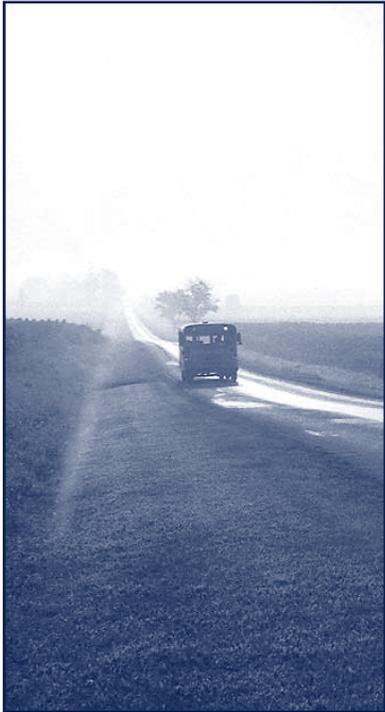


Annual Financial Report Summary

for the fiscal year ended June 30, 2001



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



Retirement Security for Illinois Educators

Retirement Security for Illinois Educators



Powerful thoughts are best expressed in simple, direct statements. This year's report summary begins with our recently adopted statement of purpose. We think these five words say a great deal about our purpose and what we should hold as our utmost priority in all that we do on behalf of members and employers. It will guide our thinking and it will focus our efforts as we actively seek to improve every aspect of TRS operations.

Improving Technology to Improve Service

Within the next several months, we will complete a massive re-engineering of our computer technology for the principal purpose of improving services and enhancing our efficiency. The project culminates years of self-study and systems development that called on staff to challenge existing processes and to implement the best practices available in the pension industry.

Investment Program

An extraordinary downturn in the capital markets resulted in the first instance of negative investment returns since 1984. The overall return on investments was (4.2) percent. Even though TRS outperformed our sister state-funded systems, the loss is a significant setback that has eroded much of the progress made in our funded status during the past several years. Our funded ratio dropped from 68.2 percent to 59.5 percent in just one year. While short-term results proved disappointing, the average annualized five- and ten-year returns were 10.1 percent and 10.6 percent, respectively.

We will redouble our efforts to outperform the capital markets and to select investment strategies that maximize returns consistent with an acceptable risk profile.

Legislation

For annuitants and many active teachers, resolution of the retired teacher health insurance crisis remained the most significant issue facing TRS during 2001. Subsequent to fiscal year end, the General Assembly, meeting during the fall session, enacted measures that will enable the program to continue for the next few years. TRS will work with the legislature, the Governor, and each element of the educational community to reach a permanent solution.

The General Assembly approved several items of interest to TRS annuitants, members, and employers.

The statutory re-employment limitation was increased to 120 days/600 hours for the next five school years. The change responds to increasing concerns about the shortage of qualified teachers and administrators by facilitating job-sharing or flextime employment of retired teachers.

Approximately 200 individuals who had more than 34 years of creditable service and who retired under the 2.2 formula between May 27, 1998 and June 5, 1999 received partial refunds of 2.2 upgrade charges so that their cost will be the same as persons who retired after June 5, 1999.

TRS members who are employed within security facilities of the Department of Human Services were permitted to transfer their retirement coverage to the State Employees' Retirement System.

Like their counterparts at all other major retirement systems in Illinois, newly hired TRS employees will now be members of TRS, the system they help administer.

Serving Illinois Educators and Schools

Each time an active member, an annuitant, or an employer contacts TRS, it is indeed our privilege to be of service. Among our primary goals, none is more important than providing consistently superior service to all of our constituencies. We are committed to a determined and visible program of continuous improvement in our services. As an organization, we will critique ourselves, seeking to meet or exceed the expectations of our constituencies in all areas of our operation. We will also focus on the personal contact that has been the hallmark of our services to participants and employers.

For the second straight year, a study by Cost Effectiveness Measurement, Inc. (CEM) credited TRS with providing excellent services at a relatively low cost. Apart from the favorable evaluation, the report provides a wealth of information and resources for use in further improving our services. It is a task that we welcome.

Special Recognition

Kim Pollitt served as acting executive director from March 2001 through August, while concurrently performing the duties of acting chief investment officer. Both of these positions required many extra hours, loss of family time, and a tremendous commitment of intellectual energy. On behalf of the staff and our constituencies, our deepest appreciation to Kim.

Scott Eshelman retired following a 29-year career with the Elgin U-46 Schools and concluded his service as a member of the TRS Board of Trustees this summer. Scott's tenure was characterized by his dedication and determination to improve retirement security for Illinois educators. We thank him for his service and extend our best wishes for a long and enjoyable retirement.



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Financial Statements

Statement of Plan Net Assets as of June 30, 2001, and 2000

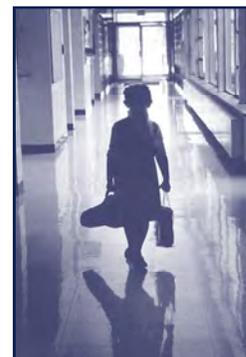
	2001	2000
ASSETS		
Cash	\$7,889,353	\$3,213,679
Receivables and prepaid expenses		
Member payroll deduction	160,440,980	213,579,965
Member contributions	31,052,076	31,263,832
Employer Early Retirement Incentive	0	679,813
Employer contributions	7,379,527	9,203,574
State of Illinois	0	412,206
Investment income	202,756,810	232,706,956
Prepaid expenses	968,066	368,526
Total receivables and prepaid expenses	<u>402,597,459</u>	<u>488,214,872</u>
Investments, at fair value		
Fixed income	8,817,862,697	8,845,767,666
Equities	11,015,551,513	11,543,579,021
Real estate	2,424,554,513	2,428,110,937
Short-term investments	1,036,104,680	1,089,576,833
Private equity investments	689,740,876	877,028,687
Foreign currency	26,752,464	39,495,154
Total investments	<u>24,010,566,743</u>	<u>24,823,558,298</u>
Collateral from securities lending	<u>2,288,995,477</u>	<u>1,952,295,799</u>
Property and equipment, at cost, net of accumulated depreciation of \$5,780,569 and \$5,763,526 in 2001 and 2000, respectively	<u>3,658,427</u>	<u>3,420,592</u>
Total assets	<u>26,713,707,459</u>	<u>27,270,703,240</u>
LIABILITIES		
Benefits and refunds payable	5,694,934	6,179,594
Administrative and investment expenses payable	71,323,165	69,959,589
Payable to brokers for unsettled trades, net	1,032,047,800	760,855,651
Securities lending transactions	<u>2,288,995,477</u>	<u>1,952,295,799</u>
Total liabilities	<u>3,398,061,376</u>	<u>2,789,290,633</u>
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS	<u>\$23,315,646,083</u>	<u>\$24,481,412,607</u>



Financial Statements

Statement of Changes in Plan Net Assets Years Ended June 30, 2001, and 2000

	2001	2000
ADDITIONS		
Contributions		
Members	\$643,563,304	\$619,622,840
State of Illinois	724,007,792	639,298,949
Employers		
Early retirement	38,632,385	36,751,052
Federal funds	23,175,955	21,425,188
2.2 benefit formula	35,809,273	33,122,050
Total contributions	1,465,188,709	1,350,220,079
Investment income		
Net appreciation (depreciation) in fair value	(1,860,498,992)	1,451,074,361
Interest	565,646,688	559,584,336
Real estate operating income, net	190,286,928	243,815,891
Dividends	137,819,508	109,959,618
Private equity income	18,741,785	29,631,911
Securities lending income	145,941,616	106,909,999
Other investment income	3,193,440	2,183,038
	(798,869,027)	2,503,159,154
Less investment expense		
Securities lending expense	133,283,965	97,475,237
Investment activity expenses	83,102,245	69,466,794
	(1,015,255,237)	2,336,217,123
Total additions	449,933,472	3,686,437,202
DEDUCTIONS		
Retirement benefits	1,475,489,564	1,317,841,317
Survivor benefits	74,630,874	68,797,583
Disability benefits	16,672,793	15,607,144
Refunds	35,849,079	28,797,054
Administrative expenses	12,640,595	11,680,647
Prior service credits and transfers	417,091	9,849
Total deductions	1,615,699,996	1,442,733,594
NET INCREASE (DECREASE)	(1,165,766,524)	2,243,703,608
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS		
Beginning of year	24,481,412,607	22,237,708,999
End of year	\$23,315,646,083	\$24,481,412,607



Investments

TRS Fund Posts Investment Loss; Long-term Returns Exceed 10 Percent

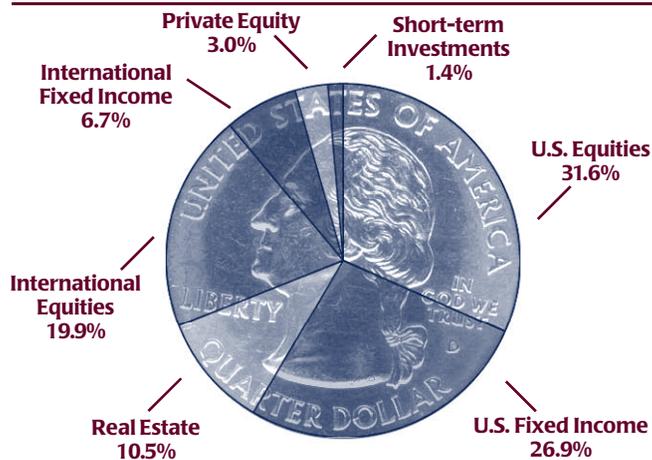


World financial markets proved quite challenging over the course of fiscal year 2001. Equity markets declined sharply, both in the United States and abroad. The TRS investment portfolio declined by 4.2 percent, net of fees, the first decline experienced since 1984.

Fortunately, the impact of the equity market declines on the TRS portfolio was muted by several factors, the most significant of which is diversification — the investment of assets in a variety of different asset categories.

Domestic fixed income and real estate asset classes helped to offset the unfavorable performance in the equity markets, returning 11.3 percent and 9.8 percent, respectively. Shown below is a pie chart that illustrates the diversification of the TRS investment portfolio.

Investment Portfolio



While the recent declines in world markets are disappointing, the long-term time horizon of the pension fund calls for a long-term investment focus. The five-year and ten-year returns portfolio remain strong and compare favorably to both the actuarial return assumption and the real rate of return expectation.

Performance Summary (net of fees)

Asset Class/Index	2001	3 Years	5 Years	10 Years
TRS Total Fund	(4.2)%	5.5%	10.1%	10.6%
TRS Weighted Policy Index	(6.8)	4.5	9.2	10.7
CPI (Inflation)	3.2	3.0	2.6	2.7
TRS Equity - U.S.	(12.0)	3.1	12.2	13.4
Russell 3000 Index	(13.9)	4.2	13.8	15.0
TRS Fixed Income - U.S.	11.3	6.5	8.5	8.4
SSB BIG Index	11.3	6.2	7.5	7.9
TRS Fixed Income - Intl.	(7.7)	(1.5)	0.5	6.2
SSBNUSWGB Index	(7.5)	(0.2)	0.5	6.6
TRS Equity - Intl.	(19.5)	1.5	5.2	6.5
MSCI ACWI Ex. - U.S. Free Index	(23.8)	(0.5)	2.7	6.5
TRS Real Estate Property	9.8	10.7	11.8	8.5
NCREIF Property Index	11.2	11.9	12.7	7.2
TRS Private Equity	(5.4)	40.2	36.3	30.2
Russell 3000 Index + 3.0%	(11.3)	7.4	17.2	18.4

Rates of return are provided by The Northern Trust Company in accordance with AIMR Performance Presentation Standards.

The TRS trust fund is invested by authority of the Illinois General Assembly under the “prudent person rule,” requiring investments to be managed solely in the interest of fund participants and beneficiaries.

Growth of \$10,000



Actuarial and Statistical Data

TRS Funded Status Declines



Actuarial results for FY2001 showed a sharp decline due to the market loss on investments and continued growth in the number of teachers covered by TRS. Over the past 10 years, the number of active full-time and regular part-time teachers has increased from 105,000 to over 126,000.

What Does This Mean?

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

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

The table below summarizes the actuarial liability, assets and the funded ratio.

Actuarial Valuation with Market Value Assets (\$ thousands)

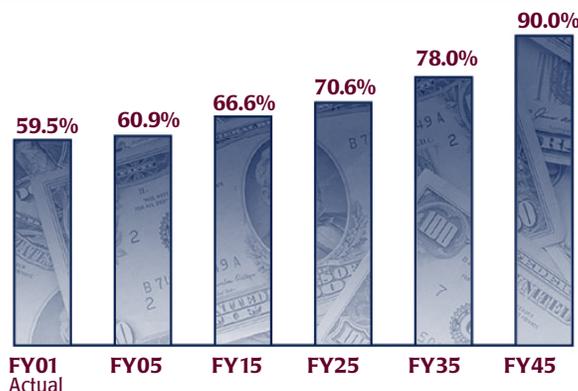
	<u>Years Ended June 30</u>	
	2001	2000
Total actuarial accrued liability	\$39,166,697	\$35,886,404
Less actuarial value of assets (net assets at market value)	\$23,315,646	\$24,481,413
Unfunded liability	\$15,851,051	\$11,404,991
Funded ratio	59.5%	68.2%

State Maintains Commitment to TRS Funding

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

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

TRS Projected Funded Ratio



Benefit Recipient and Member Count Continues to Increase

Benefit Recipients

	2001	2000
Retirees	56,549	54,040
Disabled recipients	1,045	1,021
Survivors	7,283	7,061
Total	64,877	62,122

Active Members

	2001	2000
Total Full and Part-time Members	126,335	121,459
Total Substitutes	24,448	23,516
Total	150,783	144,975

Fiscal Year Highlights

	2001	2000
Active contributing members	150,783	144,975
Inactive noncontributing members	69,512	66,025
Benefit recipients	64,877	62,122
Total membership	<u>285,172</u>	<u>273,122</u>
Actuarial accrued liability (AAL)	\$39,166,697,000	\$35,886,404,000
Less net assets held in trust for pension benefits	<u>\$23,315,646,000</u>	<u>\$24,481,413,000</u>
Unfunded actuarial accrued liability (UAAL)	\$15,851,051,000	\$11,404,991,000
Funded ratio (actuarial value of assets/AAL)	59.5%	68.2%
Total fund investment return (net of fees)	(4.2%)	10.6%
Benefits and refunds paid		
Benefits paid	\$1,566,793,231	\$1,402,246,044
Refunds paid	<u>\$35,849,079</u>	<u>\$28,797,054</u>
Total	\$1,602,642,310	\$1,431,043,098
Income		
Member contributions*	\$643,563,304	\$619,622,840
Employer contributions (includes State of Illinois contributions)	\$821,625,405	\$730,597,239
Net investment income (loss)	<u>\$(1,015,255,237)</u>	<u>\$2,336,217,123</u>
Total	<u>\$449,933,472</u>	<u>\$3,686,437,202</u>



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

This publication is a summary of the *Comprehensive Annual Financial Report* for the fiscal year ended June 30, 2001. Copies of the *Comprehensive Annual Financial Report*, which has more detailed information, are available at our Web site, www.trs.state.il.us, or by calling 800-877-7896.