

TEACHERS' RETIREMENT SYSTEM OF THE STATE OF ILLINOIS



Retirement Security for Illinois Educators

*The future is purchased
by the present.*

- Samuel Johnson



BUILDING THE FUTURE



ANNUAL FINANCIAL REPORT SUMMARY
FOR THE FISCAL YEAR ENDED JUNE 30, 2002

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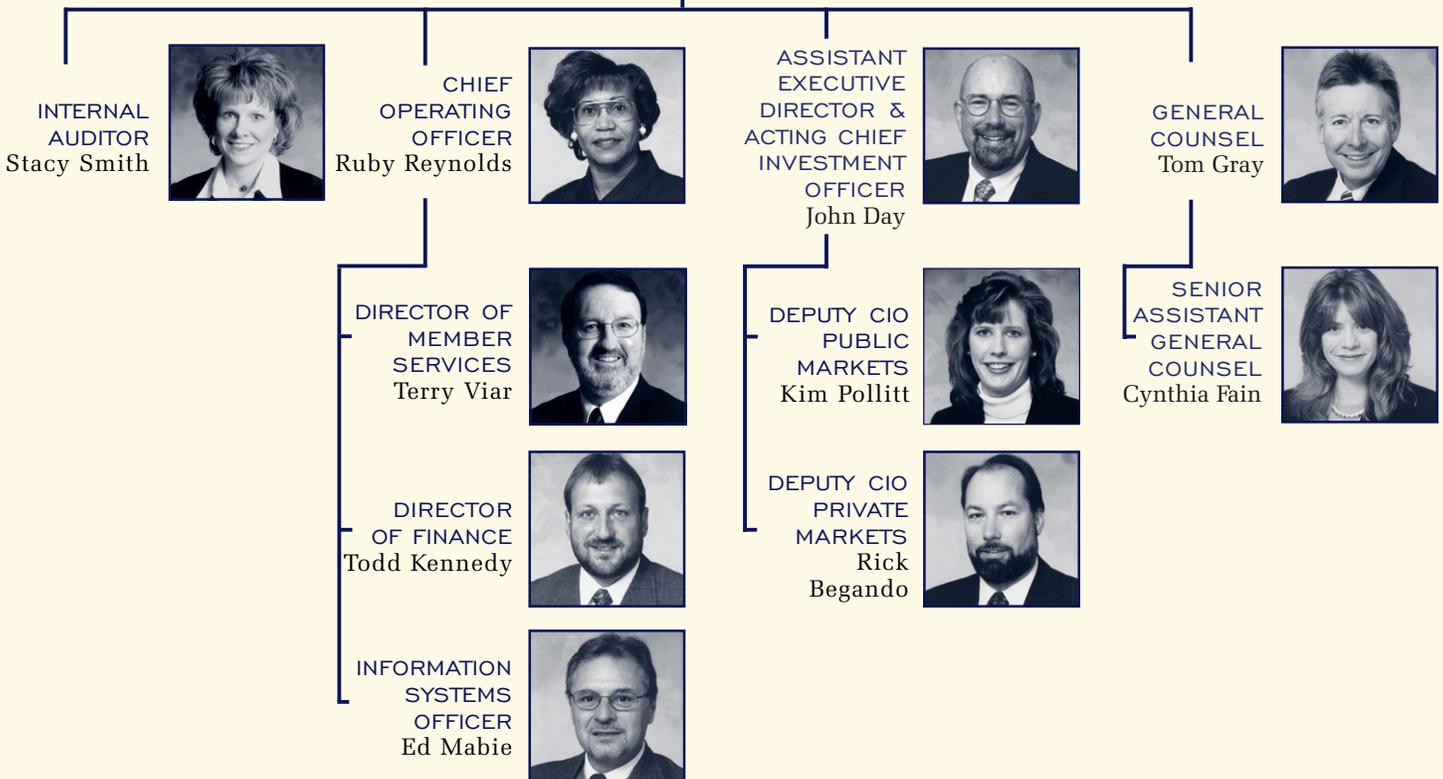


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BOARD OF TRUSTEES



EXECUTIVE DIRECTOR
Jon Bauman



A MESSAGE FROM THE EXECUTIVE DIRECTOR

Educators invest their lives in the future, seeing the next generation of workers, leaders, parents, and our country in the faces of the young people they mentor daily. In this annual report, *Building the Future*, we salute the spirit that builds the future today. Our inspiration comes from the remarkable upsurge in new and renovated schools throughout Illinois. Our *Comprehensive Annual Financial Report*, available upon request, features photographs of remodeled and newly constructed schools throughout Illinois. The bricks and mortar, steel, stone, and glass are tangible evidence of the value Illinoisans place on education. As you read this report, be heartened that our communities highly value education and are willing to sacrifice today for the good things that will occur in these buildings for years to come.

A DIFFICULT PERIOD

The path to excellence is seldom without difficulty. Your retirement fund recorded a loss on investment activity for a second consecutive year, the first such occurrence since the legislature granted prudent person investment authority to the fund in the early 1980s. Our total return after investment expenses was -3.2 percent.

Even in the face of an adverse economy, our commitment to excellence shows. In fiscal year 2002, TRS ranked near the top, with a total return that exceeded the returns of over 80 percent of public retirement funds with assets over \$1 billion. This is the best relative return ever reported in TRS history. Over the long term, our performance remains solidly over our actuarial assumption, with a 10-year return of 9.1 percent. Our hard work will doubtless pay future dividends as markets return to more normal patterns.

SEEKING THE BEST

Since being appointed director, I have made a conscious decision to seek to be the best in all that we do.

Building the best team means seeking and retaining qualified individuals who have a heart for the membership of our system. We have earned your trust by our high levels of personal, professional, and caring service. It is essential that we retain our caring character as we build retirement security and continuously improve to meet your expectations.

The TRS commitment to excellence extends to the professional investment management firms we select and retain. During the past year, we completed evaluations of all managers and took appropriate action to retain only the best. I am pleased to note that 17, or nearly one-third of our investment management firms, are based in Illinois.

A RECORD OF SUCCESS

Every section of our organization contributed to a successful year. Here are some highlights:

MEMBER SERVICES

Our Member Services Department paid over \$1.7 billion to nearly 68,000 annuitants and beneficiaries during the past year. Teacher retirements continued to grow, with a total of 4,200 retirements in FY02. Both active and retired teachers were served through an enhanced program of meetings and teleconferences held throughout the state. Our toll free telephone service remains popular with over 200,000 calls last year.

MAJOR INITIATIVES

At the outset of my administration, I made a commitment to complete several key initiatives. We began training our staff in September on the use of our new information system, TRS STAR (Serving Teachers and Retirees). Beginning with its very name, STAR exemplifies our commitment to service.

TRS worked collaboratively with state government leaders, organizations representing active and retired teachers, and the school management community to achieve an interim solution to the funding crisis facing the TRIP retiree health insurance program. In the coming year, we will do our best working with these partners to achieve a viable health insurance program for retired teachers.

COMMUNICATIONS

I made a significant commitment to improve communication with our members, retirees, and constituent groups. Our core publications have been redesigned and improved. The TRS Web site has been completely redesigned and is now accessible to the disabled.

IN CLOSING

This initial year of service as your executive director has included remarkable challenges, successes, and opportunities for improvement. I have enjoyed the opportunity to meet and to hear from many TRS members and annuitants in my first year. As we go forward, I thank you for your support and trust. I pledge my best to you in the years ahead.



Jon Bauman
Executive Director

BASIC FINANCIAL STATEMENTS

TEACHERS' RETIREMENT SYSTEM OF THE STATE OF ILLINOIS
STATEMENT OF PLAN NET ASSETS AS OF
JUNE 30, 2002, AND 2001

	2002	2001
Assets		
Cash	\$6,039,088	\$7,889,353
Receivables and prepaid expenses		
Member payroll deduction	111,106,770	160,440,980
Member contributions	38,806,046	31,052,076
Employer contributions	8,811,602	7,379,527
State of Illinois	651,505	0
Investment income	233,414,394	202,756,810
Prepaid expenses	410,160	968,066
Total receivables and prepaid expenses	<u>393,200,477</u>	<u>402,597,459</u>
Investments, at fair value		
Fixed income	8,795,239,241	8,817,862,697
Equities	10,126,648,199	11,015,551,513
Real estate	2,202,925,998	2,424,554,513
Short-term investments	1,201,995,818	1,036,104,680
Private equity investments	594,153,359	689,740,876
Foreign currency	23,955,458	26,752,464
Total investments	<u>22,944,918,073</u>	<u>24,010,566,743</u>
Collateral from securities lending	1,897,635,461	2,288,995,477
Property and equipment, at cost, net of accumulated depreciation of \$6,216,008 and \$5,780,569 in 2002 and 2001, respectively	3,113,533	3,658,427
Total assets	<u>25,244,906,632</u>	<u>26,713,707,459</u>
Liabilities		
Benefits and refunds payable	7,204,169	5,694,934
Administrative and investment expenses payable	81,017,997	71,323,165
Payable to brokers for unsettled trades, net	892,764,293	1,032,047,800
Securities lending transactions	1,897,635,461	2,288,995,477
Total liabilities	<u>2,878,621,920</u>	<u>3,398,061,376</u>
Net assets held in trust for pension benefits	<u>\$22,366,284,712</u>	<u>\$23,315,646,083</u>



*The future belongs to
those who believe in
the beauty of their
dreams.*

- Eleanor Roosevelt

TEACHERS' RETIREMENT SYSTEM OF THE STATE OF ILLINOIS
 STATEMENT OF CHANGES IN PLAN NET ASSETS
 YEARS ENDED JUNE 30, 2002, AND 2001

	2002	2001
Additions		
Contributions		
Members	\$681,151,770	\$643,563,304
State of Illinois	814,739,766	724,007,792
Employers		
Early retirement	41,347,938	38,632,385
Federal funds	26,282,792	23,175,955
2.2 benefit formula	24,987,416	35,809,273
Total contributions	<u>1,588,509,682</u>	<u>1,465,188,709</u>
Investment income		
Net depreciation in fair value	(1,461,163,444)	(1,860,498,992)
Interest	463,758,715	565,646,688
Real estate operating income, net	174,430,870	190,286,928
Dividends	132,356,304	137,819,508
Private equity income	28,036,960	18,741,785
Securities lending income	56,498,682	145,941,616
Other investment income	13,640,070	3,193,440
	<u>(592,441,843)</u>	<u>(798,869,027)</u>
Less investment expense		
Securities lending expense	45,237,012	133,283,965
Investment activity expenses	86,308,190	83,102,245
Net investment loss	<u>(723,987,045)</u>	<u>(1,015,255,237)</u>
Total additions	<u>864,522,637</u>	<u>449,933,472</u>
Deductions		
Retirement benefits	1,660,997,776	1,475,489,564
Survivor benefits	80,461,343	74,630,874
Disability benefits	18,289,549	16,672,793
Refunds	38,755,604	35,849,079
Administrative expenses	13,487,393	12,640,595
Prior service credits and transfers	1,892,343	417,091
Total deductions	<u>1,813,884,008</u>	<u>1,615,699,996</u>
Net decrease	<u>(949,361,371)</u>	<u>(1,165,766,524)</u>
Net assets held in trust for pension benefits		
Beginning of year	23,315,646,083	24,481,412,607
End of year	<u><u>\$22,366,284,712</u></u>	<u><u>\$23,315,646,083</u></u>

*They build too
 low who build
 beneath the
 skies.*

- Edward Young



INVESTMENTS

World financial markets again experienced a tumultuous year in fiscal year 2002. U.S. and international fixed income markets provided a safe haven for investors while equity markets declined significantly. The TRS investment portfolio declined by 3.2 percent, net of fees. When compared to its peers, however, the TRS investment portfolio performed quite well, surpassing the returns of over 80 percent of public retirement funds with assets over \$1 billion. This strong relative performance is due, in large part, to TRS's solid, conservative investment approach and broad diversification.

The portfolio is fully diversified across different asset classes. The fixed income and real estate asset classes helped to offset the unfavorable performance

in the equity markets. Within each asset class there are a number of investment managers to ensure the appropriate diversity across the various investment styles, allowing the portfolio to achieve broad exposure to the market while minimizing risk. This broad diversification serves as the best defense against the uncertainty of volatile world markets.

The TRS trust fund is invested by authority of the Illinois General Assembly under the "prudent person rule," requiring investments to be managed solely in the interest of fund participants and beneficiaries. As of June 30, 2002, TRS's total investments, including accrued investment income, at market value totaled \$23,178,332,467.

PERFORMANCE SUMMARY (NET OF FEES)

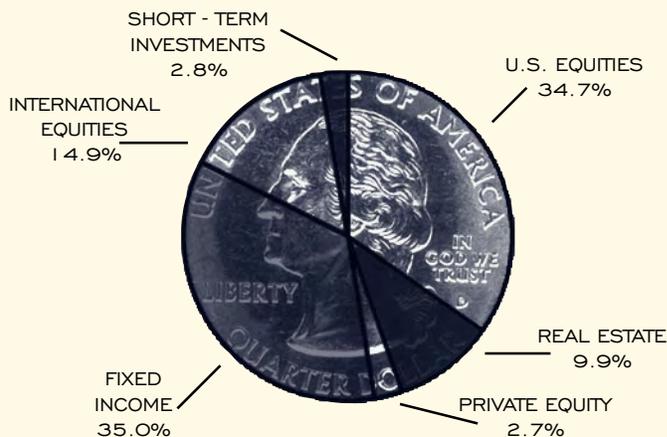
Asset Class/Index	2002	3 Years	5 Years	10 Years
TRS Total Fund	(3.2%)	0.9%	5.8%	9.1%
TRS Weighted Policy Index	(4.2)	(0.6)	4.6	9.0
CPI (Inflation)	1.1	2.7	2.3	2.5
TRS Equity - U.S.	(15.2)	(7.4)	3.3	10.2
Russell 3000 Index	(17.2)	(7.9)	3.8	11.3
TRS Fixed Income - U.S.	8.1	7.9	8.0	7.6
Salomon BIG Index	8.5	8.1	7.6	7.4
TRS Fixed Income - International	15.9	2.0	2.6	5.9
Non-U.S. Bond Index	15.8	3.1	3.0	5.6
TRS Equity - International	(6.8)	(3.5)	0.0	6.0
Non-U.S. Equity Index	(8.2)	(6.2)	(1.7)	5.5
TRS Real Estate Property	2.4	7.0	9.8	9.5
Real Estate Property Index	5.6	9.6	11.7	8.5
TRS Private Equity	(12.7)	25.2	26.6	27.3
Russell 3000 Index + 3.0%	(14.7)	(5.1)	7.0	14.6
TRS Short-Term Investments	2.7	4.9	5.2	n/a
90-Day T-Bill Index	2.2	4.4	4.6	n/a

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

GROWTH OF \$10,000



INVESTMENT PORTFOLIO (AS OF JUNE 30, 2002)



ACTUARIAL AND STATISTICAL DATA

TRS FUNDED STATUS

A second year of difficult market conditions led to a further decline in TRS's funded status during FY 2002. However, compared to most other large public retirement systems, asset losses were relatively low.

Also, continued growth in the number of active teachers increased the state's liability for the retirement benefits they will eventually earn. Over the past 10 years, the number of active full-time teachers has grown more than 20 percent, from 106,000 to over 128,000.

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
(\$ IN THOUSANDS)

	<u>Years Ended June 30</u>	
	<u>2002</u>	<u>2001</u>
Total actuarial accrued liability	\$43,047,674	\$39,166,697
Less actuarial value of assets (net assets at market value)	\$22,366,285	\$23,315,646
Unfunded liability	\$20,681,389	\$15,851,051
Funded ratio	52.0%	59.5%

FIVE-YEAR REVIEW OF ACTUARIAL ASSUMPTIONS

The TRS actuaries are required to review their economic and demographic assumptions every five years and advise the Board of Trustees whether any changes are needed. The Board accepted the actuaries' recommendations to lower the salary increase and inflation assumptions and to raise the retirement rate assumptions. Several other minor changes were also adopted. The long-term investment return assumption of 8.5 percent per year was maintained.

COMMITMENT TO TRS FUNDING MAINTAINED

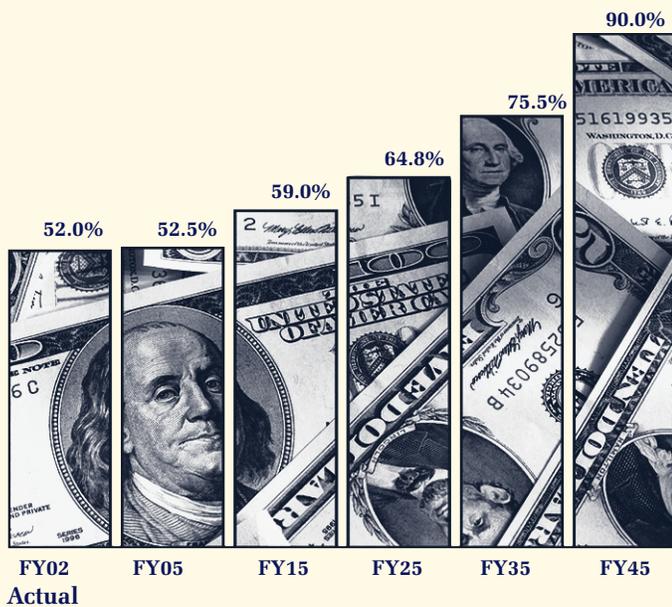
State contributions to TRS under Public Act 88-593 began in FY96. The law established the state's commitment to strengthen TRS's financial position through a 35-year funding plan following a 15-year phase-in that ends in FY10. Under the phase-in, contributions are being gradually increased to a level 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 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, even during difficult economic times. The integrity of the funding plan remains a top priority for TRS.

*We shall neither fail
nor falter; we shall not
weaken or tire...Give
us the tools and we
will finish the job.*

- Winston Churchill





MEMBERSHIP AND BENEFIT RECIPIENTS
(AS OF JUNE 30, 2002)

ACTIVE MEMBERS

Total Full and Part-time Members	128,563
Total Substitutes	27,416
Total Active Members	155,979

BENEFIT RECIPIENTS

Retirees	59,360
Disabled recipients	1,056
Survivors	7,533
	67,949

FISCAL YEAR HIGHLIGHTS

	2002	2001
Active contributing members	155,979	150,783
Inactive noncontributing members	66,971	69,512
Benefit recipients	67,949	64,877
Total membership	290,899	285,172
Actuarial accrued liability (AAL)	\$43,047,674,000	\$39,166,697,000
Less net assets held in trust for pension benefits	22,366,285,000	23,315,646,000
Unfunded actuarial accrued liability (UAAL)	\$20,681,389,000	\$15,851,051,000
Funded ratio (actuarial value of assets/AAL)	52.0%	59.5%
Total fund investment return, net of fees	(3.2%)	(4.2%)
Benefits and refunds paid		
Benefits paid	\$1,759,748,668	\$1,566,793,231
Refunds paid	38,755,604	35,849,079
Total	\$1,798,504,272	\$1,602,642,310
Income		
Member contributions*	\$681,151,770	\$643,563,304
Employer contributions (includes State of Illinois contributions)	907,357,912	821,625,405
Net investment loss	(723,987,045)	(1,015,255,237)
Total	\$864,522,637	\$449,933,472

* 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, 2002. The financial information presented in this report was derived from the *Comprehensive Annual Financial Report* and is in conformity with Generally Accepted Accounting Principles (GAAP). 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.