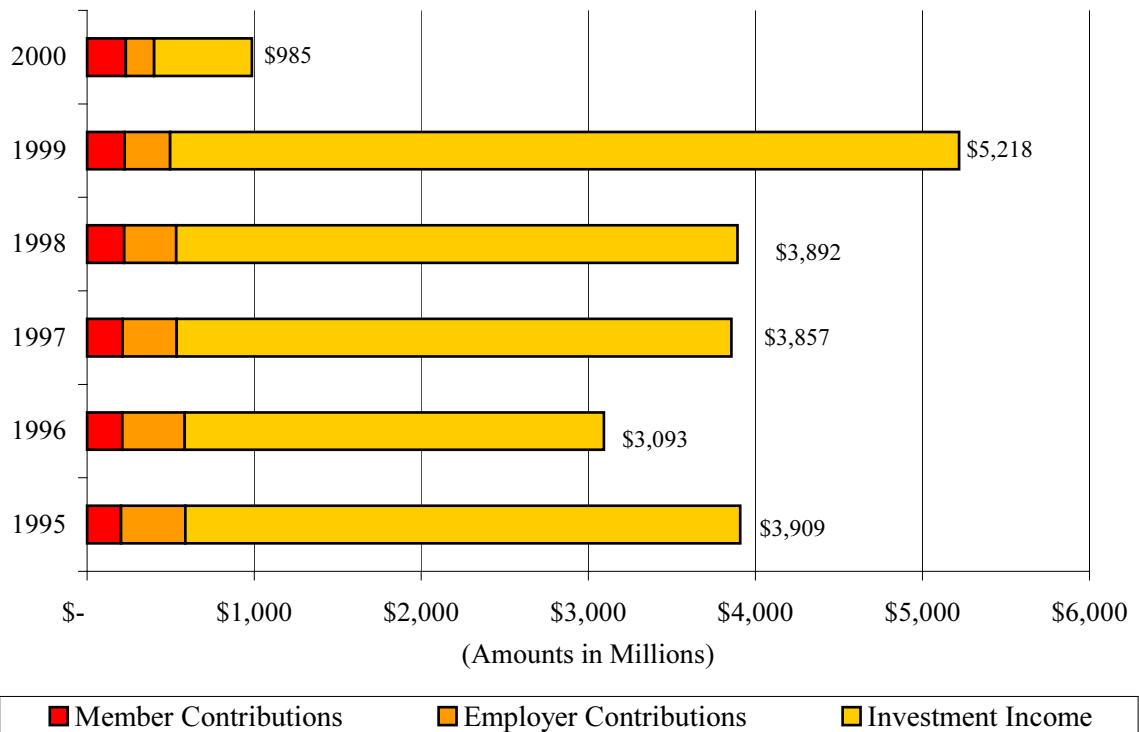
N/A - Value not available pending release of the applicable schedules of the 2000 Actuarial Valuation Report.

Schedule of Additions to Plan Net Assets

Years Ended December 31, 2000 through 1995
(Dollar amounts in thousands)

Year Ending	Member Contributions	Employer		Net Investment Income	Total
		Contributions	% of Annual Covered Payroll		
2000	\$ 231,667	\$ 168,002	3.5%	\$ 585,712	\$ 985,381
1999	224,928	270,718	6.0%	4,722,671	5,218,317
1998	221,618	310,501	7.0%	3,359,844	3,891,963
1997	212,556	324,093	7.7%	3,320,169	3,856,818
1996	209,581	373,903	9.0%	2,509,329	3,092,813
1995	201,719	384,506	9.6%	3,322,362	3,908,587

Additions to Plan Net Assets

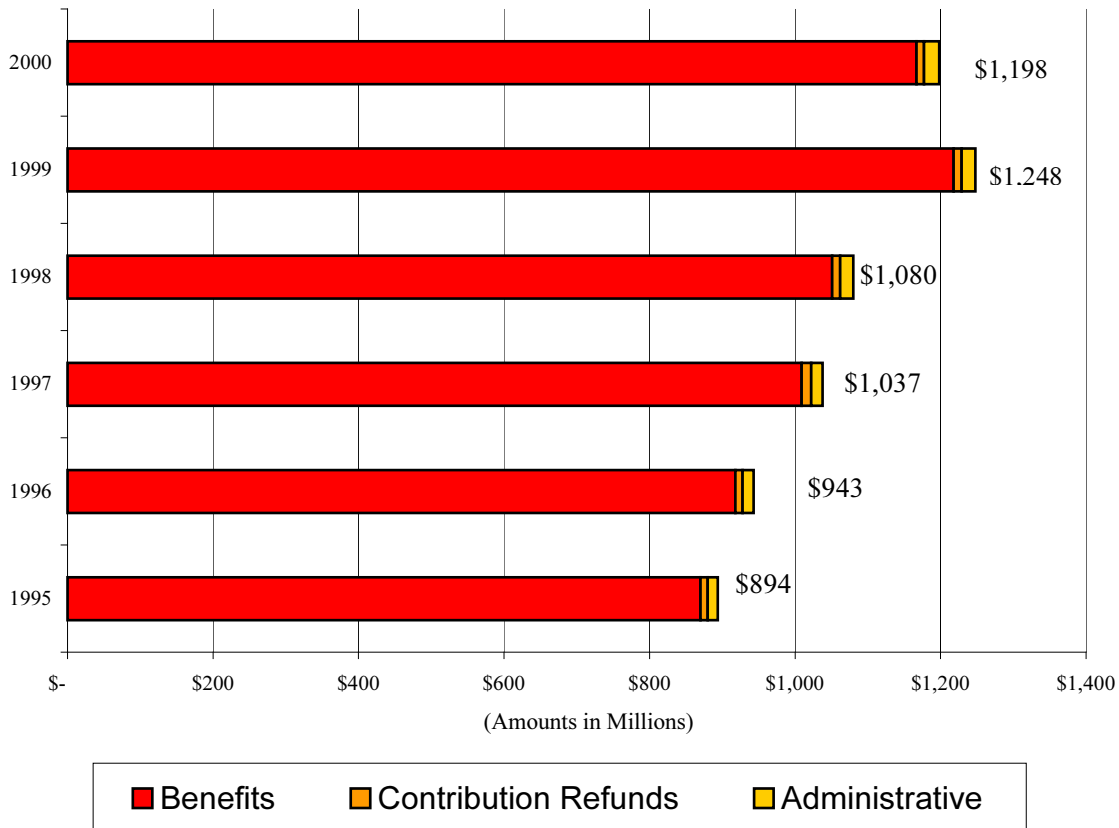


Schedule of Deductions from Plan Net Assets

Years Ended December 31, 2000 through 1995
(Amounts in thousands)

Year	Benefits	Refund of Contributions	Administrative	Total
2000	\$ 1,166,897	\$ 9,888	\$ 21,309	\$ 1,198,094
1999	1,218,133	11,215	19,146	1,248,494
1998	1,050,870	11,285	18,221	1,080,376
1997	1,008,648	13,073	15,542	1,037,263
1996	918,218	10,126	15,062	943,406
1995	869,905	9,807	14,431	894,143

Deductions from Plan Net Assets

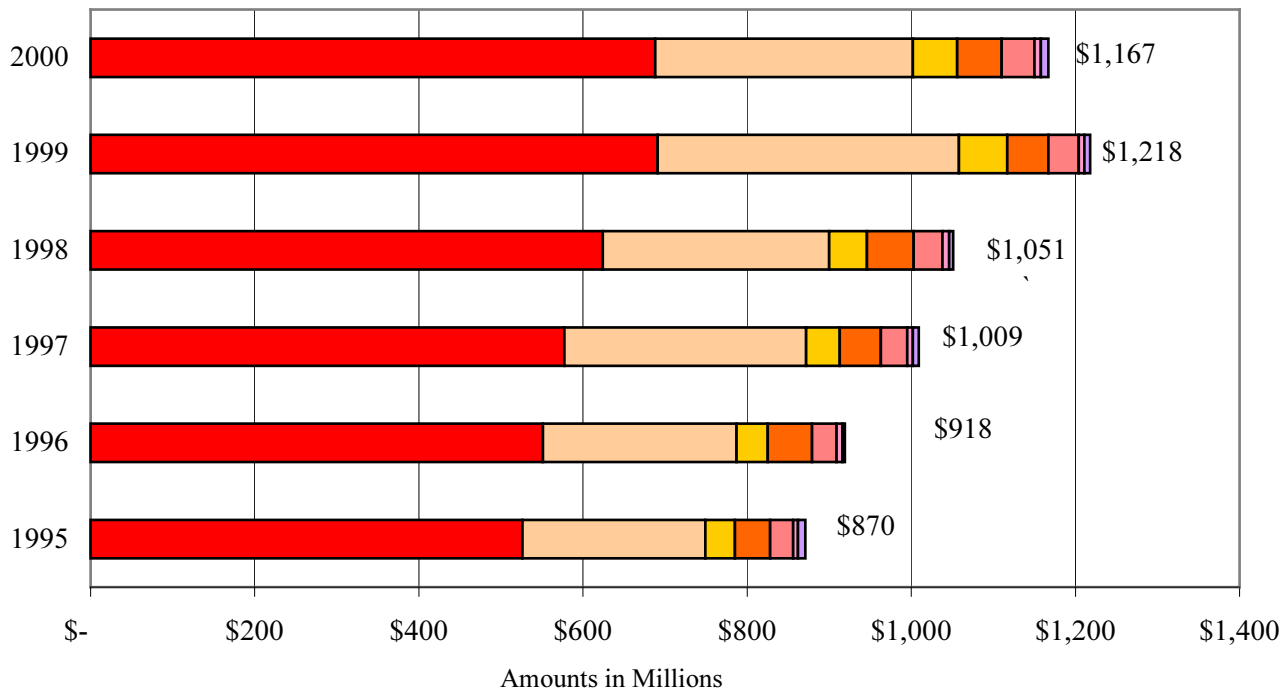


Schedule of Benefit Expenses by Type

Years Ended December 31, 2000 through 1995
(Amounts in thousands)

Year	Retirement		Death	Disability	Survivor	Beneficiary	Transfers & Other	Total
	Normal	Early						
2000	\$ 688,410	\$ 314,014	\$ 53,785	\$ 54,112	\$ 40,037	\$ 7,948	\$ 8,591	\$ 1,166,897
1999	690,840	366,515	58,675	50,496	36,830	7,283	7,494	1,218,133
1998	623,980	276,428	57,465	45,691	34,681	7,527	5,098	1,050,870
1997	576,573	294,827	50,287	40,898	32,063	6,871	7,129	1,008,648
1996	550,547	236,038	53,705	37,735	30,415	6,892	2,886	918,218
1995	525,653	222,755	43,364	35,555	27,820	6,239	8,519	869,905

Benefits by Type



■ Normal
 ■ Early
 ■ Death
 ■ Disability
 ■ Survivor
 ■ Beneficiary
 ■ Transfers & Other

Schedule of Retired Members by Type of Benefit

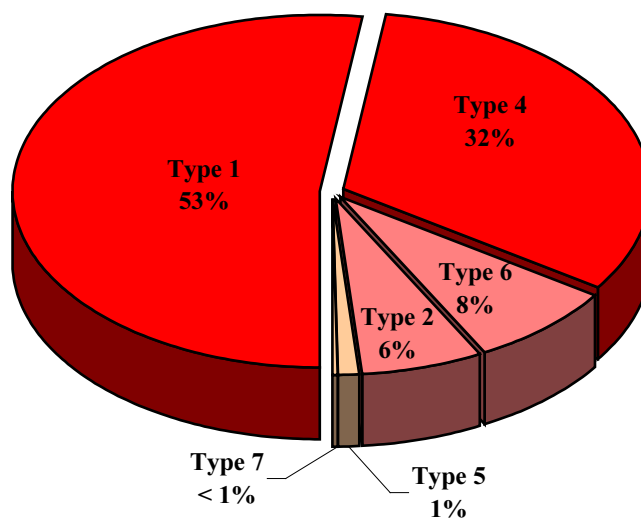
As of December 31, 2000

Amount of Monthly Benefit	Total Monthly Benefits	Total Number of Retirees	Type of Retirement					
			1	2	4	5	6	7
\$ 1 to 500	\$8,989,572	35,165	13,739	1,356	14,697	628	4,642	103
501 to 1,000	17,761,179	24,646	15,033	3,155	4,646	261	1,491	60
1,000 to 1,500	15,148,309	12,396	7,363	943	3,545	88	426	31
1,500 to 2,000	11,348,658	6,582	3,929	223	2,260	22	136	12
2,000 to 2,500	7,653,608	3,446	2,120	46	1,180	17	80	3
2,500 to 3,000	6,146,208	2,239	1,366	10	824	8	31	-
Over 3,000	14,905,191	3,918	2,672	8	1,174	19	44	1
Totals	\$81,952,725	88,392	46,222	5,741	28,326	1,043	6,850	210

Type of Retirement

- 1 - Superannuation
- 2 - Disabled
- 4 - Early
- 5 - Beneficiary
- 6 - Survivor
- 7 - Alternate Payee

Retired Members by Type



Schedule of Retired Members by Option

As of December 31, 2000

Amount of Monthly Benefit	Total Monthly Benefits	Total Number of Retirees	Option Selected					Other
			FRA	1	2	3	4	
\$ 1 to 500	\$ 8,989,572	35,165	10,067	13,243	7,623	3,160	406	666
501 to 1,000	17,761,179	24,646	8,089	8,558	4,145	2,618	931	305
1,000 to 1,500	15,148,309	12,396	3,554	4,185	2,188	1,636	716	117
1,500 to 2,000	11,348,658	6,582	1,828	2,015	1,002	1,068	633	36
2,000 to 2,500	7,653,608	3,446	934	907	558	569	456	22
2,500 to 3,000	6,146,208	2,239	634	639	364	353	232	17
Over 3,000	14,905,191	3,918	1,478	981	429	598	407	25
Totals	\$ 81,952,725	88,392	26,584	30,528	16,309	10,002	3,781	1,188

Options

FRA – Full Retirement Allowance

Opt. 1 – Annuity for Life with beneficiary receiving remainder of Present Value when member dies.

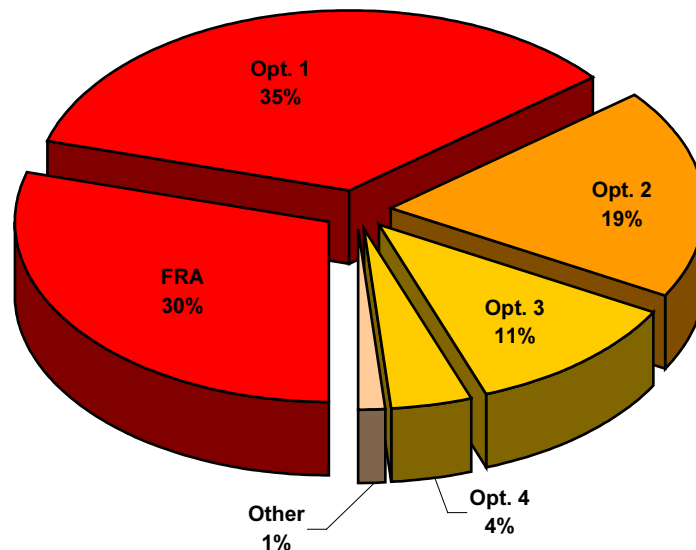
Opt. 2 – Annuity for Life with beneficiary receiving same annuity when member dies.

Opt. 3 – Annuity for Life with beneficiary receiving one half the member’s annuity amount when member dies.

Opt. 4 – Member designs a different plan approved by SERS not covered under the above option.

Other – Death Benefit and Domestic Relation Order

Retired Members by Option



Schedule of Average Annual Benefit Payment Amounts

As of December 31, 2000

Age	Superannuation		Early Retirement		Disability		Beneficiary and Survivor	
	Male	Female	Male	Female	Male	Female	Male	Female
Under 25	-	-	-	-	-	-	\$ 1,993	\$ 9,448
25-29	-	-	-	\$ 751	\$ 11,216	\$ 9,165	13,260	4,563
30-34	-	-	\$ 1,071	956	10,266	7,612	7,793	12,348
35-39	-	-	1,650	1,415	9,643	8,812	6,746	6,634
40-44	-	-	2,340	1,980	9,252	9,001	3,386	8,466
45-49	-	\$ 7,612	4,205	2,802	10,621	10,051	3,855	5,807
50-54	\$29,688	18,056	12,808	6,411	11,196	10,799	6,025	8,376
55-59	30,758	19,398	17,186	9,822	11,002	9,907	4,749	9,488
60-64	23,760	15,086	15,595	10,538	9,821	8,862	5,215	8,120
65-69	18,165	12,000	12,906	8,570	8,421	7,448	6,126	8,523
70-74	15,656	10,130	12,051	7,443	8,617	6,555	7,252	7,187
75-79	13,142	8,320	9,723	6,176	7,229	5,762	5,471	5,702
80-84	9,864	6,913	9,142	6,758	6,267	5,066	6,797	4,915
85-89	9,436	6,701	8,666	8,147	6,040	4,764	3,447	4,431
90 over	8,304	6,806	6,234	6,923	4,375	3,647	8,171	4,556
Total	\$15,715	\$ 9,442	\$ 13,024	\$ 6,963	\$ 9,767	\$ 8,712	\$ 5,835	\$ 6,075

	Superannuation	Early Retirement	Disability	Beneficiary and Survivor
Total Average Pension	\$12,935	\$10,150	\$9,223	\$6,055
Total Average Age Male & Female	74.4	59.2	59.5	75.6

Schedule of Participating Employers

As of December 31, 2000

Administrative Office-PA Courts	Department of the Auditor General
Bloomsburg University Community Activities	Department of Transportation
Board of Probation and Parole	Department of Military and Veterans Affairs
Bucks County Community College	East Stroudsburg University Student Association
Bucks County Health Department	Edinboro University Services Inc.
Bucks County Intermediate Unit	Environmental Hearing Board
California University Student Association	Erie County Health Department
Cambria County Community College	Executive Offices
Capitol Preservation Committee	Fish and Boat Commission
Center for Rural Pennsylvania	Game Commission
Central Susquehanna Intermediate Unit	Governor's Office
Chester County Health Department	Harrisburg Area Community College
Civil Service Commission	Historical and Museum Commission
Clarion University Student Association	House Appropriations Committee(D)
Community College of Allegheny County	House Appropriations Committee(R)
Community College of Philadelphia	House of Representatives
Delaware County Community College	Independent Regulatory Review Commission
Delaware River Joint Toll Bridge	Indiana University Student Co-op
Delaware River Port Authority	Insurance Department
Delaware Valley Regional Planning Commission	Joint Legislative Conservation Committee
Department of Aging	Joint State Government Commission
Department of Agriculture	Kutztown University Student Services
Department of Banking	Lancaster-Lebanon Intermediate Unit
Department of Community & Economic Development	Legislative Budget & Finance Committee
Department of Conservation & Natural Resources	Legislative Data Processing Center
Department of Corrections	Legislative Reference Bureau
Department of Education	Lehigh Carbon Community College
Department of Environmental Protection	Lieutenant Governor's Office
Department of General Services	Liquor Control Board
Department of Health	Local Government Commission
Department of Labor and Industry	Lock Haven University Student Co-op
Department of Public Welfare	Luzerne County Community College
Department of Revenue	Luzerne Intermediate Unit
Department of State	Mansfield University Community Services

Schedule of Participating Employers

As of December 31, 2000
Continued

Milk Marketing Board	Public School Employees' Retirement System
Millersville Student Services	Public Utility Commission
Montgomery County Community College	Reading Area Community College
Northampton Community College	Riverview Intermediate Unit
Office of Attorney General	Securities Commission
Office of Liquidations	Senate of Pennsylvania
Pennsylvania College of Technology	Shippensburg Student Association
Pennsylvania Convention Center Authority	Slippery Rock Student Government
Pennsylvania Health Care Cost Containment Council	State Employees' Retirement System
Pennsylvania Housing Finance Agency	State Ethics Commission
Pennsylvania Emergency Management Agency	State Public School Building Authority
Pennsylvania Higher Education Assistant Agency	State System of Higher Education
Pennsylvania Infrastructure Investment Authority	State Tax Equalization Board
Pennsylvania Municipal Retirement System	Susquehanna River Basin Commission
Pennsylvania Port Authority	Treasury Department
Pennsylvania Public Television Network Commission	Turnpike Commission
Pennsylvania State Police	U.S. Property & Fiscal Office for Pennsylvania
Pennsylvania State University	West Chester University Student Services
Port Authority Transit Corporation	Westmoreland County Community College

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State Employees' Retirement System
P.O. Box 1147
Harrisburg, PA 17108-1147