

# Tennessee Consolidated Retirement System



# Tennessee Consolidated Retirement System



*Tennessee's state animal, the raccoon is most commonly found along wooded streams. Skilled swimmers and nighttime hunters, raccoons feed upon fish, frogs and various insects. Raccoons use their fingers to tear up their food before eating, often washing it first.*

## Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2002 Pension Trust Funds of the State of Tennessee

Prepared by: State of Tennessee Treasury Department  
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Steve Adams, State Treasurer  
Ed Hennessee, TCRS Director

*Special thanks to the  
Tennessee Wildlife Resources Agency  
for sharing these animal photographs.*

**This report is available in its entirety on the Internet at: [www.treasury.state.tn.us/tcrs/ann-report.htm](http://www.treasury.state.tn.us/tcrs/ann-report.htm)**

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**INTRODUCTORY SECTION**

GFOA Certificate of Achievement ..... 1

Chairman of the Board’s Letter ..... 2

Letter of Transmittal ..... 3

Administration and Mission ..... 6

The Council on Pensions and Insurance ..... 7

The Board of Trustees ..... 9

Professional Consultants ..... 11

Treasury Department Executive Staff ..... 13

Organization Chart ..... 14

**FINANCIAL SECTION**

Independent Auditor’s Report ..... 15

Management’s Discussion and Analysis ..... 17

Financial Statements:

    Comparative Statements of Plan Net Assets ..... 22

    Comparative Statements of Changes in Plan Net Assets ..... 24

    Notes to the Financial Statements ..... 26

Required Supplementary Information:

    Schedules of Funding Progress ..... 32

    Schedules of Employer Contributions ..... 32

    Notes to Required Supplementary Information ..... 33

Supporting Schedules:

    Schedules of Administrative Expenses ..... 34

    Schedules of Investment Expenses ..... 36

    Schedules of Expenses for Consultants ..... 38

**INVESTMENT SECTION**

Report by Investment Consultant ..... 39

Letter from TCRS Chief Investment Officer ..... 40

Statutory Investment Authority ..... 41

Investment Performance Review ..... 42

Asset Allocation ..... 43

Largest Holdings ..... 44

Investment Summary ..... 45

Schedules of Investment Fees and Commissions ..... 46

*(continued)*

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**TABLE OF CONTENTS  
(CONTINUED)**

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**ACTUARIAL SECTION**

Actuarial Introduction .....	47
Actuary's Certification Letter .....	48
Summary of Actuarial Assumptions and Methods .....	50
Actuarial Data .....	52
Actuarial Balance Sheet .....	53
Short-Term Solvency Test .....	54
Summary of Accrued and Unfunded Accrued Liabilities .....	55
Selected Actuarial Funding Information .....	56
Analysis of Financial Experience .....	57
Plan Summary .....	58
Services for Active and Retired Members .....	60
Sample Benefit Calculations .....	61
Major Legislative Improvements .....	62

**STATISTICAL SECTION**

Membership:

Schedules of Active Members .....	63
Schedules of Retired Members .....	66
Retired Members by Geographical Distribution .....	69
Retired Members on Payroll and Prior Service Established .....	70
Treasury Retirement Installment Plan .....	71
Refund Activity and Political Subdivision Participation .....	72

Actuarial:

Historical Employer Contribution Rates .....	73
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Financial:

Historical Fair Value .....	74
Analysis of Member and Employer Reserves .....	75
Average Benefit Payments Schedule .....	76
Annual Benefit Payments .....	76
Schedules of Benefit Expenses .....	77
Schedules of Expenses by Type and Revenue by Source .....	78

Political Subdivision Participation:

Introduction to Political Subdivision Participation .....	79
Optional Provisions for Political Subdivisions .....	80
Political Subdivision Participants .....	81

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# Introductory Section

*A member of the weasel family, the river otter was one of the first animals placed on Tennessee's list of protected species.*

*These sleek creatures are spectacular athletes on land and water. They are well adapted for diving: their ears and nostrils can be closed. River otters live in dens and have one to five pups per litter.*

*The river otters are making a strong comeback in the wetlands and rivers of West Tennessee.*



*The red fox sports a reddish-brown coat and has black feet and ears, with a white tip on the tail. The red fox has the ability to spring up to fifteen feet to capture prey.*

## GFOA CERTIFICATE OF ACHIEVEMENT

# Certificate of Achievement for Excellence in Financial Reporting

Presented to

## Tennessee Consolidated Retirement System

For its Comprehensive Annual  
Financial Report  
for the Fiscal Year Ended  
June 30, 2001

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.



*William Patrick Pate*  
President

*Jeffrey L. Esser*  
Executive Director

## CHAIRMAN OF THE BOARD'S LETTER

STATE OF TENNESSEE



TREASURY DEPARTMENT  
STATE CAPITOL  
NASHVILLE, TENNESSEE 37243

December 13, 2002

Dear Members of the Tennessee Consolidated Retirement System:

It is my pleasure to submit this annual financial report of the Tennessee Consolidated Retirement System. This is the fifteenth consecutive year that the financial report is being submitted to the Government Finance Officers Association for review. All previous reports have received the Certificate of Achievement for Excellence in Financial Reporting.

**Administration:** To better serve our members, the TCRS web site (located at [www.treasury.state.tn.us/tcrs](http://www.treasury.state.tn.us/tcrs)) includes a benefit calculation module which allows members to input a limited amount of data to obtain a retirement benefit estimate. The benefit estimate reflects the regular plan amount and the survivorship options. Since its inception, the calculator returned more than 149,000 benefit projections, with 61,000 occurring in fiscal year 2002. Further, TCRS forms and up-to-date information is available to assist our members.

**Investments:** The financial marketplace had a difficult year at June 30, 2002 with the S&P 500 down 18.0% and the EAFE index down 9.5%. TCRS had a relatively good year with a loss of only 1.9%, while the average public pension plan lost more than 5.2%. The well diversified, risk adverse portfolio of TCRS prevented any significant erosion of the fund. Despite the weak market the past two years, TCRS has been able to earn 8.5% during the last 10 years to exceed our actuarial earnings assumption of 7.5%. In two separate studies by the Pennsylvania State Employees Retirement System and the Pension Fund Data Exchange, TCRS had the best performance of the largest public pension systems in the country for the year ended June 30, 2002.

**Financial Soundness of the Plan:** Members of the retirement system should be assured that the benefits that have been promised will be paid. TCRS is considered one of the strongest funded pension plans in the nation. TCRS has received an AAA long-term rating and an A-1(+) short-term rating by Standard and Poor's (S&P), the highest possible ratings issued by this nationally recognized rating agency. The next actuarial valuation to be performed July 1, 2003, will offer significant challenges when considering the difficult investment environment we are experiencing.

**Recognition:** The retirement division dedicates this annual report to the memory of Representative Shelby Rhinehart. Representative Rhinehart served for more than 28 years on the Council on Pensions and Insurance and is recognized as a leader in pension funding and plan benefits.

The Legislature, the Board of Trustees and the TCRS staff have worked diligently to provide the best possible management of the system, to invest the system assets in a prudent manner without undue risk, to fund the system on an actuarially strong basis, and to provide the best possible services to the members in the system.

Sincerely,

A handwritten signature in cursive script that reads "Steve Adams".

Steve Adams, State Treasurer  
Chairman of the Board



## LETTER OF TRANSMITTAL

STATE OF TENNESSEE



TREASURY DEPARTMENT  
TENNESSEE CONSOLIDATED RETIREMENT SYSTEM  
10TH FLOOR ANDREW JACKSON STATE OFFICE BUILDING  
NASHVILLE, TENNESSEE 37243

December 13, 2002

Board of Trustees  
Tennessee Consolidated Retirement System  
Nashville, TN 37243

Ladies and Gentlemen:

We are pleased to present to you the Tennessee Consolidated Retirement System (TCRS) comprehensive annual financial report for the fiscal year ended June 30, 2002. Responsibility for the accuracy of the data and the fairness and completeness of this presentation, including all disclosures, rests with the management of TCRS. To the best of our knowledge and belief, the enclosed data is accurate in all material respects and is reported in a manner designed to provide a precise representation of the financial position and results of operations of the system.

TCRS was established in 1972 with the consolidation of seven separate retirement systems for state employees, public higher education institution employees, public school teachers, and employees of political subdivisions electing to participate in TCRS. As of June 30, 2002, active membership in TCRS totaled 197,971: 43,628 state employees; 17,919 higher education employees; 66,076 teachers; and 70,348 political subdivision employees. A total of 80,426 retirees and beneficiaries were receiving monthly retirement annuities. The state of Tennessee is responsible for the pension benefits of state employees and higher education employees, and funds a significant portion of the retirement liability for teachers through the Basic Education Program. Each of the 407 participating political subdivisions are responsible for the pension benefits of its employees. The TCRS is a qualified pension plan under Section 401(a) of the Internal Revenue Code. As such, the system is exempt from federal income taxation on its investment earnings. Since January 1, 1987, member contributions have been tax deferred under Section 414(h) of the Internal Revenue Code.

The TCRS was established as a retirement program for the public employees of Tennessee. A variety of services are provided for the membership including: investing assets; counseling of rights and benefits; publishing newsletters, booklets, pamphlets, and financial statements; processing deductions for retiree insurance programs and federal income tax; calculating death, disability, and retirement benefits; and processing refund and prior service requests.

Five sections comprise the 2002 report: (1) an Introductory Section, which includes this letter of transmittal, an administrative overview of TCRS, and an operational outline of the system conveying the TCRS commitment to its long-term mission; (2) a Financial Section, containing the independent auditor's report, TCRS financial statements, and supplementary financial information; (3) an Investment Section, including a summary of investment results and various investment schedules; (4) an Actuarial Section, consisting of the report from the independent actuary, the actuarial balance sheet, a summary of actuarial assumptions, a plan summary, services offered to active and retired members, sample benefit calculations, and major legislative improvements; and (5) a Statistical Section reflecting membership, retiree, and financial statistical data.

*(continued)*

**LETTER OF TRANSMITTAL  
(CONTINUED)****ECONOMIC CONDITION AND OUTLOOK**

TCRS, being a strongly funded pension plan, has a conservative investment strategy as demonstrated by a high quality bond portfolio and by a somewhat lower equity exposure than other plans. This strategy has been extremely beneficial during the last two years where the pension fund had losses of only 1.57 percent at June 30, 2001 and 1.92 percent at June 30, 2002 despite double digit negative returns in the domestic and international stock markets. TCRS will continue to evaluate the stock and bond markets to determine the appropriate asset allocation to meet TCRS's funding objective.

For the year ended June 30, 2002, the domestic stock portfolio significantly outperformed the S&P 500 benchmark, (16.76) percent versus (17.99) percent. The domestic bond portfolio nearly equaled the Lehman Brothers Aggregate benchmark of 8.63 percent with a return of 8.60 percent. The international stock return was (5.27) percent, significantly better than the EAFE index benchmark of (9.49) percent. The total return for the TCRS plan was (1.92) percent, exceeding the Callan public plan sponsor database median return of (5.15) percent.

TCRS does not plan to make any significant investment policy or strategy changes. Increased strategic allocations to Real Estate, which was added as a new asset class in 1999, will continue over the next several years to attain a target of 5 percent. Real Estate currently represents 1.54 percent of the portfolio. Within the allocation for the domestic fixed income asset class, purchases will include inflation hedged bonds, a new security type for the TCRS portfolio.

**MAJOR INITIATIVE**

TCRS continues the conversion of the active member system to a DB2 database with completion expected in the summer of 2003. Using this new format will allow TCRS the capability to pursue its goals of having member information available 24 hours a day, seven days a week through the Internet and will extend the life of the active member system.

**FINANCIAL INFORMATION**

This report has been prepared in accordance with generally accepted accounting principles as promulgated or adopted by the Government Accounting Standards Board and the American Institute of Certified Public Accountants. Specific accounting treatments are detailed in the Notes to the Financial Statements found in the Financial Section of this report. Management is responsible for establishing and maintaining internal controls for TCRS. The accounting systems are designed to include internal controls to provide reasonable assurances regarding safekeeping of assets and the reliability of financial records.

For additional discussion regarding financial information, please review Management's Discussion and Analysis located in the Financial Section of this report.

Funding of TCRS is provided through employee and employer contributions plus earnings from the invested assets. A standard actuarial "advanced funding" method is used to provide for the accumulation of assets to fund the cost of retirement, disability, and death benefits provided by the system. The funding objective of TCRS is being met as the state and political subdivisions continue to make contributions to the plan at the rate established by the Board of Trustees. The Board is utilizing a strong actuarial method and has adopted reasonable actuarial assumptions for the determination of the appropriate employer contribution rates.

*(continued)*

LETTER OF TRANSMITTAL  
(CONTINUED)

An actuarial valuation of TCRS is performed by an independent actuarial firm every two years to determine the funding requirements for the employers participating in TCRS. At July 1, 2001, the latest valuation date, the unfunded accrued liability for the entire system totaled \$421.4 million. Unfunded accrued liability of \$81.2 million associated with a closed group of state judges, attorneys general, and county officials is funded over a 14-year period, while the remainder is attributable to political subdivisions. There is no unfunded accrued liability attributable to state employees and teachers. The next actuarial valuation will be performed as of July 1, 2003.

The funds of TCRS are invested by the Investment Division of the Treasury Department in low-risk, high-yield stocks and bonds. Investment policy is established by the Board of Trustees upon receiving and considering the advice of the Investment Advisory Council. These members are appointed by the Treasurer with the consent of the Board of Trustees.

**OTHER INFORMATION**

By statute, the Comptroller of the Treasury serves as the independent auditor for the system. The Board of Trustees has appointed the actuarial and consulting firm of Bryan, Pendleton, Swats and McAllister to provide actuarial services for the system. The firm of Callan Associates, Inc. is employed as the investment consultant for TCRS.

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to Tennessee Consolidated Retirement System for its comprehensive annual financial report for the fiscal year ended June 30, 2001. This was the fourteenth consecutive year that the government has achieved this prestigious award. 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.

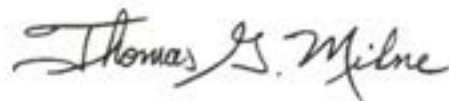
The TCRS is a recipient of the Public Pension Principles Achievement Award. This program, administered by the Public Pension Coordinating Council, recognizing the professional achievements of public employee retirement systems.

**ACKNOWLEDGMENTS**

The dedicated effort of the Treasury Department team to assemble the information contained in this publication is hereby acknowledged with our sincerest appreciation. The report will be provided to state legislators, members of the Board of Trustees, state officials, participating employers, and other interested parties.



Ed W. Hennessee, TCRS Director



Thomas G. Milne, TCRS Chief Investment Officer

## ADMINISTRATION AND MISSION

### ADMINISTRATION

The State Treasurer is a constitutional officer elected every two years by a joint session of the General Assembly. He serves as the Chief Executive Officer of the Treasury Department, a part of the legislative branch of state government. The administration and operation of TCRS is one of the primary responsibilities of the State Treasurer. In order to meet the statutory requirements and fiduciary responsibilities of administering TCRS, the Treasurer appoints two executive officers: the Director of TCRS and the Chief Investment Officer.

The Director of TCRS is responsible for the daily operation of the retirement system which includes providing counseling services for the active and retired members; issuance of payments to retired members, disabled members, beneficiaries of deceased members, and refunds to terminated employees; enrollment of members; maintenance of member account balances and records; establishment of service credit; and issuance of various publications to inform members of their rights and benefits.

The Chief Investment Officer is responsible for the investment and oversight of TCRS assets in accordance with statutory guidelines and the investment policies and strategies established by the Board of Trustees.

Other divisions within the Treasury Department which support the operations of TCRS include Information Systems, Accounting, Management Services, Internal Audit and Personnel. Through these divisions, data processing services, accounting services, records maintenance, control reviews and personnel services are provided.

The administrative budget of TCRS is subject to approval by the General Assembly and is part of the overall annual budget process of the state of Tennessee. Funding for the operation of TCRS is provided by two sources. The state of Tennessee is responsible for the operation cost associated with state employees and higher education employees; the state and local education agencies share the cost related to K-12 teachers; political subdivisions are responsible for the operation cost associated with their employees.

### MISSION

The mission of the Tennessee Consolidated Retirement System is to provide superior services to constituents in a cost-effective manner through qualified personnel while maintaining the highest ethical standards. The mission will be accomplished by TCRS in cooperation with the Board of Trustees, the Council on Pensions and Insurance, and the TCRS membership through the following objectives:

- ❖ *Exemplary Service* – To provide accurate, courteous and prompt service to members of TCRS.
- ❖ *Benefit Standards* – To provide retirement coverage through TCRS, social security and personal savings vehicles which will allow public employees to maintain their standard of living after retirement.
- ❖ *Funding Standards* – To provide for the long-term funding of TCRS on an actuarial basis which will ensure that sufficient assets will be accumulated to pay the statutory benefits of current and future retirees.
- ❖ *Staffing* – To attract and retain professional, highly-trained staff in an atmosphere conducive to innovation, challenges and a high level of performance.
- ❖ *Research* – To continuously perform studies on pension issues and to compare the TCRS plan with other public and private pension systems.
- ❖ *Management* – To manage by leading, planning, organizing and controlling the operation of TCRS in a cost-effective manner for the benefit of members and Tennessee taxpayers utilizing personnel, technology and capital efficiently, while providing the highest level of service.
- ❖ *Ethical Standards* – To maintain the highest ethical standards.
- ❖ *Investment Return* – To obtain the highest available return on investments consistent with the preservation of principal while maintaining sufficient liquidity to react to the changing environment and to pay benefits when due.

## THE COUNCIL ON PENSIONS AND INSURANCE

### THE COUNCIL ON PENSIONS AND INSURANCE

Created as a legislative oversight committee, the Council on Pensions and Insurance develops, recommends, and establishes pension and retirement standards and maintains a progressive state policy on retirement. Additionally, the Council reviews legislation affecting state provided insurance programs for both active and retired members of the Tennessee Consolidated Retirement System.

The Council periodically reviews Tennessee's retirement and state provided insurance provisions and recommends changes in state law as deemed necessary. Since its creation, the Council has continuously performed studies and comparisons of other pension systems including those of other states and private industry and the federal government's social security program. All proposed legislation affecting Tennessee's retirement laws must be reviewed by the Council before the legislature may take action. The Council is authorized to prepare and propose amendments which are then forwarded to the standing committees to which the bills are referred. Information regarding the actuarial cost or impact of proposed legislation is provided by the Council to the other members of the legislature. The staff of the TCRS director also serves as staff to the Council.

The voting membership of the Council consists of the Speaker of each house of the General Assembly; the officers of the House and the Senate Committees on Finance, Ways and Means; and three additional members of each finance committee. The Speaker of the Senate may designate a member of the Senate and the Speaker of the House of Representatives may designate a member of the House to serve as alternates to vote or otherwise act at Council meetings in absence of the respective speaker. Nonvoting members include the Commissioner of Personnel, the Commissioner of Finance and Administration, the Comptroller of the Treasury, the State Treasurer, and the Director of TCRS.

### VOTING MEMBERS – SENATORS



**Ben Atchley**  
*Council Chairman*



**William Clabough**



**Ward Crutchfield**



**John Ford**



**Douglas Henry**  
*Finance, Ways & Means Chairman*



**James Kyle**



**Robert Rochelle**  
*Finance, Ways & Means Secretary*



**John S. Wilder**  
*Lieutenant Governor*

*(continued)*

**THE COUNCIL ON PENSIONS AND INSURANCE  
(CONTINUED)**

**VOTING MEMBERS – REPRESENTATIVES**



**Ronnie Cole**  
*Finance, Ways & Means  
Secretary*



**Tommy Head**  
*Council Secretary  
Finance, Ways & Means  
Vice-Chairman*



**Joe Kent**



**Matt Kisber**  
*Finance, Ways &  
Means Chairman*



**Steve McDaniel**



**Jimmy Naifeh**  
*Speaker of the House*



**Shelby Rhinehart**  
*Council Vice-Chairman*

**NON-VOTING MEMBERS**



**Steve Adams**  
*State Treasurer*



**Walter Butler**  
*Commissioner of Personnel*



**C. Warren Neel**  
*Commissioner of Finance  
& Administration*



**Ed Hennessee**  
*TCRS Director*



**John Morgan**  
*Comptroller of the Treasury*

## THE BOARD OF TRUSTEES

### THE BOARD OF TRUSTEES

The Tennessee Consolidated Retirement System Board of Trustees is responsible for the general administration and proper operation of TCRS within the requirements and provisions of state statute (T.C.A., Title 8, Chapters 34-37). The 18-member Board meets quarterly and is subject to the call of the chairman for special meetings. Nine voting members constitute a quorum, and nine affirmative votes are needed for decision making.

The Board consists of nine ex-officio members, eight representatives of the active TCRS membership, and one representative for retirees. Ex-officio members include the chairman and vice-chairman of the Legislative Council on Pensions and Insurance as nonvoting members, the Commissioner of Personnel, the Commissioner of Finance and Administration, the Comptroller of the Treasury, the Secretary of State, and the Administrative Director of the Courts. In addition, the State Treasurer sits as Chairman of the Board, and the Director of TCRS serves as Secretary.

Employee representation consists of three teachers, one from each grand division of the state, two state employees from departments other than those represented by ex-officio members, and three representatives of local governments. The three teachers are elected for three-year terms by the Representative Assembly of the Tennessee Education Association; state employees elect two representatives who also serve three-year terms.

One representative is appointed for a two-year term by each of the following organizations: The Tennessee County Services Association, the Tennessee Municipal League and the Tennessee County Officials Association.

All employee representatives must be vested members of TCRS. The retiree representative is appointed by the Governor.

### ELECTED MEMBERS



**Rebecca Collins**  
West Tennessee Regional  
Health Office  
Term Expires: June 30, 2004



**Florestine Evans**  
West Tennessee Teacher  
Term Expires: June 30, 2005



**Rebecca Reel**  
East Tennessee Teacher  
Term Expires: June 30, 2004



**Michael Fort**  
Department of Employment  
Security  
Term Expires: June 30, 2004



**Brian Randy Wright**  
Middle Tennessee Teacher  
Term Expires: June 30, 2003

(continued)

**THE BOARD OF TRUSTEES  
(CONTINUED)**

**APPOINTED MEMBERS**



**Leonard Bradley**  
*Retired Member*  
*Term Expires: June 30, 2004*



**James Crumley**  
*Tenn. Municipal League*  
*Term Expires: June 30, 2003*



**Bill Kemp**  
*Sumner County Clerk*  
*Term Expires: June 30, 2003*



**Bob Wormsley**  
*Tenn. County Services Assoc.*  
*Term Expires: June 30, 2003*

**EX-OFFICIO MEMBERS**



**Steve Adams**  
*State Treasurer*



**Ben Atchley, Senator**  
*Council on Pensions & Insurance Chairman*



**Walter Butler**  
*Commissioner of Personnel*



**Cornelia Clark**  
*Administrative Director of the Courts*



**Riley Darnell**  
*Secretary of State*



**C. Warren Neel**  
*Commissioner of Finance & Administration*



**Ed Hennessee**  
*TCRS Director*



**John Morgan**  
*Comptroller of the Treasury*



**Shelby Rhinehart**  
*Council Vice-Chairman*



## PROFESSIONAL CONSULTANTS

## PROFESSIONAL CONSULTANTS

Independent professional consultants are appointed by the Board of Trustees to advise the Board and the TCRS staff on investment, medical and actuarial issues. Service fees related to investment professionals may be found on page 46.

## INVESTMENT ADVISORY COUNCIL

The Investment Advisory Council (IAC) was established to assist both the Board of Trustees and the TCRS investment staff. The investment professionals on the IAC serve five-year terms, meet quarterly and are available to the TCRS staff for consultation. IAC members include:

Frederick S. Crown, CFA  
AmSouth Bank  
Nashville, Tennessee

David Fussel, CFA  
Provident Companies, Inc.  
Chattanooga, Tennessee

Susan Huffman, CFA  
Reliant Investment Management, LLC  
Memphis, Tennessee

Joseph Lee, III  
City of Memphis  
Memphis, Tennessee

George B. Stadler, CFA  
SunTrust Bank, Nashville  
Nashville, Tennessee

C. Stephen Temple, CPA  
Investment Limited Partner  
Brentwood, Tennessee

## INTERNATIONAL EQUITY INVESTMENT MANAGERS

The international investment managers are responsible for purchasing stock of companies domiciled in foreign countries as set out in the investment policy.

Brenda Walker  
J.P. Morgan Investment Management  
522 Fifth Avenue  
New York, New York 10036

Paul Mackey  
Putnam Investments  
One Post Office Square  
Boston, Massachusetts 02109

George Dole  
S.G. Pacific Asset Management  
30 Wall St. 8<sup>th</sup> Floor  
New York, New York 10005

Judith Timoll  
Newgate Management Associates  
80 Field Point Road  
Greenwich, Connecticut 06830

Neil Ostrer  
Marathon Asset Management  
5 Upper St. Martin's Lane  
London, England

Marilyn Harrison  
Walter Scott Partners Ltd.  
Millburn Tower  
Gogar, Edinburgh, Scotland

Gene Waldron  
Capital International  
3000 K Street N.W.  
Suite 230  
Washington, D.C. 20007

## GENERAL INVESTMENT CONSULTANT

An investment consultant is employed to assist in the long-term financial planning process, to evaluate various investment strategies, to measure investment performance, to determine whether the system's objectives are being met, to research investment proposals regarding the use of new asset classes or variations of existing asset classes and to provide investment information on various issues which may arise.

Charles Mathis  
Callan Associates, Inc.  
Six Concourse Parkway  
Suite 2900  
Atlanta, Georgia 30328-6111

(continued)

**PROFESSIONAL CONSULTANTS  
(CONTINUED)**

**REAL ESTATE INVESTMENT CONSULTANT**

The real estate consultant provides general market advice relative to real estate, measures performance of real estate properties, assists in the formulation of policy and assists in the selection of real estate advisors.

Frank L. Blaschka  
The Townsend Group  
M.K. Ferguson Plaza  
1500 West Third Street  
Suite 410  
Cleveland, Ohio 44113

**REAL ESTATE INVESTMENT ADVISORS**

The real estate investment advisors identify potential co-investors as well as prospective real estate transactions.

Stephen J. Furnary  
Clarion Partners  
335 Madison Avenue  
New York, New York 10017

Charles H. Wurtzebach  
Henderson Global Investors North America  
737 N. Michigan Avenue  
Chicago, Illinois 60611

Laler DeCosta  
Lend Lease Real Estate Investments  
3424 Peachtree Road  
Atlanta, Georgia 30326

**THE MEDICAL BOARD**

The physicians serving on the Medical Board evaluate applications for disability retirement to determine whether the applicants are totally and permanently disabled and unable to engage in gainful employment. Additionally, the panel reviews medical data submitted by disabled retirees who are subject to periodic evaluation. The Medical Board consists of the following:

Suzanne Fletcher, M.D.  
Brentwood, Tennessee

Marshall L. Koonce, M.D.  
Memphis, Tennessee

**CONSULTING ACTUARY**

An independent consulting actuarial firm performs an actuarial valuation every two years to determine the funding status of the system and recommend employer contribution rates. The actuary also conducts an experience study every four years to evaluate and adjust actuarial assumptions and methods.

Anthony S. Johnston  
Bryan, Pendleton, Swats & McAllister, LLC  
5301 Virginia Way  
Suite 400  
Brentwood, TN 37027

**OTHER PROFESSIONAL SERVICES**

State statute provides that the state Attorney General and Reporter will be the legal advisor of the Board and that the Office of the Comptroller of the Treasury will conduct an annual audit of the TCRS. These government officers are as follows:

Paul G. Summers  
Attorney General/Reporter  
Nashville, Tennessee

John G. Morgan  
Comptroller of the Treasury  
Nashville, Tennessee

## TREASURY DEPARTMENT EXECUTIVE STAFF

## TREASURER'S OFFICE

Treasurer .....	Steve Adams, CPA
Executive Assistant .....	Dale Sims
Executive Assistant .....	Janice H. Cunningham
Treasurer Assistant .....	Steven Curry, CPA, CEBS, CCM

## TCRS ADMINISTRATION

TCRS Director .....	Ed Hennessee, CFP
TCRS Assistant Director .....	Jill Bachus, CPA
Counseling Services Manager .....	Donna Finley
Member Services Manager .....	Velva Booker
Financial Services Manager .....	Connie Gibson, CPA
Benefit Services Supervisor .....	Charlotte Fuller
Prior Service Supervisor .....	Robert Smith
Counseling Services Supervisor .....	Sandra Sewell
Membership and Field Services Supervisor .....	Roger Amos
Retired Payroll Supervisor .....	Bernard Gentry
Disbursements Supervisor .....	Fred Marshall, CPA
Insurance & General Changes Supervisor .....	Jennifer Brown

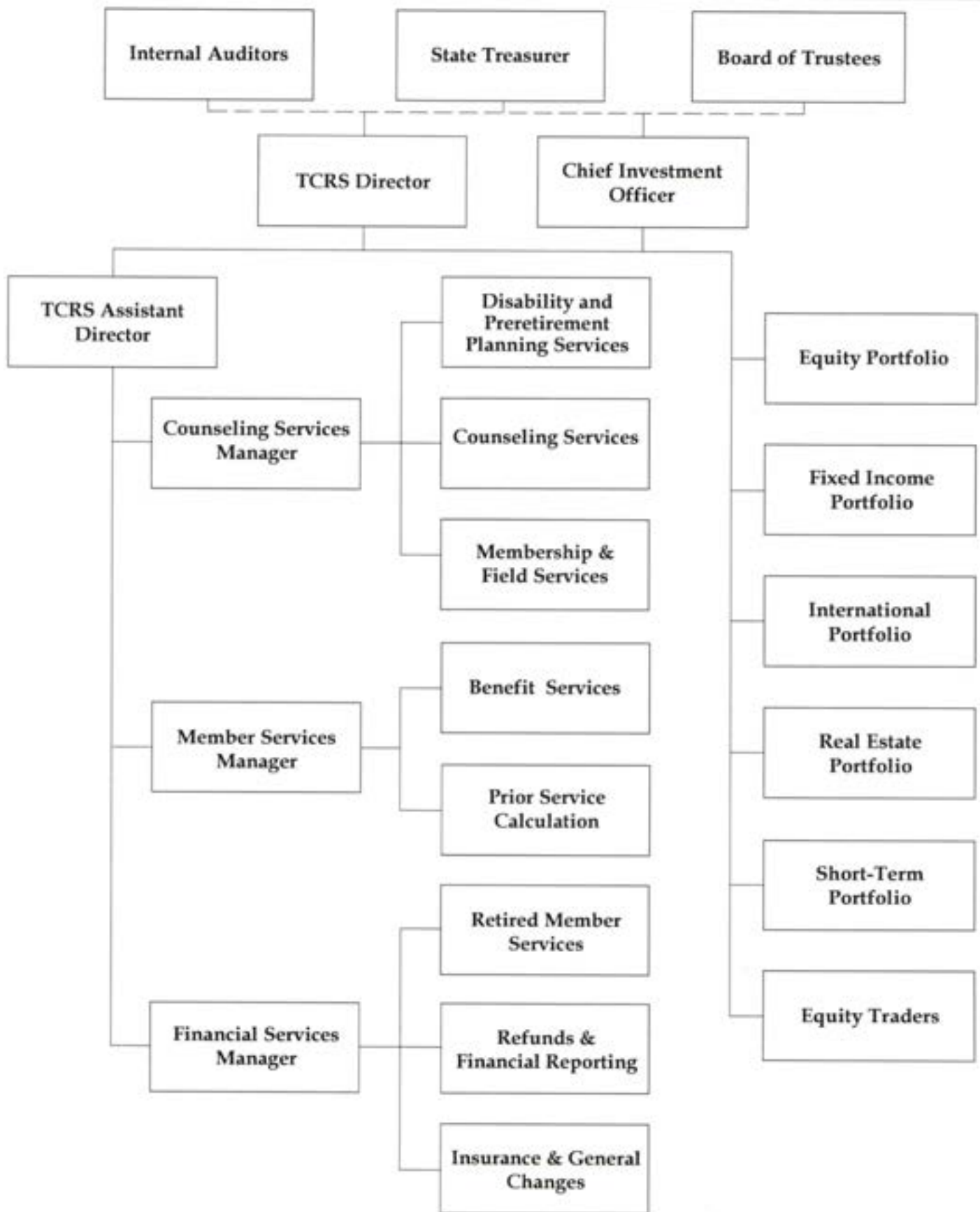
## TCRS INVESTMENT

Chief Investment Officer .....	Thomas Milne, CFA
Equity Director .....	Mike Keeler, CFA
Senior Equity Portfolio Manager .....	Jeremy Conlin, CLU, ChFC, CFA
Senior Equity Portfolio Manager .....	Jim Robinson, CFA
Senior Equity Portfolio Manager .....	Roy Wellington, CFA
Associate Portfolio Manager .....	Rachel Roberts, CPA, CFA
Equity Analyst .....	William Redmond
Equity Analyst .....	Daniel Crews
Equity Analyst .....	Mike Moulder, CGFM
Equity Analyst .....	David Head
Senior Fixed Income Portfolio Manager .....	Leighton Shantz, CFA
Senior Fixed Income Portfolio Manager .....	Terry Davis, CFA
Credit Analyst .....	Chris Daniel
Real Estate Director .....	Peter Katseff
Senior Short-Term Portfolio Manager .....	Randy Graves, CPA
Short-Term Portfolio Manager .....	Tim McClure, CCM
Equity Trader .....	Dianne Willocks
Equity Trader .....	Jenny King
Operations Manager .....	Sharon Harris

## SUPPORTING DIVISIONS

Information Systems Director .....	Newton Molloy III, CDP
Accounting Director .....	Rick DuBray, CPA
Accounting Manager .....	Kim Morrow, CPA
Retirement Accounting Supervisor .....	Tom Jordan
Investment Accounting Supervisor .....	Karen Baumgartel
Treasury Operations Manager .....	Gaylon Bandy
Human Resource Director .....	Ann Taylor-Tharpe
Internal Audit Director .....	Jamie Wayman, CPA
Research and Publications Director .....	Deana Reed Hannah, CRC, CRA
Publications Editor/Web Designer .....	Janice Reilly
Publications Officer/Web Publisher .....	Teresa Gibson
General Counsel .....	Mary Roberts-Krause, JD
Counsel .....	Vernon G. Bush, JD
Administrative Services Manager .....	Brian Derrick

ORGANIZATION CHART



# Financial Statements

*The bald eagle nests each year near Tennessee's 530,000 acres of reservoirs.*

*Bald eagles gain their full adult plumage between four and eight years of age, turning slowly from their juvenile brown color to white-headed and white-tailed.*

*The bald eagle was declared the National Emblem of the U.S. by the 2nd Continental Congress on June 20, 1782. In celebration, June 20 is designated as "Tennessee Bald Eagle Day."*



*The wild turkey is the forefather of all domesticated turkeys. Considered strong fliers, turkeys can also run at speeds up to 12 miles per hour.*

*Raised tail feathers form a fan, as seen on this turkey. The fan is displayed during aggressive behavior or during courtship.*

*A survey of Tennessee landowners in the 1950s revealed that wild turkeys inhabited only 16 counties. After a successful restoration project, the wild turkey population reached 100,000 by the late 1990s.*

## INDEPENDENT AUDITOR'S REPORT

## STATE OF TENNESSEE



COMPTROLLER OF THE TREASURY  
 DEPARTMENT OF AUDIT  
 DIVISION OF STATE AUDIT  
 SUITE 1500, JAMES K. POLK STATE OFFICE BUILDING  
 NASHVILLE, TENNESSEE 37243-0264  
 PHONE (615) 401-7897

December 11, 2002

The Honorable John G. Morgan  
 Comptroller of the Treasury  
 State Capitol  
 Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the accompanying statements of plan net assets of the Tennessee Consolidated Retirement System as of June 30, 2002, and June 30, 2001, and the related statements of changes in plan net assets for the years then ended. These financial statements are the responsibility of 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits 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.

As discussed in note A.1., the financial statements referred to above present only the plan net assets and changes in plan net assets of the Pension Trust Funds of the State of Tennessee and are not intended to present fairly the financial position and changes in financial position of the State of Tennessee, in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Tennessee Consolidated Retirement System as of June 30, 2002, and June 30, 2001, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note A.6. to the financial statements, the Tennessee Consolidated Retirement System implemented GASB Statements 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus*, and 38, *Certain Financial Statement Note Disclosures*.

The management's discussion and analysis and the schedules of funding progress and employer contributions are not required parts of the basic financial statements but are 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 required supplementary information. However, we did not audit the information and express no opinion on it.

(continued)

**INDEPENDENT AUDITOR'S REPORT  
(CONTINUED)**

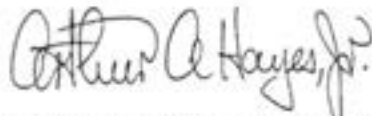
The Honorable John G. Morgan  
December 11, 2002  
Page Two

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying financial information listed as supporting schedules in the table of contents 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.

The introductory, investment, actuarial, and statistical sections, listed in the table of contents, are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 11, 2002, on our consideration of the system's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,



Arthur A. Hayes, Jr., CPA, Director  
Division of State Audit

**TENNESSEE CONSOLIDATED RETIREMENT SYSTEM  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FOR THE YEAR ENDED JUNE 30, 2002**

The Management of the Tennessee Consolidated Retirement System (TCRS) provides this discussion and analysis as an overview of the TCRS' financial activities for the fiscal year ended June 30, 2002.

### FINANCIAL HIGHLIGHTS

- ❖ The plan net assets (total assets minus total liabilities) of the TCRS at June 30, 2002 were over \$23.0 billion. This is a decrease of over \$690 million (2.9 percent) from the plan net assets at June 30, 2001. The net assets are held in trust to meet future benefit obligations.
- ❖ The TCRS relies upon contributions from employees and employers, along with investment income, to meet the funding requirements of an actuarially determined accrued liability. As of July 1, 2001, the date of the latest actuarial valuation, the TCRS' funded ratio was 99.61 percent for the SETHEPP group and 90.36 percent for the PSPP group.
- ❖ Total revenues for fiscal year 2002 were \$157,281,294 (decrease of 16.7 percent compared to fiscal year 2001), which consisted of \$536,137,611 in contributions (increase of 3.8 percent compared to fiscal year 2001) and \$378,856,317 of net investment loss (increase of 15.7 percent compared to fiscal year 2001).
- ❖ Total expenses for fiscal year 2002 were \$847,399,657 - an increase of 7.5 percent over fiscal year 2001 total expenses.

### OVERVIEW OF THE FINANCIAL STATEMENTS

The TCRS financial statements consist of the *Statement of Plan Net Assets* (on pages 22 through 23), the *Statement of Changes in Plan Net Assets* (on pages 24 through 25), and the *Notes to the Financial Statements* (on pages 26 through 31). In addition, *Required Supplementary Information* is presented, which includes this *Management Discussion and Analysis*, as well as the schedules and notes on pages 32 through 33.

The *Statement of Plan Net Assets* and the *Statement of Changes in Plan Net Assets* report information about the plan net assets as of the end of the fiscal year and the changes in those plan net assets during the fiscal year. These statements include all assets and liabilities using the accrual basis of accounting. Under the accrual basis of accounting, the current year's revenues and expenses are included in the financial activity, regardless of when cash is received or paid. The difference between the total assets and total liabilities on the *Statement of Plan Net Assets*, or net assets held in trust for pension benefits, provides a measurement of the financial position of the TCRS as of the end of the fiscal year. The *Statement of Changes in Plan Net Assets* provides information on the activities that caused the financial position to change during the fiscal year. Over time, increases or decreases in the plan net assets of the TCRS are one indicator of whether the system's financial health is improving or deteriorating.

In addition to the two basic financial statements, the reader should also review the *Schedules of Funding Progress*, the *Schedules of Employer Contributions* and the accompanying *Notes to Required Supplementary Information* to gain an understanding of the funded status of the TCRS over time. This information provides an indication of the TCRS' ability to meet both current and future benefit payment obligations. The *Notes to the Financial Statements* are also important to the reader's understanding of the financial statements and provide additional information regarding the TCRS, such as descriptions of the plans administered by the TCRS, including contribution and benefit provisions, and information about the accounting policies and investment activities.

### ANALYSIS OF ASSETS, LIABILITIES AND PLAN NET ASSETS

At June 30, 2002, the TCRS had plan net assets of over \$23.0 billion, down over \$690 million (2.9 percent) from \$23.7 billion as of June 30, 2001. The assets of the TCRS consist primarily of cash and investments. The decrease in plan net assets, as seen over the past two fiscal years, is the result of net negative investment income due primarily to the depreciation in the fair value of investments, caused by unfavorable equity market conditions. Condensed financial information comparing the TCRS' plan net assets for the past two fiscal years is presented on the following page.

(continued)



**TENNESSEE CONSOLIDATED RETIREMENT SYSTEM  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FOR THE YEAR ENDED JUNE 30, 2002 (CONTINUED)**

**PLAN NET ASSETS AT JUNE 30, 2002 AND JUNE 30, 2001**

	June 30, 2002	June 30, 2001	Percentage Change
<b>ASSETS</b>			
Cash and cash equivalents	\$ 1,621,359,545	\$ 779,786,367	107.9 %
Contributions receivables	46,238,224	44,992,609	2.8 %
Investment income receivables	147,069,784	189,993,764	(22.6)%
Investments sold	17,336,115	269,774,623	(93.6)%
Short-term securities	317,388,429	519,748,610	(38.9)%
Long-term investments	21,015,023,754	22,599,841,303	(7.0)%
Invested securities lending collateral	0	113,685,867	(100.0)%
<b>TOTAL ASSETS</b>	<u>23,164,415,851</u>	<u>24,517,823,143</u>	(5.5)%
<b>LIABILITIES</b>			
Death benefits, refunds and other payables	1,141,905	1,014,443	12.6 %
Investments purchased	112,553,617	662,796,260	(83.0)%
Other investment payables	2,633,994	2,121,875	24.1 %
Securities lending collateral	0	113,685,867	(100.0)%
<b>TOTAL LIABILITIES</b>	<u>116,329,516</u>	<u>779,618,445</u>	(85.1)%
<b>NET ASSETS HELD IN TRUST FOR PENSION BENEFITS</b>	<u>\$ 23,048,086,335</u>	<u>\$ 23,738,204,698</u>	(2.9)%

**ANALYSIS OF REVENUES AND EXPENSES**

While contributions to TCRS for fiscal year 2002 increased by \$19.7 million (3.8 percent) over contributions for fiscal year 2001, net investment income for fiscal year 2002 decreased by more than \$51.3 million (15.7 percent) compared to fiscal year 2001. Overall, revenues for fiscal year 2002 declined 16.7 percent compared to revenues for fiscal year 2001. Although employer contribution rates did not change during fiscal year 2002, the increase in contributions can be attributed to new employers joining TCRS and increased salaries. Market conditions resulted in reduced investment income with an overall loss to the TCRS investment portfolio of 1.9 percent.

In addition, total expenses, including benefits and administrative expenses for fiscal year 2002 increased by 7.5 percent over fiscal year 2001. The increase in benefit expenses can be attributed to a 3 percent cost of living adjustment awarded to retirees on July 1, 2001 in addition to more retirees being added to payroll than removed during the fiscal year. Administrative expenses were more consistent than would appear. A one-time refund of \$1.14 million related to several years of office space overbilling charges was returned to TCRS in fiscal year 2001, thus reducing the total administrative cost. Additionally during fiscal year 2002, a biennial actuarial study was performed increasing actuarial consulting costs.

Condensed financial information comparing the TCRS' revenues and expenses for the past two fiscal years follows.

*(continued)*

**TENNESSEE CONSOLIDATED RETIREMENT SYSTEM  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FOR THE YEAR ENDED JUNE 30, 2002 (CONTINUED)**

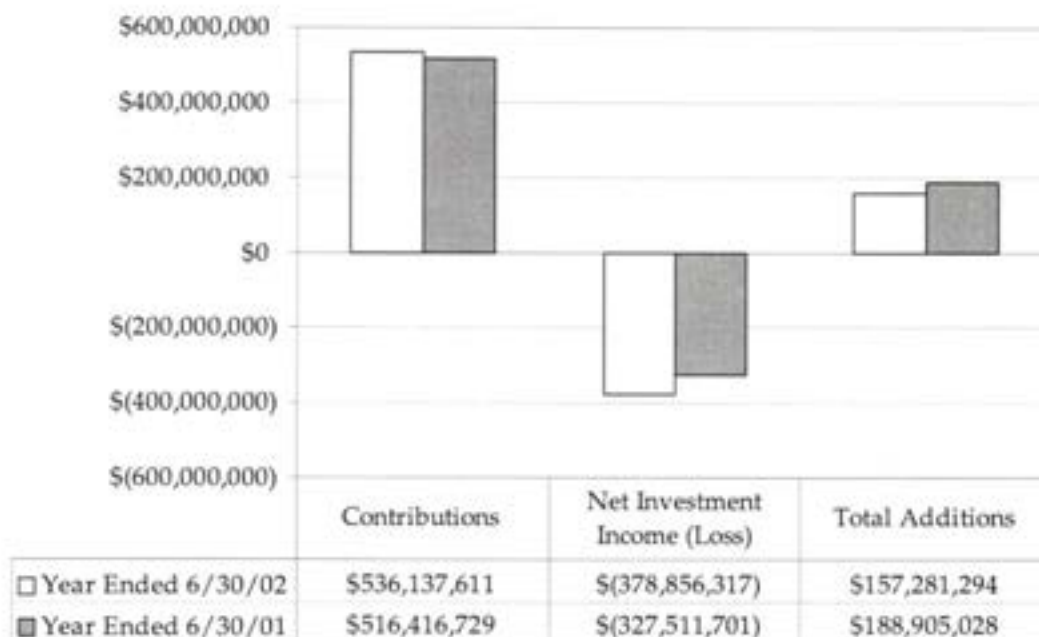
**STATEMENT OF CHANGES IN PLAN NET ASSETS**

	For the Year Ended June 30, 2002	For the Year Ended June 30, 2001	Percentage Change
<b>ADDITIONS</b>			
Contributions	\$ 536,137,611	\$ 516,416,729	3.8 %
Investment income			
Net depreciation in fair value of investments	(1,290,032,957)	(1,382,747,281)	(6.7)%
Interest, dividends and other investment income	924,647,372	1,066,991,030	(13.3)%
Less: Investment expense	(14,093,999)	(12,375,102)	13.9%
Net income from securities lending activities	623,267	619,652	0.6 %
Net investment loss	(378,856,317)	(327,511,701)	15.7%
<b>TOTAL ADDITIONS</b>	<u>157,281,294</u>	<u>188,905,028</u>	(16.7)%
<b>DEDUCTIONS</b>			
Annuity benefits			
Retirement benefits	610,554,871	566,721,390	7.7 %
Survivor benefits	38,723,935	36,024,095	7.5 %
Disability benefits	20,109,341	18,567,921	8.3 %
Cost of living	145,335,114	130,369,319	11.5 %
Death benefits	3,367,876	4,701,538	(28.4)%
Refunds	24,304,536	28,517,803	(14.8)%
Administrative expenses	5,003,984	3,477,600	43.9 %
<b>TOTAL DEDUCTIONS</b>	<u>847,399,657</u>	<u>788,379,666</u>	7.5 %
<b>NET DECREASE</b>	(690,118,363)	(599,474,638)	15.1%
<b>NET ASSETS HELD IN TRUST FOR PENSION BENEFITS</b>			
<b>BEGINNING OF YEAR</b>	23,738,204,698	24,337,679,336	(2.5)%
<b>END OF YEAR</b>	<u>\$ 23,048,086,335</u>	<u>\$ 23,738,204,698</u>	(2.9)%

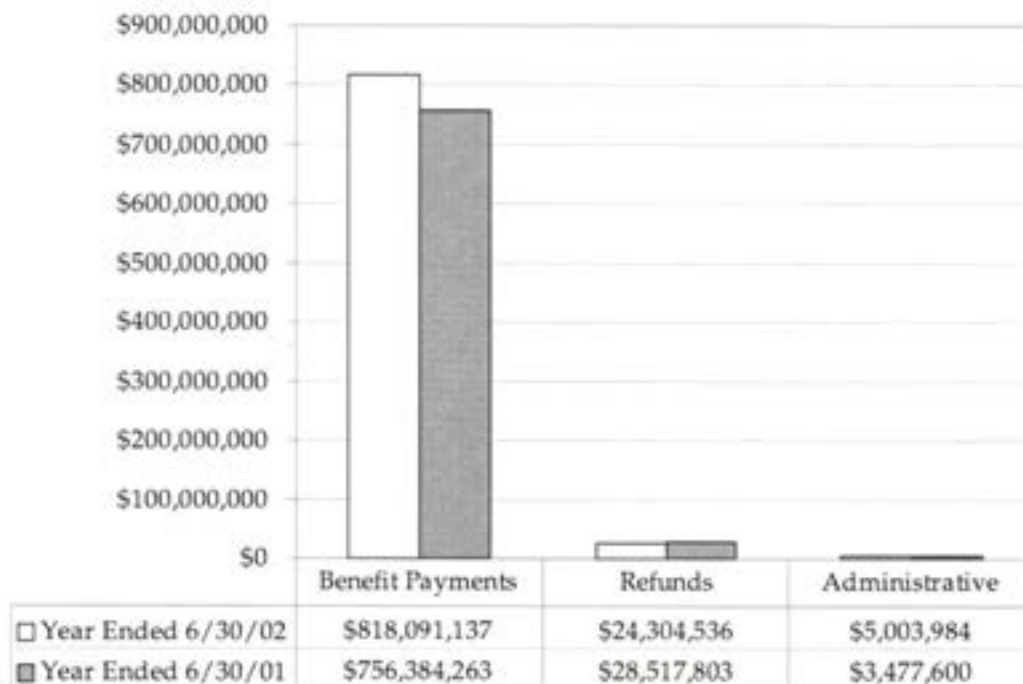
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**TENNESSEE CONSOLIDATED RETIREMENT SYSTEM  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FOR THE YEAR ENDED JUNE 30, 2002 (CONTINUED)**

**REVENUES BY TYPE FOR THE YEARS ENDED JUNE 30, 2002 AND JUNE 30, 2001**



**EXPENSES BY TYPE FOR THE YEARS ENDED JUNE 30, 2002 AND JUNE 30, 2001**



(continued)

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**TENNESSEE CONSOLIDATED RETIREMENT SYSTEM  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FOR THE YEAR ENDED JUNE 30, 2002 (CONTINUED)**

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**ECONOMIC FACTORS, FUTURE FUNDING PROVISIONS, OVERALL OUTLOOK**

The past two years have been difficult for both the domestic and international stock markets. The S & P 500, TCRS's domestic equity benchmark, was down 14.83 percent at June 30, 2001 and 17.99 percent at June 30, 2002. The NASDAQ, an index that includes the hard hit technology sector, small cap stocks, and dot.com companies, was down 45.37 percent and 32.05 percent during the same period. The international markets, as measured by the EAFE index, did not fair any better being down 23.83 percent and 9.49 percent. Fortunately, the domestic bond market performed better with positive results of 11.22 percent and 8.63 percent.

The last two years proved the benefits of having a diversified portfolio. Despite large negative stock returns, the TCRS portfolio had losses of only 1.57 percent at June 30, 2001 and 1.92 percent at June 30, 2002. TCRS was ranked near the top in investment performance of public pension plans during this period.

The first quarter of the 2002-03 fiscal year was even more difficult with the domestic stock market down 17.28 percent (nearly the same as the previous 12 months) and the international market down 19.73 percent. Again, the bond market had positive returns of 4.58 percent.

While the TCRS has had excellent performance on a relative basis, it must be recognized that the losses during the last two years as compared to the 7.5 percent actuarial earnings assumption will put upward pressure on the employer contribution rate at the next actuarial valuation set for July 1, 2003, as well as subsequent valuations.

**CONTACTING THE TCRS**

This report is designed to provide a financial overview of the TCRS to state legislators, members of the Board of Trustees of the TCRS, state officials, participating employers and any other interested parties. Questions or requests for additional information regarding the financial information presented in this report may be addressed in writing to the Tennessee Treasury Department, Consolidated Retirement System, 10<sup>th</sup> Floor Andrew Jackson Building, Nashville, Tennessee 37243-0230.

**TENNESSEE CONSOLIDATED RETIREMENT SYSTEM**  
**COMPARATIVE STATEMENTS OF PLAN NET ASSETS**  
**AS OF JUNE 30, 2002 AND JUNE 30, 2001**

*Expressed in Thousands*

	State Employees, Teachers, Higher Education Employees Pension Plan (SETHEEPP)	Political Subdivisions Pension Plan (PSPP)
<b>ASSETS</b>		
Cash and cash equivalents	\$ 1,400,985	\$ 220,375
Receivables		
Member contributions receivable	15,250	4,050
Employer contributions receivable	18,191	8,747
Accrued interest receivable	116,555	18,334
Accrued dividends receivable	10,524	1,656
Other investment receivable	1	0
Investments sold	14,980	2,356
Total receivables	175,501	35,143
Investments, at fair value		
Short-term securities	274,249	43,139
Government bonds	7,517,687	1,182,530
Corporate bonds	2,404,488	378,226
Corporate stocks	7,931,835	1,247,676
Real estate	304,659	47,923
Invested securities lending collateral	0	0
Total investments	18,432,918	2,899,494
<b>TOTAL ASSETS</b>	<b>20,009,404</b>	<b>3,155,012</b>
<b>LIABILITIES</b>		
Accounts payable		
Death benefits and refunds payable	461	645
Other	36	0
Investments purchased	97,256	15,298
Other investment payables	2,276	358
Securities lending collateral	0	0
<b>TOTAL LIABILITIES</b>	<b>100,029</b>	<b>16,301</b>
<b>NET ASSETS HELD IN TRUST FOR PENSION</b>		
<b>BENEFITS</b> (Schedules of funding progress for the plans are presented on page 32)	<b>\$ 19,909,375</b>	<b>\$ 3,138,711</b>

*See accompanying Notes to the Financial Statements*

*(continued)*

(CONTINUED)

June 30, 2002 Total	State Employees, Teachers, Higher Education Employees Pension Plan (SETHEPP)	Political Subdivisions Pension Plan (PSPP)	June 30, 2001 Total
\$ 1,621,360	\$ 676,173	\$ 103,613	\$ 779,786
19,300	15,055	3,809	18,864
26,938	17,681	8,447	26,128
134,889	160,809	24,641	185,450
12,180	3,840	588	4,428
1	101	15	116
<u>17,336</u>	<u>233,929</u>	<u>35,846</u>	<u>269,775</u>
<u>210,644</u>	<u>431,415</u>	<u>73,346</u>	<u>504,761</u>
317,388	450,688	69,061	519,749
8,700,217	7,795,671	1,194,563	8,990,234
2,782,714	3,100,092	475,040	3,575,132
9,179,511	8,449,363	1,294,730	9,744,093
352,582	251,798	38,584	290,382
0	98,580	15,106	113,686
<u>21,332,412</u>	<u>20,146,192</u>	<u>3,087,084</u>	<u>23,233,276</u>
<u>23,164,416</u>	<u>21,253,780</u>	<u>3,264,043</u>	<u>24,517,823</u>
1,106	644	359	1,003
36	11	0	11
112,554	574,728	88,068	662,796
2,634	1,840	282	2,122
0	98,580	15,106	113,686
<u>116,330</u>	<u>675,803</u>	<u>103,815</u>	<u>779,618</u>
<u>\$ 23,048,086</u>	<u>\$ 20,577,977</u>	<u>\$ 3,160,228</u>	<u>\$ 23,738,205</u>

**TENNESSEE CONSOLIDATED RETIREMENT SYSTEM**  
**COMPARATIVE STATEMENTS OF CHANGES IN PLAN NET ASSETS**  
**FOR THE YEARS ENDED JUNE 30, 2002 AND JUNE 30, 2001**

*Expressed in Thousands*

	State Employees, Teachers, Higher Education Employees Pension Plan (SETHEPP)	Political Subdivisions Pension Plan (PSPP)
<b>ADDITIONS</b>		
Contributions		
Member contributions	\$ 142,126	\$ 47,139
Employer contributions	243,498	103,374
Total contributions	<u>385,624</u>	<u>150,513</u>
Investment income		
Net depreciation in fair value of investments	(1,114,237)	(175,796)
Interest	642,392	101,391
Dividends	132,758	20,953
Real estate income, net of operating expenses	23,452	3,701
Total investment loss	<u>(315,635)</u>	<u>(49,751)</u>
Less: Investment expense	<u>(12,190)</u>	<u>(1,904)</u>
Net loss from investing activities	(327,825)	(51,655)
Securities lending activities		
Securities lending income	1,492	235
Less: securities lending expense	(953)	(150)
Net income from securities lending activities	<u>539</u>	<u>85</u>
Net investment loss	(327,286)	(51,570)
Transfer of assets from PSPP	0	0
<b>TOTAL ADDITIONS</b>	<u>58,338</u>	<u>98,943</u>
<b>DEDUCTIONS</b>		
Annuity benefits		
Retirement benefits	528,471	82,084
Survivor benefits	33,518	5,206
Disability benefits	17,405	2,704
Cost of living	129,918	15,417
Death benefits	2,225	1,143
Refunds	12,689	11,616
Administrative expense	2,714	2,290
Transfer of assets to SETHEPP	0	0
<b>TOTAL DEDUCTIONS</b>	<u>726,940</u>	<u>120,460</u>
<b>NET DECREASE</b>	(668,602)	(21,517)
<b>NET ASSETS HELD IN TRUST FOR PENSION BENEFITS</b>		
BEGINNING OF YEAR	20,577,977	3,160,228
END OF YEAR	<u>\$ 19,909,375</u>	<u>\$ 3,138,711</u>

*See accompanying Notes to the Financial Statements*

*(continued)*

(CONTINUED)

June 30, 2002 Total	State Employees, Teachers, Higher Education Employees Pension Plan (SETHEEP)	Political Subdivisions Pension Plan (PSPP)	June 30, 2001 Total
\$ 189,265	\$ 135,154	\$ 45,433	\$ 180,587
346,872	232,149	103,681	335,830
<u>536,137</u>	<u>367,303</u>	<u>149,114</u>	<u>516,417</u>
(1,290,033)	(1,198,688)	(184,059)	(1,382,747)
743,783	806,941	123,906	930,847
153,711	101,496	15,585	117,081
27,153	16,525	2,538	19,063
<u>(365,386)</u>	<u>(273,726)</u>	<u>(42,030)</u>	<u>(315,756)</u>
(14,094)	(10,738)	(1,637)	(12,375)
<u>(379,480)</u>	<u>(284,464)</u>	<u>(43,667)</u>	<u>(328,131)</u>
1,727	2,078	319	2,397
(1,103)	(1,540)	(237)	(1,777)
624	538	82	620
<u>(378,856)</u>	<u>(283,926)</u>	<u>(43,585)</u>	<u>(327,511)</u>
0	12,604	0	12,604
<u>157,281</u>	<u>95,981</u>	<u>105,529</u>	<u>201,510</u>
610,555	491,204	75,517	566,721
38,724	31,224	4,800	36,024
20,109	16,094	2,474	18,568
145,335	116,892	13,477	130,369
3,368	3,720	982	4,702
24,305	16,484	12,034	28,518
5,004	1,795	1,683	3,478
0	0	12,604	12,604
<u>847,400</u>	<u>677,413</u>	<u>123,571</u>	<u>800,984</u>
(690,119)	(581,432)	(18,042)	(599,474)
23,738,205	21,159,409	3,178,270	24,337,679
<u>\$ 23,048,086</u>	<u>\$ 20,577,977</u>	<u>\$ 3,160,228</u>	<u>\$ 23,738,205</u>



**TENNESSEE CONSOLIDATED RETIREMENT SYSTEM**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**JUNE 30, 2002 AND JUNE 30, 2001**

The Tennessee Consolidated Retirement System (TCRS) administers two defined benefit pension plans - State Employees, Teachers and Higher Education Employees Pension Plan (SETHEEPP) and Political Subdivisions Pension Plan (PSPP). Although the assets of the plans are commingled for investment purposes, each plan's assets may be used only for the payment of benefits to members of that plan, in accordance with the terms of the plan.

**A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

1. **Reporting Entity** - The TCRS is included in the State of Tennessee Financial Reporting Entity. Because of the state's fiduciary responsibility, the TCRS has been included as pension trust funds in the *Tennessee Comprehensive Annual Financial Report*.
2. **Measurement Focus and Basis of Accounting** - The accompanying financial statements have been prepared in conformity with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB). The TCRS follows all applicable GASB pronouncements, as well as applicable private sector pronouncements issued on or before November 30, 1989. The financial statements have been prepared using the flow of economic resources measurement focus and the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.  
  
Plan member contributions are recognized in the period in which the contributions are due. Plan employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of each plan.
3. **Cash and Cash Equivalents** - Cash and cash equivalents, by definition, includes cash and short-term investments with a maturity date within three months of the acquisition date. The state's accounting policy regarding the definition of cash and cash equivalents includes cash management pools as cash. Cash received by the TCRS that cannot be invested immediately in securities is invested in the State Pooled Investment Fund administered by the State Treasurer. The State Pooled Investment Fund is authorized by state statute to invest funds in accordance with policy guidelines approved by the Funding Board of the State of Tennessee. The current resolution of that board gives the Treasurer authority to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, certain repurchase agreements, various U.S. Treasury and Agency obligations, and in obligations of the state of Tennessee pursuant to *Tennessee Code Annotated*, Section 9-4-602(b). The State Pooled Investment Fund is also authorized to enter into securities lending agreements in which U.S. Government Securities may be loaned for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities. The pool's custodial credit risk is presented in the *Tennessee Comprehensive Annual Financial Report* for the years ended June 30, 2002 and June 30, 2001. The classification of cash and cash equivalents also includes cash held in a custody account under a contractual arrangement for master custody services. Cash balances with the custodial agent are not classified into the credit risk categories established by Statement Number 3 of the Governmental Accounting Standards Board as the custody account relationship does not meet the definition for either a deposit with a financial institution or a security.
4. **Method Used to Value Investments** - Investments are reported at fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Short-term investments that do not have an established market are reported at cost plus accrued interest which approximates fair value. The fair value of real estate investments is determined at least every three years by qualified independent appraisers who are members of the Appraisal Institute and internally by real estate advisors for those years when independent appraisals are not performed. Investment income consists of realized and unrealized appreciation (depreciation) in the fair value of investments. Interest income is recognized when earned. Securities and securities transactions are recorded in the financial statements on trade-date basis.
5. **Receivables** - Receivables primarily consist of interest which is recorded when earned. The receivables for contributions as of June 30, 2002 consist of member contributions of \$15.3 million and \$4.0 million due to SETHEEPP and PSPP respectively, and employer contributions of \$18.2 million and \$8.7 million due to SETHEEPP and PSPP respectively. The receivables for contributions as of June 30, 2001 consist of member contributions of \$15.1 million and \$3.8 million due to SETHEEPP and PSPP respectively, and employer contributions of \$17.7 million and \$8.4 million due to SETHEEPP and PSPP respectively.

(continued)

**TENNESSEE CONSOLIDATED RETIREMENT SYSTEM**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**JUNE 30, 2002 AND JUNE 30, 2001 (CONTINUED)**

6. **Adoption of New Accounting Pronouncements** - Effective July 1, 2001, the TCRS, along with the State of Tennessee, adopted the provisions of Statement No. 34 of the Governmental Accounting Standards Board, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments* and its related *Omnibus Statement No. 37*. Accordingly, a management's discussion and analysis (MD&A) has been included in the presentation of required supplementary information (RSI). The TCRS has also adopted the provisions of Statement No. 38, *Certain Financial Statement Note Disclosures* and has included applicable disclosures in the Notes to the Financial Statements.

**B. PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION**

At July 1, 2001, the date of the latest actuarial valuation, the membership of each plan consisted of the following:

	SETHEEPP	PSPP
Retirees and beneficiaries currently receiving benefits	56,444	21,298
Terminated members entitled to but not receiving benefits	15,895	3,500
Current active members	<u>126,069</u>	<u>68,656</u>
Total	198,408	93,454
Number of participating employers	140	404

**State Employees, Teachers and Higher Education Employees Pension Plan**

*Plan Description* - SETHEEPP is a cost-sharing, multiple employer defined benefit pension plan that covers the employees of the state, teachers with Local Education Agencies (LEA's) and higher education employees. The TCRS provides retirement benefits as well as death and disability benefits to plan members and their beneficiaries. Benefits are determined by a formula using the member's high five-year average salary and years of service. Members become eligible to retire at the age of 60 with five years of service or at any age with 30 years of service. A reduced retirement benefit is available to vested members who are at least 55 years of age or have 25 years of service. Disability benefits are available to active members with five years of service who become disabled and cannot engage in gainful employment. There is no service requirement for disability that is the result of an accident or injury occurring while the member was in the performance of duty. Members joining the plan on or after July 1, 1979 are vested after five years of service. Members joining prior to July 1, 1979 are vested after four years of service. Compounded cost of living adjustments (COLA) are provided each July based on the percentage change in the Consumer Price Index (CPI) during the previous calendar year except that (a) no COLA is granted if the CPI is less than one-half percent; (b) a COLA of 1 percent will be granted if the CPI increases between one-half percent and one percent; (c) the maximum annual COLA is capped at three percent. Benefit provisions are established by state statute found in Title Eight, Chapters 34 through 37 of the *Tennessee Code Annotated*. State statutes are amended by the Tennessee General Assembly. Ad hoc increases may only be authorized by the General Assembly. Public safety officers receive an additional supplemental benefit that is paid from age 60 to age 62.

*Superseded Systems and Certain Employment Classifications* - Members of superseded systems that became members of the TCRS at consolidation in 1972, have their rights preserved to the benefits of the superseded system, if the benefit from the superseded plan exceeds that provided by the Group 1 (teachers and general employees) TCRS formula. Likewise, public safety employees and officials of TCRS Groups 2, 3 and 4 are entitled to the benefits of those formulas, if better than the Group 1 benefits.

*Contributions and Reserves* - Effective July 1, 1981, the plan became noncontributory for most state and higher education employees. The contribution rate for teachers is five percent of gross salary. The employers contribute a set percentage of their payrolls, determined by an actuarial valuation. *Tennessee Code Annotated* Title Eight, Chapter 37 provides that the contribution rates be established and may be amended by the Board of Trustees of the TCRS. The administrative budget for the plan is approved through the state of Tennessee's annual budget process. Funding for the administrative budget is included in employer contributions.

The net assets of the plan are legally required to be reserved in two accounts, the Member Reserve and the Employer Reserve. The Member Reserve represents the accumulation of employee contributions plus interest. The Employer Reserve represents the accumulation of employer contributions, investment income and transfers from the Member Reserve for retiring members. Benefit payments and interest credited to the members' accounts are reductions to the Employer Reserve. At June 30, 2002, the plan's Member Reserve and Employer Reserve

*(continued)*

**TENNESSEE CONSOLIDATED RETIREMENT SYSTEM**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**JUNE 30, 2002 AND JUNE 30, 2001 (CONTINUED)**

were fully funded with balances of \$2,781.9 million and \$17,127.5 million, respectively. At June 30, 2001, the plan's Member Reserve and Employer Reserve were fully funded with balances of \$2,640.7 million and \$17,937.3 million, respectively.

**Political Subdivisions Pension Plan**

*Plan Description* - PSPP is an agent multiple-employer defined benefit pension plan that covers the employees of participating political subdivisions of the state of Tennessee. Employee class differentiations are not made under PSPP. The TCRS provides retirement benefits as well as death and disability benefits to plan members and their beneficiaries. Benefits are determined by a formula using the member's high five-year average salary and years of service. Members become eligible to retire at the age of 60 with five years of service or at any age with 30 years of service. A reduced retirement benefit is available to vested members who are at least 55 years of age or have 25 years of service. Disability benefits are available to active members with five years of service who become disabled and cannot engage in gainful employment. There is no service requirement for disability that is the result of an accident or injury occurring while the member was in the performance of duty. Members joining the plan prior to July 1, 1979 are vested after four years of service. Members joining on or after July 1, 1979 are vested upon completion of 10 years of service, unless five years vesting is authorized by resolution of the chief governing body. Cost of living adjustments (COLA) are the same as provided by SETHEEPP except that the local government may elect (a) to provide no COLA benefits or (b) to provide COLA benefits under a non-compounding basis rather than the compounded basis applicable under SETHEEPP. Benefit provisions are established and amended by state statute. Pursuant to Article Two, Section 24 of the *Constitution of the State of Tennessee*, the state cannot mandate costs on local governments. Any benefit improvement may be adopted by the governing body of a governmental entity participating in the TCRS.

*Contributions and Reserves* - Political subdivisions may elect contributory or noncontributory retirement for their employees. The contribution rate for contributory employees of political subdivisions is five percent of gross salary. The employers contribute a set percentage of their payrolls, equal to at least, the percentage determined by an actuarial valuation. State statute provides that the contribution rates be established and may be amended by the Board of Trustees of the TCRS. The administrative budget for the plan is approved through the state's annual budget process. Funding for the administrative budget is included in employer contributions.

The net assets of the plan are legally required to be reserved in two accounts, the Member Reserve and the Employer Reserve. The Member Reserve represents the accumulation of employee contributions plus interest. The Employer Reserve represents the accumulation of employer contributions, investment income and transfers from the Member Reserve for retiring members. Benefit payments and interest credited to the members' accounts are reductions to the Employer Reserve.

At June 30, 2002, the plan's Member Reserve and Employer Reserve were fully funded with balances of \$643.7 million and \$2,495.0 million, respectively. At June 30, 2001, the plan's Member Reserve and Employer Reserve were fully funded with balances of \$592.3 million and \$2,567.9 million respectively.

**C. PLAN TRANSFERS**

During Fiscal Year 2001, assets in the amount of \$12.6 million, relating to the Regional Library System, were transferred from the PSPP to the SETHEEPP. Under *Tennessee Code Annotated*, Section 10, Chapter 5, Part 2, the employees of the Regional Library System, whose retirement assets were included in the PSPP, became employees of the Department of State, which is under the SETHEEPP plan.

**D. INVESTMENTS**

State statute authorizes the TCRS to invest in bonds, debentures, preferred stock and common stock, real estate and in other good and solvent securities subject to the approval of the Board of Trustees and further subject to the following restrictions:

- a. The total sum invested in common and preferred stocks shall not exceed seventy-five percent (75 percent) of the total of the funds of the retirement system.
- b. The total sum invested in notes and bonds or other fixed income securities exceeding one year in maturity shall not exceed seventy-five percent (75 percent) of the total funds of the retirement system. Private Placements are limited to 15 percent of the total fixed income portfolio.

(continued)

**TENNESSEE CONSOLIDATED RETIREMENT SYSTEM**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**JUNE 30, 2002 AND JUNE 30, 2001 (CONTINUED)**

- c. Within the restrictions in (a) and (b) above, an amount not to exceed fifteen percent (15 percent) of the total of the funds of the retirement system may be invested in securities of the same kinds, classes, and investment grades as those otherwise eligible for investment in various approved foreign countries.
- d. The total amount of securities loaned under a securities lending program cannot exceed thirty percent (30 percent) of total assets.
- e. The total sum invested in real estate shall not exceed five percent (5 percent) of the total of the funds of the retirement system.

The TCRS investment securities are categorized on the chart that follows according to the level of custodial credit risk associated with the custodial arrangements. Category 1 includes investments that are insured or registered, or for which the securities are held by the TCRS or its agent in the name of the TCRS. Category 2 includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent in the name of the TCRS. Category 3 includes uninsured and unregistered investments for which the securities are held by the broker or dealer, or by the counterparty's trust department or agent, but not in the name of the TCRS.

*Expressed in Thousands*

	Fair Value June 30, 2002	Fair Value June 30, 2001
Investments - Category 1		
Cash equivalents and short-term securities		
Commercial paper	\$ 762,737	\$ 751,889
Corporate notes	90,489	15,320
Government bonds	1,089,855	533,584
Long-term investments		
Government bonds	8,588,873	8,872,472
Corporate bonds	2,782,714	3,575,132
Corporate stocks	9,167,281	9,102,052
Total Investments - Category 1	<u>22,481,949</u>	<u>22,850,449</u>
Investments - Category 2	<u>0</u>	<u>0</u>
Investments - Category 3		
Short-term securities lending collateral investments held by custodian bank		
Government bonds	0	63,135
Tri-party repurchase agreements	0	50,551
Margin deposit on futures contracts		
Government bonds	9,438	0
Total Investments - Category 3	<u>9,438</u>	<u>113,686</u>
Investments - Not Categorized		
Investments held by broker-dealers under securities on loan contracts for cash collateral		
Corporate stocks	0	97,563
Real estate	352,582	290,382
Unsettled investment acquisitions		
Government bonds	101,906	117,762
Corporate stocks	12,230	544,478
Total Investments - Not Categorized	<u>466,718</u>	<u>1,050,185</u>
Total investments and invested securities lending collateral	<u>22,958,105</u>	<u>24,014,320</u>
Less: Short-term securities classified as cash equivalents on the Statements of Plan Net Assets	<u>(1,625,693)</u>	<u>(781,044)</u>
Total investments and invested securities lending collateral as shown on the Statements of Plan Net Assets	<u>\$ 21,332,412</u>	<u>\$ 23,233,276</u>

*(continued)*

**TENNESSEE CONSOLIDATED RETIREMENT SYSTEM**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**JUNE 30, 2002 AND JUNE 30, 2001 (CONTINUED)**

As of June 30, 2002 and June 30, 2001, the TCRS had no concentrations of investments, other than those issued or guaranteed by the U.S. government, in any one organization that represents five percent or more of plan net assets.

*Securities Lending* - The TCRS is authorized by its investment policy, as adopted by the Board of Trustees, to enter into collateralized securities lending agreements whereby the TCRS loans its debt and equity securities for a fee to a select few of the highest quality securities firms and banks. Loans must be limited so the total amount on loan does not exceed 30 percent of the TCRS' assets. The TCRS' custodian bank manages the lending program and maintains the collateral on behalf of the TCRS. The borrower must deliver cash collateral to the lending agent. The cash collateral may be reinvested by the lending agent in accordance with the investment policy, as further restricted under the TCRS securities lending agreement. Collateral securities cannot be pledged or sold unless the borrower defaults.

The loaned securities are initially collateralized at 102 percent of their fair value for domestic securities and 105 percent for international. Collateral is marked-to-market daily and additional collateral is pledged by the borrower if the fair value of the collateral subsequently falls below 100 percent for domestic securities and 105 percent for international. Although there is no specific policy for matching the maturities of collateral investments and the securities loans, the securities on loan can be terminated on demand by either the TCRS or the borrower. As of June 30, 2002, there were no securities on loan. The TCRS securities lending income, net of expenses, for the year ended June 30, 2002 was \$623,267. As of June 30, 2001, the fair value of securities on loan to brokers was \$97,563,290 and the fair value of collateral pledged for the securities on loan was \$113,685,867. At June 30, 2001, the TCRS had no credit risk exposure to borrowers as the amounts owed to borrowers exceeded the amounts the borrowers owed the TCRS.

*Financial Instruments with Off-Balance Sheet Risk* - The TCRS is a party to financial instruments with off-balance sheet risk used in the normal course of business to generate earnings and reduce its own exposure to fluctuations in market conditions. The TCRS is authorized by statute to engage in forward contracts to exchange different currencies at a specified future date and rate and in domestic stock index futures contracts. These contracts involve elements of custodial credit, market and legal risk in excess of amounts recognized in the Statement of Plan Net Assets as of June 30, 2002 and June 30, 2001. The TCRS may purchase or sell domestic stock index futures contracts for the purposes of making asset allocation changes and improving liquidity. Futures contracts are limited to the S&P 500 Index, the S&P Midcap 400 Index and the Russell 2000 Index. The contractual or notional amounts express the extent of the TCRS' involvement in these instruments and do not represent exposure to credit loss. The credit risk on forward and futures contracts is controlled through limits and monitoring procedures. Market risk, the risk that changing market conditions may make a financial instrument less valuable, is controlled through limitations on the use of such instruments. Legal risk is controlled through the use of only authorized instruments and brokers. The allowable currencies for hedging purposes are limited by policy of the Board of Trustees to the currencies of those countries otherwise authorized for investment.

At June 30, 2002, there were forward exchange contracts outstanding at a total net notional amount of \$896,129,128 and a fair value of \$961,336,292. At June 30, 2001, there were forward exchange contracts outstanding at a total net notional amount of \$17,113,000 and a fair value of \$17,392,319.

At June 30, 2002, the notional amount of futures contracts was \$128,868,750 at a fair value of \$123,762,500. At June 30, 2001, the TCRS was not under any futures contracts. The changes in fair value of outstanding futures contracts are settled daily.

The TCRS is also authorized by investment policy to engage in the issuance of options. Activity is limited to selling covered call options. The TCRS had no options outstanding at June 30, 2002 and June 30, 2001.

*Asset-Backed Securities* - The TCRS invests in collateralized mortgage obligations (CMOs) which are mortgage-backed securities. These securities are based on cash flows from interest and principal payments on underlying mortgages. Therefore, they are sensitive to prepayments by mortgagees, which may result from a decline in interest rates. The CMOs held were issued by quasi-U.S. governmental agencies. There were no CMOs held at June 30, 2002 and June 30, 2001. The TCRS also invests in various asset-backed securities, representing ownership interests in trusts consisting of credit card or auto loan receivables. These securities are issued by organizations with AAA or AA credit ratings.

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**TENNESSEE CONSOLIDATED RETIREMENT SYSTEM  
NOTES TO THE FINANCIAL STATEMENTS  
JUNE 30, 2002 AND JUNE 30, 2001 (CONTINUED)**

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TCRS invests in these securities primarily to enhance returns by taking advantage of opportunities available in this sector of the securities markets.

During Fiscal Year 2001, the TCRS purchased commercial paper issued by Pacific Gas and Electric Company (PG&E) which was due to mature at \$25,994,000. PG&E defaulted on the maturity payment and filed for reorganization under Chapter 11 of the U.S. Bankruptcy Code. As of the date of the issuance of the TCRS financial statements, the TCRS continued to hold the PG&E commercial paper and the reorganization plan was still pending.

**E. COMMITMENTS**

**Standby Commercial Paper Purchase Agreement** - The TCRS has agreed to serve as standby commercial paper purchaser for commercial paper issued by the Funding Board of the State of Tennessee. By serving as a standby commercial paper purchaser, the TCRS receives an annual fee of 7.5 basis points on the \$250 million maximum issuance under this agreement during times when both Moody's and Standard and Poor's investment ratings assigned to the State of Tennessee's general obligation bonds are Aaa and AAA respectively, and 12 basis points during times when either Moody's or Standard and Poor's has assigned ratings other than Aaa and AAA respectively. In the unlikely event that the TCRS would be called upon to purchase the commercial paper, the TCRS would receive interest at a rate equal to prime plus 75 basis points during the first 30 consecutive days, plus an additional 50 basis points for each consecutive 30 days thereafter, up to a maximum rate allowed by state law.

**TENNESSEE CONSOLIDATED RETIREMENT SYSTEM  
REQUIRED SUPPLEMENTARY INFORMATION  
SCHEDULES OF FUNDING PROGRESS AND EMPLOYER CONTRIBUTIONS**

**SCHEDULES OF FUNDING PROGRESS**

*Expressed in Thousands*

	Actuarial Valuation Date	Actuarial Value of Plan Assets (a)	Actuarial Liability (AAL) Frozen Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Annual Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
SETHEEPP	7/1/01	\$ 20,760,989	\$ 20,842,216	\$ 81,227	99.61%	\$ 4,451,452	1.82%
	7/1/99	18,327,133	18,420,156	93,023	99.49%	4,132,409	2.25%
	6/30/97	15,671,678	15,782,850	111,172	99.30%	3,810,231	2.92%
PSPP	7/1/01	3,187,990	3,528,137	340,147	90.36%	1,545,593	22.01%
	7/1/99	2,690,781	2,890,942	200,161	93.08%	1,341,363	14.92%
	6/30/97	2,226,891	2,287,904	61,013	97.33%	1,130,585	5.40%

The SETHEEPP is comprised of a number of employee groups. However, the unfunded liability of \$81.2 million at July 1, 2001 is attributable to two employee groups: 1) County Officials employed prior to July 1, 1972 and 2) State Judges and Attorneys General employed prior to July 1, 1972. The PSPP represents 404 participating entities at July 1, 2001. The unfunded liability of \$340.1 million is attributable to 318 of the 404 entities.

*See accompanying Notes to Required Supplementary Information*

**SCHEDULES OF EMPLOYER CONTRIBUTIONS**

*Expressed in Thousands*

Year Ended June 30	SETHEEPP		PSPP	
	Annual Required Contribution	Percentage Contributed	Annual Required Contribution	Percentage Contributed
2002	\$ 243,498	100%	\$ 103,374	100%
2001	232,149	100%	103,681	100%
2000	252,162	100%	82,749	100%
1999	244,453	100%	69,230	100%
1998	166,756	100%		

An actuarial valuation of the TCRS is performed every two years with the next valuation scheduled to be effective July 1, 2003. The June 30, 1995 valuation determined the employer contribution rate for the year ended June 30, 1997 for the SETHEEPP and the PSPP, and for the year ended June 30, 1998 for the PSPP. Therefore, the Schedule of Employer Contributions, in accordance with the parameters of GASB Statement Number 25, is not available for the year ended June 30, 1997 for either plan or for the year ended June 30, 1998 for the PSPP.

*See accompanying Notes to Required Supplementary Information*

**TENNESSEE CONSOLIDATED RETIREMENT SYSTEM  
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION  
AS OF JUNE 30, 2002 AND JUNE 30, 2001**

The information presented in the required supplementary schedules was determined as part of the actuarial valuations at the dates indicated. Additional information as of the July 1, 2001 actuarial valuation follows.

	<u>SETHEEPP</u>	<u>PSPP</u>
Valuation Date	July 1, 2001	July 1, 2001
Actuarial cost method	Frozen Entry Age	Frozen Entry Age
Amortization method	Level Dollar	Level Dollar
Remaining amortization period	14 years closed period	(1) closed period
Asset valuation method	5-year Moving Market Average	5-year Moving Market Average
Actuarial assumptions:		
Investment rate of return	7.50%	7.50%
Projected salary increases	4.75% (3)	4.75% (3)
Includes inflation at	(2)	(2)
Cost-of-living adjustments	3.00%	3.00%
Increase in Social Security wage base	3.50%	3.50%

- (1) The length of the amortization period varies by political subdivision. For political subdivisions entering the plan on or after July 1, 1994, the amortization period does not exceed 20 years.
- (2) No explicit assumption is made regarding the portion attributable to the effect of inflation on salaries.
- (3) Uniform rate that approximates the effect of a graded salary scale.



**TENNESSEE CONSOLIDATED RETIREMENT SYSTEM**  
**SCHEDULES OF ADMINISTRATIVE EXPENSES**  
**FOR THE YEAR ENDED JUNE 30, 2002**

	SETHEEPP	PSPP	Total
<b>PERSONNEL SERVICES</b>			
Salaries and wages	\$ 933,885	\$ 788,139	\$ 1,722,024
Employee benefits	223,297	188,449	411,746
<b>TOTAL PERSONNEL SERVICES</b>	<u>1,157,182</u>	<u>976,588</u>	<u>2,133,770</u>
<b>PROFESSIONAL SERVICES</b>			
Accounting	84,235	71,089	155,324
Actuarial services	174,861	147,572	322,433
Data processing	276,653	233,477	510,130
Information systems	285,235	240,720	525,955
Management services	149,323	126,018	275,341
Medical review	13,262	11,193	24,455
Administrative, Internal Audit, Legal, Personnel	298,508	251,922	550,430
<b>TOTAL PROFESSIONAL SERVICES</b>	<u>1,282,077</u>	<u>1,081,991</u>	<u>2,364,068</u>
<b>COMMUNICATION</b>			
Travel	10,568	8,919	19,487
Telephone	21,088	17,797	38,885
Printing	26,194	22,106	48,300
Postage	104,799	88,444	193,243
<b>TOTAL COMMUNICATION</b>	<u>162,649</u>	<u>137,266</u>	<u>299,915</u>
<b>MISCELLANEOUS</b>			
Office space	79,730	67,287	147,017
Refund of prior year office space overbilling	0	0	0
Supplies and maintenance	24,974	21,076	46,050
Equipment	0	0	0
Other services and charges	7,139	6,025	13,164
<b>TOTAL MISCELLANEOUS</b>	<u>111,843</u>	<u>94,388</u>	<u>206,231</u>
<b>TOTAL ADMINISTRATIVE EXPENSES</b>	<u>\$ 2,713,751</u>	<u>\$ 2,290,233</u>	<u>\$ 5,003,984</u>

With 197,971 active members and 80,426 retired members, the operating cost per member was \$17.97 for the year ended June 30, 2002.

**TENNESSEE CONSOLIDATED RETIREMENT SYSTEM**  
**SCHEDULES OF ADMINISTRATIVE EXPENSES**  
**FOR THE YEAR ENDED JUNE 30, 2001**

	SETHEEPP	PSPP	Total
<b>PERSONNEL SERVICES</b>			
Salaries and wages	\$ 851,315	\$ 798,232	\$ 1,649,547
Employee benefits	193,598	181,527	375,125
<b>TOTAL PERSONNEL SERVICES</b>	<u>1,044,913</u>	<u>979,759</u>	<u>2,024,672</u>
<b>PROFESSIONAL SERVICES</b>			
Accounting	92,439	86,674	179,113
Actuarial services	58,942	55,267	114,209
Data processing	247,151	231,740	478,891
Information systems	272,800	255,790	528,590
Management services	145,419	136,352	281,771
Medical review	12,924	12,120	25,044
Administrative, Internal Audit, Legal, Personnel	226,730	212,593	439,323
<b>TOTAL PROFESSIONAL SERVICES</b>	<u>1,056,405</u>	<u>990,536</u>	<u>2,046,941</u>
<b>COMMUNICATION</b>			
Travel	11,848	11,110	22,958
Telephone	15,985	14,989	30,974
Printing	42,325	39,685	82,010
Postage	108,189	101,443	209,632
<b>TOTAL COMMUNICATION</b>	<u>178,347</u>	<u>167,227</u>	<u>345,574</u>
<b>MISCELLANEOUS</b>			
Office space	73,664	69,071	142,735
Refund of prior year office space overbilling	(590,631)	(553,803)	(1,144,434)
Supplies and maintenance	20,524	19,245	39,769
Equipment	5,481	5,139	10,620
Other services and charges	6,050	5,673	11,723
<b>TOTAL MISCELLANEOUS</b>	<u>(484,912)</u>	<u>(454,675)</u>	<u>(939,587)</u>
<b>TOTAL ADMINISTRATIVE EXPENSES</b>	<u>\$ 1,794,753</u>	<u>\$ 1,682,847</u>	<u>\$ 3,477,600</u>

With 194,725 active members and 77,742 retired members, the operating cost per member was \$12.76 for the year ended June 30, 2001.

**TENNESSEE CONSOLIDATED RETIREMENT SYSTEM**  
**SCHEDULES OF INVESTMENT EXPENSES**  
**FOR THE YEAR ENDED JUNE 30, 2002**

	SETHEPP	PSPP	Total
<b>PERSONNEL SERVICES</b>			
Salaries and wages	\$ 1,159,528	\$ 181,126	\$ 1,340,654
Employee benefits	235,176	36,736	271,912
<b>TOTAL PERSONNEL SERVICES</b>	<u>1,394,704</u>	<u>217,862</u>	<u>1,612,566</u>
<b>PROFESSIONAL SERVICES</b>			
Accounting	147,159	22,987	170,146
Legal services	101,844	15,909	117,753
Data processing	93,032	14,532	107,564
Information systems	110,475	17,257	127,732
Management services	11,070	1,729	12,799
External investment manager fees	6,976,823	1,089,825	8,066,648
Investment consulting fees	197,197	30,803	228,000
Investment custodian fees	842,603	131,620	974,223
Real estate manager fees	1,832,145	286,194	2,118,339
Administrative, Internal Audit, Personnel	235,348	36,763	272,111
<b>TOTAL PROFESSIONAL SERVICES</b>	<u>10,547,696</u>	<u>1,647,619</u>	<u>12,195,315</u>
<b>COMMUNICATION</b>			
Travel	11,824	1,847	13,671
Telephone	22,582	3,527	26,109
Printing	2,161	337	2,498
Postage	8,121	1,268	9,389
<b>TOTAL COMMUNICATION</b>	<u>44,688</u>	<u>6,979</u>	<u>51,667</u>
<b>MISCELLANEOUS</b>			
Office space	61,151	9,552	70,703
Supplies and maintenance	35,038	5,473	40,511
Other services and charges	106,587	16,650	123,237
<b>TOTAL MISCELLANEOUS</b>	<u>202,776</u>	<u>31,675</u>	<u>234,451</u>
<b>TOTAL INVESTMENT EXPENSES</b>	<u>\$ 12,189,864</u>	<u>\$ 1,904,135</u>	<u>\$ 14,093,999</u>

**TENNESSEE CONSOLIDATED RETIREMENT SYSTEM  
SCHEDULES OF INVESTMENT EXPENSES  
FOR THE YEAR ENDED JUNE 30, 2001**

	SETHEPP	PSPP	Total
<b>PERSONNEL SERVICES</b>			
Salaries and wages	\$ 1,068,040	\$ 162,810	\$ 1,230,850
Employee benefits	213,307	32,516	245,823
<b>TOTAL PERSONNEL SERVICES</b>	<u>1,281,347</u>	<u>195,326</u>	<u>1,476,673</u>
<b>PROFESSIONAL SERVICES</b>			
Accounting	132,435	20,188	152,623
Legal services	94,170	14,355	108,525
Data processing	100,036	15,249	115,285
Information systems	107,768	16,428	124,196
Management services	11,537	1,759	13,296
External investment manager fees	6,302,539	960,747	7,263,286
Investment consulting fees	206,432	31,468	237,900
Investment custodian fees	851,760	129,841	981,601
Real estate manager fees	1,263,004	192,531	1,455,535
Administrative, Internal Audit, Personnel	218,938	33,374	252,312
<b>TOTAL PROFESSIONAL SERVICES</b>	<u>9,288,619</u>	<u>1,415,940</u>	<u>10,704,559</u>
<b>COMMUNICATION</b>			
Travel	22,222	3,387	25,609
Telephone	13,614	2,075	15,689
Printing	2,599	396	2,995
Postage	6,189	943	7,132
<b>TOTAL COMMUNICATION</b>	<u>44,624</u>	<u>6,801</u>	<u>51,425</u>
<b>MISCELLANEOUS</b>			
Office space	59,564	9,080	68,644
Supplies and maintenance	2,051	313	2,364
Other services and charges	61,988	9,449	71,437
<b>TOTAL MISCELLANEOUS</b>	<u>123,603</u>	<u>18,842</u>	<u>142,445</u>
<b>TOTAL INVESTMENT EXPENSES</b>	<u>\$ 10,738,193</u>	<u>\$ 1,636,909</u>	<u>\$ 12,375,102</u>

**TENNESSEE CONSOLIDATED RETIREMENT SYSTEM  
SCHEDULES OF EXPENSES FOR CONSULTANTS  
FOR THE YEARS ENDED JUNE 30, 2002 AND JUNE 30, 2001**

**FOR THE YEAR ENDED JUNE 30, 2002**

	SETHEEPP	PSPP	Total
<b>ACTUARIAL SERVICES</b>			
Bryan, Pendleton, Swats and McAllister	<u>\$ 174,861</u>	<u>\$ 147,572</u>	<u>\$ 322,433</u>
<b>MEDICAL REVIEW SERVICES</b>			
Sarada Misra, M.D.	3,900	3,293	7,193
Suzanne M. Fletcher, M.D.	4,681	3,950	8,631
Marshall L. Koonce, M.D.	4,681	3,950	8,631
<b>TOTAL MEDICAL REVIEW SERVICES</b>	<u>13,262</u>	<u>11,193</u>	<u>24,455</u>
<b>TOTAL EXPENSES FOR CONSULTANTS</b>	<u>\$ 188,123</u>	<u>\$ 158,765</u>	<u>\$ 346,888</u>

Note: For information regarding fees paid to investment professionals, refer to the Investment Section of this report.

**FOR THE YEAR ENDED JUNE 30, 2001**

	SETHEEPP	PSPP	Total
<b>ACTUARIAL SERVICES</b>			
Bryan, Pendleton, Swats and McAllister	<u>\$ 58,942</u>	<u>\$ 55,267</u>	<u>\$ 114,209</u>
<b>MEDICAL REVIEW SERVICES</b>			
Sarada Misra, M.D.	4,308	4,040	8,348
Suzanne M. Fletcher, M.D.	4,308	4,040	8,348
Marshall L. Koonce, M.D.	4,308	4,040	8,348
<b>TOTAL MEDICAL REVIEW SERVICES</b>	<u>12,924</u>	<u>12,120</u>	<u>25,044</u>
<b>TOTAL EXPENSES FOR CONSULTANTS</b>	<u>\$ 71,866</u>	<u>\$ 67,387</u>	<u>\$ 139,253</u>

Note: For information regarding fees paid to investment professionals, refer to the Investment Section of this report.

# Investment Section



*Barred owls are identified by their dark brown eyes and a barred pattern across the upper chest. Found in swampy forests, they are best known for their loud, rhythmic call of "who-cooks-for-you, who-cooks-for-you-all."*

*The primary wild rabbit of North America is the cottontail. Named for its short puffy tail, the cottontail is prolific. In a single year, a female may have four litters of up to nine rabbits in each litter.*

*Cottontails often evade enemies by jumping into a nearby stream or lake and swimming away from the danger.*



## REPORT BY INVESTMENT CONSULTANT

## CALLAN ASSOCIATES

November 19, 2002

Mr. Eddie W. Hennessee  
Executive Director  
Tennessee Consolidated Retirement System  
Fifth and Deadrick, 10<sup>th</sup> Floor  
Andrew Jackson Building  
Nashville, TN 37243-0230

CHARLES L. MATHIS  
VICE PRESIDENT



SAN FRANCISCO

NEW YORK

CHICAGO

ATLANTA

DENVER

Dear Ed:

The quarterly performance reports are prepared by Callan Associates in full compliance with AIMR standards. The year ended June 30, 2002 was horrendous for equity markets virtually all over the world, but fixed-income markets earned very positive returns. The relatively high (in comparison to other retirement funds) fixed-income allocation of the TCRS resulted in an excellent comparative overall return for the year ended June 30, 2002.

As of June 30, 2002, the System's asset allocation and one year respective returns were:

<u>Asset Class</u>	<u>% of Assets</u>	<u>One-Year Return</u>
Domestic Equities	30.67%	(16.76%)
Domestic Fixed Income	47.37%	8.60%
International Equities	9.91%	(5.27%)
International Fixed-Income	2.63%	11.88%
Cash and Equivalents	7.88%	2.64%
Real Estate	1.54%	5.94%
Total	100.0%	(1.92%)

The conservative nature of the System's asset allocation is warranted because of the excellent funded status in comparison to most other state retirement funds. The median fund in the Callan Associates Public Plan Sponsor Database lost 5.15% for the year ended June 30, 2002, largely as a result of the aforementioned equity markets.

The United States and many other countries have experienced a bursting of equity market "bubbles" over the past few years. The good news is that the long-term attractiveness of the U.S. financial markets is excellent, i.e., market corrections are a normal and beneficial event as excesses are cleansed from the system paving the way for future growth.

Callan Associates is a twenty-nine year old firm and has been the System's investment consultant since 1988. Among the services provided by Callan are performance evaluation, manager search, and asset allocation.

Callan is a national consulting firm with five regional offices and well over 200 clients. The System is one of almost twenty state retirement systems that Callan serves.

Please give me a call should you have any questions or comments.

Sincerely,

*Charles L. Mathis*

Charles L. Mathis

## LETTER FROM TCRS CHIEF INVESTMENT OFFICER

STATE OF TENNESSEE

STEVE ADAMS  
STATE TREASURERTHOMAS G. MILNE  
CHIEF INVESTMENT  
OFFICERTREASURY DEPARTMENT  
TENNESSEE CONSOLIDATED RETIREMENT SYSTEM  
11TH FLOOR ANDREW JACKSON STATE OFFICE BUILDING  
NASHVILLE, TENNESSEE 37243

December 13, 2002

Dear Members:

I am pleased to present the Investment Section of the TCRS Comprehensive Annual Financial Report for the fiscal year ended June 30, 2002.

With more than \$23 billion in assets, TCRS is one of the largest public pension plans in the United States. TCRS assets are invested to preserve principal value, to achieve a superior rate of return within acceptable risk levels, and to provide the liquidity necessary to pay beneficiaries in a timely manner.

The TCRS portfolio is diversified among domestic and international stocks and bonds, real estate, and short-term securities. A diversified portfolio is used to manage risk and minimize significant exposure to unpredictable events. The TCRS consultant periodically prepares an asset allocation study to determine the optimal long-term mix of assets to best meet the plans investment objectives. TCRS has adopted a conservative investment strategy that has yielded excellent returns with a low level of risk.

The financial markets continue to be volatile. The equity bear market is now over two years old and one of the deepest on record. During these difficult times, the benefits of a conservative, diversified investment portfolio are proven.

I am proud to report that the TCRS achieved one of the highest returns among public plans for the year ended June 30, 2002. The fund earned (1.92)% for the year, while the average large pension fund returned (5.15)%.

The experienced TCRS investment staff is committed to providing superior investment returns in a financially sound manner with the highest ethical and professional standards. With the leadership of our Board and the work of our dedicated staff, this goal will be met.

Sincerely,

A handwritten signature in cursive script that reads "Thomas G. Milne".

Thomas G. Milne



## STATUTORY INVESTMENT AUTHORITY

### STATUTORY INVESTMENT AUTHORITY

The investment authority of TCRS is prescribed in the *Tennessee Code Annotated*, Title 8, Chapter 37. This chapter provides that, with certain enumerated exceptions, investments of TCRS assets are subject to the same terms, conditions and limitations imposed on domestic life insurance companies as set forth in *T.C.A.*, Section 56, Chapter 3. The Board of Trustees of TCRS adopts investment policy relative to the investment of TCRS assets. The investment objective is to obtain the highest available return on investments consistent with the preservation of principal while maintaining sufficient liquidity to react to the changing environment and to pay beneficiaries in a timely manner. A summary of statutory and policy provisions follow.

#### DOMESTIC STOCKS

- ❖ No more than 75% of the TCRS portfolio may be invested in common stock, preferred stock and convertible bonds.
- ❖ No more than 4.99% of the outstanding shares of any one company may be purchased.

#### DOMESTIC FIXED INCOME

- ❖ No more than 75% of the TCRS portfolio may be invested in fixed income securities exceeding one year.
- ❖ Only issues that are investment grade securities (four highest ratings) may be purchased.
- ❖ Triple B bonds are limited to 7% of the domestic fixed income portfolio.
- ❖ Private placements are limited to 15% of the domestic fixed income portfolio. Private placements may be purchased if staff evaluation determines that the credit quality is equivalent to double A.

#### INTERNATIONAL EQUITY

- ❖ No more than 15% of the TCRS portfolio may be invested in international securities, including international fixed income.
- ❖ Canadian securities shall be treated as domestic securities for policy purposes.
- ❖ Thirty-nine countries have been approved by the Board for international investing.

#### INTERNATIONAL FIXED INCOME

- ❖ No more than 15% of TCRS portfolio may be invested in international securities, including international equity.
- ❖ Investments are limited to seven major developed countries.

#### SHORT-TERM SECURITIES

- ❖ Commercial paper should be rated A1 or P1.

#### STOCK OPTIONS AND BOND FUTURES

- ❖ Limited to 10% of the portfolio.
- ❖ Only covered call options may be written.

#### DOMESTIC STOCK INDEX FUTURES

- ❖ Contracts shall not exceed 5% of the TCRS portfolio.
- ❖ Shall only be used for asset allocation purposes and not for speculative leveraging. The system's cash and short-term securities must exceed the amount of the contract obligation.

#### SECURITIES LENDING

- ❖ May not lend more than 30% of the portfolio.
- ❖ Collateral, other than cash, must have a market value of 102% of the security loaned.

#### STANDBY NOTE PURCHASE AGREEMENT

- ❖ TCRS may enter into contracts to serve as a standby note purchaser for the Tennessee State School Bond Authority, the Tennessee State Funding Board and the Tennessee Local Development Authority.

#### FOREIGN CURRENCY HEDGING

- ❖ May not exceed 80% of the international securities.

#### REAL ESTATE

- ❖ No more than 5% of the TCRS portfolio may be invested in real estate.

#### PROXY VOTING

- ❖ Shall vote proxies in a manner which will provide the best ultimate value to shareholders.

**INVESTMENT PERFORMANCE REVIEW**

**INVESTMENT PERFORMANCE REVIEW**

*Periods Ending June 30, 2002*

	<b>Annualized Returns</b>		
	<b>Current Year</b>	<b>3-Year</b>	<b>5-Year</b>
<b>Pension Plan Portfolio</b>			
TCRS Performance	(1.92)%	1.36 %	5.58 %
Benchmark - Public Fund Index Median Index	(5.15)%	0.52 %	5.57 %
<b>Domestic Equity</b>			
TCRS Performance	(16.76)%	(8.03)%	4.35 %
Benchmark - Dow Jones Average	(10.30)%	(4.20)%	5.58 %
Benchmark - S & P 500	(17.99)%	(9.18)%	3.66 %
Benchmark - Russell 2000	(8.42)%	1.93 %	4.60 %
<b>Domestic Fixed Income</b>			
TCRS Performance	8.60 %	7.99 %	7.40 %
Benchmark - Shearson Lehman Aggregate	8.63 %	8.10 %	7.57 %
<b>International Equity</b>			
TCRS Performance	(5.27)%	(2.99)%	0.17 %
Benchmark - MSCI EAFE Index	(9.49)%	(6.78)%	(1.55)%
Benchmark - MSCI EAFE & Emerging Markets	(8.26)%	(6.48)%	(1.95)%
<b>International Fixed Income</b>			
TCRS Performance	11.88 %	2.60 %	3.84 %
Benchmark - Soloman Brothers Non-US Government Bond Index	15.73 %	3.14 %	3.03 %
<b>Real Estate</b>			
TCRS Performance	5.94 %	0.00 %	0.00 %
<b>Short-term Securities</b>			
TCRS Performance	2.64 %	4.78 %	5.10 %
Benchmark - Three month Treasury Bill	2.63 %	4.67 %	4.84 %

**Callan Public Plan Sponsor Database  
Percentile Rankings  
Asset Allocation Adjusted Basis**

Ranking of TCRS Portfolio	
Last six years	22
Last ten years	15

The percentile ranking is the position of the TCRS portfolio as compared with other public funds with 1 being the best and 100 being the worst. The investment performance for TCRS was computed using a market, time weighted rate of return by an independent investment consultant for TCRS in accordance with the AIMR standards.

## ASSET ALLOCATION

**ASSET ALLOCATION**  
*as of June 30, 2002*  
*Expressed in Thousands*

<b>Asset Class</b>	<b>Fair Value</b>	<b>Percentage</b>
Domestic Equity	\$ 6,933,050	30.2%
Domestic Fixed	10,886,624	47.4%
International Equity	2,229,257	9.7%
International Fixed Income	613,511	2.7%
Short-term Securities	1,943,081	8.5%
Real Estate	352,582	1.5%
<b>Total</b>	<u>\$ 22,958,105</u>	<u>100.0%</u>

This schedule classifies convertible bonds as fixed income securities, and preferred stock as fixed income securities. For investment purposes, convertible bonds and preferred stock are considered equity securities. Accordingly, the asset allocation percentages in this schedule will vary from the investment consultant's asset allocation percentages.

**LARGEST HOLDINGS**  
**JUNE 30, 2002**

**LARGEST STOCK HOLDINGS**

*as of June 30, 2002*  
*by Fair Value*

Shares	Security Name	Fair Value
3,940,000	MICROSOFT CORPORATION	\$ 215,518,000
7,073,000	GENERAL ELECTRIC COMPANY	205,470,650
4,916,594	EXXON MOBIL CORPORATION	201,187,026
3,388,000	WAL-MART STORES INCORPORATED	186,373,880
4,858,000	PFIZER INCORPORATED	170,030,000
3,846,004	CITIGROUP INCORPORATED	149,032,655
1,913,035	AMERICAN INTL GROUP INCORPORATED	130,526,378
2,378,742	JOHNSON & JOHNSON	124,313,057
1,901,000	THE COCA-COLA COMPANY	106,456,000
1,492,743	BANK OF AMERICA CORPORATION	105,029,397

**LARGEST BOND HOLDINGS**

*as of June 30, 2002*  
*by Fair Value*

Par Value	Security Name	Yield	Maturity	Moody's Quality Rating	Fair Value
353,500,000	U.S. TREASURY NOTES	3.77%	5/15/2006	Aaa	\$ 392,494,585
305,000,000	U.S. TREASURY NOTES	4.29%	5/15/2008	Aaa	325,587,500
267,000,000	U.S. TREASURY BONDS	3.23%	11/15/2009	Aaa	310,053,750
206,400,000	U.S. TREASURY BONDS	4.63%	8/15/2014	Aaa	303,602,016
187,000,000	U.S. TREASURY BONDS	5.61%	5/15/2021	Aaa	241,114,060
220,000,000	FEDERAL HOME LN MTG CORP	3.50%	2/15/2005	Aaa	222,475,000
140,000,000	U.S. TREASURY BONDS	5.60%	2/15/2021	Aaa	176,268,400
152,862,214	FNMA POOL 545338	4.61%	11/1/2031	Aaa	158,307,166
150,000,149	FNMA POOL 254262	6.05%	4/1/2032	Aaa	149,625,149
143,634,500	FED HM LN PC C00702	6.10%	1/1/2029	Aaa	143,858,570

*A complete portfolio listing is available upon request.*

Key to Ratings: All ratings presented are from Moody's Investors Service with the exception of some of the government securities. Moody's does not rate these securities. Standard & Poor's does provide ratings for the securities (AAA is Standard & Poor's highest rating.) Government Securities are not rated per se' but are considered the best quality securities.

Moody's rates securities as follows:

- Aaa.....Best Quality
- Aa.....High Quality
- A.....Upper Medium Quality

## INVESTMENT SUMMARY

## INVESTMENT SUMMARY

as of June 30, 2002

	Domestic		International		Total	
	Fair Value	%	Fair Value	%	Fair Value	%
<b>Fixed Income</b>						
Government Bonds	\$ 8,299,599,468	36.15%	\$ 400,617,024	1.75%	\$ 8,700,216,492	37.90%
Corporate Bonds	2,587,024,127	11.27%	195,585,692	0.85%	2,782,609,819	12.12%
Convertible Bonds	0	0.00%	104,658	0.00%	104,658	0.00%
<b>Total Bonds</b>	<b>\$ 10,886,623,595</b>	<b>47.42%</b>	<b>\$ 596,307,374</b>	<b>2.60%</b>	<b>\$ 11,482,930,969</b>	<b>50.02%</b>
Preferred Stock	0	0.00%	17,203,856	0.07%	17,203,856	0.07%
<b>Total Fixed Income</b>	<b>\$ 10,886,623,595</b>	<b>47.42%</b>	<b>\$ 613,511,230</b>	<b>2.67%</b>	<b>\$ 11,500,134,825</b>	<b>50.09%</b>
<b>Common Stock</b>						
Commingled Fund	\$ 0	0.00%	\$ 17,673,510	0.08%	\$ 17,673,510	0.08%
Consumer Discretionary	990,054,874	4.31%	399,308,372	1.74%	1,389,363,246	6.05%
Consumer Staples	713,204,222	3.11%	250,608,209	1.09%	963,812,431	4.20%
Energy	518,464,847	2.26%	154,938,137	0.67%	673,402,984	2.93%
Financials	1,311,175,040	5.71%	363,841,442	1.58%	1,675,016,482	7.29%
Health Care	951,359,516	4.14%	163,807,296	0.71%	1,115,166,812	4.85%
Industrials	790,531,096	3.45%	255,348,668	1.11%	1,045,879,764	4.56%
Information Technology	952,066,215	4.15%	192,313,557	0.84%	1,144,379,772	4.99%
Materials	230,391,045	1.00%	197,195,406	0.86%	427,586,451	1.86%
Miscellaneous	0	0.00%	2,850,379	0.02%	2,850,379	0.02%
Telecommunication Svc.	259,816,129	1.13%	162,390,895	0.71%	422,207,024	1.84%
Utilities	215,986,581	0.94%	68,981,257	0.30%	284,967,838	1.24%
<b>Total Common Stock</b>	<b>\$ 6,933,049,565</b>	<b>30.20%</b>	<b>\$ 2,229,257,128</b>	<b>9.71%</b>	<b>\$ 9,162,306,693</b>	<b>39.91%</b>
<b>Short-term Investments</b>						
Commercial Paper	\$ 762,737,102	3.32%	\$ 0	0.00%	\$ 762,737,102	3.32%
Corporate Bonds	90,489,362	0.39%	0	0.00%	90,489,362	0.39%
U.S. Gov't Securities	1,089,854,869	4.75%	0	0.00%	1,089,854,869	4.75%
<b>Total Short-term Investments</b>	<b>\$ 1,943,081,333</b>	<b>8.46%</b>	<b>\$ 0</b>	<b>0.00%</b>	<b>\$ 1,943,081,333</b>	<b>8.46%</b>
<b>Real Estate</b>	<b>\$ 352,582,235</b>	<b>1.54%</b>	<b>\$ 0</b>	<b>0.00%</b>	<b>\$ 352,582,235</b>	<b>1.54%</b>
<b>Total Investments</b>	<b>\$ 20,115,336,728</b>	<b>87.62%</b>	<b>\$ 2,842,768,358</b>	<b>12.38%</b>	<b>\$ 22,958,105,086</b>	<b>100.00%</b>
<b>Short-term Investments Classified as Cash Equivalents</b>	<b>\$ (1,625,692,903)</b>		<b>\$ 0</b>		<b>\$ (1,625,692,903)</b>	
<b>Total Investments and Invested Securities Lending Collateral as Shown on the Statement of Plan Net Assets</b>	<b>\$ 18,489,643,825</b>		<b>\$ 2,842,768,358</b>		<b>\$ 21,332,412,183</b>	

This schedule classifies Canadian investments as domestic securities, convertible bonds as fixed income securities, and preferred stock as fixed income securities. For investment purposes convertible bonds and preferred stock are considered equity securities. Accordingly, the asset allocation percentages in this schedule will vary from the investment consultant's asset allocation percentages.

**SCHEDULES OF INVESTMENT FEES AND COMMISSIONS  
FOR THE YEAR ENDED JUNE 30, 2002**

**SCHEDULE OF FEES**

	Assets Under Management	Fees
<b>Asset Management</b>		
International Investment Manager Fees	\$ 2.2 Billion	\$ 8,066,648
Real Estate Asset Management	353.0 Million	2,118,339
Total Asset Management		<u>\$ 10,184,987</u>
<b>Other Investment Services Fees</b>		
Custodian Bank	\$ 23 Billion	\$ 974,223
General Investment Consultant	23 Billion	128,000
Real Estate Investment Consultant	353 Million	100,000
Total Investment Services Fees		<u>\$ 1,202,223</u>

**SCHEDULES OF COMMISSIONS**

*Domestic Exchange Traded Shares*

<b>Broker</b>	<b>Shares Traded</b>	<b>Domestic Commissions</b>	<b>Commission per Share</b>
Banc America Security LLC	11,470,100	\$ 562,945	\$ 0.0491
Bear Stearns Securities Corporation	14,238,730	627,774	0.0441
Capital Institutional Services	13,297,850	649,383	0.0488
Credit Suisse First Boston Corporation	12,475,850	590,243	0.0473
Deutsche Banc Alex. Brown Incorporated	11,140,710	547,462	0.0491
Edwards Ag Sons Incorporated	5,990,966	297,598	0.0497
Instinet Clearing Services Incorporated	8,893,428	204,080	0.0229
J P Morgan Securities Incorporated	12,100,731	576,792	0.0477
Jefferies Company Incorporated	5,956,718	288,268	0.0484
Lehman Brothers Incorporated	11,787,099	573,308	0.0486
Merrill Lynch Pierce Fenner & Smith	2,166,909	103,071	0.0476
Prudential Securities Incorporated	10,942,375	534,636	0.0489
Salomon Smith Barney Incorporated	4,815,991	236,217	0.0490
Sanford C Bernstein Co LLC	7,416,600	368,080	0.0496
Sturdivant & Company	2,480,630	114,249	0.0461
Suntrust Robinson Humphrey	3,100,164	154,388	0.0498
Other Brokers*	20,475,526	989,833	0.0483
Totals	<u>158,750,377</u>	<u>\$ 7,418,327</u>	

Program Trades where total commission cost includes trading commission, liquidity fees, and market impact fees.

<b>Broker</b>	<b>Shares Traded</b>	<b>Domestic Commissions</b>	<b>Commission per Share</b>
Deutsche Banc Alex Brown Incorporated	34,226,600	\$ 1,717,296	\$ 0.0502
Goldman Sachs & Company	11,446,055	542,877	0.0474
Merrill Lynch Pierce Fenner & Smith	5,215,800	297,301	0.0570
Totals	<u>50,888,455</u>	<u>\$ 2,557,474</u>	

*Domestic Stock Index Futures*

<b>Broker</b>	<b>Contracts Traded</b>	<b>Domestic Commissions</b>	<b>Commission per Contract</b>
Goldman Sachs & Company	12,000	205,510	\$ 17.1258
Totals	<u>12,000</u>	<u>\$ 205,510</u>	

*International Exchange Traded Shares*

<b>Broker</b>	<b>Shares Traded</b>	<b>International Commissions</b>	<b>Commission per Share</b>
ABN Amro	58,424,571	\$ 121,712	\$ 0.0021
Credit Suisse First Boston Corporation	163,918,296	306,292	0.0019
Deutsche Banc Alex Brown Incorporated	11,686,933	179,066	0.0153
Goldman Sachs & Company	63,363,743	491,805	0.0078
Lehman Brothers Incorporated	17,106,909	180,537	0.0106
Merrill Lynch Pierce Fenner & Smith	17,048,764	111,529	0.0065
Merrill Lynch International	148,269,209	507,509	0.0034
Morgan Stanley Co Incorporated	73,092,214	483,714	0.0066
Salomon Smith Barney Incorporated	25,051,549	280,331	0.0112
UBS AG	14,416,139	315,421	0.0219
UBS Warburg LLC	24,415,829	149,961	0.0061
Other Brokers*	775,365,605	1,641,617	0.0021
Totals	<u>1,392,159,761</u>	<u>\$ 4,769,494</u>	

Shares for international stocks are based on the actual foreign shares traded while the commission is expressed in U.S. dollars. Therefore, commissions per share between domestic and international are not comparable.

\*Less than \$100,000 total commission per brokerage firm.

# Actuarial Section



*Black bears, which once inhabited the entire state of Tennessee, are now located in the eastern portion of the state. Five sanctuaries were established in the Great Smoky Mountains National Park and the Cherokee National Forest to offer them refuge.*

*North American black bears are true hibernators: they go without food for up to seven months.*

*Cubs, like this one, generally arrive with one to three siblings. Cubs stay with their mother for nearly two years. In the wild, bears have a life span of up to 30 years.*

*Normally seen at dawn or dusk, white-tailed deer are among Tennessee's most popular animals. The deer population was estimated to be around 1,000 in 1900. It has now grown to approximately 800,000.*

*Females give birth once a year to one or two fawns, which are hidden in thickets. Bucks lose their calcium-rich antlers each autumn.*



## ACTUARIAL INTRODUCTION

**BIENNIAL ACTUARIAL VALUATIONS**

Biennial actuarial valuations of the TCRS are performed by an independent actuarial consulting firm to assess the funding status of the system and to determine employer contribution rates for its various components. The latest valuation, performed as of July 1, 2001, set new employer rates effective July 1, 2002. The Board of Trustees of the system is responsible for adopting the employer contribution rates after reviewing the actuarial results. The next valuation is scheduled to be performed as of July 1, 2003.

**FUNDING OF PENSIONS**

It is the policy of the state to fund pensions by actuarially determined contributions which are intended to provide funding for both the normal liability cost and the unfunded actuarial accrued liability cost. This policy seeks to ensure that sufficient assets will be available to pay benefits as they are due.

**ACCRUED LIABILITY**

With the 2001 actuarial valuation, the accrued liability, which was frozen in 1981 was again reestablished. This was accomplished by setting the unfunded accrued liability equal to the excess of the Entry Age Normal Past Service Liability over the valuation assets for each group. This action affected local government employers and two minor closed groups.

**SPECIFICS**

Valuations are based on demographic data (employee ages, salaries and service credits), economic projections (salary increases, interest rates and investment earnings), and decrement estimates (mortality and disability rates).

The economic projections and decrement estimates used for valuation purposes utilized the assumptions recommended by the actuary and adopted by the Board of Trustees based on an actuarial experience study conducted every four

years. The earnings rate assumption adopted by the Board is subject to the approval of the Council on Pensions and Insurance.

**QUADRENNIAL EXPERIENCE STUDY**

A quadrennial experience study was conducted as of June 30, 2000. A number of changes were made to the economic and decrement assumptions. The salary assumption was changed to a graded scale that reflects plan experience, while the increase in the Social Security wage base assumption was reduced to three and one-half percent. Preretirement and post-retirement mortality assumptions were also modified to more closely reflect past experience.



## ACTUARY'S CERTIFICATION LETTER



Bryan, Pendleton, Swartz & McAllister, LLC  
A Wells Fargo Company

November 3, 2002

Mr. Stephen D. Adams  
Chairman, Board of Trustees  
Tennessee Consolidated Retirement System  
Tenth Floor  
Andrew Jackson State Office Building  
Nashville, Tennessee 37243-0230

Dear Mr. Adams:

Re: Actuary's Certification Letter

The purpose of this letter is to certify the actuarial adequacy of contributions being made by the State of Tennessee and participating Political Subdivisions to the Tennessee Consolidated Retirement System and to discuss the approach currently being taken toward meeting the financing objectives of the Plan.

The most recent biennial actuarial valuation of the Tennessee Consolidated Retirement System was performed as of July 1, 2001. That valuation was based on a set of actuarial assumptions (described in detail in the section headed "Summary of Actuarial Methods and Assumptions") which was adopted by the Board of Trustees on the recommendation of the actuary, as a result of a study of actual experience under the TCRS during the four year period ending June 30, 2000. The experience study concluded that the assumed rate of return and inflation assumption should remain unchanged. Modifications were recommended for many of the demographic assumptions including changes to more conservative mortality, termination and retirement rates. For Consolidated State and Political Subdivision groups, one third of the effect of termination/retirement rates was recognized as of July 1, 2001 with the remainder to be recognized in succeeding actuarial valuations. The salary increase rate was altered from a uniform 5.5% annual rate to a graded scale that reflects the plan experience pattern of declining escalation rates as participant ages increase. The aggregate effect of recommended assumption changes as of July 1, 2001 is a contribution rate increase of 0.31% and 1.07%, respectively, for the Contributory Teachers and Consolidated State groups.

There have been no significant changes in the level of benefits provided by the plan since the date of the preceding valuation.

The Board of Trustees in 1975 established as its financing objective the amortization of unfunded accrued liabilities over the ensuing 40-year period. In the years since then, the implementation of that general goal has involved a gradual strengthening of the methods utilized in computing required annual contributions. This has been accomplished by such steps as (1) taking advance funding of expected cost-of-living increases into account, (2) placing all amortization payments on a "level dollar" basis—a stronger basis than the "percentage of payroll" method previously utilized and (3) elimination of the unfunded accrued liability for the major contribution classes, primarily as a result of actuarial gains attributable to favorable investment performance.

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**ACTUARY'S CERTIFICATION LETTER  
(CONTINUED)**

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Mr. Stephen D. Adams  
November 3, 2002  
Page Two

In performing the 2001 valuation, we relied on employee data and asset information provided by the administrative staff of the Tennessee Consolidated Retirement System. In the case of employee data, each individual record was audited thoroughly for reasonableness and internal consistency, although the validity of the information was not traced to source documents or compared with data for the same participants utilized in prior valuations. With respect to plan assets, a general review for consistency with the information furnished for prior valuations was performed.

Certain tables presented in the Comprehensive Financial Annual Report are derived from the July 1, 2001 actuarial valuation report prepared by Bryan, Pendleton, Swats and McAllister, LLC. The tables were prepared by the staff of the Tennessee Consolidated Retirement System and examined by our firm. These tables include the following –

***Financial Section***

- Schedules of Funding Progress

***Actuarial Section***

- Summary of Actuarial Assumptions and Methods
- Actuarial Data (current year data)
- Actuarial Balance Sheet
- Short-Term Solvency Test
- Summary of Unfunded Accrued Liabilities and Selected Funding Information
- Analysis of Financial Experience

The Schedule of Retired Member Activity in the Actuarial Section of the report was prepared by our firm using information gathered from the 1995, 1997, 1999 and 2001 actuarial valuations.

The 2001 valuation was prepared in accordance with accepted actuarial principles of practice prescribed by the Actuarial Standards Board and the principles of Governmental Accounting Standards Board Statement 25. I am a Member of the American Academy of Actuaries with experience in performing valuations for public retirement systems; all calculations were performed either by me or by other qualified actuaries under my direct supervision.

Based upon the valuation results and the contribution rates adopted by the Board of Trustees, it is our opinion that the Tennessee Consolidated Retirement System continues to fund its liabilities in accordance with standard actuarial principles of advance funding, continuing a program first adopted in 1975.

Sincerely,



Anthony S. Johnston, F.S.A.

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**SUMMARY OF ACTUARIAL ASSUMPTIONS AND METHODS**

The following assumptions were adopted by the Board of Trustees for use beginning with the July 1, 2001 valuation based on the consulting actuary's recommendations resulting from the June 30, 2000 actuarial experience study.

**GENERAL ACTUARIAL METHODS**

- ❖ *Actuarial Cost Method (Frozen Entry Age)* – Unfunded accrued liabilities are being funded over a 40-year period commencing in 1975. The unfunded accrued liability was reestablished as part of the July 1, 2001 valuation. This was accomplished by setting the unfunded accrued liability equal to the excess (if any) of the Entry Age Normal Past Service Liability over the valuation assets for each group or zero.
- ❖ *Treatment of Actuarial Gains and Losses* – Under the Frozen Entry Age Method, any actuarial gains or losses are absorbed into the normal cost.
- ❖ *Asset Valuation Method* – Assets are valued on a basis which reflects a five-year moving average of the fair market value. Investment losses are applied to offset accumulated investment gains prior to determining the amount of earnings to be phased in.
- ❖ *Valuation Data* – The administrative staff of TCRS furnishes the actuary with demographic data relating to the active life members and the retired life members. The fair value of system assets are also provided by retirement system staff. All data is reviewed for reasonableness and consistency from year to year, but is not audited by the actuary.
- ❖ *Post-Retirement Adjustments* – Retirement benefits are assumed to increase at the maximum geometric rate of 3% annually, reflecting the 1997 adoption of compounded cost-of-living adjustments.

**ECONOMIC ASSUMPTIONS**

- ❖ *Investment Return Rate* – Seven and one-half percent per annum, compounded annually.
- ❖ *Employee Salary Increases* – Graded scale that reflects the plan experience pattern of declining escalation rates as participant ages increase. No explicit assumption is made regarding the portion attributable to the effects of inflation on salaries. Active membership is assumed to remain constant.
- ❖ *Increase in Social Security Wage Base* – Three and one-half percent annual increase.

**DECREMENT ASSUMPTIONS**

- ❖ *Post-Retirement Mortality* – Annuity mortality tables previously used are no longer compatible with TCRS results. Specifically adopted tables have been created to more accurately reflect patterns that occur among TCRS retirees. Sample rates are below.

	Male	Female
<i>Teachers</i>		
Age 50	0.3%	0.2%
Age 60	0.7%	0.5%
Age 70	2.1%	1.3%
<i>State &amp; Political Subdivisions</i>		
Age 50	0.4%	0.2%
Age 60	1.2%	0.6%
Age 70	3.2%	1.7%

- ❖ *Preretirement Mortality* – The 1994 Group Annuity mortality table is used for state employees and political subdivision employees. For teachers, the 1983 Group Annuity Mortality Table is used with an adjustment of 60% for females and 50% for males.

- ❖ *Withdrawal Due to Disability* – Sample rates of disability based on experience:

	Male	Female
<i>Teachers</i>		
Age 30	0.03%	0.03%
Age 40	0.09%	0.09%
Age 50	0.17%	0.17%
<i>State</i>		
Age 30	0.05%	0.05%
Age 40	0.16%	0.17%
Age 50	0.35%	0.37%
<i>Political Subdivisions</i>		
Age 30	0.05%	0.04%
Age 40	0.14%	0.08%
Age 50	0.53%	0.36%

- ❖ *Turnover Assumption* – Tables for probabilities of separation due to termination of employment are developed utilizing a "two-year select and ultimate" approach.

(continued)

**SUMMARY OF ACTUARIAL ASSUMPTIONS AND METHODS  
(CONTINUED)**

**Teachers**

	<b>1st Year Employment</b>	<b>2nd Year Employment</b>	<b>Ultimate</b>
<i>Male</i>			
Age 30	15.0%	12.0%	5.6%
Age 40	15.0%	12.0%	1.5%
Age 50	15.0%	12.0%	2.0%
<i>Female</i>			
Age 30	15.0%	12.0%	8.1%
Age 40	15.0%	12.0%	1.8%
Age 50	15.0%	12.0%	1.8%

**State Employees**

	<b>1st Year Employment</b>	<b>2nd Year Employment</b>	<b>Ultimate</b>
<i>Male</i>			
Age 30	27.2%	23.1%	10.7%
Age 40	23.1%	16.7%	4.8%
Age 50	16.5%	14.0%	2.9%
<i>Female</i>			
Age 30	27.2%	23.1%	10.7%
Age 40	23.1%	16.7%	4.8%
Age 50	16.5%	14.0%	2.9%

**Political Subdivision Employees**

	<b>1st Year Employment</b>	<b>2nd Year Employment</b>	<b>Ultimate</b>
<i>Male</i>			
Age 30	24.8%	21.0%	10.3%
Age 40	21.0%	15.2%	7.2%
Age 50	15.0%	12.8%	5.5%
<i>Female</i>			
Age 30	24.8%	21.0%	11.8%
Age 40	21.0%	15.2%	8.1%
Age 50	15.0%	12.8%	5.9%

**Retirement** – The probabilities of retirement for members eligible to retire:

<b>Age</b>	<b>Teachers</b>	<b>State</b>	<b>P.S.</b>
Age 60	15.0%	9.0%	10.0%
Age 61	22.0%	12.0%	17.0%
Age 62	26.0%	23.0%	26.0%
Age 63	22.0%	15.0%	17.0%
Age 64	31.0%	18.0%	19.0%
Age 65	43.0%	34.0%	29.0%
Age 70	100.0%	21.0%	20.0%
Age 75	100.0%	100.0%	100.0%

In addition, for members younger than age 60, a loading factor of 10 percent is added during the year the member is first eligible for unreduced retirement. After age 60, for those members with 15 or more years of service, a 10% load is added for teachers and 5% for state employees and political subdivision employees.

**ACTUARIAL DATA**

**SCHEDULE OF ACTIVE MEMBER VALUATION DATA**

Valuation Year	Number	Annual Payroll In Thousands	Average Annual Pay	Average Annual Percentage Increase In Average Annual Pay
1983	137,054	\$ 2,040,979	\$ 14,892	6.58%
1985	140,744	2,377,928	16,895	6.51%
1987	147,779	2,800,035	18,947	5.90%
1989	153,664	3,215,050	20,922	5.08%
1991	158,820	3,636,495	22,897	4.61%
1993	166,443	3,943,079	23,690	1.72%
1995	175,584	4,580,041	26,085	4.93%
1997	180,637	4,940,816	27,352	2.40%
1999	189,592	5,473,772	28,871	2.74%
2001	195,946	5,997,047	30,606	2.96%

**SCHEDULE OF RETIRED MEMBER VALUATION DATA**

Valuation Year	Number	Annual Allowances In Thousands	Average Annual Allowances	Average Annual Percentage Increase In Average Allowances
1983	39,952	\$ 153,817	\$ 3,850	5.00%
1985	46,171	195,435	4,233	4.86%
1987	49,386	234,163	4,741	5.83%
1989	51,836	264,479	5,102	3.74%
1991	55,146	315,248	5,717	5.86%
1993	58,268	367,844	6,313	5.08%
1995	61,992	449,310	7,248	7.15%
1997	66,908	535,485	8,003	5.08%
1999	71,812	663,140	9,234	7.42%
2001	77,831	795,676	10,223	5.22%

**SCHEDULE OF RETIRED MEMBER ACTIVITY**

*Expressed in Thousands*

2-year period June 30	Added to Rolls		Removed from Rolls		Rolls - End of Year		% Increase in Annual Allowances	Average Annual Allowances
	No.	Annual Allowances	No.	Annual Allowances	No.	Annual Allowances		
1995	7,505	\$100,453	3,781	\$18,988	61,992	\$449,310	22.15%	\$7,248
1997	9,118	115,447	4,202	29,272	66,908	535,485	19.18%	8,003
1999	10,001	162,709	5,097	35,054	71,812	663,140	23.84%	9,234
2001	10,526	163,723	4,507	31,187	77,831	795,676	19.99%	10,223

*Note:* Timing differences exist between the data utilized for statistical information and that used for actuarial valuation purposes. Data is not available to present the required six year history on this schedule. Additional years will be added in future reports.

**ACTUAL VS. RECOMMENDED CONTRIBUTION RATES**

The Board adopted the contribution rates as recommended by the actuary.

## ACTUARIAL BALANCE SHEET

**ACTUARIAL BALANCE SHEET**  
*as of July 1, 2001*

ASSETS	Political Subdivision Pension Plan (PSPP)	State Employees, Teachers, Higher Ed. Employees Pension Plan (SETHEPP)	Total
Present assets creditable to			
Employer accumulation fund	\$ 2,595,966,677	\$ 18,122,409,253	\$ 20,718,375,930
Members' accumulation fund	592,023,782	2,638,579,836	3,230,603,618
Total present assets	<u>3,187,990,459</u>	<u>20,760,989,089</u>	<u>23,948,979,548</u>
Present value of prospective contributions payable to Employer accumulation fund			
Normal	562,004,620	1,858,475,622	2,420,480,242
Accrued liability	340,147,400	81,226,933	421,374,333
Total employer accumulation	<u>902,152,020</u>	<u>1,939,702,555</u>	<u>2,841,854,575</u>
Members' accumulation fund	<u>322,137,337</u>	<u>1,219,837,846</u>	<u>1,541,975,183</u>
Total prospective contributions	1,224,289,357	3,159,540,401	4,383,829,758
<b>TOTAL ASSETS</b>	<b><u>\$ 4,412,279,816</u></b>	<b><u>\$ 23,920,529,490</u></b>	<b><u>\$ 28,332,809,306</u></b>
<b>LIABILITIES</b>			
Present value of prospective benefits payable on account of Present retired members and beneficiaries	1,104,213,183	7,837,600,100	8,941,813,283
Present active members	3,223,007,501	15,723,108,792	18,946,116,293
Former members	85,059,132	359,820,598	444,879,730
<b>TOTAL LIABILITIES</b>	<b><u>\$ 4,412,279,816</u></b>	<b><u>\$ 23,920,529,490</u></b>	<b><u>\$ 28,332,809,306</u></b>

UNAUDITED

## SHORT-TERM SOLVENCY TEST

### SHORT-TERM SOLVENCY TEST

The financing objective of the Tennessee Consolidated Retirement System is to pay for the benefits provided by the plan through contributions that remain approximately level from year to year as a percentage of payroll, except that the strategy to fund the unfunded accrued liability is to make level-dollar payments over an established amortization period. A short-term solvency test is one means of checking a system's progress under its funding program. In a short-term solvency test, the plan's present assets are compared with: (1) active member contributions on deposit; (2) the liabilities for future benefits to present retired

lives; and (3) the liabilities for service already rendered by active members. In a system that has been following the approach of level percent of payroll financing for some time, the liabilities for active member contributions on deposit (liability 1) and the liabilities for future benefits to present retired lives (liability 2) should be fully covered by present assets. In addition, the liabilities for service already rendered by active members (liability 3) should be partially covered by the remainder of present assets. Generally, if the system has been using level cost financing, the funded portion of liability 3 will increase over time.

### Solvency Test

*Dollar Amounts Expressed in Millions*

Actuarial Valuation Year	Actuarial Accrued Liabilities for:			Valuation Assets	Portion of Actuarial Accrued Liabilities Covered by Assets		
	(1) Active Member Contributions	(2) Retirees and Beneficiaries	(3) Active Members (Employer Financed)		(1)	(2)	(3)
1991 SETHEEPP	\$ 1,452.0	\$ 2,784.0	\$ 5,728.8	\$ 8,307.7	100%	100%	71%
PSPP	260.2	329.8	511.6	1,101.7	100%	100%	100%
Total	\$ 1,712.2	\$ 3,113.8	\$ 6,240.4	\$ 9,409.4	100%	100%	73%
1993 SETHEEPP (1)	\$ 1,720.4	\$ 3,384.2	\$ 5,800.6	\$ 10,404.3	100%	100%	91%
PSPP (1)	321.6	426.1	696.1	1,400.9	100%	100%	94%
Total	\$ 2,042.0	\$ 3,810.3	\$ 6,496.7	\$ 11,805.2	100%	100%	92%
1995 SETHEEPP	\$ 1,995.7	\$ 3,958.4	\$ 6,731.6	\$ 12,319.2	100%	100%	95%
PSPP	384.8	534.2	830.1	1,707.8	100%	100%	95%
Total	\$ 2,380.5	\$ 4,492.6	\$ 7,561.7	\$ 14,027.0	100%	100%	95%
1997 SETHEEPP (2)	\$ 2,141.7	\$ 5,456.1	\$ 8,185.1	\$ 15,671.7	100%	100%	99%
PSPP (2)	426.4	743.6	1,117.9	2,226.9	100%	100%	95%
Total	\$ 2,568.1	\$ 6,199.7	\$ 9,303.0	\$ 17,898.6	100%	100%	98%
1999 SETHEEPP	\$ 2,396.6	\$ 6,401.8	\$ 9,621.8	\$ 18,327.1	100%	100%	99%
PSPP	501.4	877.1	1,512.4	2,690.8	100%	100%	87%
Total	\$ 2,898.0	\$ 7,278.9	\$ 11,134.2	\$ 21,017.9	100%	100%	97%
2001 SETHEEPP	\$ 2,638.6	\$ 7,837.6	\$ 10,366.1	\$ 20,761.0	100%	100%	99%
PSPP	592.0	1,104.2	1,831.9	3,188.0	100%	100%	81%
Total	\$ 3,230.6	\$ 8,941.8	\$ 12,198.0	\$ 23,949.0	100%	100%	97%

(1) Includes effect of five percent benefit improvement which became effective January 1, 1994.

(2) Includes effect of compound COLA and 3.6% indexing improvements.

## SUMMARY OF ACCRUED AND UNFUNDED ACCRUED LIABILITIES

## SUMMARY OF ACCRUED AND UNFUNDED ACCRUED LIABILITIES

The unfunded accrued liability represents the excess of the accrued actuarial liability over the actuarial value of assets. For funding purposes, the Board of Trustees of TCRS has adopted the frozen initial liability method.

Under this method, the unfunded accrued liability is being funded by level-dollar contributions during an amortization period which ends in the year 2015. Also, actuarial gains and losses are absorbed in normal cost rather than as part of the unfunded liability. The statute governing TCRS allows the Board of Trustees to reestablish the unfunded accrued liability for actuarial gains and losses.

For the July 1, 2001 actuarial valuation, the Board reestablished the unfunded accrued liability. In an inflationary

economy where the covered payroll continues to grow, the level-dollar amounts which are being contributed to fund the unfunded accrued liability will, if expressed as a percentage of payroll, continue to decrease.

While concern is generally expressed regarding the dollar amount of the unfunded accrued liability, an analysis should also include the method being used to fund this liability as well as a review of this liability expressed as a percentage of active member payroll. The smaller the ratio of unfunded liabilities to the active member payroll, the stronger the system. A review of this ratio over a period of years will give an indication of whether the system is becoming financially stronger or weaker with respect to its unfunded liabilities.

## SUMMARY OF ACCRUED AND UNFUNDED ACCRUED LIABILITIES

*Dollar Amounts Expressed in Millions*

Actuarial Valuation Year	Actuarial Accrued Liabilities (AAL)	Valuation Assets	Ratio Assets to AAL	Unfunded Actuarial Accrued Liabilities (UAAL)	Active Member Payroll	UAAL as a Percentage of Active Member Payroll
1991	\$ 11,066.4	\$ 9,409.4	85%	\$ 1,657.0	\$ 3,636.5	46%
1993 (3)	12,349.0	11,805.2	96%	543.8	3,943.1	14%
1995	14,434.8	14,027.0	97%	407.8	4,580.0	9%
1997 (4)	18,070.8	17,898.6	99%	172.2 (1) (2)	4,940.8	3%
1999	21,311.1	21,017.9	99%	293.2 (1)	5,473.8	5%
2001	24,370.4	23,949.0	98%	421.4 (1) (2)	5,997.0	7%

- Notes:
- (1) Unfunded accrued liability was reestablished.
  - (2) Includes adjustments for changes in actuarial assumptions.
  - (3) Includes effect of five percent benefit improvement effective January 1, 1994.
  - (4) Includes effect of compound COLA and 3.6% indexing improvement.



SELECTED ACTUARIAL FUNDING INFORMATION

SELECTED ACTUARIAL FUNDING INFORMATION

Actuarial Valuation Year	Earnings Assumption	Salary Assumption	Unfunded Liability		State Amortization Period (3)
			SETHEPP	PSPP	
1991	8.0%	7.00%	\$ 1,657,057,111	\$ 0	24
1993 (1)	8.0%	7.00%	500,933,773	42,897,901	10/22 (2)
1995	8.0%	7.00%	366,528,134	41,288,942	20
1997 (4)	7.5%	5.50%	111,172,072	61,012,975	18
1999	7.5%	5.50%	93,022,745	200,161,388	16
2001	7.5%	4.75% (5)	81,226,933	340,147,400	14

- Notes:
- (1) Includes effect of five percent benefit improvement which became effective January 1, 1994.
  - (2) \$436.8 million is funded over 10 years and \$107 is funded over 22 years.
  - (3) The amortization period varies among political subdivisions participating in TCRS with the maximum period limited to 30 years.
  - (4) Includes effect of compound COLA and 3.6% indexing improvement.
  - (5) Approximates the effect of a graded salary scale.

## ANALYSIS OF FINANCIAL EXPERIENCE

## GAIN AND LOSS ANALYSIS, JULY 1, 2001 VALUATION

Normal Cost	State and Higher Education	Teacher
Effective Employer Normal Cost Rate Pursuant to 1999 Valuation	6.19%	3.72%
Investment Results and asset valuation method change	(0.54%)	(0.48%)
Salary Increases: If there are smaller pay increases than assumed, the normal cost is reduced; if there are greater increases than assumed, the normal cost is increased.	(0.87%)	(0.71%)
New Entrants: Includes the effect where normal cost for new entrants since the previous evaluation differs from the normal cost of the group.	0.42%	0.61%
Social Security Changes: More rapid increases in the Social Security wage base	(0.02%)	(0.03%)
Cost of Living Escalation: COLA in 2000 was 2.70%, 2001 was 3.00%, 2002 was 1.60%	(0.05%)	(0.05%)
Retiree Mortality (estimated)	0.10%	-
Prior Service Purchases : Employee purchases of prior service credits result in liabilities to the plan that are not fully offset by related employee contributions	0.12%	0.08%
Contribution rate change delay	0.10%	(0.17%)
Changes in Actuarial Assumptions	1.07%	0.31%
Other	0.78%	0.12%
<b>Effective Employer Normal Cost Rate Pursuant to 2001 Valuation</b>	<b>7.30%</b>	<b>3.40%</b>

RECONCILIATION OF UNFUNDED ACTUARIAL LIABILITIES  
STATE EMPLOYEES, TEACHERS, AND HIGHER EDUCATION EMPLOYEES

Unfunded Actuarial Liabilities at June 30, 2001*	\$ 81,226,933
Interest Accrual Fiscal Year 2001-2002	5,424,463
Contributions Made toward Unfunded Actuarial Liabilities (Fiscal Year 2001-2002)	(8,900,763)
<b>Unfunded Actuarial Liabilities at June 30, 2002</b>	<b>\$ 77,750,633</b>

\*The remaining unfunded actuarial liabilities relates to two small closed plans for certain elected state and county officials. The two major plans for state employees and teachers do not have an unfunded liability.

Note: Unfunded Actuarial Liabilities were re-established as of July 1, 2001 with a reduction of \$5,157,557.

## PLAN SUMMARY

### HISTORY AND ADMINISTRATION

The TCRS was established in 1972 by an Act of the Tennessee General Assembly. Seven existing retirement systems were consolidated to provide retirement, disability and death benefits to state employees, public school teachers, higher education employees and the employees of participating local governments. State laws governing the plan may be found in Chapters 34-37, 39 of Title 8, *Tennessee Code Annotated*. Amendments to the plan can only be made by legislation enacted by the General Assembly of the State of Tennessee.

A 17-member Board of Trustees has the responsibility to manage and oversee the operation of the consolidated system. The Board consists of nine ex-officio members from the executive, legislative, and judicial branches of state government and eight representatives of the active TCRS membership. Employee representation consists of three teachers, one from each grand division of the state, two state employees from departments other than those represented by ex-officio members, and three representatives of local governments. Local government representatives are appointed for two-year terms by each of the following organizations: the Tennessee County Services Association, the Tennessee Municipal League and the Tennessee County Officials Association. All employee representatives must be vested members of TCRS.

TCRS is administered by the Treasury Department under the legislative branch of state government. By state law, the State Treasurer serves as chairman of the Board of Trustees and as custodian of the funds of the system. The Director of the retirement system is appointed by the Treasurer and serves as the chief administrative officer of the plan.

The state is responsible for the pension cost of state employees and teachers; costs for the participation of local government employees are paid by political subdivisions. Administrative expenses are paid from employers' account balance. The operating budget is funded by local governments on a per member fee basis and by state government as part of the employer contribution rate.

### MEMBERSHIP

Membership in the retirement system is a condition of employment for full-time state employees, K-12 teachers, higher education general employees and the employees of participating local governments. Membership is optional for part-time state employees and the part-time employees of political subdivisions which have authorized such coverage.

Interim teachers and part-time teachers have optional membership. The faculty employees of institutions of higher education may elect participation in either TCRS or an optional retirement program (ORP), a defined contribution plan for higher education faculty.

### CONTRIBUTIONS

TCRS membership became noncontributory on July 1, 1981 for most state employees, teachers in state supported institutions of higher education and teachers employed in the Department of Education. At that time, the contributions, up to five percent of compensation payable to these employees, were assumed by the state, but this amount continued to be credited to the individual member's accounts from employer funds. State employees hired after July 1, 1981 join TCRS as noncontributory members with no funds credited to their individual accounts.

Participating political subdivisions may either adopt non-contributory retirement provisions or require employee contributions. The contribution rate for local government employees is five percent up to the social security wage base and 5.5 percent above that base, unless the employing government has authorized a level five percent rate. Public school teachers contribute at a rate of five percent of gross salary.

Individual accounts are maintained for all contributory members with interest credited annually at a rate of five percent. Since the TCRS is a defined benefit plan, benefits are based upon the member's average final compensation and years of creditable service. The member's account balance including interest accrued has no bearing on the monthly benefit amount payable at retirement. Account balances plus interest are fully refundable upon termination of service or death.

(continued)

## PLAN SUMMARY (CONTINUED)

Contributory members are now covered by Section 414(h) of the Internal Revenue Code. Under this provision, retirement contributions are made on a tax-deferred basis, with income tax due only when contributions are returned to members as benefits or refunds. Political subdivisions may adopt the 414(h) provision for their employees.

The state also makes contributions on behalf of higher education faculty members who select membership in the ORP. These contributions are equal to 10 percent of salary up to social security wage base and 11 percent of any excess salary.

### BENEFITS

TCRS provides three valuable benefits to its members: disability, death and service retirement. Disability benefits are available to qualified TCRS members who become totally disabled before meeting the requirements for service retirement. Two types of disability retirement are available: ordinary and accidental.

To qualify for ordinary disability, a member must have a minimum of five years of TCRS service credit. The ordinary disability benefit is equal to 90 percent of what the member would receive under service retirement. If a disabled retiree has less than 20 years of service credit, the service is projected to age 60 or 20 years, whichever comes first. When service is projected, the actual and projected service combined cannot exceed 20 years. If the member's actual service credit exceeds 20 years, the benefit is based on actual service only.

There is no minimum service requirement to qualify for an accidental disability benefit. However, the disability must be the result of a job-related accident that occurs without negligence on the part of the member, during the performance of duty. Prior to the onset of social security benefits, an accidental disability benefit is equal to 50 percent of the member's average final compensation (AFC). Once social security benefits begin, the accidental benefit is 33.3 percent of AFC. For members joining TCRS on or after July 1, 1997, accidental disability benefits are determined in the same manner as ordinary disability using the projection of service method. Disability benefits are increased by five percent for state employees, teachers and employees of participating political subdivisions which have authorized the five percent benefit improvement. The accidental benefit is adjusted if the

member's combined benefits from social security and/or workers' compensation exceed 75 percent of his AFC.

One of several death benefits may be payable to the designated beneficiary of an active member who dies prior to retirement. The type of death benefit payable will be determined by whether or not death occurred while in service, who is named as beneficiary, and the member's length of service.

A member may designate one or more persons, his estate, an institution, or any combination of such as his beneficiary. However, estates, institutions, and/or multiple beneficiaries are only eligible for a lump-sum refund of the member's accumulated contributions and interest unless one of the beneficiaries named is the surviving spouse. Other death benefits offered by TCRS include a 100 percent Joint and Surviving Spouse Annuity after 10 Years Service, a 100 percent Joint and Survivor Annuity for Any Beneficiary and a Line of Duty Benefit. Any beneficiary of a member who had 10 years of service and who is eligible for a lump-sum death benefit may elect a benefit to be paid over 10 years.

All members, with the exception of state judges, joining TCRS after 1976 enter the same membership group. The benefit formula for this group provides 1.5 percent of AFC computed over five years for each year of service credit. If a member's AFC exceeds the social security integration level (SSIL) applicable at retirement, the formula provides an additional 0.25 percent of the amount of the excess for each service year. These benefits are increased by five percent for state employees, teachers, and employees of participating political subdivisions which have authorized the five percent benefit improvement. State judges joining TCRS after September 1, 1990 become Group IV members.

Members become eligible for regular service retirement at age 60 and vested or at any age with 30 years. Vested members are eligible for reduced early retirement benefits when they have reached age 55 or have completed 25 years of service. Members joining TCRS after June 30, 1979 attain vesting rights after five years of service; the vesting period for members who joined prior to July 1, 1979 is four years. Five-year vesting and 25-year retirement are benefits that are optional to local governments. Otherwise, vesting for local governments is 10 years of service.

## SERVICES FOR ACTIVE AND RETIRED MEMBERS

### SERVICES FOR ACTIVE MEMBERS

TCRS provides a number of services for active members through its various sections.

#### *Field Services*

- ❖ TCRS staff is available to conduct employee presentations on all aspects of the retirement system.
- ❖ Employer seminars are conducted annually to educate retirement officers on legislation affecting TCRS.

#### *Membership*

- ❖ Comprehensive membership statements are provided to all members annually.
- ❖ Computer generated membership letters and membership pamphlets are mailed to all new members.
- ❖ Membership booklets are provided to all members periodically.
- ❖ The members' newsletter, *TCRS Report*, is sent to members semiannually.

#### *Prior Service*

- ❖ An automated calculation and eligibility system generates billings for members who wish to establish prior service.
- ❖ An installment program is available to purchase certain types of prior service.
- ❖ Prior Service may be purchased with a rollover from a tax-deferred 401(k) plan, 403(b) plan, 457 plan or an IRA.
- ❖ TCRS staff is available for personal counseling on an individual basis at their Nashville office.

#### *Benefits*

- ❖ Interactive benefit calculator via Internet.
- ❖ Computer generated benefit estimates are available for those members approaching retirement age.
- ❖ Annual regional employee benefit counseling workshops are available to educate potential retirees.
- ❖ TCRS staff is available for personal counseling on an individual basis at their Nashville office.
- ❖ Preretirement planning seminars, which explain all facets of post-career retirement planning, are provided for members.

### SERVICES FOR RETIRED MEMBERS

A number of services are made available to TCRS retirees.

- ❖ A toll-free telephone line.
- ❖ Retiree identification cards.
- ❖ Semiannual retiree newsletter: *The Retiree Advisor*.
- ❖ Direct deposit service.
- ❖ Continuation of medical insurance.
- ❖ Medicare supplement coverage.
- ❖ Income tax information.
- ❖ Certification of monthly benefits.
- ❖ Certification of student discounts.
- ❖ Credit Union deductions.
- ❖ Tennessee State Employee Association deductions.
- ❖ Tennessee Retired Teachers Association deductions.

## SAMPLE BENEFIT CALCULATIONS

**TENNESSEE'S RETIREMENT PROGRAM, TCRS AND SOCIAL SECURITY BENEFITS**  
*for Calendar Year 2002*

Five-Year AFC*	Projected Annual Retirement Income	15 Years Service	% of AFC	20 Years Service	% of AFC	25 Years Service	% of AFC	30 Years Service	% of AFC	35 Years Service	% of AFC
\$15,000	TCRS	\$ 3,544		\$ 4,725		\$ 5,906		\$ 7,088		\$ 8,269	
	Social Security	8,628		8,628		8,628		8,628		8,628	
	Total	\$ 12,172	81.1%	\$ 13,353	89.0%	\$ 14,534	96.9%	\$ 15,716	104.8%	\$ 16,897	112.6%
\$20,000	TCRS	\$ 4,725		\$ 6,300		\$ 7,875		\$ 9,450		\$ 11,025	
	Social Security	10,236		10,236		10,236		10,236		10,236	
	Total	\$ 14,961	74.8%	\$ 16,536	82.7%	\$ 18,111	90.6%	\$ 19,686	98.4%	\$ 21,261	106.3%
\$25,000	TCRS	\$ 5,906		\$ 7,875		\$ 9,844		\$ 11,813		\$ 13,781	
	Social Security	11,832		11,832		11,832		11,832		11,832	
	Total	\$ 17,738	71.0%	\$ 19,707	78.8%	\$ 21,676	86.7%	\$ 23,645	94.6%	\$ 25,613	102.5%
\$30,000	TCRS	\$ 7,088		\$ 9,450		\$ 11,813		\$ 14,175		\$ 16,538	
	Social Security	13,440		13,440		13,440		13,440		13,440	
	Total	\$ 20,528	68.4%	\$ 22,890	76.3%	\$ 25,253	84.2%	\$ 27,615	92.1%	\$ 29,978	99.9%
\$35,000	TCRS	\$ 8,269		\$ 11,025		\$ 13,781		\$ 16,538		\$ 19,294	
	Social Security	15,036		15,036		15,036		15,036		15,036	
	Total	\$ 23,305	66.6%	\$ 26,061	74.5%	\$ 28,817	82.3%	\$ 31,574	90.2%	\$ 34,330	98.1%
\$40,000	TCRS	\$ 9,560		\$ 12,747		\$ 15,934		\$ 19,121		\$ 22,307	
	Social Security	16,584		16,584		16,584		16,584		16,584	
	Total	\$ 26,144	65.4%	\$ 29,331	73.3%	\$ 32,518	81.3%	\$ 35,705	89.3%	\$ 38,891	97.2%
\$45,000	TCRS	\$ 10,938		\$ 14,585		\$ 18,231		\$ 21,877		\$ 25,523	
	Social Security	17,220		17,220		17,220		17,220		17,220	
	Total	\$ 28,158	62.6%	\$ 31,805	70.7%	\$ 35,451	78.8%	\$ 39,097	86.9%	\$ 42,743	95.0%
\$50,000	TCRS	\$ 12,317		\$ 16,422		\$ 20,528		\$ 24,633		\$ 28,739	
	Social Security	17,820		17,820		17,820		17,820		17,820	
	Total	\$ 30,137	60.3%	\$ 34,242	68.5%	\$ 38,348	76.7%	\$ 42,453	84.9%	\$ 46,559	93.1%
\$55,000	TCRS	\$ 13,695		\$ 18,260		\$ 22,824		\$ 27,389		\$ 31,954	
	Social Security	18,324		18,324		18,324		18,324		18,324	
	Total	\$ 32,019	58.2%	\$ 36,584	66.5%	\$ 41,148	74.8%	\$ 45,713	83.1%	\$ 50,278	91.4%
\$60,000	TCRS	\$ 15,073		\$ 20,097		\$ 25,121		\$ 30,146		\$ 35,170	
	Social Security	18,828		18,828		18,828		18,828		18,828	
	Total	\$ 33,901	56.5%	\$ 38,925	64.9%	\$ 43,949	73.2%	\$ 48,974	81.6%	\$ 53,998	90.0%

\* Average Final Compensation (AFC) is the average of the member's five highest consecutive years of salary.

This chart is based on a date of retirement in 2002. Social security benefits have been calculated by Bryan, Pendleton, Swats & McAllister, actuarial consultants for the TCRS, utilizing the following assumptions:

- (1) Retirement is taking place at age 65 in 2002;
- (2) The retiree has worked a full career (TCRS plus other employers, if necessary) of 35 years or more; and
- (3) Salary increases throughout the retiree's career have followed the same pattern as National Average Earnings.

The department's Internet benefits calculator allows members to receive an immediate estimate: [www.treasury.state.tn.us/tcrs/](http://www.treasury.state.tn.us/tcrs/)

## MAJOR LEGISLATIVE IMPROVEMENTS

- 1972** Benefit formula improved from 1.12% of salary up to the SSIL to 1.5% of salary up to the SSIL.
- 1973** Annual cost-of-living increase based on the CPI with a cap of 1.5% adopted for retirees.
- 1974** Disability retirement eligibility requirement reduced from 10 years to 5 years of service.
- Minimum benefit increased from \$5.34 to \$7 per month per year of service.
- Maximum annual cost-of-living increase raised to 3%.
- Provision to increase retirees' benefits whenever the benefit formula is improved.
- Service credit authorized for unused accumulated sick leave.
- 1976** Service retirement eligibility requirements reduced from age 65 or 35 years of service to age 60 or 30 years of service.
- Early retirement eligibility requirements reduced from age 60 or 30 years of service to age 55.
- 1978** A bonus cost-of-living increase granted to retirees at a lump-sum cost of \$15.3 million.
- An optional retirement plan established for teachers in the Board of Regents system.
- 1980** Death benefits for members dying in-service with 10 years of service improved by offering a 100% joint and survivor annuity of the member's accrued benefit for the spouse.
- 1981** Noncontributory retirement for state employees and higher education employees adopted. Employees' contributions, up to 5%, were assumed by the state.
- 1983** An actuarially reduced retirement benefit at any age with 25 years of service authorized.
- 1984** Credit for out-of-state service for the purpose of determining retirement eligibility authorized.
- Retirement credit for armed conflict approved.
- Minimum benefit increased from \$7 to \$8 per month per year of service.
- Part-time employees permitted to participate in TCRS and members allowed to establish credit for previous part-time employment.
- 1985** \$22 million ad-hoc increase granted to retirees.
- Death benefits for spouse and children were provided when member's death is in the line of duty.
- 1987** Service credit for half of peacetime military service made available.
- \$17 million ad-hoc increase granted to retirees.
- Retirement incentive for state employees.
- Section 414(h) of the IRC adopted, allowing employee contributions to be made on a tax-deferred basis.
- 1990** Retirement incentive for state employees.
- 1991** 3.6% indexing of salaries for noncontributory employees extended one year. Each succeeding year up to 1997, the 3.6% indexing was extended. In 1997, it was extended indefinitely.
- 1992** Minimum number of years required to qualify for retirement was reduced from 10 to 5 years.
- 1993** Salary portability for service in different classifications authorized effective January 1, 1994.
- Benefit improvement up to 5% authorized.
- 1994** Retirees permitted to work 100 days per year for a covered employer without loss of benefits.
- 1997** Compounded COLA for retirees approved.
- Beginning date for armed conflict military service credit during the Vietnam Era was changed from August 4, 1964 to February 28, 1961.
- 1998** Group 2 and 3 service requirements amended to permit service retirement with 30 years of service, regardless of age.
- Group 1 and Prior Class C benefit limitations increased to 80%.
- Mandatory retirement established with supplemental bridge benefit for all state public safety officers.
- 1999** Group 1 benefit maximum increased to 90%.
- 2000** Group 2 benefit maximum increased to 80%.
- 2001** Line of Duty Death Benefits improved to guarantee a minimum \$50,000 death benefit.

# Statistical Section

*Bobcats are characterized by their long legs and large, heavy paws. They range in length from 2 to 4 feet and have soft fur and short, stubby tails.*

*Bobcats are good climbers and in pleasant weather, can often be found on tree limbs waiting for passing prey.*

*In inclement weather or when breeding, bobcats take shelter in caves or hollow logs.*



*Named for its plaintive call, the mourning dove is the most populous dove in North America.*

*Originally found in the countryside, this dove is becoming a familiar site in urban residential areas.*



SCHEDULES OF ACTIVE MEMBERS

SCHEDULE OF ACTIVE MEMBERS

by Service Credit

Years of Service	SETHEEPP			PSPP	Total
	State Employees	Teachers	Higher Education Employees	Political Subdivision Employees	
0 - 4	14,823	18,341	5,708	30,375	69,247
5 - 9	7,098	13,444	2,988	16,450	39,980
10 - 14	5,302	8,112	2,487	9,813	25,714
15 - 19	6,225	7,646	2,122	6,267	22,260
20 - 24	4,164	6,499	1,952	3,992	16,607
25 - 29	3,661	7,448	1,532	2,334	14,975
30 - 34	1,622	3,588	831	841	6,882
35 - 39	533	833	247	213	1,826
40 - 44	153	124	35	45	357
Over 44	47	41	17	18	123
<b>Total</b>	<b>43,628</b>	<b>66,076</b>	<b>17,919</b>	<b>70,348</b>	<b>197,971</b>

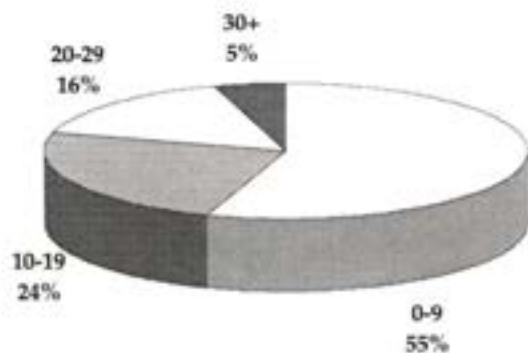
SCHEDULE OF ACTIVE MEMBERS

by Enrollment Date

Date of Membership	SETHEEPP			PSPP	Total
	State Employees	Teachers	Higher Education Employees	Political Subdivision Employees	
1940s	3	10	4	0	17
1950s	87	79	17	12	195
1960s	1,161	2,704	383	172	4,420
1970s	6,708	13,538	3,252	4,385	27,883
1980s	12,361	14,212	4,890	12,899	44,362
1990s	15,022	26,350	6,261	35,528	83,161
2000s	8,286	9,183	3,112	17,352	37,933
<b>Total</b>	<b>43,628</b>	<b>66,076</b>	<b>17,919</b>	<b>70,348</b>	<b>197,971</b>

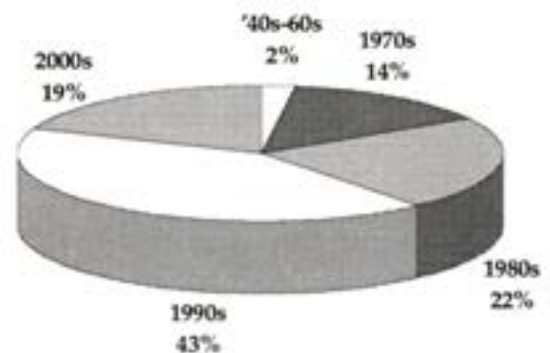
PERCENTAGE OF ACTIVE MEMBERS

by Service Credit



PERCENTAGE OF ACTIVE MEMBERS

by Enrollment Date



**SCHEDULES OF ACTIVE MEMBERS**

**SCHEDULE OF ACTIVE MEMBERS**

*by Current Age*

Current Age	SETHEEPP			PSPP	Total
	State Employees	Teachers	Higher Education Employees	Political Subdivision Employees	
Less than 20	83	1	12	70	166
20-29	4,936	8,974	1,395	6,788	22,093
30-39	8,239	15,249	3,151	16,317	42,956
40-49	13,263	18,061	5,497	21,731	58,552
50-54	7,415	12,691	2,957	9,811	32,874
55-59	5,598	7,933	2,599	7,958	24,088
60-64	2,762	2,617	1,571	4,804	11,754
65-69	890	423	528	1,867	3,708
Over 69	442	127	209	1,002	1,780
<b>Total</b>	<b>43,628</b>	<b>66,076</b>	<b>17,919</b>	<b>70,348</b>	<b>197,971</b>

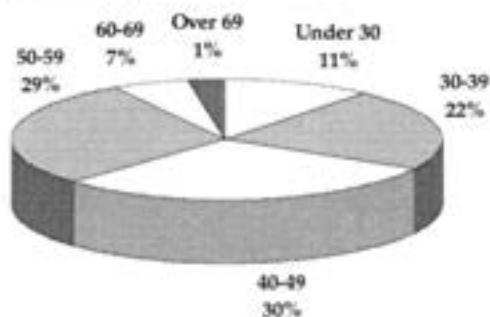
**SCHEDULE OF ACTIVE MEMBERS**

*by Age at Enrollment*

Age at Enrollment	SETHEEPP			PSPP	Total
	State Employees	Teachers	Higher Education Employees	Political Subdivision Employees	
Less than 20	1,743	119	336	1,068	3,266
20 - 24	9,452	23,994	2,999	8,663	45,108
25 - 29	9,196	15,782	3,489	10,632	39,099
30 - 34	6,660	8,735	3,175	11,629	30,199
35 - 39	5,561	7,054	2,853	12,035	27,503
40 - 44	4,372	5,187	2,176	10,161	21,896
45 - 49	3,220	3,138	1,496	6,987	14,841
50 - 54	1,997	1,469	848	4,748	9,062
55 - 59	1,063	489	366	2,702	4,620
60 - 64	268	86	123	1,100	1,577
65 - 69	70	19	43	450	582
Over 69	26	4	15	173	218
<b>Total</b>	<b>43,628</b>	<b>66,076</b>	<b>17,919</b>	<b>70,348</b>	<b>197,971</b>

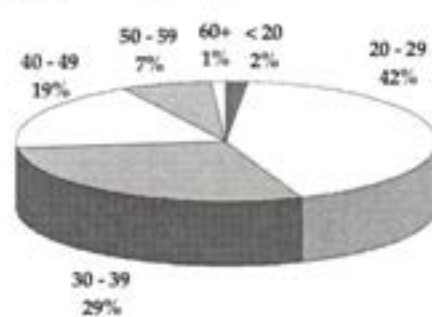
**PERCENTAGE OF ACTIVE MEMBERS**

*by Current Age*



**PERCENTAGE OF ACTIVE MEMBERS**

*by Age at Enrollment*



SCHEDULES OF ACTIVE MEMBERS

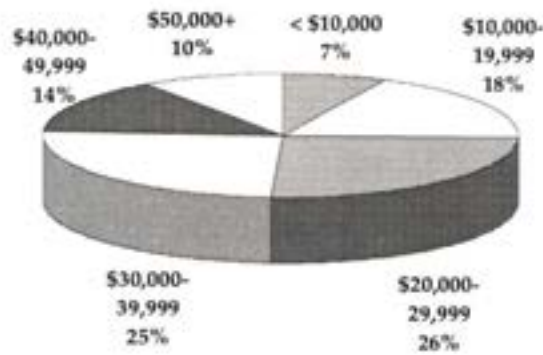
SCHEDULE OF ACTIVE MEMBERS

by Salary

Annual Salary	SETHEEPP			PSPP	Total
	State Employees	Teachers	Higher Education Employees	Political Subdivision Employees	
Less than \$10,000	2,536	249	1,033	10,220	14,038
\$10,000-19,999	7,426	981	4,005	23,678	36,090
\$20,000-29,999	15,467	9,067	5,678	20,183	50,395
\$30,000-39,999	9,715	27,236	2,810	9,949	49,710
\$40,000-49,999	4,616	18,456	1,665	3,702	28,439
\$50,000+	3,868	10,087	2,728	2,616	19,299
<b>Total</b>	<b>43,628</b>	<b>66,076</b>	<b>17,919</b>	<b>70,348</b>	<b>197,971</b>

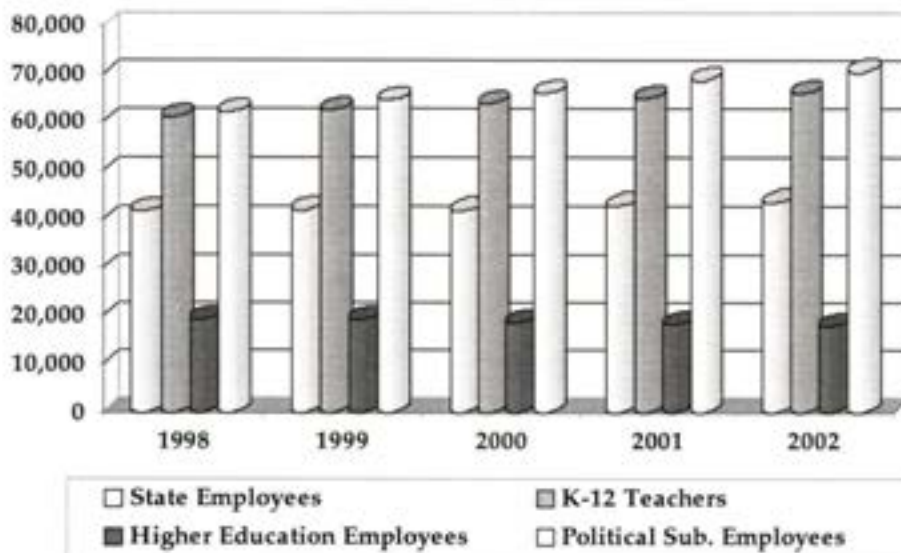
PERCENTAGE OF ACTIVE MEMBERS

by Salary



ACTIVE MEMBERS

Fiscal Years 1998-2002



**SCHEDULES OF RETIRED MEMBERS**

**SCHEDULE OF RETIRED MEMBERS**

*by Type of Benefit Plan*

Benefit Plan*	SETHEEPP			PSPP	Total
	State Employees	Teachers	Higher Education Employees	Political Subdivision Employees	
Regular	10,730	18,207	5,389	14,648	48,974
Option I	1,466	1,323	1,197	1,595	5,581
Option II	801	695	509	566	2,571
Option III	1,798	1,963	941	1,601	6,303
Option IV	1,454	1,884	795	944	5,077
S.S. Leveling	1,156	2,617	288	928	4,989
Subtotal	17,405	26,689	9,119	20,282	73,495
Survivors	2,326	1,589	1,121	1,895	6,931
Total	19,731	28,278	10,240	22,177	80,426

- \* Regular Maximum Plan - No Survivor Benefits
- \* Option I 100% Joint and Survivor Annuity
- \* Option II 50% Joint and Survivor Annuity
- \* Option III 100% Joint and Survivor Annuity with Pop-up Feature
- \* Option IV 50% Joint and Survivor Annuity with Pop-up Feature
- \* S.S. Leveling Benefit Level Coordinated with Social Security

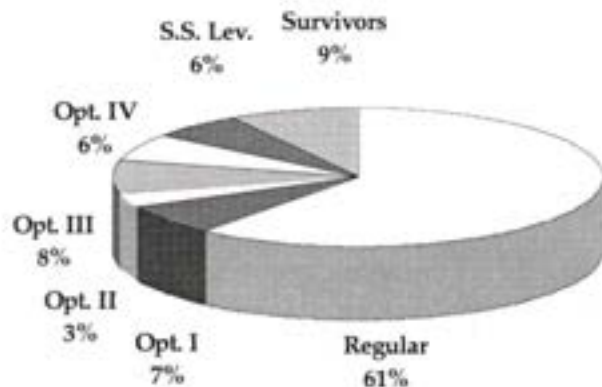
**SCHEDULE OF RETIRED MEMBERS**

*by Type of Retirement*

Type of Retirement	SETHEEPP			PSPP	Total
	State Employees	Teachers	Higher Education Employees	Political Subdivision Employees	
Retirees:					
Service	13,901	22,244	7,294	15,811	59,250
Early	2,225	3,617	1,339	2,995	10,176
Disability	1,279	828	486	1,476	4,069
Total Retirees	17,405	26,689	9,119	20,282	73,495
Survivors	2,326	1,589	1,121	1,895	6,931
Total	19,731	28,278	10,240	22,177	80,426

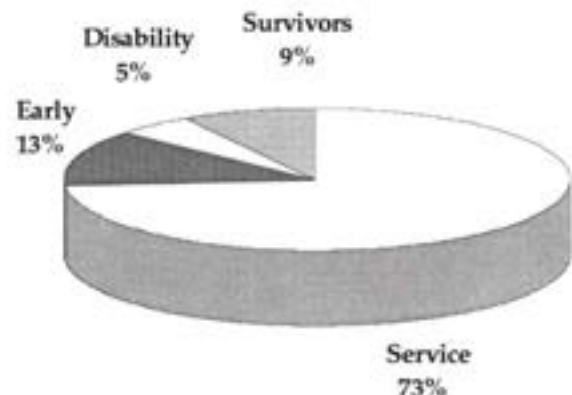
**PERCENTAGE OF RETIRED MEMBERS**

*by Type of Benefit Plan*



**PERCENTAGE OF RETIRED MEMBERS**

*by Type of Retirement*



SCHEDULES OF RETIRED MEMBERS

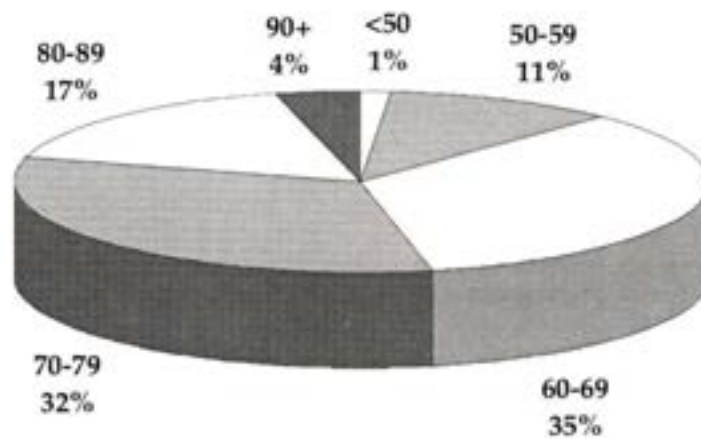
SCHEDULE OF RETIRED MEMBERS

by Current Age

Current Age	SETHEPP			PSPP	Total
	State Employees	Teachers	Higher Education Employees	Political Subdivision Employees	
Under 40	103	67	33	63	266
40-44	112	50	53	70	285
45-49	223	118	90	200	631
50-54	646	822	235	494	2,197
55-59	1,606	2,869	666	1,342	6,483
60-64	2,965	4,438	1,506	3,305	12,214
65-69	3,779	4,891	2,097	4,780	15,547
70-74	3,546	4,618	2,121	4,312	14,597
75-79	3,020	3,430	1,631	3,385	11,466
80-84	2,115	2,788	1,109	2,434	8,446
85-89	1,136	2,243	520	1,294	5,193
90-94	397	1,466	140	420	2,423
95-99	76	431	34	70	611
Over 99	7	47	5	8	67
<b>Total</b>	<b>19,731</b>	<b>28,278</b>	<b>10,240</b>	<b>22,177</b>	<b>80,426</b>

PERCENTAGE OF TOTAL RETIRED MEMBERS

by Current Age



**SCHEDULES OF RETIRED MEMBERS**

**SCHEDULE OF RETIRED MEMBERS**

*by Date of Retirement*

Date of Retirement	SETHEEPP			PSPP	Total
	State Employees	Teachers	Higher Education Employees	Political Subdivision Employees	
1940s	0	1	0	0	1
1950s	4	28	0	3	35
1960s	44	280	12	12	348
1970s	1,637	4,010	582	1,650	7,879
1980s	4,914	7,376	2,509	5,470	20,269
1990s	10,079	11,997	5,470	11,206	38,752
2000s	3,053	4,586	1,667	3,836	13,142
<b>Total</b>	<b>19,731</b>	<b>28,278</b>	<b>10,240</b>	<b>22,177</b>	<b>80,426</b>

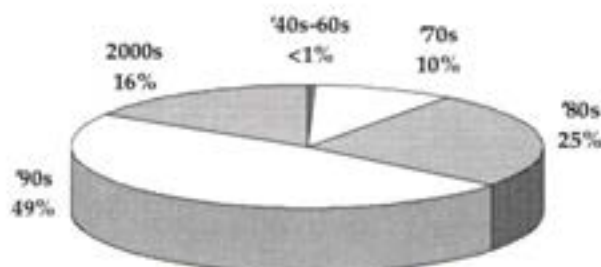
**SCHEDULE OF RETIRED MEMBERS**

*by Service Credit at Retirement*

Years of Service	SETHEEPP			PSPP	Total
	State Employees	Teachers	Higher Education Employees	Political Subdivision Employees	
Under 10	4,047	2,132	1,922	4,798	12,899
10-14	2,973	1,733	1,609	4,762	11,077
15-19	2,669	2,204	1,508	3,991	10,372
20-24	2,715	3,221	1,377	3,508	10,821
25-29	2,246	4,325	1,217	2,385	10,173
30-34	3,270	8,911	1,603	1,963	15,747
35-39	1,175	3,742	637	543	6,097
40-44	518	1,692	275	189	2,674
Over 44	118	318	92	38	566
<b>Total</b>	<b>19,731</b>	<b>28,278</b>	<b>10,240</b>	<b>22,177</b>	<b>80,426</b>

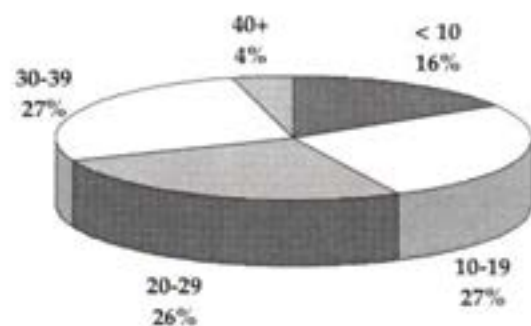
**PERCENTAGE OF RETIRED MEMBERS**

*by Date of Retirement*



**PERCENTAGE OF RETIRED MEMBERS**

*by Service Credit at Retirement*



RETIRED MEMBERS BY GEOGRAPHICAL DISTRIBUTION

UNITED STATES

Alabama	376	Kentucky	334
Alaska	12	Louisiana	50
Arizona	96	Maine	11
Arkansas	235	Maryland	52
California	137	Massachusetts	11
Colorado	48	Michigan	67
Connecticut	11	Minnesota	14
Delaware	10	Mississippi	675
Dist. of Columbia	6	Missouri	82
Florida	857	Montana	5
Georgia	595	Nebraska	4
Hawaii	15	Nevada	28
Idaho	13	New Hampshire	9
Illinois	90	New Jersey	11
Indiana	71	New Mexico	21
Iowa	8	New York	39
Kansas	27	North Carolina	313

North Dakota	3
Ohio	97
Oklahoma	46
Oregon	28
Pennsylvania	47
Rhode Island	2
South Carolina	141
South Dakota	1
Tennessee	75,030
Texas	254
Utah	8
Vermont	7
Virginia	324
Washington	44
West Virginia	18
Wisconsin	18
Wyoming	1

INTERNATIONAL COUNTRIES

Australia	2
Canada	4
England	2
France	1
Germany	2
Greece	2
Ireland	1
Israel	1
Japan	1
Kenya	1
Kuwait	1
Mexico	1
Total Foreign Countries	19
Overseas Military Bases	5
Total U.S.	80,402
Total	80,426

Total U.S. 80,402

TENNESSEE

Anderson	1,198	Fentress	241
Bedford	483	Franklin	569
Benton	236	Gibson	869
Bledsoe	272	Giles	370
Blount	1,822	Grainger	194
Bradley	942	Greene	1,360
Campbell	584	Grundy	205
Cannon	229	Hamblen	829
Carroll	460	Hamilton	3,722
Carter	1,083	Hancock	64
Cheatham	442	Hardeman	711
Chester	308	Hardin	419
Claiborne	461	Hawkins	655
Clay	110	Haywood	435
Cocke	414	Henderson	242
Coffee	619	Henry	610
Crockett	255	Hickman	393
Cumberland	616	Houston	70
Davidson	6,539	Humphreys	303
Decatur	168	Jackson	158
Dekalb	231	Jefferson	598
Dickson	498	Johnson	234
Dyer	378	Knox	5,059
Fayette	577	Lake	201

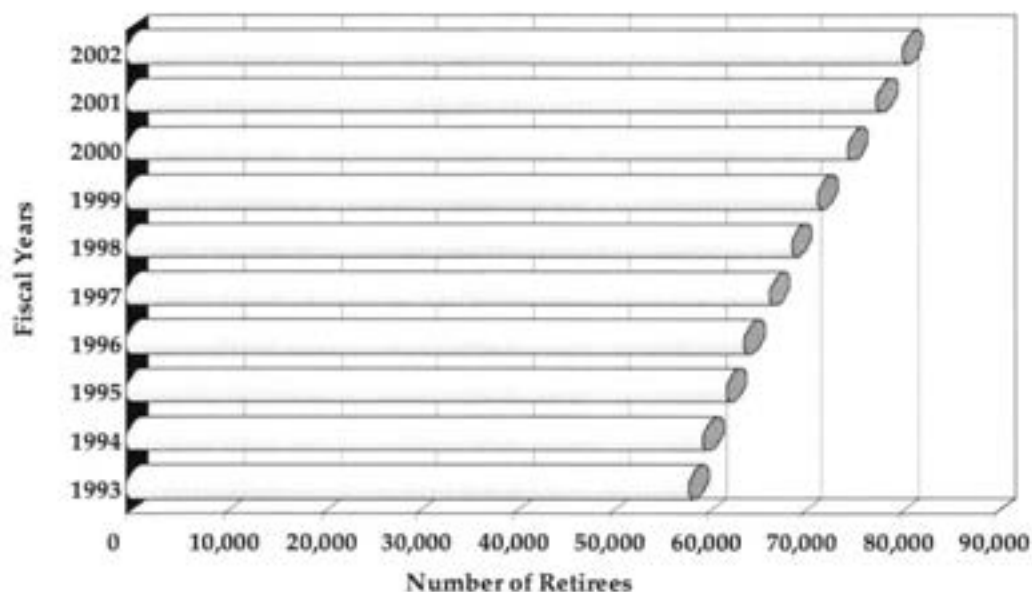
Lauderdale	522
Lawrence	545
Lewis	225
Lincoln	421
Loudon	536
McMinn	636
McNairy	372
Macon	169
Madison	1,663
Marion	358
Marshall	358
Maury	597
Meigs	118
Monroe	487
Montgomery	1,541
Moore	73
Morgan	487
Obion	569
Overton	326
Perry	180
Pickett	88
Polk	151
Putnam	1,332
Rhea	344

Roane	964
Robertson	678
Rutherford	2,049
Scott	345
Sequatchie	189
Sevier	657
Shelby	8,714
Smith	288
Stewart	139
Sullivan	2,407
Sumner	1,405
Tipton	469
Trousdale	154
Unicoi	302
Union	226
VanBuren	107
Warren	574
Washington	1,952
Wayne	224
Weakley	794
White	474
Williamson	1,245
Wilson	1,140
Total Tennessee	75,030

**RETIRED MEMBERS ON PAYROLL  
AND PRIOR SERVICE ESTABLISHED**

**NUMBER OF RETIREES ON PAYROLL**

*Fiscal Years 1993-2002*



**PRIOR SERVICE ESTABLISHED**

*for the Year Ended June 30, 2002*

Type of Service	Members	Years of Service	Payments
<b>State:</b>			
Backpayment	152	231	\$ 462,936
Military	138	323	43,018
Redeposit	170	812	1,791,084
<b>Total</b>	<b>460</b>	<b>1,366</b>	<b>\$ 2,297,038</b>
<b>Teachers:</b>			
Backpayment	75	151	\$ 465,690
Military	58	123	9,505
Redeposit	205	996	2,148,067
<b>Total</b>	<b>338</b>	<b>1,270</b>	<b>\$ 2,623,262</b>
<b>Higher Education:</b>			
Backpayment	172	200	\$ 233,808
Military	57	137	10,786
Redeposit	34	129	290,832
<b>Total</b>	<b>263</b>	<b>466</b>	<b>\$ 535,426</b>
<b>Political Subdivisions:</b>			
Backpayment	683	2,489	\$ 817,536
Military	130	287	15,935
Redeposit	73	299	489,201
<b>Total</b>	<b>886</b>	<b>3,075</b>	<b>\$ 1,322,672</b>
<b>Totals by Category:</b>			
Backpayment	1,082	3,071	\$ 1,979,970
Military	383	870	79,244
Redeposit	482	2,236	4,719,184
<b>Total</b>	<b>1,947</b>	<b>6,177</b>	<b>\$ 6,778,398</b>



## TREASURY RETIREMENT INSTALLMENT PLAN

The Treasury Retirement Installment Plan, known as TRIP, was established in 1996 to be an alternative for members who have prior service to be established. Previously, prior service payments were required to be made in a lump sum payment. TRIP has allowed these members to establish their prior service by making monthly installment payments in the form of Automated Clearing House (ACH) withdrawals from a designated bank account. Prior service may be financed over a period not to exceed five years.

Examples of service types which are eligible to be included on TRIP are previously withdrawn service, peacetime military service, educational leave and enrollment service for new participating employers. When a member is billed for their prior service, a statement is generated showing a lump sum payment. In addition, TRIP information is given with regard to financing over 6 to 60 months. The member may elect to finance the entire amount or elect to make a down payment and finance the balance.

Annual statements are also generated as of the fiscal year ending June 30. Statements reflect the principle and interest payments made and remaining balance. The member may choose at any time to pay off the remaining balance.

### TREASURY RETIREMENT INSTALLMENT PLAN Payments Received for the Year Ended June 30, 2002

Type of Service	Members	Years of Service	Payments
<b>State:</b>			
Backpayment	19	86	\$ 74,187
Military	2	2	5,844
Redeposit	212	1,275	574,341
<b>Total</b>	<b>233</b>	<b>1,363</b>	<b>\$ 654,372</b>
<b>Teachers:</b>			
Backpayment	36	116	\$ 55,648
Military	0	0	0
Redeposit	292	1,471	839,731
<b>Total</b>	<b>328</b>	<b>1,587</b>	<b>\$ 895,379</b>
<b>Higher Education:</b>			
Backpayment	33	178	\$ 68,546
Military	1	2	0
Redeposit	38	216	96,367
<b>Total</b>	<b>72</b>	<b>396</b>	<b>\$ 164,913</b>
<b>Political Subdivisions:</b>			
Backpayment	91	588	\$ 178,563
Military	0	0	0
Redeposit	90	463	180,757
<b>Total</b>	<b>181</b>	<b>1,051</b>	<b>\$ 359,320</b>
<b>Totals by Category:</b>			
Backpayment	179	968	\$ 376,944
Military	3	4	5,844
Redeposit	632	3,425	1,691,196
<b>Total</b>	<b>814</b>	<b>4,397</b>	<b>\$ 2,073,984</b>

**REFUND ACTIVITY AND POLITICAL SUBDIVISION PARTICIPATION**

**REFUND ACTIVITY**

For the Year Ended June 30	Number of Refunds Processed	Amount Refunded
1993	4,627	\$ 17,141,499
1994	4,449	17,636,340
1995	4,788	20,914,496
1996	4,663	20,721,711
1997	4,632	23,833,152
1998	4,571	24,649,359
1999	4,874	25,634,380
2000	5,029	28,562,230
2001	4,771	28,517,803
2002	4,259	24,304,536

The TCRS became noncontributory July 1, 1981 for state employees, higher education employees, and certain political subdivisions, resulting in fewer refunds for members withdrawing from the system.

**POLITICAL SUBDIVISION PARTICIPATION**

*Schedule by Category*

Year Ended June 30	Number of Cities	Number of Counties	Miscellaneous Political Subdivisions	Total
1993	115	83	127	325
1994	118	83	137	338
1995	123	83	140	346
1996	128	84	144	356
1997	134	84	147	365
1998	142	86	151	379
1999	147	87	160	394
2000	151	87	151	390
2001	156	87	161	404
2002	158	87	162	407

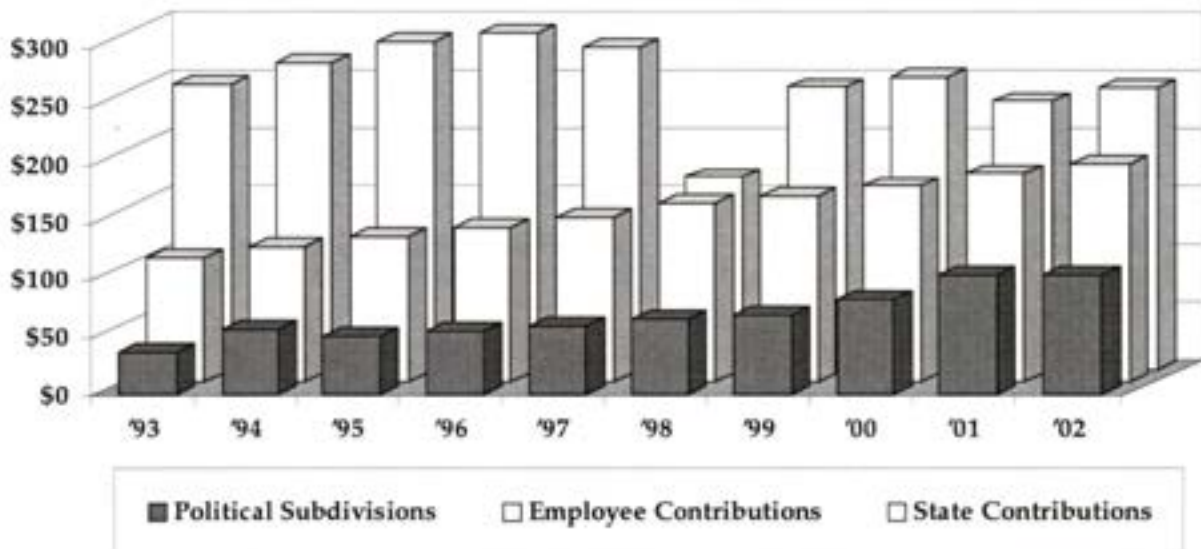
**HISTORICAL EMPLOYER CONTRIBUTION RATES**

**HISTORICAL EMPLOYER CONTRIBUTION RATES**  
*Expressed as a Percentage of Salary*

Year Ended June 30	Higher Education Employees			
	State Employees	Teachers	Faculty	General
1993	6.44%	8.68%	6.44%	6.44%
1994	6.69	8.70	6.69	6.69
1995	6.33	8.51	6.33	6.33
1996	6.33	8.51	6.33	6.33
1997	7.36	6.50	7.36	7.36
1998	3.65	3.89	3.65	3.65
1999	5.43	5.47	5.43	5.43
2000	5.43	5.47	5.43	5.43
2001	6.19	3.72	6.19	6.19
2002	6.19	3.72	6.19	6.19

The employer contribution rates for political subdivisions are individually determined based on the biennial actuarial valuation of each political subdivision.

**RETIREMENT CONTRIBUTIONS**  
*Fiscal Years 1993-2002*



**HISTORICAL FAIR VALUE**

**HISTORICAL FAIR VALUE**

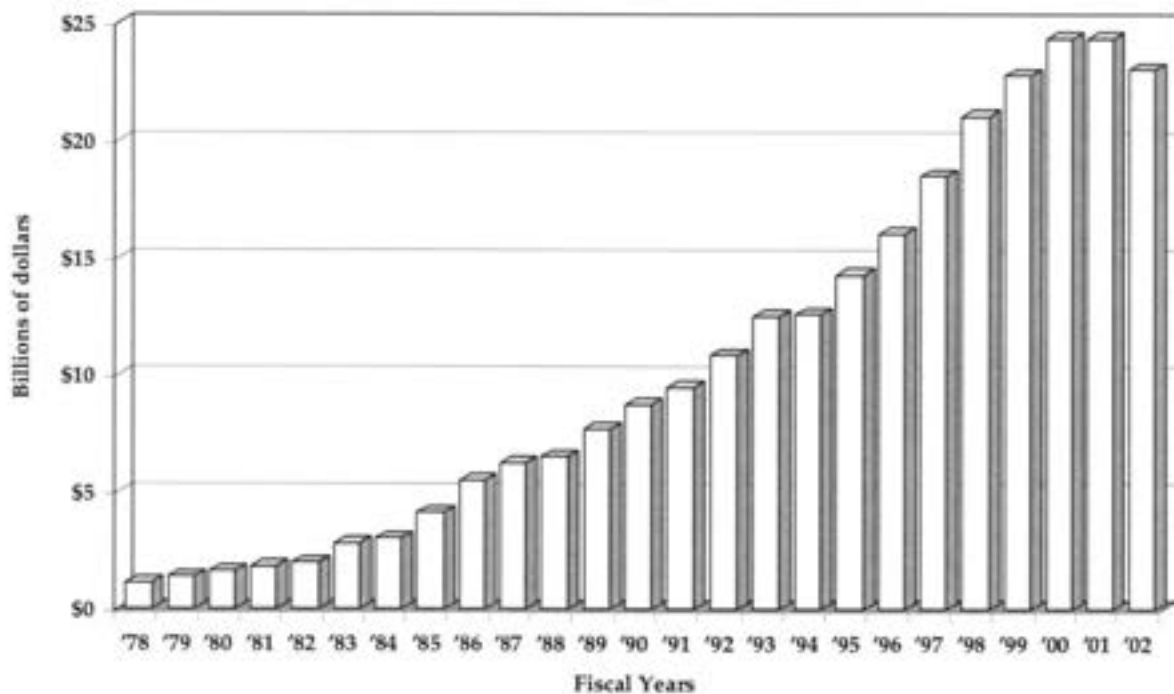
*Fiscal Years 1978-2002*

*Expressed in Thousands*

As of June 30	Fair Value	As of June 30	Fair Value
1978	\$ 1,146,321	1991	\$ 9,499,347
1979	1,415,959	1992	10,850,328
1980	1,651,664	1993	12,524,434
1981	1,854,588	1994	12,632,853
1982	2,024,415	1995	14,293,461
1983	2,837,842	1996	16,072,177
1984	3,057,519	1997	18,519,341
1985	4,167,052	1998	21,057,487
1986	5,507,372	1999	22,797,512
1987	6,242,556	2000	24,337,679
1988	6,541,570	2001	23,738,205
1989	7,710,790	2002	23,048,086
1990	8,757,167		

**HISTORICAL FAIR VALUE**

*Fiscal Years 1978-2002*



**ANALYSIS OF MEMBER AND EMPLOYER RESERVES  
FOR THE YEAR ENDED JUNE 30, 2002**

**MEMBER RESERVE FUND**

The legislation which created the TCRS established two funds, the Member Reserve Fund and the Employer Reserve Fund, to account for the financial transactions of the pension plans. The Member Reserve Fund represents the accumulation of employee contributions plus interest.

	SETHEPP	PSPP	Total
June 30, 2001 Member Reserve Fund	\$ 2,640,727,883	\$ 592,316,016	\$ 3,233,043,899
Member contributions	142,125,794	47,139,494	189,265,288
Employer provided contributions	26,825,579	11,843,082	38,668,661
Interest	125,262,877	28,240,007	153,502,884
Refunded account balances	(12,688,536)	(11,616,000)	(24,304,536)
Transfers to employer fund of retiring members'	<u>(140,349,093)</u>	<u>(24,229,168)</u>	<u>(164,578,261)</u>
June 30, 2002 Member Reserve Fund	<u>\$ 2,781,904,504</u>	<u>\$ 643,693,431</u>	<u>\$ 3,425,597,935</u>

**EMPLOYER RESERVE FUND**

The Employer Reserve Fund represents the accumulation of employer contributions, investment income and transfers from the Member Reserve Fund for retirees. Benefit payments and interest credited to members' accounts are reductions to the Employer Reserve Fund.

	SETHEPP	PSPP	Total
June 30, 2001 Employer Reserve Fund	\$ 17,937,248,837	\$ 2,567,911,962	\$ 20,505,160,799
Employer contributions	243,498,601	103,373,722	346,872,323
Investment income	(327,286,158)	(51,570,159)	(378,856,317)
Transfers from retiring members' account	140,349,093	24,229,168	164,578,261
Employer provided contributions	(26,825,579)	(11,843,082)	(38,668,661)
Interest credited to members' account	(125,262,877)	(28,240,007)	(153,502,884)
Lump-Sum death benefits	(2,224,865)	(1,143,011)	(3,367,876)
Retirement and survivors annuities	(709,312,628)	(105,410,633)	(814,723,261)
Administrative expenses	<u>(2,713,753)</u>	<u>(2,290,231)</u>	<u>(5,003,984)</u>
June 30, 2002 Employer Reserve Fund	<u>\$ 17,127,470,671</u>	<u>\$ 2,495,017,729</u>	<u>\$ 19,622,488,400</u>
June 30, 2002 Assets Held in Trust for Pension Benefits	<u>\$ 19,909,375,175</u>	<u>\$ 3,138,711,160</u>	<u>\$ 23,048,086,335</u>

## AVERAGE BENEFIT PAYMENTS SCHEDULE

### AVERAGE BENEFIT PAYMENTS SCHEDULE

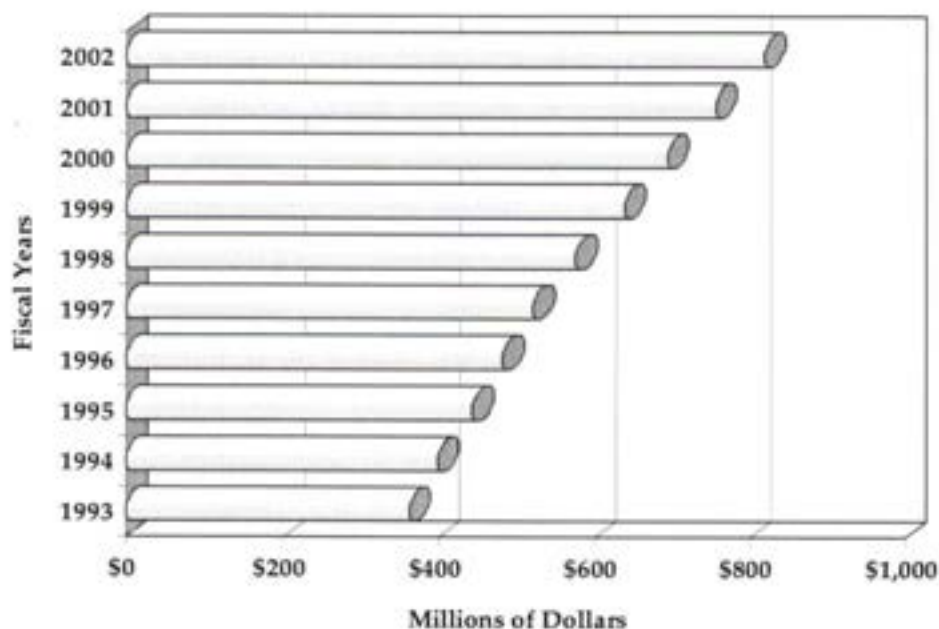
*Fiscal Year of Retirement*

	Years of Service Credit				
	10 - 14	15 - 19	20 - 24	25 - 29	30 or more
2002 Average Monthly Benefit	\$ 442	\$ 693	\$ 976	\$ 1,417	\$ 2,092
Number of Retirees	347	331	346	370	1,537
Average Final Salary	\$ 25,923	\$ 29,913	\$ 31,628	\$ 38,091	\$ 45,015
2001 Average Monthly Benefit	\$ 421	\$ 722	\$ 1,035	\$ 1,420	\$ 2,064
Number of Retirees	375	323	376	391	1,440
Average Final Salary	\$ 25,291	\$ 31,157	\$ 33,609	\$ 37,869	\$ 44,220
2000 Average Monthly Benefit	\$ 397	\$ 703	\$ 970	\$ 1,369	\$ 2,041
Number of Retirees	443	321	367	425	1,312
Average Final Salary	\$ 24,289	\$ 28,880	\$ 31,562	\$ 36,242	\$ 42,795
1999 Average Monthly Benefit	\$ 452	\$ 735	\$ 1,024	\$ 1,399	\$ 2,092
Number of Retirees	422	326	399	384	1,197
Average Final Salary	\$ 26,001	\$ 30,189	\$ 31,930	\$ 35,899	\$ 43,034
1998 Average Monthly Benefit	\$ 386	\$ 673	\$ 918	\$ 1,358	\$ 1,932
Number of Retirees	401	344	430	379	1,153
Average Final Salary	\$ 23,347	\$ 27,627	\$ 30,058	\$ 35,104	\$ 39,957
1997 Average Monthly Benefit	\$ 387	\$ 624	\$ 904	\$ 1,299	\$ 1,845
Number of Retirees	423	374	421	366	957
Average Final Salary	\$ 22,973	\$ 25,809	\$ 28,644	\$ 33,255	\$ 38,367

Note: This schedule represents the average monthly benefits under the maximum plan of members retiring with an unreduced service retirement benefit. It excludes members retiring with a reduced early retirement benefit or under disability.

### ANNUAL BENEFIT PAYMENTS

*Fiscal Years 1993-2002*



## SCHEDULES OF BENEFIT EXPENSES

## SCHEDULES OF BENEFIT EXPENSES

*Expressed in Thousands*

Year Ending	Base Annuity	Disability Annuity	Survivor Annuity	Cost of Living	Lump-Sum Death Benefits	Total Benefits	Refunds	Total
<b>SETHEPP</b>								
6/30/1997	\$ 346,192	\$ 11,578	\$ 21,829	\$ 73,751	\$ 2,395	\$ 455,745	\$ 11,444	\$ 467,189
6/30/1998	378,485	12,694	24,127	88,435	2,557	506,298	14,311	520,609
6/30/1999	414,149	13,948	25,934	99,823	2,616	556,470	13,491	569,961
6/30/2000	450,919	15,089	28,839	106,542	2,658	604,047	15,474	619,521
6/30/2001	491,204	16,094	31,224	116,892	3,720	659,134	16,484	675,618
6/30/2002	528,471	17,405	33,518	129,918	2,225	711,537	12,689	724,226
<b>PSPP</b>								
6/30/1997	\$ 49,478	\$ 1,655	\$ 3,120	\$ 10,540	\$ 801	\$ 65,594	\$ 12,389	\$ 77,983
6/30/1998	53,991	1,811	3,441	12,615	746	72,604	10,338	82,942
6/30/1999	60,182	2,027	3,769	14,506	778	81,262	12,143	93,405
6/30/2000	69,164	2,315	4,423	11,933	852	88,687	13,088	101,775
6/30/2001	75,517	2,474	4,800	13,477	982	97,250	12,034	109,284
6/30/2002	82,084	2,704	5,206	15,417	1,143	106,554	11,616	118,170

**SCHEDULES OF EXPENSES BY TYPE AND REVENUE BY SOURCE  
FOR THE YEAR ENDED JUNE 30, 2002**

**SCHEDULES OF EXPENSES BY TYPE**

*Expressed in Thousands*

Year Ending	Benefit Payments	Administrative Expenses	Refunds	Total
<b>SETHEEPP</b>				
6/30/1997	\$ 455,745	\$ 2,221	\$ 11,444	\$ 469,410
6/30/1998	506,298	2,191	14,311	522,800
6/30/1999	556,470	2,350	13,491	572,311
6/30/2000	604,047	2,363	15,474	621,884
6/30/2001	659,134	1,795	16,484	677,413
6/30/2002	711,537	2,714	12,689	726,940

**PSPP**

6/30/1997	\$ 65,594	\$ 1,636	\$ 12,389	\$ 79,619
6/30/1998	72,604	1,694	10,338	84,636
6/30/1999	81,262	1,840	12,143	95,245
6/30/2000	88,687	1,990	13,088	103,765
6/30/2001	97,250	1,683	12,034	110,967
6/30/2002	106,554	2,290	11,616	120,460

**SCHEDULES OF REVENUE BY SOURCE**

*Expressed in Thousands*

Year Ending	Member Contributions	Employer Contributions		Investment Income (Loss)	Total
		Dollars	% of Annual Covered Payroll		
<b>SETHEEPP</b>					
6/30/1997	\$ 110,697	\$ 278,417	7.31%	\$ 2,203,247	\$ 2,592,361
6/30/1998	116,196	166,756	4.19%	2,410,112	2,693,064
6/30/1999	122,565	244,453	5.88%	1,685,780	2,052,798
6/30/2000	129,925	252,162	5.93%	1,533,113	1,915,200
6/30/2001	135,154	232,149	5.20%	(283,926)	83,377
6/30/2002	142,126	243,498	5.19%	(327,286)	58,338

**PSPP**

6/30/1997	\$ 32,959	\$ 59,167	5.16%	\$ 311,706	\$ 403,832
6/30/1998	39,086	65,276	5.28%	348,156	452,518
6/30/1999	38,618	69,230	5.15%	246,936	354,784
6/30/2000	39,906	82,749	5.69%	227,961	350,616
6/30/2001	45,433	103,681	6.65%	(43,585)	105,529
6/30/2002	47,139	103,374	6.15%	(51,570)	98,943



**INTRODUCTION TO POLITICAL SUBDIVISION PARTICIPATION**

**PARTICIPANTS**

TCRS has established pension plans for four groups of public employees: state employees, higher education employees, teachers and the employees of governmental entities (political subdivisions). Employees of political subdivisions may participate in TCRS if the entity's governing body authorizes participation and accepts all liability associated with coverage for their employees.

Participation is subject to the approval of the Board of Trustees. As of June 30, 2002, 407 political subdivisions were participating in TCRS.

Participation as of June 30, 2002:

Cities	158
Counties	87
Utility Districts	40
Special School Districts	22
Joint Ventures	24
Development Agencies	13
Housing Authorities	10
911 Emergency Communication Districts	30
Miscellaneous Authorities	23
Total	407

**ADMINISTRATION**

TCRS administers the pension plan for political subdivisions in accordance with state statute. Each employer is responsible for the pension cost for its employees. The cost is not shared with other political subdivisions nor with the state. A separate fund balance is maintained by the retirement system for each participating political subdivision and employer contribution rates are determined individually.

**APPLICATION**

To apply for TCRS participation, the chief governing body of the political subdivision must first pass a resolution authorizing an actuarial study to estimate the potential cost of participation. Once the governing body has had an opportunity to review the estimated pension cost and liability, a second resolution must then be passed in order to authorize TCRS participation. Political subdivisions electing TCRS coverage accept the liability for pension benefits to be accrued by their employees.

**COVERAGE**

A political subdivision is required to offer coverage under the same terms and conditions to all the employees of each of its departments and agencies.

Political subdivisions have the option of purchasing, or allowing their employees to purchase, retirement credit for service rendered prior to the employer's date of participation. The amount of prior service allowed may be limited.

Political subdivisions opting to join TCRS do so under the plan provisions that exist at the time of their participation. Subsequent legislative changes, however, are optional if they result in increased cost to the political subdivision. These optional improvements may be adopted by resolutions approved by the chief governing body.

**THE TCRS PROVIDES  
THE ADMINISTRATION  
OF A RETIREMENT  
PROGRAM FOR 407  
LOCAL GOVERNMENTS.**

**OPTIONAL PROVISIONS FOR POLITICAL SUBDIVISIONS**

**MEMBERSHIP**

- ❖ Optional membership for part-time employees
- ❖ Probationary period of up to six months during which the employees are not eligible for membership in TCRS and no contributions to TCRS are required of either the employees or the employer
- ❖ Reduce vesting requirement to qualify for retirement benefits from 10 years to five years

**CONTRIBUTIONS**

- ❖ Employee contributions at a level five percent both below and above the social security wage base
- ❖ Exclusion of employee contributions from taxable income under 414(h) provisions of the Internal Revenue Code
- ❖ Noncontributory retirement plan
- ❖ Extension of 3.6 percent indexing feature for non-contributory members' salaries used in calculating the average final compensation component of a benefit calculation

**CREDITABLE SERVICE**

- ❖ Credit for service credit lost as a result of advanced age
- ❖ Service credit for unused sick leave
- ❖ Service credit for military service during periods of armed conflict at no cost to the employee
- ❖ Service credit for periods of temporary disability during which the employee was receiving workers' compensation payments based on covered employment
- ❖ Service credit purchase for peacetime military service between October 15, 1940 and May 7, 1975
- ❖ Purchase of service credit for probation period

**SURVIVOR BENEFITS**

- ❖ 100 percent joint and survivor spouse death benefit for members with 10 years of service
- ❖ Provide inactive members with certain death and disability benefits

**RETIREMENT BENEFITS**

- ❖ Provide current retirees and members a five percent increase in base retirement benefit
- ❖ The actuarial equivalent of an age 65 benefit for employees retiring after age 65
- ❖ 25-year retirement with actuarially reduced benefits
- ❖ Minimum benefit level increase to \$8 per year of service
- ❖ Mandatory retirement with supplemental bridge benefit for public safety officers.

**RETIRED MEMBERS**

- ❖ Exclusion of cost-of-living benefit increases at the date of participation for all employees or at a later date for new employees
- ❖ Inclusion of compounded cost-of-living adjustment (COLA) to current and future retirees of employers now providing a simple COLA or employers who previously elected not to provide a COLA.

**MISCELLANEOUS**

- ❖ A participating entity may voluntarily withdraw from TCRS by submitting written notice one year in advance. At the time of withdrawal, TCRS membership ceases to be open to new employees. The political subdivision's retirement responsibility to current TCRS members remains, however, contribution obligations and benefit and service credit accruals continue.

**POLITICAL SUBDIVISION PARTICIPANTS**

**911 EMERGENCY COMMUNICATION DISTRICTS**

Campbell County	Gibson County	Hawkins County	McNairy Co.	Rutherford Co.	Warren County
Carroll County	Greene County	Lauderdale Co.	Montgomery Co.	Sevier County	Washington Co.
Carter County	Hamilton County	Lawrence County	Overton County	Shelby County	Weakley County
Cheatham Co.	Hamblen County	Madison County	Roane County	Sullivan County	White County
Claiborne County	Hardeman Co.	Monroe County	Robertson Co.	Tipton County	Wilson County

**CITIES**

Adams	Clifton	Forest Hills	Lafayette	Moscow	Savannah
Alamo	Clinton	Friendship	Lafollette	Mt. Carmel	Selmer
Alcoa	Collegedale	Friendsville	Lake City	Mountain City	Sevierville
Ashland City	Collierville	Gainesboro	Lakewood	Mt. Juliet	Signal Mountain
Athens*	Collinwood	Gatlinburg	Lawrenceburg	Munford	Soddy Daisy
Atoka	Cookeville	Gleason	Lebanon	Murfreesboro*	Somerville
Atwood	Cornersville	Goodlettsville	Lenoir City*	New Johnsonville	South Carthage
Belle Meade	Covington*	Gordonsville	Linden	New Tazewell	Sparta
Bells	Cowan	Greenbrier	Livingston	Newport	Spencer
Benton	Crossville	Greeneville	Lobelville	Nolensville	Spring Hill
Big Sandy	Dandridge	Greenfield	Lookout Mountain	Norris	Spring City
Bluff City	Dayton	Harriman	Loretto	Oak Ridge	Springfield
Bolivar	Decaturville	Hartsville	Loudon	Oakland	Sweetwater
Brentwood	Dickson	Henderson	Luttrell	Obion	Tazewell
Bristol	Dover	Hendersonville	Madisonville	Oliver Springs	Tellico Plains
Brownsville	Dunlap	Hohenwald	Martin	Paris	Trenton
Byrdstown	Dyer	Humboldt	Maryville	Parsons	Tusculum
Camden	East Ridge	Jacksboro	Maury City	Pikeville	Unicoi
Carthage	Elizabethton	Jackson	Maynardville	Pittman Center	Union City
Caryville	Elkton	Jamestown	McEwen	Pleasant View	Waynesboro
Centerville	Erin	Jefferson City	McMinnville	Portland	Waverly
Charleston	Erwin	Johnson City	Middleton	Puryear	Westmoreland
Chattanooga*	Estill Springs	Jonesboro	Milan	Red Bank	White House
Church Hill	Etowah	Kenton	Millersville	Ripley	White Pine
Clarksville	Fairview	Kingsport	Millington	Rockwood	Whiteville
Cleveland	Fayetteville	Kingston Springs	Morristown	Rogersville*	Whitwell
				Rutledge	Woodbury

**COUNTIES**

Anderson	Coffee	Hamilton	Lincoln	Perry	Tipton
Bedford	Crockett	Hardeman	Loudon	Pickett	Trousdale
Benton	Cumberland	Hardin	Madison	Polk	Unicoi
Bledsoe	Decatur	Hawkins	Macon	Putnam	Union
Blount	DeKalb	Haywood	Marion	Rhea	Van Buren
Bradley	Dickson	Henry	Marshall	Roane	Warren
Campbell	Fayette	Hickman	Maury	Robertson	Washington
Cannon	Fentress	Humphreys	McMinn	Rutherford	Wayne
Carroll	Franklin	Jackson	McNairy	Scott	Weakley
Carter	Gibson	Jefferson	Monroe	Squatchie	White
Cheatham	Giles	Johnson	Montgomery	Sevier	Williamson
Chester	Grainger	Lake	Moore*	Shelby*	Wilson
Claiborne	Greene	Lauderdale	Morgan	Smith	
Clay	Grundy	Lawrence	Obion	Sullivan	
Cocke	Hamblen	Lewis*	Overton	Sumner	

**HOUSING AUTHORITIES**

Bristol	Cookeville	Hohenwald	Memphis	Rogersville
Clinton	Hartsville	Lawrenceburg	Morristown	Sweetwater

\* All departments not covered by TCRS.

(continued)

**POLITICAL SUBDIVISION PARTICIPANTS  
(CONTINUED)**

**DEVELOPMENT AGENCIES**

Beech River Watershed  
Bristol/Kingsport/Sullivan Co.  
Industrial Commission Dist.  
Delta Human Resource Agency  
First Tenn. Dev. District

First Tenn. Human Resource Agency  
Greater Nashville Regional Council  
Hamilton Co. Community Srv. Agency  
Sequatchie Valley Plan. & Dev. Dist.  
Southeast Tenn. Dev. District

Southeast Tenn. Human Res. Agency  
Southwest Tenn. Dev. District  
Southwest Tenn. Human Res. Agency  
Upper East Tenn. Human Dev. Agency

**JOINT VENTURES**

Argie Cooper Public Library  
Bradley-Cleveland Civil Defense  
Bradley-Cleveland Community  
Services Agency  
Clarksville Memorial Hospital  
Clarksville/Montgomery County  
Public Library  
Clarksville/Montgomery County  
Regional Planning Commission  
Cleveland/Bradley Communications  
Center Committee

Edward Gauche Fisher Public Library  
Fayetteville/Lincoln Co. Public  
Library  
Gorham/MacBane Public Library  
Jackson/Madison County Library  
Johnson City/Washington Co. EMS  
Kinser Park  
Lawrence Co. Library  
Lebanon/Wilson Co. Civil Defense  
Linebaugh Public Library  
Morristown/Hamblen Co. Landfill

Sevier Solid Waste  
Smyrna/Rutherford Co. Airport  
Authority  
Tellico Area Services System  
Tri-City Airport Commission  
Tri-County Vocational School  
W. G. Rhea Public Library  
Washington County/Johnson City  
Animal Control Center

**MISCELLANEOUS**

Blount County Fire Protection Dist.  
Cookeville Reg. Medical Center Auth.  
County Officials Assoc. of Tenn.  
Tenn. Assoc. of Assessing Officers  
Tenn. Assoc. of County Executives  
Tenn. Assoc. of Secondary School  
Principals  
Tenn. Athletic Coaches Assoc.

Tenn. Co. Commissioners Assoc.  
Tenn. Co. Highway Officials Assoc.  
Tenn. County Services Assoc.  
Tenn. Education Assoc.  
Tenn. Historical Society  
Tenn. Municipal Bond Fund  
Tenn. Municipal League  
Tenn. Mun. League Risk Mgt. Pool

Tenn. Org. of School Superintendents  
Tenn. Reg. Comm. Health Agencies  
Tenn. School Board Assoc.  
Tenn. Secondary Sch. Athletic Assoc.  
Tenn. Sheriffs Assoc.  
Tenn. State Employees Assoc.  
Tenn. Veterans Home Board  
Volunteer General Hospital

**SPECIAL SCHOOL DISTRICTS**

Bradford  
Clinch Powell Education Coop.  
Crockett Mills  
Elizabethton Board of Education  
Franklin  
Gadsden  
Gibson County Schools District  
Hollow Rock-Bruceton

Huntingdon  
Lebanon  
Little Tenn. Valley Education Coop.  
McKenzie  
Memphis  
Milan  
Oak Ridge Board of Education  
Oneida

Paris  
South Carroll Special School District  
Trenton  
Union City Board of Education  
West Carroll County  
Watauga

**UTILITY DISTRICTS**

Alpha-Talbott  
Arthur Shawnee  
Bloomingdale  
Bristol Electric System  
County Wide  
Dyersburg Suburban  
East Side  
Fall Creek Falls  
First Carter County  
First Tipton County  
First Hawkins County  
Gladeville  
Glen Hills  
Greeneville Light & Power

Hampton  
Hardeman-Fayette County  
Hendersonville  
Hixson  
Jackson County  
Johnson City Power Bd.  
Lake County  
Lincoln Co. Board of Public Utilities  
Middle Tennessee  
North Utility District of Decatur and  
Benton Counties  
Northeast Henry County  
Oak Ridge  
Old Hickory

Poplar Grove  
Riceville  
Savannah Valley  
Sevier County  
Sylvia-Tennessee City Pond Water  
Sneedville  
Soddy Daisy-Falling Water  
Smith  
South Elizabethton  
Washington County  
Weakley Co. Municipal Electric  
West Knox  
Wolf Branch

\* All departments not covered by TCRS.

Tennessee Consolidated Retirement System  
10th Floor Andrew Jackson State Office Building  
Nashville, TN 37243