Michigan State Employees Retirement System

Comprehensive Annual Financial Report for the Fiscal Year Ended September 30, 2000

A Pension Trust Fund of the State of Michigan

John Engler, Governor

Michigan State Employees' Retirement System

a Pension Trust Fund of the State of Michigan

Comprehensive Annual Financial Report for the Fiscal Year Ended September 30, 2000

MSERS

Prepared by: Office of Retirement Services P.O. Box 30171 Lansing, Michigan 48909-7671 517-322-5103 1-800-381-5111

Table of Contents

Introductory Section	
Certificate of Achievement	4
Letter of Transmittal	5
Board Members	11
Advisors & Consultants	11
Organization Chart	12
Financial Section	
Independent Auditors' Report	15
Basic Financial Statements	
Statements of Pension Plan and Postemployment Heathcare Plan Net Assets	16
Statements of Changes in Pension Plan and Postemployment Heathcare Plan Net Assets	17
Notes to General Purpose Financial Statements	18
Required Supplementary Information	29
Supporting Schedules	32
Investment Section	
Report on Investment Activity	37
Asset Allocation	42
Investment Results	42
List of Largest Stock Holdings	43
List of Largest Bond Holdings	43
Schedule of Investment Fees	44
Schedule of Investment Commissions	45
Investment Summary	46
Actuarial Section	
Actuary's Certification	48
Summary of Actuarial Assumptions and Methods	49
Schedule of Active Member Valuation Data	51
Schedule of Changes in the Retirement Rolls	51
Prioritized Solvency Test	52
Summary of Plan Provisions	53
Statistical Section	
Schedule of Revenues by Source	5 <i>6</i>
Schedule of Expenses by Type	
Schedule of Benefit Expenses by Type	
Schedule of Retired Members by Type of Benefit	
Schedule of Average Benefit Payments	
Ten Year History of Membership	

The cost of printing this report was \$1,254.77 (\$2.51 each), which was paid for by the System at no cost to taxpayers.

INTRODUCTORY SECTION

Certificate of Achievement Letter of Transmittal Board Members Advisors & Consultants Organization Chart

Certificate of Achievement

Certificate of Achievement for Excellence in Financial Reporting

Presented to

Michigan State Employees' Retirement System

For its Comprehensive Annual Financial Report for the Fiscal Year Ended September 30, 1999

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



anne Spray Kinney President

Olhen S. Esses

Executive Director

Letter of Transmittal

State Employees' Retirement System P.O. Box 30171 Lansing, Michigan 48909 Telephone 517-322-5103 Outside Lansing 1-800-381-5111

STATE OF MICHIGAN

JOHN ENGLER, Governor

DEPARTMENT OF MANAGEMENT AND BUDGET

February 9, 2001

The Honorable John Engler Governor, State of Michigan,

Members of the Legislature State of Michigan

Retirement Board Members and Members, Retirees and Beneficiaries

Ladies and Gentlemen:

We are pleased to present the annual report of the Michigan State Employees' Retirement System (System) for fiscal year 2000.

Responsibility for both the accuracy of the data and the completeness and fairness of the presentation, including all disclosures, rests with the leadership team of the System. 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 present fairly the financial position and results of operations of the System.

The Michigan State Employees' Retirement System was established by legislation under Public Act 240 of 1943 (the State Employees' Retirement Act) and is administered by the Office of Retirement Services (ORS). The number of active and retired members and beneficiaries of the System is presented in Note 1 of the financial statements in the Financial Section of this report. The services performed by the staff provide benefits to members.

The 2000 annual report is presented in five sections. The Introductory Section contains the transmittal letter, and identifies the administrative organization and professional consultants used by the System. The Financial Section contains the independent auditors' report, the financial statements of the System and certain supplemental schedules. The Investment Section summarizes investment activities. The Actuarial Section contains the independent consulting actuary's certification, an outline of actuarial assumptions and methods, and other actuarial statistics. The Statistical Section contains statistical tables of significant data pertaining to the System.

5

Letter of Transmittal (Continued)

MAJOR GOALS ACCOMPLISHED

Customer Service

ORS continues its customer-focused direction, as evidenced by our mission and vision:

ORS Mission: We deliver pensions, related benefits, and services to promote the future financial security of our customers.

ORS Vision: Fast, easy access to complete and accurate information and exceptional service.

This year we conducted our semi-annual Retiree Customer Satisfaction Survey to assess how well we rated with what we currently offer our customers. The results were very positive with 94% rating ORS's service as "good" or "excellent." In addition, to find out what *other* needs our customers have, we conducted a Customer Needs and Expectations study. Using a series of focus groups and mail surveys, we learned what our customers want from this System, and their preferred method(s) of delivery.

One affirmation of how well ORS is doing came from a local organization, *Capital Quality Initiative*, that encourages the pursuit of excellence in business. ORS was one of three organizations recognized this year for excellence in serving customers' needs.

Communications

ORS continues to reach out to customers through a variety of media, allowing customers to use the one they find most comfortable. The ORS web site has a wealth of information about the System, along with publications, newsletters, frequently used forms, information about upcoming pre-retirement meetings, and links to other useful sites. Employers can also sign up to receive periodic special-interest e-mail updates via a subscription service called *ListServ*. The five ORS *ListServ* options now have over 900 subscribers.

Many individuals prefer traditional communications methods, such as the telephone, personal contact, and mail service. Because of this, ORS continues to refine and improve these services. In the past year, ORS handled 208,922 incoming phone calls through our Customer Information Center (CIC), a 27% increase over the previous year. Customers can call ORS via a toll-free number and receive direct, personal contact – not a series of telephone menu options. These customers reached CIC Retirement Information Representatives who were able to personally respond to 86% of their inquiries without transfers to others.

Customers who prefer one-on-one contact can arrange an appointment at an Outreach Office in Holland or Detroit, or come to the Main Office in Lansing anytime during normal business hours. There were 3,559 individuals who met with Retirement Information Representatives at the Main Office, while the Outreach Offices handled another 2,573.

A large number of individuals who are comfortable with electronic media contact ORS through our Customer Service e-mail address. This past year 5,099 e-mails were sent to this address – an increase of 205% over 1998-99. ORS staff members provide next-day turn-around time for most of these e-mail inquiries.

Retirement Information Representatives participated in the Department of Civil Service's Pre-Retirement Orientation sessions (PROs). These sessions held throughout the state are designed for those seeking information about retirement. Over 1,775 members attended 24 PROs during the 1999-2000 fiscal year.

Letter of Transmittal (Continued)

ORS also expended additional efforts to keep State Human Resource personnel informed and build a partnership relationship between them and ORS. Information is now disseminated to them through the semi-annual HR Exchange newsletter and periodic *ListServ* postings.

Our semi-annual retiree newsletter, the *ORS Connections*, continues to meet the original purposes: 1) To establish and maintain a direct connection with all retirees; 2) Remind retirees that we are available to assist them and how to access that assistance; 3) Provide information that will assist retirees in doing business with ORS.

Services

In October 1999, administration of the Defined Contribution and Deferred Compensation Retirement Plans were transferred to ORS. In an effort to provide members with more information about these plans, the Retirement Guidelines booklet were updated to include additional information about these plans as they relate to the Defined Benefit Retirement Plan and individuals' preparations for retirement.

As of January 1, 2000, those choosing to retire were able to select from three different survivor pension options – the previous 100% and 50% survivor options, and a new 75% survivor option. Pending retirees and others who are looking ahead to retirement can use our web-based pension estimator to project what their pension payments might be, based on various scenarios.

Future Direction

ORS recognizes that by 2003 there will be an anticipated growth of 40% in the number of new ORS retirees, requiring ORS to be more efficient and productive as we handle this rapidly increasing demand for services with no increase in personnel. Recognizing the need for change, this past year ORS began a systematic evaluation of how we can do a better job. We implemented Vision ORS to begin the transition to a Business Process focused organization. This approach delineates the interrelationships between the different core business functions within the organization, and assigns authority and accountability to specific individuals for each Business Process. Transitioning to this new organizational structure has helped us to identify and eliminate redundancies, streamline workflows, and focus on what is required to accomplish our business priorities and provide excellent customer service.

Having completed the first two steps in our Vision ORS plan, we now have a solid foundation and a clear understanding of how our business functions. Using this information, we can construct a new, more efficient organization to better serve our customers. Our next steps will be to look at many of the critical core processes and research "Best In Class" organizations to determine what tools or techniques make them outstanding in these areas. Utilizing the best of these ideas, we can create a new, forward-looking operational structure and identify innovative technology to help us effectively handle our future demands.

CERTIFICATE OF ACHIEVEMENT

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the System for its comprehensive annual financial report for the fiscal year ended September 30, 1999.

In order to be awarded the 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.

Letter of Transmittal (Continued)

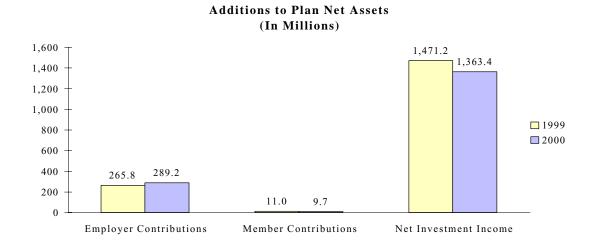
A Certificate of Achievement is valid for a period of one year only. We believe our current report continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

FINANCIAL INFORMATION

Additions to Plan Net Assets

The reserves needed to finance retirement and health benefits are accumulated through the collection of employer contributions and through earnings on investments. Contributions and net investment income for fiscal year 2000 totaled approximately \$1.7 billion. Net investment income accounted for 82.0% and employer contributions accounted for 17.4% of the total revenue.

Total contributions and net investment income decreased 4.9% from those of the prior year due primarily to decreased member contributions. The System is non-contributory; however, members may purchase service credit. The decrease in member contributions occurred because fewer individuals purchased service credit. Member contributions decreased 12.5%, employer contributions increased 8.8% and net investment income (including interest income) decreased 7.3% from the prior year. The Investment Section of this report reviews the results of investment activity for 2000.



Deductions From Plan Net Assets

The primary expenditures of the System include the payment of pension benefits to members and beneficiaries, payments for health, dental and vision benefits, refund of contributions to former members, and cost of administering the System. The growth of health care expenditures continued during the year. As a result, expenditures for health care increased by \$24.5 million from \$184.1 million to \$208.6 million during the fiscal year. Total deductions for fiscal year 2000 were \$671.6 million, an increase of 5.7% from 1999 deductions.

Letter of Transmittal (Continued)

1999

2000

Internal Control

100

0

Pension Benefits

The leadership team of the System is responsible for maintaining adequate internal accounting controls designed to provide reasonable assurance that transactions are executed in accordance with management's general or specific authorization, and are recorded as necessary to maintain accountability for assets and to permit preparation of financial statements in accordance with generally accepted accounting principles. The internal control process is designed to provide reasonable assurance regarding the safekeeping of assets and reliability of all financial records.

0.7

Health Care Benefits Refunds and Transfers

0.2

4.3

4.0

Administrative

INVESTMENT

The State Treasurer is the investment fiduciary and custodian of all investments of the System pursuant to state law. The primary investment objective is to maximize the rate of return on the total investment portfolio, consistent with a high degree of prudence and sufficient diversity to eliminate inordinate risks and to meet the actuarial assumption for the investment return rate. The investment activity for the year produced a total rate of return on the portfolio of 14.8%. For the last five years, the System has experienced an annualized dollar weighted rate of return of 15.4%. A summary of asset allocation and rates of return can be found in the Investment Section of this report.

FUNDING

Funds are derived from the excess of additions to plan net assets over deductions from plan net assets. Funds are accumulated by the System in order to meet future benefit obligations to retirees and beneficiaries. The percentage computed by dividing the actuarial value of assets by the actuarial accrued liability is referred to as the "funded ratio." This ratio provides an indication of the funding status of the System and, generally, the greater this percentage, the stronger the System. As of September 30, 2000, the actuarial value of the assets and actuarial accrued liability of the system were \$10.3 billion and \$9.5 billion, respectively, resulting in a funded ratio of 109.1%. As of September 30,

Letter of Transmittal (Continued)

1999, the amounts were \$9.6 billion and \$9 billion, respectively. A historical perspective of funding levels for the System is presented on the Schedule of Funding Progress in the Required Supplementary Information in the Financial Section of this report.

POSTEMPLOYMENT BENEFITS

The System also administers the postemployment health benefits (health, dental and vision) offered to retirees. The benefits are funded on a cash or "pay as you go" basis. An actuarial valuation was completed to determine the actuarial accrued liability if the benefits were to be pre-funded. If these benefits were pre-funded, the actuarial accrued liability for these benefits would be in excess of \$6.6 billion and the employer contribution for health care benefits would be in excess of 18.62%. Only members of the defined benefit plan were included when calculating the actuarial accrued liability.

PROFESSIONAL SERVICES

An annual audit of the System was conducted by Andrews Hooper & Pavlik P.L.C., independent auditors. The auditors' report on the System's financial statements is included in the Financial Section of this report.

Statute requires an annual actuarial valuation be conducted. The purpose of the valuation is to evaluate the mortality, service, compensation and other financial experience of the System and to recommend employer funding rates for the subsequent year. This annual actuarial valuation was completed by The Segal Company for the fiscal years ended September 30, 2000 and 1999. Actuarial certification and supporting statistics are included in the Actuarial Section of this report.

ACKNOWLEDGMENTS

The preparation of this report was accomplished with the dedication and cooperation of many people. It is intended to provide complete and reliable information as a basis for making management decisions, as a means of determining compliance with legal provisions, and as a means for determining responsible stewardship of the funds of the System.

We would, therefore, like to express our appreciation for the assistance given by staff, the advisors and many people who contributed to its preparation. We believe their combined efforts have produced a report that will enable the employers and plan members to better evaluate and understand the Michigan State Employees' Retirement System. Their cooperation contributes significantly to the success of the System.

Sincerely,

Janet E. Phipps, Director

Department of Management and Budget

Christopher M. DeRose, Director Office of Retirement Services

Administrative Organization

Retirement Board Members

R. Douglas Trezise, Chair Retiree Member Term Expired July 31, 2000

Janine Winters Employee Member Term Expired July 31, 2000

Janet McClelland, Vice Chair Employee Member Term Expires July 31, 2002 Roy Pentilla, C.P.A. Representing State Treasurer Statutory Member

George M. Elworth Representing Attorney General Statutory Member

D. Daniel McLellan Representing State Personnel Director Statutory Member Dr. James S. Neubecker, C.P.A. Representing Auditor General Statutory Member

John Schoonmaker Representing State Insurance Commissioner Statutory Member

Doug Drake Retiree Member Term Expires July 31, 2001

Administrative Organization

Department of Management and Budget Office of Retirement Services P.O. Box 30171 Lansing, Michigan 48909-7671 517-322-5103 1-800-381-5111

Advisors and Consultants

Actuary

The Segal Company Michael J. Karlin, F.S.A., M.A.A.A. New York, New York Auditors

Thomas H. McTavish, C.P.A. Auditor General State of Michigan

Andrews Hooper & Pavlik P.L.C. Jeffrey J. Fineis, C.P.A. Okemos, Michigan Investment Manager and Custodian

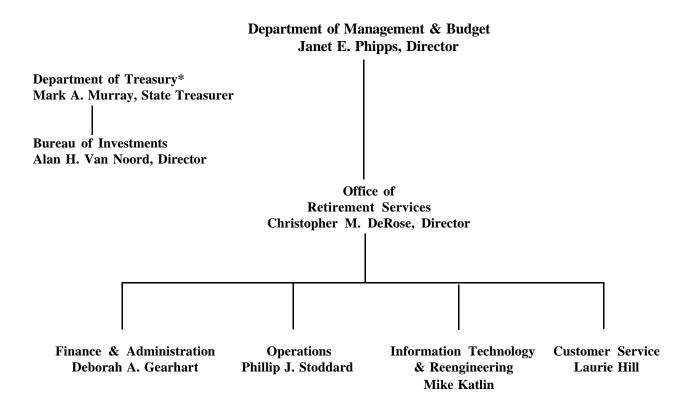
Mark A. Murray State Treasurer State of Michigan

Legal AdvisorJennifer M. Granholm
Attorney General
State of Michigan

Investment Performance Measurement Capital Resource Advisors Chicago, Illinois

Administrative Organization

Organization Chart



^{*} The investments of the system are managed by the Michigan Department of Treasury. Information on the investments and the fiduciary, Michigan Department of Treasury, can be found in the Investment Section.

This page has intentionally been left blank

Independent Auditors' Report **Basic Financial Statements** Notes to General Purpose Financial Statements Required Supplementary Information Supporting Schedules

Independent Auditors' Report



Ms. Janet Phipps, Director
Department of Management and Budget
Mr. Christopher M. DeRose, Director
Office of Retirement Services
Mr. Thomas H. McTavish, CPA
Auditor General
Michigan State Employees
Retirement System Board

We have audited the accompanying statements of pension plan and postemployment healthcare plan net assets of the Michigan State Employees Retirement System, as of September 30, 2000 and 1999, and the related statements of changes in pension plan and postemployment healthcare plan net assets for the years then ended. These financial statements are the responsibility of the management of the Michigan State Employees Retirement System. 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the Michigan State Employees Retirement System, as of September 30, 2000 and 1999, and the changes in plan net assets for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The required supplementary information and supporting schedules listed in the table of contents are presented for the purpose of additional analysis and are not a required part of the basic financial statements. The required supplementary information and supporting schedules are the responsibility of the Michigan State Employees Retirement System's management. The Schedules of Funding Progress and Employer Contributions and related notes on pages 29 to 31 and the supporting schedules on pages 32 to 35 have been subjected to the auditing procedures applied in our audits of the basic financial statements, and in our opinion, are fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

In accordance with Government Auditing Standards, we have also issued a report dated January 31, 2001 on our consideration of the Michigan State Employees Retirement System's internal control over financial reporting and on 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.

January 31, 2001

4295 Okemos Road, Suite 200 • Okemos, Michigan 48864 • ph 517.487.5000 fx 517.487.9535 • www.ahpplc.com

andrews Goope & Faulik P.L.C.

Statements of Pension Plan and Postemployment Healthcare Plan Net Assets

As of Fiscal Years Ending September 30, 2000 and 1999

	September 30, 2000			September 30, 1999					
	Pension]	Health			Pension		Health	
	Plan		Plan	Total		Plan		Plan	 Total
Assets:									
Cash	\$ 65,018,976	\$	84,856	\$ 65,103,832	\$	59,392,238	\$	273,451	\$ 59,665,689
Receivables:									
Amounts due from employers	11,551,620		15,076	11,566,696		11,006,485		50,675	11,057,160
Interest and dividends	41,014,141		53,527	41,067,668		41,951,824		193,153	42,144,977
Sale of Investments	58,883,151		76,848	 58,959,999		7,431,608		34,216	 7,465,824
Total receivables	111,448,912		145,451	 111,594,363		60,389,917		278,044	 60,667,961
Investments:									
Short term investments	356,102,125		464,746	356,566,871		223,873,552		1,030,748	224,904,300
Bonds, notes, mortgages									
and preferred stock	2,230,817,140		2,911,421	2,233,728,561		2,271,066,543		10,456,334	2,281,522,877
Common stock	5,045,375,714		6,584,678	5,051,960,392		5,243,863,719		24,143,542	5,268,007,261
Real estate	954,304,019		1,245,454	955,549,473		783,559,113		3,607,624	787,166,737
Alternative investments	1,778,313,637		2,320,862	1,780,634,499		1,027,335,139		4,730,006	1,032,065,145
International investments	713,884,997		931,685	714,816,682		580,370,116		2,672,112	583,042,228
Collateral on loaned securities	145,637,667		190,071	 145,827,738		312,143,756		1,437,157	 313,580,913
Total investments	11,224,435,299		14,648,917	 11,239,084,216		10,442,211,938		48,077,523	 10,490,289,461
Total assets	11,400,903,187		14,879,224	 11,415,782,411		10,561,994,093		48,629,018	 10,610,623,111
Liabilities:									
Warrants outstanding	1,774,397		2,315	1,776,712		2,534,717		11,670	2,546,387
Accounts payable and	1,771,007		2,313	1,770,712		2,55 1,717		11,070	2,5 10,507
other accrued liabilities	5,558,700		7,255	5,565,955		22,435,014		103,294	22,538,308
Obligations under securities lending	145,637,667		190,071	 145,827,738		312,143,756		1,437,157	 313,580,913
Total liabilities	152,970,764		199,641	 153,170,405		337,113,487		1,552,121	 338,665,608
Restricted Net Assets - DC Savings			744,200	744,200				170,600	170,600
Unrestricted Net Assets	11,247,932,423		13,935,383	 11,261,867,806		10,224,880,606		46,906,297	 10,271,786,903
Net Assets Held in Trust for Pension									
and Health Benefits*	\$ 11,247,932,423	\$	14,679,583	\$ 11,262,612,006	\$	10,224,880,606	\$	47,076,897	\$ 10,271,957,503

 $^{^*}$ A schedule of funding progress is presented in the Required Supplementary Information in the Financial Section.

The accompanying notes are an integral part of these financial statements.

Statements of Changes in Pension Plan and Postemployment Healthcare Plan Net Assets

For the Fiscal Years Ended September 30, 2000 and 1999

	September 30, 2000			September 30, 1999			
	Pension	Health		Pension	Health		
	Plan	Plan	Total	Plan	Plan	Total	
Additions:							
Members contributions	\$ 4,606,662	\$ 5,056,971	\$ 9,663,633	\$ 6,186,018	\$ 4,861,628	\$ 11,047,646	
Employer contributions	121,817,366	166,833,573	288,650,939	121,119,857	144,515,776	265,635,633	
DC Savings		573,600	573,600		170,600	170,600	
Investment income:							
Investment income	1,373,692,210		1,373,692,210	1,475,060,958		1,475,060,958	
Securities lending income	15,447,180		15,447,180	17,317,384		17,317,384	
Investment expenses:							
Real estate operating expenses	(602,289)		(602,289)	(1,163,465)		(1,163,465)	
Securities lending expenses	(14,452,406)		(14,452,406)	(16,330,884)		(16,330,884)	
Other investment expenses	(14,478,754)		(14,478,754)	(9,687,920)		(9,687,920)	
Interest Income		3,766,152	3,766,152		6,048,620	6,048,620	
Miscellaneous income	2,777		2,777	159		159	
Total additions	1,486,032,746	176,230,296	1,662,263,042	1,592,502,107	155,596,624	1,748,098,731	
Deductions:							
Benefits and refunds paid to plan							
members and beneficiaries:							
Retirement allowances	458,803,774		458,803,774	446,219,254		446,219,254	
Employer share of health insurance		193,427,912	193,427,912		169,003,923	169,003,923	
Employer share of dental/vision insurance		15,199,690	15,199,690		15,123,552	15,123,552	
Refunds of member contributions	43,486	8	43,494	21,110		21,110	
Transfers to other systems	178,677		178,677	707,256		707,256	
Administrative expenses	3,954,992		3,954,992	4,330,623		4,330,623	
Total deductions	462,980,929	208,627,610	671,608,539	451,278,243	184,127,475	635,405,718	
Net Increase (Decrease)	1,023,051,817	(32,397,314)	990,654,503	1,141,223,864	(28,530,851)	1,112,693,013	
Net Assets Held in Trust							
for Pension and Health Benefits:							
Beginning of Year	10,224,880,606	47,076,897	10,271,957,503	9,083,656,742	75,607,748	9,159,264,490	
End of Year*	\$ 11,247,932,423	\$ 14,679,583	\$ 11,262,612,006	\$ 10,224,880,606	\$ 47,076,897	\$ 10,271,957,503	

^{*}A schedule of funding progress is presented in the required supplementary information in the Financial Section.

The accompanying notes are an integral part of these financial statements.

Notes to General Purpose Financial Statements

NOTE 1 - PLAN DESCRIPTION

ORGANIZATION

The Michigan State Employees' Retirement System is a cost sharing, multiple employer, state-wide, defined benefit public employee retirement plan governed by the State of Michigan (State) and created under Public Act 240 of 1943, as amended. The System was established by the State to provide retirement, survivor and disability benefits to the State's government employees. The System is a qualified trust fund under section 401(a) of the Internal Revenue Code. By statute, employees of the following employers are also covered by this plan: American Legion, American Veterans, Disabled American Veterans, Probate Judges, Mackinac Island State Park, Marine Corps League, Michigan Bar Association, Michigan Veterans Trust Fund, Military Order of the Purple Heart, Commission for Independent Vendors, Third Circuit Court, Recorders Court and 36th District Court. Michigan judges and elected officials, legislators, national guard and state police officers are covered by separate retirement plans.

The System's financial statements are included as a pension trust fund in the combined financial statements of the State of Michigan.

The System is administered by the Office of Retirement Services, within the Michigan Department of Management and Budget. The Department Director appoints the Office Director who serves as Executive Secretary to the System's Board, with whom the general oversight of the System resides. The State Treasurer serves as the investment officer and custodian for the System.

MEMBERSHIP

At September 30, 2000 and 1999, the System's membership consisted of the following:

Retirees and beneficiaries		
currently receiving benefits:	2000	1999
Regular benefits	28,350	28,403
Survivor benefits	5,267	5,039
Disability benefits	3,088	2,904
Total	36,705	36,346
Current employees:		
Vested	37,290	36,745
Non-vested	10,488	12,867
Total	47,778	49,612
Inactive employees entitled to benefits and not yet		
receiving them	7,556	7,376
Total All Members	92,039	93,334

Enrollment in the health care plan is voluntary. The number of participants is as follows:

Health/Dental/Vision Plan	2000	1999
Eligible participants	36,705	36,346
Participants receiving benefits:		
Health	33,700	33,478
Dental	33,028	32,712
Vision	33,158	32,858

Notes to General Purpose Financial Statements

BENEFIT PROVISIONS

Introduction

Benefit provisions of the defined benefit pension plan are established by state statute, which may be amended. Public Act 240 of 1943, as amended, establishes eligibility and benefit provisions for the defined benefit pension plan. Retirement benefits are determined by final average compensation and years of service. Members are eligible to receive a monthly benefit when they meet certain age and service requirements. The System also provides duty disability, non-duty disability and survivor benefits.

Members who have separated from employment may request a refund of his or her member contribution account. (The System is currently non-contributory.) A refund cancels a former member's rights to future benefits. Former members who return to employment and who previously received a refund of their contributions may reinstate their service through repayment of the refund upon satisfaction of certain requirements.

Effective March 31, 1997, Public Act 487 of 1996 closed the plan to new entrants. All new employees become members of the defined contribution plan. The Public Act allows returning employees and members who left state employment on or before March 31, 1997, to elect the defined benefit plan instead of the defined contribution plan.

Regular Retirement

The retirement benefit is based on a member's years of credited service (employment), and final average compensation. The normal benefit equals 1.5% of a member's final average compensation multiplied by the years and partial year of credited service and is payable monthly over the member's lifetime.

Final average compensation is the average of a member's monthly pay during 36 consecutive months of credited service. The 36 consecutive month period producing the highest monthly average is used. For most members, this is the last three years of employment.

A member may retire and receive a monthly benefit after attaining:

- 1. age 60 with 10 or more years of credited service; or
- 2. age 55 with 30 or more years of credited service; or
- 3. age 55 with at least 15 but less than 30 years of credited service. The benefit allowance is permanently reduced 0.5% for each month from the member's age on the effective date of retirement to the date the member will attain age 60.

Employees in covered positions are eligible for supplemental benefits and may retire after attaining:

- 1. age 51 with 25 or more years in a covered position; or
- 2. age 56 with 10 or more years in a covered position.

In either case, the three years immediately preceding retirement must have been in a covered position. Employees in covered positions are responsible for the custody and supervision of inmates.

Employees of closing Department of Community Health facilities are eligible for retirement under one of the following conditions:

- 1. age 51 with 25 years of service, the last 5 of which were rendered in the closing facility;
- 2. age 56 with 10 years of service, the last 5 of which were rendered in the closing facility; or
- 3. 25 years of service at the closing facility regardless of age.

Notes to General Purpose Financial Statements

Employees of the State Accident Fund, Michigan Biologic Products or Liquor Control Commission who were terminated as the result of privatization may retire if the member's age and length of service was equal to or greater than 70 on the date of transfer or termination.

Conservation Officers (CO) with a hire date on or before April 1, 1991, are eligible to retire after 25 years of service, 20 of which must have been rendered as a CO. CO's hired after April 1, 1991 and before March 31, 1997, must have 23 years of service as a CO to be eligible for a full retirement with only 25 years of service. In either case, 2 years immediately preceding retirement must be as a CO.

Deferred Retirement

Any member with 10 or more years of credited service who terminates employment but has not reached the age of retirement is a deferred member and is entitled to receive a monthly pension upon reaching age 60, provided the member's accumulated contributions have not been refunded. Deferred retirement is available after 5 years of service for State employees occupying unclassified positions in the executive and legislative branches and certain Department of Community Health employees subject to reduction in force lay-offs by reason of deinstitutionalization.

Non-Duty Disability Benefit

A member with 10 or more years of credited service who becomes totally and permanently disabled not due to performing duties as a state employee is eligible for a non-duty disability pension. The non-duty disability benefit is computed in the same manner as an age and service allowance based upon service and salary at the time of disability.

Duty Disability Benefit

A member who becomes totally and permanently disabled from performing duties as a state employee as a direct result of state employment and who has not met the age and service requirement for a regular pension, is eligible for a duty disability pension. If the member is under age 60, the duty disability allowance is a maximum payment of \$6,000 payable annually. At age 60 the benefit is recomputed under service retirement.

Survivor Benefit

Upon the death of a member who was vested, the surviving spouse shall receive a benefit calculated as if the member had retired the day before the date of death and selected a survivor pension. Certain designated beneficiaries can be named to receive a survivor benefit.

Pension Payment Options

When applying for retirement, an employee may name a person other than his or her spouse as a beneficiary if the spouse waives this right. If a beneficiary is named, the employee must choose whether the beneficiary will receive 100%, 75% or 50% of the retiree's pension benefit after the retiree's death. The decision is irrevocable. A description of the options follows.

<u>Regular Pension</u> — The pension benefit is computed with no beneficiary rights. If the retiree made contributions while an employee and has not received the total accumulated contributions before death, a refund of the balance of the contributions is made to the beneficiary of record. If the retiree did not make any contributions, there will not be payments to beneficiaries.

100% Survivor Pension — Under this option, after the retiree's death, the beneficiary will receive 100% of the pension for the remainder of the beneficiary's lifetime. If this option is elected, the normal retirement benefit is reduced by a factor based upon the ages of the retiree and of the beneficiary. If the beneficiary predeceases the retiree, the pension "pops-up" to the regular pension amount; another beneficiary cannot be named.

Notes to General Purpose Financial Statements

<u>75% Survivor Pension</u> - Under this option, after the retiree's death, the beneficiary will receive 75% of the pension for the remainder of the beneficiary's lifetime. If this option is elected, the normal retirement benefit is reduced by a factor based upon the ages of the retiree and of the beneficiary. If the beneficiary predeceases the retiree, the pension "pops-up" to the regular pension amount; another beneficiary cannot be named.

50% Survivor Pension — Under this option, after the retiree's death, the beneficiary will receive 50% of the pension for the remainder of the beneficiary's lifetime. If this option is elected, the normal retirement benefit is reduced by a factor based upon the ages of the retiree and of the beneficiary. The reduction factor is lower than the factor used in the 100% or 75% option previously described. If the beneficiary predeceases the retiree, the pension "pops-up" to the regular pension amount; another beneficiary cannot be named.

Equated Pension — An equated pension may be chosen by any member under age 65 except a disability retiree and an early supplemental retiree. Equated pensions provide an additional amount until age 65 and may be combined with Regular, 100%, 75% or 50% option. At age 65 the monthly amount is permanently reduced. The initial and reduced amounts are based on an estimate of social security benefits at age 65, provided by the Social Security Administration Office. In order to calculate this benefit, members choosing this option must provide ORS with an estimate from the Social Security Administration Office. The actual amount received from social security may vary from the estimate.

Post Retirement Adjustments

One time upward benefit adjustments were made in 1972, 1974, 1976, 1977 and 1987. Beginning October 1, 1988, a 3% non-compounding increase, up to a maximum of \$25 monthly, is paid each October to recipients who have been retired 12 full months. Beginning in 1983, eligible benefit recipients share in a distribution of investment income earned in excess of 8% annually. This distribution is known as the supplemental payment. The supplemental payment is offset by one year's cumulative increases received after the implementation of the annual 3% increase in benefits. These adjustment payments were not issued during fiscal years 1991 through 1994. Members who retired on or after October 1, 1987, are not eligible for the supplemental payment.

Contributions

<u>Member Contributions</u> — Members currently participate in the System on a noncontributory basis. Under certain circumstances, members may contribute to the System for the purchase of creditable service, such as military service or maternity leave, or a universal buy-in. If a member terminates the System employment before a retirement benefit is payable, the member's contribution and interest on deposit may be refunded. If the member dies before being vested, the member's contribution and interest are refunded to the designated beneficiaries.

<u>Employer contributions</u> — The statute requires the employer to contribute to finance the benefits of plan members. These employer contributions are determined annually by the System's actuary and are based upon level-percent-of-payroll funding principles so the contribution rates do not have to increase over time.

Transfers to Defined Contribution Plan

During fiscal year 1998, the Michigan State Employees' Retirement Act provided members an opportunity to transfer to the Defined Contribution Plan. This was a one-time opportunity and the decision is irrevocable. The transfer was completed by September 30, 1998. With the passage of the legislation permitting the transfer, the System also became a closed system. All new employees are members of the Defined Contribution Plan.

Notes to General Purpose Financial Statements

Other Postemployment Benefits

Under the Michigan State Employees' Retirement Act, all retirees have the option of receiving health, prescription, dental and vision coverage. The employer funds health benefits on a pay-as-you-go basis. Retirees with this coverage contribute 5% and 10% of the monthly premium amount for the health (including prescription coverage), dental and vision coverage, respectively. The employer's payroll contribution rate to provide this benefit was 5.5% and 5.0% for fiscal years 2000 and 1999 respectively.

Retirees are provided with life insurance coverage equal to 25% of the active life insurance coverage, \$1,000 for spouse and \$1,000 for each dependent under age 23. Premiums are fully paid by the State.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting and Presentation

The System's financial statements are prepared using the accrual basis of accounting. Contributions from the State are recognized as revenue in the period in which employees provide service. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

Reserves

Public Act 240 of 1943, as amended, created the employees' savings reserve, pension reserve, employer's accumulation reserve, income account and expense account, and health insurance reserve. The financial transactions of the plan are recorded in these accounts as required by Public Act 240 of 1943, as amended.

Employees' Savings Reserve — Members no longer contribute to this fund except to purchase eligible service credit or repay previously refunded contributions. This fund represents active member contributions and interest less amounts transferred to the Pension Reserve for regular and disability retirement, amounts refunded to terminated members and unclaimed amounts transferred to the income account. At September 30, 2000, and 1999, the balance in this account was \$5.9 million and \$5.1 million, respectively.

<u>Pension Reserve</u> — This represents the reserves for payment of future retirement benefits to current retirees. At retirement, a member's accumulated contributions plus interest are transferred into this reserve from the Employees' Savings Reserve. Monthly benefits, which are paid to the retiree, reduce the reserve. At the end of each fiscal year, an amount determined by an annual actuarial valuation is transferred from the Employer's Accumulation Reserve to this reserve to bring the balance into balance with the actuarial present value of retirement allowances. At September 30, 2000 and 1999, the balance in this account was \$4.4 billion and \$4.4 billion, respectively.

<u>Employer's Accumulation Reserve</u> — All employer contributions are credited to this reserve. Interest from the income account is credited annually. Amounts are transferred annually from this reserve to the Pension Reserve to fund that reserve. At September 30, 2000 and 1999, the balance in this account was \$3.3 billion and \$3.1 billion, respectively.

<u>Income Account and Expense Account</u> — The income account is credited with all investment earnings. Interest is transferred annually to the reserves. Administrative expenses are paid from the expense account. The legislature appropriates the funds necessary to defray and cover the administrative expenses of the plan. At September 30, 2000 and 1999, the net balance of these accounts was \$3.5 billion and \$2.7 billion, respectively.

<u>Health Insurance Reserve</u> — This fund is credited with employee and employer contributions for retirees' health (including prescription coverage), dental and vision benefits and interest is allocated on the beginning balance. Premiums for health, dental and vision benefits are paid from this fund. At September 30, 2000 and 1999, the unrestricted balance in this account was \$13.9 million and \$46.9 million, respectively.

Notes to General Purpose Financial Statements

<u>DC Savings Subaccount</u> — The savings in employer contributions attributable to the transfer to the Defined Contribution Retirement Plan are contributed to this subaccount. Interest will also be allocated to this subaccount. The subaccount is restricted because the statute stipulates that the funds cannot be used until health benefits are fully funded. As of September 30, 2000 and 1999, the balance in this account was \$744,200 and \$170,600, respectively.

Reporting Entity

The System is a pension trust fund of the State of Michigan. As such, the System is considered part of the State and is included in the State's comprehensive annual financial report as a pension trust fund. The System and its board are not financially accountable for any other entities or other organizations. Accordingly, the System is the only entity included in this financial report.

Fair Value of Investments

Plan investments are reported at fair value, except for short-term investments. Short-term investments are carried at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Corporate bonds not traded on a national or international exchange are based on equivalent values of comparable securities with similar yield and risk. Real estate debt is valued on the basis of future principal and interest payments, and is discounted at prevailing interest rates for similar instruments. The fair value of real estate investments is based on independent appraisals. Other investments not having an established market are recorded at estimated fair value.

Investment Income

Dividend income is recognized based on the ex-dividend date and interest income is recognized on the accrual basis as earned. Fair value changes are recorded as investment income or loss. Purchases and sales of investments are recorded as of the trade date (the date upon which the transaction is initiated), except for purchase and sale of mortgages, real estate, and alternative investments which are recorded as of the settlement date (the date upon which the transaction is ultimately completed). The effect of recording such transactions as of the settlement date does not materially affect the financial statements.

Property and Equipment

Office space is leased from the State on a year to year basis. Office equipment is capitalized if the value exceeds \$5,000. These assets are recorded at cost and are reported net of depreciation in the Statement of Pension and Postemployment Heathcare Plan Net Assets. Such assets are depreciated on a straight line basis over 10 years. As of September 30, 1998, all capitalized equipment was fully depreciated. No additional equipment has been capitalized for the system since that date.

Related Party Transactions

<u>Leases and services</u> — The Retirement System leases operating space and purchases certain administrative, data processing, legal and investment services from the State. The space and services are not otherwise available by competitive bid. The following summarizes costs incurred by the System for such services.

	<u>2000</u>	<u>1999</u>
Building rentals	\$ 102,555	\$ 98,996
Technological Support	779,970	1,411,364
Attorney General	226,471	328,537
Investment Services	1,698,100	1,641,600

Notes to General Purpose Financial Statements

<u>Cash</u> — On September 30, 2000 and 1999, the System had \$65 million and \$59 million, respectively in a common cash investment pool maintained for various State operating funds. The participating funds in the common cash pool earn interest at various rates depending upon prevailing short-term interest rates. Earnings from these activities amounted to \$1.1 million and \$1.0 million for the years ended September 30, 2000 and 1999, respectively.

Reclassification of Prior Year Amounts

Certain prior year amounts have been reclassified to conform with the current year presentation.

NOTE 3 - CONTRIBUTIONS

Members currently participate in the System on a non-contributory basis. Under certain circumstances, members may contribute to the System for the purchase of creditable service such as military service or maternity leave. Effective August 1, 1998, the retirement act was amended to permit a "universal buy-in". With a universal buy-in, a member may elect to purchase no more than 5 years of service credit (less other service credit purchased). The State is required by Public Act 240 of 1943, as amended, to contribute amounts necessary to finance the benefits of its employees. Contribution provisions are specified by state statute and may be amended only by action of the state legislature.

Periodic employer contributions to the System are determined on an actuarial basis using the entry age normal actuarial cost method. Under this method, the actuarial present value of the projected benefits of each individual included in the actuarial valuation is allocated on a level basis over the service of the individual between entry age and assumed exit age. The portion of this cost allocated to the current valuation year is called the normal cost. The remainder is called the actuarial accrued liability. Normal cost is funded on a current basis. The unfunded (overfunded) actuarial accrued liability is amortized over a 36-year period for the 1999-2000 fiscal year.

Actual employer contributions paid for retirement benefits for the year were \$121.8 million and \$121.1 million, representing 6.5% and 5.7% of annual covered payroll, for the years ended September 30, 2000, and 1999, respectively. Required employer contributions for pensions included:

- 1. \$171.6 million and \$161.2 million for fiscal years 2000 and 1999, respectively, for normal cost of pensions representing 7.75% and 7.65% (before reconciliation), respectively, of annual covered payroll.
- 2. \$(50.6 million) and (\$49.8 million) for fiscal years 2000 and 1999, respectively, for amortization of (overfunded)/unfunded actuarial accrued liability, representing (2.29%) and (2.36%) (before reconciliation), respectively, of annual covered payroll.

The fund is required to reconcile actuarial requirements annually. Any funding excess or deficiency is included in the subsequent years appropriation request, and is not recognized as a payable or receivable in the accounting records. Based on this reconciliation and other adjustments, the differences are smoothed over 5 years.

NOTE 4 - INVESTMENTS

Investment Authority

Under Public Act 380 of 1965, as amended, the authority for the purchase and the sale of investments resides with the State Treasurer. Investments are made subject to the Michigan Public Pension Investment Act, Public Act 314 of 1965, as amended. The Michigan Public Pension Investment Act authorizes, with certain restrictions, the investment of pension fund assets in stock, corporate and government bonds and notes, mortgages, real estate, and certain short-term and alternative investments. Investments must be made for the exclusive purposes of providing benefits to active members, retired members and beneficiaries, and for defraying the expenses of investing the assets.

Notes to General Purpose Financial Statements

Under Public Act 314 of 1965, as amended, the State Treasurer may invest up to 5.0% of the System's assets in a small business having more than one-half of assets or employees within Michigan as described in section 20(a) of the act and up to 15% (20.0% as of October 16, 2000) of the System's assets in investments not otherwise qualified under the act as described in section 20(d). Alternative investments include limited partnerships and distributions from these partnerships in the form of bonds, preferred stock, common stock and direct investments.

Derivatives

The State Treasurer does not employ the use of derivatives in the investment of Common Cash or the investment of trust funds other than the pension trust funds.

Derivatives are used in managing pension trust fund portfolios, but uses do not include speculation or leverage of investments. Less than 7.0% of the total pension trust fund's portfolio has been invested from time to time in future contracts, collateralized mortgages and swap agreements. State investment statutes limit total derivative exposure to 15.0% of a fund's total asset value, and restrict uses to replication of returns and hedging of assets. Swap agreements represent the largest category of derivatives used, and they represented 6.2% of market value of total assets on September 30, 2000.

To diversify the pension fund's portfolio into international equities, the State Treasurer has entered into swap agreements with investment grade counterparties which are tied to stock market indices in twenty foreign countries. The notional amounts of the swap agreements at September 30, 2000 and 1999, were \$622.0 million and \$477.5 million, respectively. Approximately one half of the notional amount is hedged against foreign currency fluctuations. The swap agreements provide that the retirement system will pay quarterly, over the term of the swap agreements, interest indexed to the three month London InterBank Offer Rate (LIBOR), adjusted for an interest rate spread, on the notional amount stated in the agreements. At the maturity of the swap agreements, the pension fund will either receive the increase in the value of the international equity indices from the level at the inception of the agreements, or pay the decrease in the value of the indices. Swap agreement maturities range from October 2000 to October 2003. U.S. domestic LIBOR based floating rate notes were purchased in the open market to correspond with the notional amount of the swap agreements. The State Treasurer maintains custody and control of these notes.

The value of these synthetic equity structures is a combination of the value of the swap agreements and the value of the notes. The book value represents the cost of the notes. The current value represents the current value of the notes and the change in value of the underlying indices from the inception of the swap agreements. The current value is used as a representation of the fair value based upon the intention to hold all swap agreements until maturity. Since the inception of the international equity investment program, over \$204.0 million of gains on international equity exposure and excess interest received have been realized. The unrealized gain of \$69.1 million at September 30, 2000 reflects the increase in international stock indices and changes in currency exchange rates.

The respective September 30, 2000 and 1999 values are as follows:

	Notional Value	Current Value
9/30/00 (dollars in millions)	\$622.0	\$690.1
9/30/99 (dollars in millions)	477.5	573.0

Investments Exceeding 5% of Plan Net Assets

The System did not hold an individual investment (other than U.S. Government securities) that exceeded 5% of net assets available for benefits at September 30, 2000 or 1999.

Notes to General Purpose Financial Statements

Securities Lending

State statutes allow the retirement system to participate in securities lending transactions, and the retirement system has, via a Securities Lending Authorization Agreement, authorized the agent bank to lend its securities to broker-dealers and banks pursuant to a form of loan agreement.

During the fiscal year, the agent bank lent, at the direction of the retirement system, the retirement system's securities and received cash (United States and foreign currency), securities issued or guaranteed by the United States government, sovereign debt rated A or better, convertible bonds, and irrevocable bank letters of credit as collateral. The agent bank did not have the ability to pledge or sell collateral securities delivered absent a borrower default. Borrowers were required to deliver collateral for each loan equal to: (i) at least 102% of the market value of the loaned securities in the case of loaned securities denominated in United States dollars or whose primary trading market was located in the United States or sovereign debt issued by foreign governments or (ii) 105% of the market value of the loaned securities in the case of loaned securities not denominated in United States dollars or whose primary trading market was not located in the United States.

The retirement system did not impose any restrictions during the fiscal year on the amount of the loans that the agent bank made on its behalf. There were no failures by any borrowers to return loaned securities or pay distributions thereon during the fiscal year. Moreover, there were no losses during the fiscal year resulting from a default of the borrowers or the agent bank.

During the fiscal year, the retirement system and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other qualified tax-exempt plan lenders, in a collective investment pool. As of September 30, 2000, such investment pool had an average duration of 75 days and an average weighted maturity of 490 days. Because the loans were terminable at will, their duration did not generally match the duration of the investments made with cash collateral. On September 30, 2000, the retirement system had no credit risk exposure to borrowers because the collateral is marked to the required market value collateral percentage daily. The collateral held and the market value of securities on loan for the retirement system as of September 30, 2000 were \$263,011,784 and \$247,053,752 respectively.

Gross income from security lending for the fiscal year was \$15,447,180. Expenses associated with this income amounted to \$14,120,068 for the borrower's rebate and \$332,337 for fees paid to the agent.

Categories of Investment Risk

Investments made by the fund, including repurchase agreements and information concerning reverse repurchase agreements, are summarized below. The investments represented by specific identifiable investment securities are classified as to credit risk in three categories.

Category 1 includes investments insured, registered, or held by the System or its agent in the System's name. Category 3 includes uninsured and unregistered investments held by the counterparty, its trust department, or agent, but not in the System's name.

At September 30, 2000, all investments of the pension trust fund were classified as Category 1, except for certain investments not categorized.

The following table summarizes the investments:

Notes to General Purpose Financial Statements

Category 1	2000		1999	9 (Reclassified)
Prime Commercial Paper	\$ 313,967,311	_	\$	82,062,984
Short Term Notes	42,599,560			142,841,316
Government Securities	1,217,116,265			1,201,685,132
Corporate Bonds & Notes	843,037,789			764,027,799
Preferred Stock	331			213
Common Stock	5,013,248,625			5,184,891,906 ³
Real Estate	56,099,807	1		64,583,917
Alternative Investments	142,226,604	2		39,742,769 2
International Investments	 714,816,682	_		583,042,228 4
Total Category 1	\$ 8,343,112,974	- -	\$	8,062,878,264
Category 3 Government Securities	\$ -	-	\$	5,450,000
Non-Categorized				
Private Placements	\$ 65,186,820		\$	81,013,268
Mortgages	5,166,117			5,954,693
Real Estate	899,449,666	1		722,582,820
Alternative Investments	1,638,407,895	2		992,322,376 2
Cash Collateral	145,827,738			313,580,913
Securities on Loan:				
Government Securities	99,088,854			216,660,918
Corporate Bonds & Notes	4,132,385			6,730,854
Common Stock	 38,711,767	_		83,115,355
Total Non-Categorized	\$ 2,895,971,242	_	\$	2,421,961,197
Grand Total	\$ 11,239,084,216	=	\$	10,490,289,461

¹ In Category 1, the real estate investments are all publicly traded real estate investment trusts. Non-categorized real estate consists of investments through various legal entities.

² In Category 1, the alternative investments are publicly traded stocks and bonds. Non-categorized alternative investments consist of limited partnerships and non publicly traded stocks and bonds.

³ Changed name of Equities to Common Stock and moved the American Depository Receipts (ADR) Equities of \$10,028,964 from Common Stock to International Investment.

⁴ Changed name of Derivative (International) to International Investment.

Notes to General Purpose Financial Statements

NOTE 5 - COMMITMENTS AND CONTINGENCIES

Under the Administrative Procedures Act, members may appeal a decision made by the Board. Once the administrative procedure has been exhausted, the decision may be appealed in Michigan's court system. Various cases that have exhausted the administrative procedures have been appealed in the court system. These cases are in the normal course of business and the System does not anticipate any material loss as a result of the contingent liabilities.

Required Supplementary Information

Schedule of Funding Progress

Expressing the net assets available for benefits as a percentage of the actuarial accrued liability provides one indication of the Michigan State Employees' Retirement System funding status. Analysis of this percentage over time indicates whether the System is becoming financially stronger or weaker. Generally, the greater this percentage, the stronger the System. Trends in unfunded actuarial accrued liability and annual covered payroll are both affected by inflation. Expressing the unfunded or overfunded actuarial accrued liability as a percentage of annual covered payroll approximately adjusts for the effects of inflation and aids analysis of progress made in accumulating sufficient assets to pay benefits when due. Generally, the smaller this percentage, the stronger the System.

Retirement Benefits (\$ in Millions)

Valuation Date Sept 30	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) ⁽¹⁾ (b)	Unfunded (Overfunded) Accrued Liability (UAAL) (b-a)	Funded Ratio AAL (a/b)	Covered Payroll (c)	UAAL as a % of Covered Payroll ((b-a)/c)
1991@	\$ 4,347	\$ 4,939	\$ 592	88.0	\$ 2,315	25.6 %
1992	4,534	5,480	946	82.7	2,266	41.8
1993+	5,043	6,172	1,129	81.7	2,261	49.9
1994*	5,476	6,560	1,084	83.5	2,351	46.1
1995	6,090	6,861	771	88.8	2,431	31.7
1996	6,678	7,147	469	93.4	2,515	18.6
1997	7,515	8,213	698	91.5	2,273	30.7
1997#	8,834	8,100	(734)	109.1	2,273	(32.3)
1998	9,109	8,374	(735)	108.8	2,108	(34.9)
1998#	9,109	8,497	(612)	107.2	2,108	(29.0)
1999	9,648	9,029	(619)	106.9	2,214	(28.0)
2000	10,337	9,474	(863)	109.1	2,254	(38.3)

⁽¹⁾ Based on entry age normal actuarial method.

[@] Benefits amended.

Revised asset valuation method.

[#] Revised actuarial assumptions and revised asset valuation method.

^{*} Revised actuarial assumptions.

Required Supplementary Information (Continued)

Schedule of Employer Contributions

Fiscal Year Ending Sept. 30	R Coi	Annual Required atribution (ARC)*	Co	Actual ontribution**	Percentage Contributed	<u>l</u>
1991	\$ 1	195,590,162	\$	154,027,600	78.8	%
1992	2	215,470,500		187,004,712	86.8	
1993	2	219,912,052		247,047,499	112.3	
1994	2	230,231,706		263,791,739	114.6	
1995	2	260,769,716		306,488,437	117.5	
1996	2	262,458,665		285,766,953	108.9	
1997	2	244,102,003		288,366,799	118.1	
1998	1	126,396,181		145,734,677	115.3	
1999	1	111,415,984		121,119,857	108.7	
2000	1	120,906,261		121,817,366	100.8	

^{*} The ARC has been recalculated based on the covered payroll for each year.

^{**} The actual contributions have been recalculated based on the same measure of covered payroll utilized to calculate the ARC.



Notes to Required Supplemental Information

NOTE A - DESCRIPTION

Ten year historical trend information designed to provide information about the Michigan State Employees' Retirement System's progress made in accumulating sufficient assets to pay benefits when due is presented in the preceding schedules. Other ten year historical trend information related to the pension plan is presented in the Statistical and Actuarial Sections of the report. This information is presented to enable the reader to assess the progress made by the System in accumulating sufficient assets to pay pension benefits as they become due.

The comparability of trend information is affected by changes in actuarial assumptions, benefit provisions, actuarial funding methods, accounting policies, and other changes. Those changes usually affect trends in contribution requirements and in ratios that use the pension benefit obligation as a factor.

The Schedule of Funding Progress and Schedule of Employer Contributions are reported as historical trend information. The Schedule of Funding Progress is presented to measure the progress being made to accumulate sufficient assets to pay benefits when due. The Schedule of Employer Contributions is presented to show the responsibility of the Employer in meeting the actuarial requirements to maintain the System on a sound financial basis.

NOTE B - SUMMARY OF ACTUARIAL ASSUMPTIONS

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 latest actuarial valuation follows:

Valuation Date
Actuarial Cost Method
Amortization Method

Remaining Amortization Period 36 Years
Asset Valuation Method 5-Year Smoothed Market Value

Actuarial Assumptions:

Inflation Rate
Investment Rate of Return
Projected Salary Increases
Cost-of-Living Adjustments

09/30/00 Entry Age, Normal Level Percent of Payroll, Closed

Tour Smoothed Hanker V

4% - 16% 3% Annual Non-Compounded with Maximum Annual Increase of \$300 for those Eligible

4%

8%

Supporting Schedules

Comparative Summary Schedule of Pension Plan Administrative Expenses for the Years Ended September 30, 2000 and 1999

	2000	1999
Personnel Service:		
Staff Salaries	\$ 1,174,625	\$ 1,152,512
Retirement and Social Security	226,794	199,764
Other Fringe Benefits	180,277	160,477
Total	1,581,696	1,512,753
Professional Services:		
Actuarial	67,890	57,758
Attorney General	226,471	328,537
Audit	44,325	28,637
Consulting	127,437	20,873
Medical	355,822	272,273
Total	821,945	708,078
Building and Equipment:		
Building Rentals	102,555	98,996
Equipment Purchase, Maintenance and Rentals	96,592	60,718
Total	199,147	159,714
Miscellaneous:		
Travel and Board Meetings	11,696	11,882
Office Supplies	21,066	48,618
Postage, Telephone and Other	474,394	433,350
Printing	65,078	44,865
Technological Support	779,970	1,411,363
Total	1,352,204	1,950,078
Total Administrative Expenses	\$ 3,954,992	\$ 4,330,623

Supporting Schedules (Continued)

Schedule of Investment Expenses

	2000	1999
Real Estate	\$ 602,289	\$ 1,163,465
Securities Lending Expense	14,452,406	16,330,884
Other*	14,478,754	9,687,920
Total Investment Expenses	\$29,533,449	\$27,182,269

^{*}See Investment Section for fees paid to investment professionals

Schedule of Payments to Consultants

	2000	1999
Independent Auditors Legal Actuary	\$ 44,325 226,471 67,890	\$ 28,637 328,537 57,758
Total Payments	\$ 338,686	\$ 414,932

Supporting Schedules (Continued)

Detail of Changes in Plan Net Assets (Pension and Postemployment Healthcare Benefits)

			For the Year Ende	d September 30, 200	0	
	Employee	Pension	Employer		Health	TD 4.1
	Savings	Reserve	Accumulation	Income	Insurances	<u>Total</u>
Additions:						
Members contributions	\$4,606,662				\$ 5,056,971	\$ 9,663,633
Employer contributions	, , ,		\$ 121,817,366		166,833,573	288,650,939
DC Savings			, ,, ,, ,, ,,		573,600	573,600
Investment income:					ŕ	,
Investment income				\$1,373,692,210		1,373,692,210
Securities lending income				15,447,180		15,447,180
Investment Expenses:						
Real estate operating expenses				(602,289)		(602,289)
Securities lending expenses				(14,452,406)		(14,452,406)
Other investment expenses				(14,478,754)		(14,478,754)
Interest income					3,766,152	3,766,152
Miscellaneous income				2,777		2,777
Total additions	4,606,662		121,817,366	1,359,608,718	176,230,296	1,662,263,042
Deductions:						
Benefits and refunds paid to plan						
members and beneficiaries:						
Retirement allowances		\$ 458,803,774				458,803,774
Employer share of health insurance					193,427,912	193,427,912
Employer share						
of dental/vision insurance					15,199,690	15,199,690
Refunds of member contributions	43,486				8	43,494
Transfers to other systems	17,674		161,003			178,677
Administrative Expenses			,	3,954,992		3,954,992
•						
Total deductions	61,160	458,803,774	161,003	3,954,992	208,627,610	671,608,539
Net Increase (Decrease)	4,545,502	(458,803,774)	121,656,363	1,355,653,726	(32,397,314)	990,654,503
Other Changes in Net Assets:						
Interest allocation		350,481,636	247,481,077	(597,962,713)		
Transfers upon retirements	(3,688,268)	3,688,268				
Transfers of inactive balances						
Transfers of employer shares		156,825,665	(156,825,665)			
Total other changes in net assets	(3,688,268)	510,995,569	90,655,412	(597,962,713)		
Net Increase (Decrease)	857,234	52,191,795	212,311,775	757,691,013	(32,397,314)	990,654,503
After Other Changes	037,231	32,171,773	212,311,773	737,031,013	(32,377,311)	770,00 1,000
Net Assets Held in Trust for Pension and Health Benefits:						
Beginning of Year	5,052,694	4,381,020,455	3,093,513,459	2,745,293,998	47,076,897	10,271,957,503
End of Year	\$5,909,928	\$4,433,212,250	\$3,305,825,234	\$3,502,985,011	\$14,679,583	\$11,262,612,006

Supporting Schedules (Continued)

Detail of Changes in Plan Net Assets (Pension and Postemployment Healthcare Benefits)

	For the Year Ended September 30, 1999					
	Employee	Pension	Employer		Health	
	Savings	Reserve	Accumulation	Income	Insurances	<u>Total</u>
Additions:						
Members contributions	\$6,186,018				\$ 4,861,628	\$ 11,047,646
Employer contributions			\$ 121,119,857		144,515,776	265,635,633
DC Savings					170,600	170,600
Investment income:						
Investment income				\$1,475,060,958		1,475,060,958
Securities lending income				17,317,384		17,317,384
Investment Expenses:				(1.162.465)		(1.162.465)
Real estate operating expenses Securities lending expenses				(1,163,465) (16,330,884)		(1,163,465) (16,330,884)
Other investment expenses				(9,687,920)		(9,687,920)
Interest income				(3,007,320)	6,048,620	6,048,620
Miscellaneous income				159		159
Total additions	6,186,018		121,119,857	1,465,196,232	155,596,624	1,748,098,731
Deductions:						
Benefits and refunds paid to plan						
members and beneficiaries:						
Retirement allowances		\$ 446,219,254				446,219,254
Employer share of health insurance					169,003,923	169,003,923
Employer share of						
dental/vision insurance	21.000			42	15,123,552	15,123,552
Refunds of member contributions Transfers to other systems	21,068 57,263		649,993	42		21,110 707,256
Transfers to other systems Administrative Expenses	37,203		049,993	4,330,623		4,330,623
Administrative Expenses				4,550,025		4,550,025
Total deductions	78,331	446,219,254	649,993	4,330,665	184,127,475	635,405,718
Net Increase (Decrease)	6,107,687	(446,219,254)	120,469,864	1,460,865,567	(28,530,851)	1,112,693,013
Other Changes in Net Assets:						
Interest allocation	1,148,261	339,045,681	238,434,887	(578,628,829)		
Transfers upon retirements	(4,295,638)	4,295,638				
Transfers of inactive balances	(86)		(2.12.022.201)	86		
Transfers of employer shares		245,827,381	(245,827,381)			
Total other changes in net assets	(3,147,463)	589,168,700	(7,392,494)	(578,628,743)		
Net Increase (Decrease)						
After Other Changes	2,960,224	142,949,446	113,077,370	882,236,824	(28,530,851)	1,112,693,013
Net Assets Held in Trust for Pension and Health Benefits:						
Beginning of Year	2,092,470	4,238,071,009	2,980,436,089	1,863,057,174	75,607,748	9,159,264,490
End of Year	\$5,052,694	\$4,381,020,455	\$3,093,513,459	\$2,745,293,998	\$47,076,897	\$10,271,957,503

Prepared by Michigan Department of Treasury, Bureau of Investments

Report on Investment Activity **Asset Allocation Investment Results** List of Largest Stock Holdings List of Largest Bond Holdings Schedule of Investment Fees Schedule of Investment Commissions **Investment Summary**

Report on Investment Activity

INTRODUCTION

The State Treasurer reports quarterly the investment activity to the Investment Advisory Committee, who reviews the investments, goals and objectives of the retirement funds and may submit recommendations regarding them to the State Treasurer. The Investment Advisory Committee may also, by a majority vote, direct the State Treasurer to dispose of any holdings that, in the committee's judgement, are not suitable for the funds involved, and may, by unanimous vote, direct the State Treasurer to make specific investments.

The Investment Advisory Committee was created by Act 380 of the Public Acts of 1965. The three public members of the five-member committee are appointed by the Governor with the advice and consent of the Senate for three-year terms. The Director of the Department of Consumer and Industry Services and the Director of the Department of Management and Budget are ex-officio members. The members of the committee are as follows: Mr. Samuel Valenti III (public member), Robert E. Swaney, CFA (public member), David G. Sowerby (public member), Kathleen M. Wilbur (ex-officio member), and Janet E. Phipps (ex-officio member). The public members serve without pay, but are paid actual and necessary travel and other expenses.

INVESTMENT POLICY & GOAL

The primary function of the System is to provide retirement, survivor and disability benefits to its members. The State Treasurer is the sole investment fiduciary and custodian of the System's investments pursuant to state law. The primary investment objective is to maximize the rate of return on the total investment portfolio, consistent with a high degree of prudence and sufficient diversity to eliminate inordinate risks and to meet the actuarial assumption for the investment rate of return, at a reasonable cost achieved by cultivating a motivated team of dedicated professionals. The goals of the fund are:

- 1. To outperform the actuarial assumptions over the long-term.
- 2. To produce competitive results at a low cost.
- 3. To achieve a balance between risk and return.
- 4. To perform in the top half of the Capital Resource Advisors public plan universe.
- 5. To exceed individual asset class benchmarks over the long-term.

The strategy for achieving these goals is carried out by investing the assets of the System according to a five-year asset allocation model. The System currently has seven different asset classes which provides for a well diversified portfolio.

Asset Allocation (Excludes Collateral on Loaned Securities)

Investment Category	As of 9/30/00 Actual %	Target %
	0.00/	0.00/
Mortgages	0.0%	0.0%
International Equities-Passive	e 6.4%	12.0%
Real Estate	8.6%	8.5%
Alternative Investments	16.0%	14.0%
Short Term Investments	3.8%	2.5%
Fixed Income	20.0%	20.0%
Domestic Equity	45.2%	43.0%
TOTAL	100.0%	100.0%

Report on Investment Activity

STATE LAW

Pursuant to State Law (Section 91 of Act No. 380 of the Public Acts of 1965, as amended), the State Treasurer, State of Michigan, is the investment fiduciary for the following four State sponsored retirement systems: Michigan Public School Employees' Retirement System; Michigan State Employees' Retirement System; Michigan State Police Retirement System; and Michigan Judges' Retirement System.

Act No. 314 of the Public Act of 1965, as amended, authorizes the investment of assets of public employee retirement systems or plans created and established by the state or any political subdivision.

PROXY VOTING POLICY

The System's Proxy Voting Policy sets forth directives on the following issues: Board of Directors, corporate governance, social issues, corporate restructurings and defenses. All proxies are reviewed and voted in accordance with the above mentioned items.

INVESTMENT RESULTS

Total Portfolio Result

For the fiscal year ended September 30, 2000, the total portfolio returned 14.8%, as compiled by Capital Resource Advisors. Annualized for the three-year period, the fund returned 13.0%, and for the five-year period, the fund returned 15.4%.

During the fiscal year ending September 30, 2000, the nation's economy was characterized by full employment, low inflation, and moderate economic growth. The equity market experienced a dichotomy as growth stocks, paced by technology stocks, outperformed the broad averages during the first half of the fiscal year and value stocks, paced by capital goods stocks, outperformed in the second half of the fiscal year.

By index, the NASDAQ increased 84.0% during the first half of the fiscal year, fell 27.0% over the second half, yet ended with a net gain of 34.0%. The S&P 500 increased 13.3% while the Dow Jones Industrial Average was ahead 4.6%. The Federal Reserve increased the federal funds rate by 1 1/4% points during the fiscal year. In spite of the tightening moves, the Lehman Government/Corporate Index still managed to post a 6.7% increase.

The returns were calculated using a time-weighted rate of return in accordance with standards of the Association for Investment Management and Research (AIMR), unless a modification is described in the discussion of the return.

The System is well diversified among asset classes. As of September 30, 2000, the portfolio consisted of 45.2% domestic equities, 20.0% fixed income, 16.0% alternative investments, 8.6% real estate, 3.8% short-term investments, and 6.4% international securities.

Domestic Stocks - Active

The objective of actively managed domestic stock investments is long-term capital appreciation by investing in publicly-traded stocks of primarily U.S.-based companies. The portfolio is diversified among various securities and industries.

Equity markets began the fiscal year with leadership concentrated in the technology sector. However, the exuberance peaked in March, accompained by a flurry of initial public offerings (IPOs), primarily in the technology and telecommunication equipment sectors. In the meantime, corporate earnings continued their double-digit gains, employment remained high, and energy and other commodity prices came roaring back from 1998 lows. In response, the Federal

Report on Investment Activity

Reserve acted to put the brakes on the economy by raising rates four times during the fiscal year for a total of 1 1/4% points. This created even more market volatility than had been witnessed in recent years, with both the S&P 500 and Dow Jones Industrial Average finishing the fiscal year 6% below their springtime peaks and the NASDAQ 27% off it's peak.

The actively managed domestic stock portfolio achieved a total rate of return of 9.1% for the fiscal year, compared with 13.3% for the S&P 500 Index and 4.6% for the Dow Jones Industrial Average. The markets were led by a 34.0% gain for financial stocks, followed closely by 33.3% for capital goods. Three-year and five-year annualized rates of return for the actively managed domestic stock portfolio were 12.2% and 18.7%, respectively. This compared with 16.4% and 21.7% for the S&P 500.

At the close of Fiscal Year 2000, actively managed domestic stocks represented 29.9% of total System investments, compared to 37.5% at the end of Fiscal Year 1999.

Effective January 31, 2000, the actively managed domestic stock portfolio was divided into two distinct portfolios: Growth and Value. Since historical returns for value and growth strategies have been negatively correlated, this will allow for further diversification and more focused selection of investments. Value investing derives its returns from the market's tendency to periodically undershoot a stock's fair value and then eventually correct back to fair value. Growth stock returns accrue from longer-term broad themes from which companies evolve that will grow faster than the economy. Performance and other pertinent data on the separate portfolios will be provided in future reports.

Domestic Stocks - Passive

The objective of the enhanced S&P 500 and S&P MidCap Index Funds is to closely match the return performance of their benchmarks, use low risk strategies to offset transaction costs and add to performance when possible. The S&P 500 Index Fund return for the fiscal year was 13.7% versus the benchmark's 13.3%. The S&P MidCap Index Fund return for the fiscal year was 45.0% versus its benchmark's 43.2%. The enhancements to the returns were the result of strategic allocations of additional funds to passive equity investments during market corrections and the opportunistic use of derivative programs. During Fiscal Year 2000, \$71 million was added to U.S. index funds. At the end of the fiscal year, the passive domestic stock portfolios represented 15.2% of total assets, the S&P 500 Index Fund accounting for 14.0% and the S&P MidCap Index Fund 1.2%. Indexed stock portfolios represented 14.0% of total investment assets at the end of the prior fiscal year.

International Equities - Passive

The objective of the passive international equity portfolio is to match the return performance of the Salomon Smith Barney Broad Market Index (BMI) Europe and Pacific Composite (EPAC) adjusted for net dividends. Fifty percent of the benchmark is hedged to the U.S. dollar and the other half is affected by foreign currency exchange rate changes. The total passive international return of 10.6% in the fiscal year compared favorably with the Salomon Smith Barney Index BMI-EPAC return of 10.4%. The passive international return of 11.6% for three years compared well with the benchmark's return of 10.1% over the same period.

Core passive exposure to international equity returns is achieved by investing in a combination of fixed income notes and equity swap agreements on foreign stock indices in developed markets. Interest on the dedicated notes is exchanged for international stock returns, and the total notional amount of the swap agreements is invested in the approximate proportions of the Salomon Smith Barney Broad Market Index (BMI) Europe and Pacific Composite (EPAC) country weightings in those country indices. Use of swap agreements for a core position began in 1993, and an American Depository Receipts (ADR) and index-related security portfolio was added in June of 1999 to increase management flexibility. During Fiscal Year 2000, \$80.3 million of exposure was added, raising passive international investments to 6.4% of total investment assets.

Report on Investment Activity

The combination of fixed income LIBOR notes and equity swap agreements was valued at \$690.1 million on September 30, 2000. That valuation included a net unrealized gain of \$69.1 million on equity index exposures and an unrealized gain of \$0.2 million on LIBOR note investments held. During Fiscal Year 2000, \$70.3 million of gains on equity exposures were realized, and \$4.9 million of interest in excess of obligations on completed swaps was also recognized. At the end of the fiscal year, total realized gains and net interest received in excess of counterparty obligations on completed agreements reached a record \$204.0 million since the program began.

Fixed Income

For the fiscal year ending September 30, 2000, the fixed income portfolio returned 6.8% as compiled by Capital Resource Advisors. The portfolio returned 5.7% for the three-year period and 6.6% for the five-year period.

During the year, treasury rates decreased but spreads widened. Fixed income markets rewarded higher grade portfolios. MSERS' fixed income portfolio was weighted toward governments. The fund outperformed the Lehman Index for the one-year period 6.8% verus 6.7%, underperformed in the three-year period 5.7% versus 5.8% and outperformed the index for the five-year period 6.6% versus 6.3%. Relative to the Salomon Brothers Broad Grade Index, MSERS underperformed in the one-year time horizon 6.8% to 6.9%, the three-year period 5.7% to 5.9% and was ahead in the five-year period 6.6% to 6.5%.

Fixed Income represented 20.0% of the total portfolio compared with 22.3% last year. The corporate sector represented 40.9% of fixed income securities with government securities accounting for 59.1%. Last year corporates were 37.4% of the total with governments representing 62.6%. The increased level of corporates was the result of quality spreads widening.

Real Estate Equity

For the fiscal year ending September 30, 2000, 8.6% of the total investment portfolio was invested in equity real estate. This compares to 7.7% for the fiscal year ending September 30, 1999. The target asset allocation for equity real estate investment is 8.5%.

The one-year, three-year and five-year total equity real estate net returns for the fiscal year ending September 30, 2000, were 11.4%, 11.7% and 11.9%, respectively, as compiled by Capital Resource Advisors. This compares to the National Council of Real Estate Investment Fiduciaries (NCREIF) Property Index returns of 10.9%, 12.9% and 11.5% relating to the same time periods. As of September 30, 2000, the NCREIF portfolio of properties is heavily weighted in the office sector at 40.0% versus the System portfolio at 27.0%. The historical volatility of the office sector returns makes it a more risky property type. Because the NCREIF Property Index returns are quoted before advisor fees/overhead and the System's returns are quoted after all advisor fees/overhead, the NCREIF returns stated above have been adjusted downward by 75 basis points to approximate comparable returns.

To reduce risk, the real estate investments are broadly diversified geographically, across the country, by type of property, and by class of property, to reduce risk. Major property types as of September 30, 2000, included: apartments (41%), retail centers, including regional malls and neighborhood/community shopping centers (27%), commercial office buildings (27%), and miscellaneous property types, such as industrial and self storage (5%). The System, through its advisors, acquires, develops, redevelops and disposes of real estate with the goal of maximizing returns while maintaining an *acceptable* level of risk. The properties are held in various investment vehicles: partnerships, LLC's, trusts, commingled funds, and REIT stock. These legal entities allow the System to enjoy the benefits of real estate ownership while limiting the liability associated with this asset class. In all new investments, the System retains approval rights over critical decisions in order to further mitigate risk. The properties are regularly valued by independent appraisers to establish market values.

Report on Investment Activity

Real Estate Debt (Mortgages)

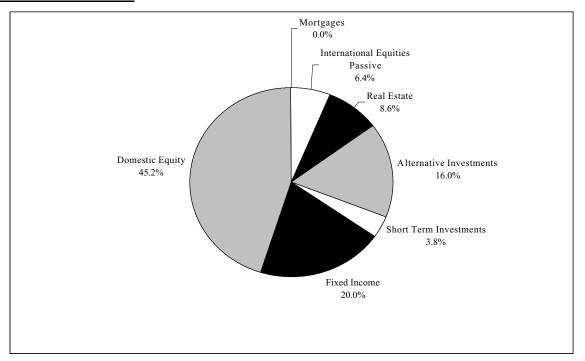
For the fiscal year ending September 30, 2000, less than 0.1% of the total investment portfolio was invested in direct mortgages. The asset allocation objective is to reduce mortgage holdings to 0% over time; a majority of the mortgage portfolio was sold in 1997 and 1998 to take advantage of the favorable low interest rate environment. The one-year, three-year and five-year total returns for the mortgage portfolio for the fiscal year ending September 30, 2000, were -6.3%, -2.5% and 1.4%, respectively.

Alternative Investments

Alternative Investments are investments in the private equity market either directly in operating companies or indirectly through limited partnerships. Through September 30, 2000, approximately 89.0% of alternative investments were made through limited partnerships. Of the investments in limited partnerships, approximately 11.0% were in partnerships investing internationally. The remaining 11.0% were direct private equity investments and public stock distributions received from the limited partnerships. The percentage of assets in alternative investments has consistently increased from 4.8% as of September 30, 1993, to 16.0% as of September 30, 2000. The target asset allocation for alternative investments is 14.0%. The System operates within a five-year range of 10%-15%. The one-year, three-year and five-year total alternative investment returns for the fiscal year ending September 30, 2000, were 43.3%, 26.5% and 26.0%, respectively.

Report on Investment Activity

Asset Allocation



Investment Results Period Ending September 30, 2000

Annualized Rate of Return **Investment Category Current Year** 3 Years 5 Years 10 Years Total Portfolio 14.8 % 13.0 % 15.4 % 13.3 % Domestic Equities Stock - Active 9.1 12.2 18.7 16.8 15.6 22.0 19.9 Domestic Equities Stock - Passive* 17.0 Standard & Poor's (S&P 500) 19.4 13.3 16.4 21.7 Standard & Poor's (MidCap) 43.2 19.0 21.7 21.8 International Equities - Passive 10.6 11.6 13.2 N/A Net Salomon BMI - EPAC 50/50 10.4 10.1 12.0 N/A Fixed Income Bonds (U.S. Corp and Govt) 6.8 5.7 6.6 8.5 Salomon Smith Barney Broad Investment Grade Bond Index 6.9 5.9 8.1 6.5 Lehman Brothers Government/Corporate 6.7 5.8 6.3 8.1 5.4 (6.3)(2.5)1.4 Mortgages Salomon Smith Barney Broad Investment Grade Bond Index 6.9 5.9 6.5 8.1 Real Estate - Equity 11.4 11.7 11.9 6.0 NCREIF minus 75 Basis Points 10.9 12.9 11.5 5.4 19.9 Alternative Investments 43.3 26.5 26.0

^{*} Passive portfolio consists of a S&P 500 fund and a S&P Midcap fund. The return is a weighted average of the two funds.

Report on Investment Activity

Largest Assets Held

Largest Stock Holdings (By Market Value) September 30, 2000

Rank	Shares	Stocks	 Market Value
1	4,163,518	General Electric Corporation	\$ 240,182,945
2	4,616,462	Pfizer Incorporated	207,452,261
3	2,979,894	Cisco Systems Incorporated	164,639,144
4	2,846,186	Citigroup Incorporated	153,871,931
5	2,501,179	Microsoft Corporation	150,852,358
6	1,491,602	Exxon Mobil Corporation	132,939,028
7	2,126,424	Wal-Mart Stores Incorporated	102,334,155
8	2,393,234	Intel Corporation	99,468,788
9	1,503,058	Home Depot Incorporated	79,756,015
10	1,107,566	Federal National Mortgage Association	79,190,969

Largest Bond Holdings (By Market Value) September 30, 2000

Rank	Par Amount	Bonds & Notes	Market Value
1	\$ 85,815,000	U.S. Treasury Bonds at 9.125% Due 5-15-2009	\$ 94,034,361
2	59,950,000	U.S. Treasury 0% Coupon Strips Due 8-15-2003	50,779,449
3	43,400,000	Ford Motor Credit Corp FRN 6.59125% Due 10-9-2001	43,508,500
4	34,880,000	Bankers Trust Corp FRN 6.74% Due 3-16-2001	34,899,184
5	49,486,000	U.S. Treasury 0% Coupon Strips Due 11-15-2011	34,704,532
6	32,700,000	FHLMC Debenture 6.70% Due 7-23-2008	31,192,857
7	34,777,000	U.S. Treasury Tiger 0% Coupon Due 8-15-2004	27,308,639
8	26,667,310	Chemical Bank FRN 6.775% Due 7-29-2003	26,911,545
9	26,395,925	First Chicago Corp FRN 6.8375% Due 7-28-2003	26,440,367
10	23,980,000	MTN Nations Bank FRN 6.76% Due 1-05-2004	23,990,791

A complete list of stock and bond holdings is available from the Michigan Department of Treasury.

Report on Investment Activity

Schedule of Investment Fees

The State Treasurer is the investment fiduciary and custodian of the System's funds pursuant to state law. Outside advisors are utilized to augment the State Treasurer's internal staff in the real estate and alternative investment markets. Only 14.6% of the total investment portfolio is managed by fully discretionary outside advisors. Outside advisors' fees are netted against the partnership or trust fund income. The Michigan Department of Treasury's cost of operations applicable to the System for the fiscal year amounted to \$1,698.1 thousand or less than two basis points (.02%) of the market value of the portfolio.

State law created an Investment Advisory Committee comprised of the directors of the Department of Consumer and Industry Services and Management and Budget, or their duly authorized representatives, and three public members appointed by the Governor with the advice and consent of the Senate. The public members serve without pay, but are paid actual and necessary travel and other expenses. The committee meets quarterly to review investments, goals and objectives and may submit recommendations to the State Treasurer. The committee may also, by a majority vote, direct the State Treasurer to dispose of any holding which in the committee's judgement is not suitable for the fund involved, and may by unanimous vote direct the State Treasurer to make specific investments.

Schedule of Investment Fees

Investment Managers' Fees:

		N	Asset under Ianagement In thousands)	(in	Fees thousands)	Basis Points*
State Treasurer		\$	9,533,609.5	\$	1,698.1	1.8
Outside Advisors -	Alternative		1,587,476.1		12,582.0	79.3
	Real Estate		38,130.8		-	-
Total		\$	11,159,216.4			

Other Investment Services Fees:

	(Assets in Custody**	(:	Fees
		n thousands)	<u>(m</u>	thousands)
Custody & Research Fees Security Lending Fees	\$	8,110,104.4 247,053.8	\$	199.4 14,452.4

^{*} Outside Advisors Fees are netted against the income of the partnership and trust income. The partnership agreements define the management fees, which range from 150 to 250 basis points of the committed capital, in most cases the fees are netted against income. For Real Estate the asset management fees normally range from 25 to 90 basis points and are netted against current year's income.

^{**} Other investment service fees are charged on assets managed by the State Treasurer at its custodial bank in the amount of \$8,110,104.4 thousand; \$247,053.8 thousand of assets were on loan at fiscal year end.

Report on Investment Activity

Schedule of Investment Commissions

	Fiscal '	Year Ended Septembe	er 30, 2000
	mmissions	Number of	Average Commission
	Paid (1)	Shares Traded	Rate Per Share
Investment Brokerage Firms:	_	_	
Merrill Lynch & Co.	\$ 183,387	3,697,124	0.05
Goldman, Sachs & Co.	173,887	3,387,279	0.05
C.S. First Boston Corporation	155,646	3,112,916	0.05
Morgan Stanley Dean Witter	154,813	3,056,874	0.05
Salomon Smith Barney, Inc.	140,153	3,149,700	0.04
Bridge Trading Company	114,706	2,273,059	0.05
UBS Warburg	107,703	2,203,735	0.05
Lehman Brothers, Inc.	103,671	2,019,625	0.05
Bear, Stearns & Co.	102,668	2,203,950	0.05
Donaldson, Lufkin & Jenrette Securities Corp.	99,956	2,076,650	0.05
Prudential Securities, Inc.	69,329	1,360,177	0.05
J.P. Morgan Securities, Inc.	54,037	1,080,732	0.05
Sanford C. Bernstein & Co.	51,797	983,627	0.05
S.G. Cowen & Company	47,251	930,390	0.05
CIBC World Market	42,654	853,090	0.05
Deutsche Bank	32,438	648,753	0.05
Standard & Poor's Securities	24,607	492,135	0.05
Cantor Fitzgerald & Co.	20,074	528,791	0.04
BancBoston Robertson Stephens	18,802	322,562	0.06
Schroder & Co. Inc.	15,874	317,478	0.05
Charles Schwab & Co., Inc.	15,161	303,219	0.05
Banc of America Securities, LLC	12,479	249,578	0.05
First Union Securities	11,503	230,055	0.05
ISI Group, Inc	9,604	192,087	0.05
Howard Weil Labouisse, Friedrichs, Inc	 8,248	143,955	0.06
Subtotal (25 highest)	\$ 1,770,448	35,817,541	0.05 (2
All Other Brokerage Firms	 24,542	444,675	0.06
Total	\$ 1,794,990	36,262,216	0.05 (4

⁽¹⁾ These amounts are included in purchase and sale prices of investments.

⁽²⁾ The average commission rate per share for the top 25 brokerage firms.

⁽³⁾ The average commission rate per share for all other brokerage firms, excluding the top 25 brokerage firms.

⁽⁴⁾ The average commission rate per share for all brokerage firms.

Investment Summary

			Fiscal Year Ended So	Ended September 30, 2000			Fisca	Fixal Year Ended September 30, 1999	September 30,	1999	
					Percent of						Percent of
			Percent of Total	Investment &	Investment &			Percent of Total	Investment &	int &	Investment &
	Mar	Market Value (a)	Market Value	Interest Income ^(c)	Interest Income	Market Value (a)		Market Value	Interest Income ^(c)	i	Interest Income
Fixed Income:											
Government Bonds	S	1,316,205,120	11.8%	\$ 92,073,008	6.7%	\$ 1,423,796,050	090	13.9%	\$	(2,541,915)	(02%)
Corporate Bonds											
& Preferred Stocks		912,357,324	82%	52,524,201	3.8%	851,772,134	134	83%		7,528,232	05%
Mortgages		5,166,117	0.0%	(301,002)	0.0%	5,954,693	693	0.1%		1,438,796	0.1%
Total Fixed Income		2,233,728,561	20.0%	144,296,207	10.5%	2,281,522,877	128,	22.3%	•	6,425,113	0.4%
Common Stock		5,051,960,392	452%	563,924,360	409%	5,268,007,261	,261	51.4%		1,090,152,636	73.6%
Real Estate		955,549,473	8.6%	93,476,943	6.8%	787,166,737	757,	7.7%		89,311,006	%09
Alternative Investments		1,780,634,499	16.0%	498,580,169	362%	1,032,065,145	,145	10.1%	140	140,880,055	95%
International Equities - Passive		714,816,682	6.4%	59,060,171	4.3%	583,042,228	5 28	5.7%		134,118,497	9.1%
Short Term Investments ^(b)		421,670,703	3.8%	18,120,512	1.3%	284,569,989	686	2.8%		20,222,271	1.4%
Total	∞	\$ 11,158,360,310	100.0%	\$ 1,377,458,362	100.0%	\$ 10236,374,237	737	100.0%	\$ 1,481	1,481,109,578	100.0%

 $^{^{\}scriptsize (a)}$ Short Term Investments are at $\cos\! \zeta$ which approximates market.

⁽b) Includes equity in the State Treasurer's Common Cash Fund. Market Values for short term investments excludes the amounts payable and receivable for sales and purchases of securities with a settlement date after September 30 for each fiscal year. The amount also excludes \$145,827,738 and \$313,580,913 in cash collateral for security lending for fiscal year 2000 and 1999, respectively.

⁽e) Total Investment & Interest Income excludes net security lending income of \$994,774 and \$986,501 for fiscal year 2000 and 1999, respectively.

Actuary's Certification Summary of Actuarial Assumptions and Methods Schedule of Active Member Valuation Data Schedule of Changes in the Retirement Rolls **Prioritized Solvency Test** Summary of Plan Provisions

Actuary's Certification

THE SEGAL COMPANY

One Park Avenue New York, New York 10016-5895 212-251-5000 FAX: 212-251-5490

January 18, 2001

Ms. Janet E. Phipps Director Department of Management and Budget Retirement Board Michigan State Employees Retirement System P.O. Box 30176 Lansing, Michigan 48909

Ladies and Gentlemen:

The Michigan State Employees Retirement System (MSERS) is funded on an actuarial reserve basis. The basic financial objective of MSERS is to establish and receive contributions that remain approximately level as a percentage of active member payroll over a long period of years.

Actuarial valuations are prepared annually to determine MSERS's actuarial liabilities and the employer contributions required to fund the System in accordance with the actuarial reserve funding provisions of the governing State Statute. The most recent actuarial valuation as of September 30, 2000 included a total of 92,039 members of MSERS. The actuarial value of MSERS's assets amounted to approximately \$10.34 billion on September 30, 2000.

The actuarial assumptions used in the 2000 valuation are the same as those used in the previous annual actuarial valuation. These assumptions produce valuation results which we consider to be reasonably indicative of the plan's underlying cost. Also, in our opinion, the actuarial assumptions and methods used for funding purposes meet the parameters for the disclosures presented in the financial section by GASB Statement No. 25.

Our actuarial valuation of MSERS as of September 30, 2000 was performed by qualified actuaries in accordance with accepted actuarial procedures. In our opinion, the calculated contribution rate meets the fundamental objectives of State law. Based on the 2000 valuation results, it is also our opinion that the Michigan State Employees Retirement System continues in sound condition, in accordance with actuarial principles of level cost financing.

Most of the information used in the supporting schedules in the Actuarial and Statistical Sections, as well as the Schedules of Funding Progress and the employer contributions shown in the Schedules of Employer Contributions in the Financial Section of this report were provided by our firm.

Sincerely.

Michael Karlin, F.S.A., M.A.A.A. Senior Vice President & Actuary

Mulael Karlin

Atlanta Boston Chicago Cleveland Denver Edmonton Hartford Houston Los Angeles Minneapolis New Orleans New York Phoenix St. Louis San Francisco Seattle Toronto Washington, D.C. West Palm Beach



Multinational Group of Actuaries and Consultants: Amsterdam Antwerp Barcelona Hamburg Lausanne London Melbourne Mexico City Oslo Paris

Summary of Actuarial Assumptions and Methods

- 1. The investment return rate used in making the valuations was 8% per year, compounded annually. This rate of return is not the assumed real rate of return. The real rate of return is the rate of investment return in excess of the inflation rate. Considering other financial assumptions, this investment return rate translates to an assumed long term real rate of return of 4%. Adopted 1994.
- 2. The mortality table used in evaluating allowances to be paid was the 1994 Group Annuity Mortality Table, set forward one year for both men and women. Adopted 1998.
- 3. Sample probabilities of retirement with an age and service allowance are shown in Schedule 1 on the next page. Adopted 1998.
- 4. Sample probabilities of withdrawal from service and disability, together with individual pay increase assumptions, are shown in Schedule 2 on the next page of this report. Adopted 1998.
- 5. Total active member payroll is assumed to increase 4% per year. This represents the portion of the individual pay increase assumptions attributable to inflation. Adopted 1994.
- 6. An individual entry age actuarial cost method of valuation was used in determining age and service allowance actuarial liabilities and normal cost. Adopted 1975. Unfunded actuarial accrued liabilities are financed over a period of 50 years and over a declining 40 year period for years beginning October 1, 1996. Adopted 1996.
- 7. During 1998, the Department of Management and Budget approved the use of market value of assets as of September 30, 1997 for valuation purposes. For investment gains and losses that occur after that date, a 5-year smoothing technique will be used. Specifically, the excess (shortfall) of actual investment income (including interest, dividends, realized and unrealized gains or losses) over the imputed income at the valuation interest rate is considered the gain (loss), which is spread over five years.
- 8. The data about persons now covered and about present assets was furnished by the System's administrative staff. Although examined for general reasonableness, the data was not audited by the actuary.
- 9. The actuarial valuation computations were made by or under the supervision of a Member of the American Academy of Actuaries (MAAA). The assumptions used in the actuarial valuations were adopted by the System's board after consulting with the actuary.

Summary of Actuarial Assumptions and Methods (Continued)

SCHEDULE 1

Percent of Eligible Active Members Retiring Each Year

Retirement Ages	Correction Officers	Conservation Officers	Other Members
45		16 %	
48		16	
51	25 %	16	
55	15	16	20 %
58	12	15	15
61	15	15	15
64	22	22	22
67	25	25	25
70	50	50	50
75	100	100	100

SCHEDULE 2

Separation From Active Employment Before

Age & Service Retirement & Individual Pay Increase Assumptions

Sample Ages	Years of Service	Percent of Active Members Withdrawing Within Next Year (Men and Women)	Percent of Active Members Becoming Disabled Within Next Year	Percent Increase In Pay During Next Year
All	0	20.00 %		
	1	14.00		
	2	9.00		
	3	7.00		
	4	5.50		
25	5 & Over	5.50	0.01 %	11.50 %
35		3.50	0.04	5.70
45		2.25	0.26	4.75
55		1.75	0.65	4.24
60		1.75	0.90	4.00

Actuarial Valuation Data

Schedule of Active Member Valuation Data

Valuation Date Sept. 30	Number	Reported Annual Payroll*	Average Annual Pay	% Increase	Average Age	Average Service
1991	65,595	\$2,236,336	\$34,093	6.5 %	42.1	11.9 years
1992	64,248	2,189,752	34,083		42.2	11.9
1993	63,906	2,185,036	34,191	0.3	42.6	12.1
1994	64,923	2,271,158	34,982	2.3	43.1	12.6
1995	65,133	2,348,534	36,058	3.1	43.2	12.7
1996	63,807	2,515,420	39,422	9.3	43.8	13.0
1997	55,434	2,273,203	41,007	4.0	43.7	13.1
1998	49,717	2,107,996	42,400	3.4	44.8	14.8
1999	49,612	2,213,851	44,623	5.2	45.9	15.8
2000	47,778	2,253,818	47,173	5.7	46.7	16.7

In thousands of dollars. Base pay only excluding 3 1/2% for overtime and shift differentials through 1995. Greater of base pay or prior year actual earnings beginning in 1996.

Schedule of Changes in the Retirement Rolls

Year	Add	led to Rolls	Remo	ved from Rolls	Rolls-	End of Year	% Increase	Average
Ended Sept. 30	No.	Annual Allowances*	No.	Annual Allowances*	No.	Annual Allowances*	in Annual Allowances	Annual Allowances
1991	1,493	\$ 20,168	790	\$ 5,936	25,566	\$194,928	7.9 %	\$ 7,624
1992	4,177	55,336	887	6,652	28,856	243,612	25.0	8,442
1993	1,105	18,468	786	4,887	29,175	257,193	5.6	8,816
1994	1,888	22,636	1,101	6,442	29,962	273,387	6.3	9,124
1995	1,566	23,575	966	6,268	30,562	290,694	6.3	9,512
1996	1,595	24,527	1,064	7,288	31,093	307,933	5.9	9,904
1997	6,098	121,005	1,068	7,878	36,123	421,060	36.7	11,656
1998	1,279	21,085	1,217	9,689	36,185	432,456	2.7	11,951
1999	1,409	21,227	1,248	9,516	36,346	444,167	2.7	12,221
2000	1,540	22,421	1,181	2,619	36,705	463,969	4.5	12,640

In thousands of dollars

Prioritized Solvency Test

The Michigan State Employees' Retirement System's funding objective is to meet long term benefit promises through contributions that remain approximately level from year to year as a percent of member payroll. If the contributions to the System are level in concept and soundly executed, the System will pay all promised benefits when due -- the ultimate test of financial soundness. Testing for level contribution rates is the long term solvency test.

A prioritized solvency test is another means of checking a system's progress under its funding program. In a short condition test, the plan's present assets (cash and investments) 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 and inactive members. In a system following the discipline of level percent of payroll financing, the liabilities for active member contributions on deposit (liability 1) and the liabilities for future benefits to present retired lives (liability 2) will be fully covered by present assets (except in rare circumstances). In addition, the liabilities for service already rendered by active members (liability 3) is normally 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. Liability 3 being fully funded is not necessarily a by-product of level percent of payroll funding methods.

The schedule below illustrates the history of the liabilities of the System and is indicative of the System's policy of following the discipline of level percent of payroll financing.

Dortion of Drocont

Actu	uarial Present V	Value of
Accr	ued Liabilities	(\$ in Millions)
(1)	(2)	(3)

Valuation Date	Active Member	Retirants and	Active and Inactive Members(Employer	sValuation		Value Covered by Assets							
Sept. 30	Contributions	s Beneficiaries	Financed Portion)	Assets	(1)	(2)	(3)	(4)***					
1991#	\$ 82	\$ 1,870	\$ 2,987	\$ 4,347	100 %	100 %	80.2 %	88.0 %					
1992	83	2,413	2,984	4,533	100	100	68.3	82.7					
1993+	72	2,561	3,540	5,043	100	100	68.1	81.7					
1994@	73	2,778	3,709	5,476	100	100	70.8	83.5					
1995	72	2,751	4,038	6,090	100	100	80.9	88.8					
1996	55	2,844	4,248	6,678	100	100	89.0	93.4					
1997	3	4,300	3,910	7,516	100	100	82.2	91.5					
1998	27	4,360	3,987	9,109	100	100	118.4	108.8					
1998@	27	4,484	3,986	9,109	100	100	115.4	107.2					
1999	35	4,538	4,456	9,648	100	100	113.9	106.9					
2000	29	4,659	4,786	10,337	100	100	118.0	109.1					

[@] Revised actuarial assumptions.

Benefits amended.

⁺ Revised asset valuation method.

^{***} Percents funded on a total valuation asset and total actuarial accrued liability basis.

Summary Of Plan Provisions

Our actuarial valuation of the System as of September 30, 2000 is based on the present provisions of the Michigan State Employees' Retirement Act, which are summarized in this section.

Regular Retirement (no reduction factor for age)

<u>Eligibility</u> — Age 55 with 30 years service, or age 60 with 10 or more years service. Corrections Officers may retire at age 51 with 25 or more years service, or age 56 with 10 or more years service. Conservation Officers may retire after 25 years of service regardless of age.

<u>Final Average Compensation</u> — Regular retirement benefit is based on final average compensation (FAC), which is the average of highest 3 consecutive years (2 years for Conservation Officers).

<u>Annual Amount</u> — Total service times 1.5% of FAC. For members with 20 or more years of service, a \$3,000 minimum annual benefit is payable. Corrections Officers receive an additional temporary supplement to age 62 equal to the product of supplemental service times 0.5% of FAC. Conservation Officers retiring after 25 years receive a benefit equal to 60% of FAC.

Early Retirement (age reduction factor used)

Eligibility — Age 55 with 15 or more years service.

Annual Amount — Computed as regular retirement benefit but reduced by 0.5% for each month under age 60.

Deferred Retirement (vested benefit)

<u>Eligibility</u> — 10 years of service (5 years for unclassified persons in the executive or legislative branch). Benefit commences at age 60.

Annual Amount — Computed as regular retirement benefit based on service and FAC at termination.

Duty Disability Retirement:

Eligibility — No age or service requirement.

<u>Annual Amount</u> — Disability after age 60: Computed as regular retirement benefit with minimum benefit based on 10 years service. Disability prior to age 60: To age 60, benefit is two-thirds of FAC but limited to \$6,000 per year. Additional limitation such that benefit plus workers' compensation does not exceed final compensation. After age 60, benefit is recomputed as a regular retirement benefit with service granted for period in receipt of disability benefit before age 60 (benefit not reduced after age 60).

Non-Duty Disability Retirement:

Eligibility — 10 years of service.

<u>Annual Amount</u> — Computed as regular retirement benefit based on service and FAC at time of disability. Minimum annual benefit is \$600.

Summary Of Plan Provisions (Continued)

Duty Death Before Retirement

<u>Eligibility</u> — No age or service requirement. Also applies to duty disability retirant who dies within 3 years of disability and before age 60.

<u>Annual Amount</u> — Accumulated employee contributions are refunded. Surviving spouse receives annual benefit of one-third of final compensation until death. Unmarried children under age 18 each receive an equal share of one-fourth of final compensation (if no spouse each child receives one-fourth, to a maximum of one-half for all children). If no spouse or eligible children, each dependent parent receives one-sixth of final compensation. Total benefits payable are limited to \$2,400 per year. Additional limitation such that benefits plus workers' compensation does not exceed final compensation.

Non Duty Death Before Retirement

<u>Eligibility</u> — 10 years of service. In the case of a deceased vested former member, the survivor benefit commences when the deceased former member would have attained age 60.

<u>Annual Amount</u> — Computed as regular retirement benefit but reduced in accordance with a 100% joint and survivor election.

Post-Retirement Cost-of-Living Adjustments

One-time upward adjustments have been made in 1972, 1974, 1976, 1977 and 1987. Beginning in 1983, some benefit recipients share in a distribution of a portion of investment income earned in excess of 8% annually (supplemental payment). Beginning in 1988, all benefit recipients are eligible for automatic 3% annual (non-compounded) benefit increases, with a maximum \$300 annual increase. Eligibility for the above benefits:

Retired before October 1, 1987 Greater of supplemental payment or the combination of the 1987 one-

time adjustment and the automatic increases.

Retired on or after October 1, 1987 Automatic increases only.

Post-Retirement Health Insurance Coverage

Persons in receipt of retirement allowance (including members who did not retire directly from the System, but come from a vested deferred status), and their dependents, are eligible for 95% System paid health insurance coverage and 90% System paid dental and vision insurance.

Member Contributions

None.

Defined Contribution

New employees hired on or after March 31, 1997, become participants in Tier 2 (i.e., the defined contribution plan) rather than Tier 1 (i.e., the above described defined benefit plan).

Active members on March 30, 1997, had an opportunity to irrevocably elect to terminate membership in Tier 1 and become participants in Tier 2. Elections were in writing and submitted between January 2, 1998 and April 30, 1998. Such members became Tier 2 participants on June 1, 1998, and had the actuarial present value of their Tier 1 accrued benefit transferred into Tier 2 by September 30, 1998.

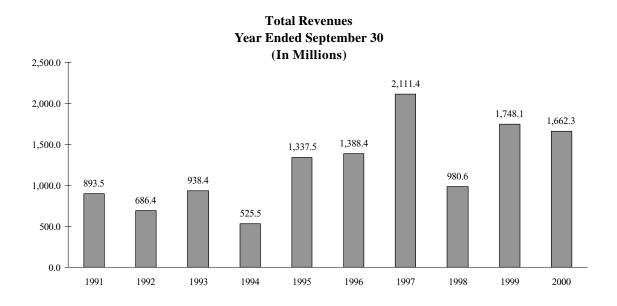
Schedule of Revenues by Source Schedule of Expenses by Type Schedule of Benefit Expenses by Type Schedule of Retired Members by Type of Benefit Schedule of Average Benefit Payments Ten Year History of Membership

Schedule of Revenues by Source

Fiscal Year		Employer	Contributions		
Ended Sept. 30	Member Contributions	Dollars*	% of Annual Covered Payroll	Net Investment & Other Income	Total
1991	\$ 4,416,336	\$ 227,348,243	10.17 %	\$ 661,760,771	\$ 893,525,350
1992	4,810,700	285,424,393	13.03	396,188,599	686,423,692
1993	4,068,696	371,902,232	17.02	562,436,683	938,407,611
1994	2,257,216	389,728,590	17.16	133,510,369	525,496,175
1995	2,260,510	422,294,609	17.98	912,938,131	1,337,493,250
1996	2,619,067	431,094,371	17.14	954,696,384	1,388,409,822
1997	15,858,366**	410,231,627	18.05	1,685,326,508	2,111,416,501
1998	9,777,845	259,799,179	12.32	711,056,989	980,634,013
1999	11,047,646	265,806,233	12.25	1,471,244,852	1,748,098,731
2000	9,663,633	289,224,539	6.50	1,363,374,870	1,662,263,042

^{*} Includes financing for early retirement pensions. Fiscal year 1999 and 2000 also includes amount received for DC Savings (see Note 2 to the financial statements in the Financial Section).

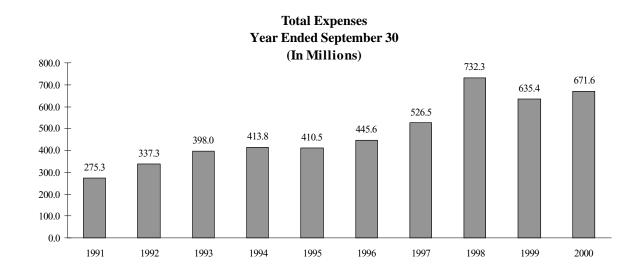
^{**} Increase is attributable to purchase of service credit in connection with "early out" retirement.



Schedule of Expenses by Type

Fiscal Year Ended Sept. 30	 Benefits *		Refunds and Transfers			inistrative & ner Expenses	Total					
1991	\$ 271,569,768	\$	126,406		\$	3,607,115	\$	275,303,289				
1992	333,082,770		123,792			4,047,661		337,254,223				
1993	394,557,537		99,369			3,412,142		398,069,048				
1994	409,975,308		92,153			3,777,812		413,845,273				
1995	406,140,322		80,453			4,268,833		410,489,608				
1996	439,056,397		30,082			6,489,761		445,576,240				
1997	513,359,239		7,848,649	**		5,247,943		526,455,831				
1998	593,453,930	1	34,533,763	**		4,297,092		732,284,785				
1999	630,346,729		728,366			4,330,623		635,405,718				
2000	667,431,376		222,171			3,954,992		671,608,539				

^{*} Includes health benefits.

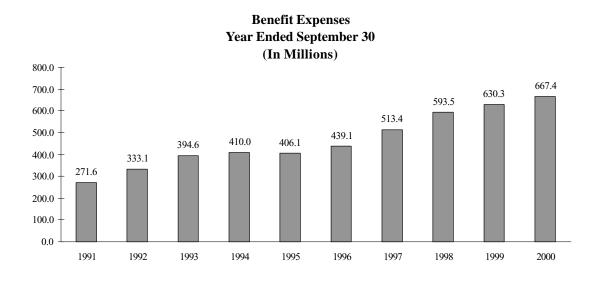


^{**} Includes transfers to defined contribution plan in connection with the "early out" retirement.

Schedule of Benefit Expenses by Type

Fiscal Year Ended Sept. 30	Regular Allowances	Disability Allowances	13th Check	Health Insurance*	Total
1991	\$ 178,896,021	\$ 11,827,319		\$ 80,846,428	\$ 271,569,768
1992	212,280,362	13,850,266		106,952,142	333,082,770
1993	245,615,207	14,725,503		134,216,826	394,557,536
1994	256,660,402	16,672,201		136,642,705	409,975,308
1995	269,206,552	20,494,647		116,439,123	406,140,322
1996	284,061,320	22,017,877	\$ 15,234,884	117,742,316	439,056,397
1997	331,964,200	26,069,505	24,832,674	130,492,860	513,359,239
1998	401,855,102	28,024,773		163,574,055	593,453,930
1999	417,313,133	28,227,807	678,314	184,127,475	630,346,729
2000	427,500,808	30,867,062	435,904	208,627,602	667,431,376

^{*} Includes vision and dental benefits.



Schedule of Retired Members by Type of Benefit **September 30, 2000**

5 6 7 8 Reg. Opt. A Opt. B Opt. C Opt. E 15 Opt. E Opt. E 15 15 Opt. E 15 Opt. E 15 15 15 15 Opt. E 15	Nimber of				Ė	no of Doth	*						Coloct	od Ontion	*		
20 1 22 534 345 318 1 100 15 142 1 104 1,783 1,304 872 3 368 74 294 2 263 2,721 1,584 944 6 359 55 260 39 333 2,661 1,315 894 5 278 74 192 46 492 1,812 1,168 765 4 173 42 142 41 551 1,570 1,110 733 4 171 65 100 40 525 1,260 1,013 717 5 186 40 53 45 263 917 749 488 6 148 40 53 70 1,113 804 12 130 45 40 427 512 298 4 130 45 38 55 2,793 </th <th>Retirees 1 2 3 4</th> <th>1 2 3 4</th> <th>2 3 4</th> <th>3 4 4</th> <th>pe or Keu 4</th> <th></th> <th>ement :</th> <th>9</th> <th>7</th> <th>œ</th> <th>Reg.</th> <th>Opt. A</th> <th>Opt. B</th> <th>Opt. C</th> <th>Opt. E</th> <th>Opt. E1</th> <th>Opt. E2</th>	Retirees 1 2 3 4	1 2 3 4	2 3 4	3 4 4	pe or Keu 4		ement :	9	7	œ	Reg.	Opt. A	Opt. B	Opt. C	Opt. E	Opt. E1	Opt. E2
142 1 104 1,783 1,304 872 3 368 74 294 2 263 2,721 1,584 944 6 359 75 260 39 333 2,051 1,315 894 5 278 55 192 46 492 1,812 1,168 765 4 173 42 142 41 551 1,570 1,110 733 4 171 65 100 40 525 1,260 1,013 717 5 186 40 53 45 263 917 749 488 6 148 40 30 70 121 606 581 346 8 161 65 178 58 1,995 1,134 804 12 45 4 1288 555 2,793 14,776 10,815 7,179 58 2,427 658 </td <td>1,348 721 422 12 138</td> <td>721 422 12 138</td> <td>422 12 138</td> <td>12 138</td> <td>138</td> <td></td> <td>12</td> <td>8</td> <td>-</td> <td>B</td> <td>534</td> <td>345</td> <td>318</td> <td>-</td> <td>120</td> <td>15</td> <td>15</td>	1,348 721 422 12 138	721 422 12 138	422 12 138	12 138	138		12	8	-	B	534	345	318	-	120	15	15
294 2 263 2,721 1,584 944 6 359 55 260 39 333 2,061 1,315 894 5 278 55 192 46 492 1,812 1,168 765 4 173 42 142 41 551 1,570 1,110 733 4 171 65 100 40 525 1,260 1,013 717 5 186 40 30 70 121 606 581 346 8 161 65 10 81 60 427 512 298 4 130 45 11 81 60 427 512 298 4 130 45 1288 555 2,793 14,776 10,815 7,179 58 2,427 658	2,637 909 25	2,637 909 25 637	909 25 637	25 637	637		80	142	1	101	1,783	1,304	872	з	368	74	71
260 39 333 2,051 1,315 894 5 278 55 192 46 492 1,812 1,168 765 4 173 42 142 41 551 1,570 1,110 733 4 173 42 190 40 525 1,260 1,013 717 5 186 40 30 70 121 606 581 346 8 161 65 11 81 60 427 512 298 4 130 45 38 189 59 1,095 1,134 804 12 333 162 1288 555 2,793 14,776 10,815 7,179 58 2,427 658	3,160 711 408	3,160 711 408 905	711 408 905	408 905	905			294	7	263	2,721	1,584	<u>¥</u>	9	329	55	77
192 46 492 1,812 1,168 765 4 173 42 142 41 551 1,570 1,110 733 4 171 65 100 40 525 1,260 1,013 717 5 186 40 33 45 263 917 749 488 6 148 40 30 70 121 606 381 346 8 161 65 11 81 60 427 512 298 4 130 45 38 189 59 1,095 1,134 804 12 333 162 1288 555 2,793 14,776 10,815 7,179 58 2,427 658	2,934 378 1	2,934 378 1 708	378 1 708	1 708	708			260	39	333	2,051	1,315	894	5	278	55	55
142 41 551 1,570 1,110 733 4 171 65 100 40 525 1,260 1,013 717 5 186 40 33 45 263 917 749 488 6 148 40 30 70 121 606 581 346 8 161 65 17 81 60 427 512 298 4 130 45 38 189 59 1,095 1,134 804 12 333 162 1288 555 2,793 14,776 10,815 7,179 58 2,427 658	2,563 234	2,563 234 492	234 492	492	492			192	4	492	1,812	1,168	765	4	173	42	55
100 40 525 1,260 1,013 717 5 186 40 33 45 263 917 749 488 6 148 40 30 70 121 606 581 346 8 161 65 17 81 60 427 512 298 4 130 45 38 189 59 1,095 1,134 804 12 333 162 1288 555 2,793 14,776 10,815 7,179 58 2,427 658	2,514 185	2,514 185 286	185 286	286	286			142	41	551	1,570	1,110	733	4	171	65	99
53 45 263 917 749 488 6 148 40 30 70 121 606 581 346 8 161 65 17 81 60 427 512 298 4 130 45 38 189 59 1,095 1,134 804 12 333 162 1288 555 2,793 14,776 10,815 7,179 58 2,427 658	3,286 2,381 126 114	2,381 126 114	126 114	114	114			100	9	525	1,260	1,013	717	5	186	4	65
30 70 121 606 581 346 8 161 65 17 81 60 427 512 298 4 130 45 38 189 59 1,095 1,134 804 12 333 162 1,288 555 2,793 14,776 10,815 7,179 58 2,427 658	1,897 86	1,897 86 62	86 62	62	62			83	45	263	617	749	488	9	148	4	28
17 81 60 427 512 298 4 130 45 38 189 59 1,095 1,134 804 12 333 162 1,288 555 2,793 14,776 10,815 7,179 58 2,427 658	1,560 45	1,560 45 28	45 28	28	78			39	92	121	909	581	346	∞	161	65	87
38 189 59 1,095 1,134 804 12 333 162 1,288 555 2,793 14,776 10,815 7,179 58 2,427 658	1,471 1,259 44 10	1,259 44 10	44 10	10	10			17	81	99	427	512	298	4	130	45	55
1,288 555 2,793 14,776 10,815 7,179 58 2,427 658	3,731 3,376 61 8	3,376 61 8	61 8	8	8			38	189	59	1,095	1,134	804	12	333	162	191
	36,705 25,002 3,201 446 3,388						32	1,288	555	2,793	14,776	10,815	7,179	28	2,427	658	792

* Type of Retirement

- 1 Normal retirement for age & service
- 2 Survivor payment normal or early retirement
 - 4 Non-duty disability retirement (incl. survivors) 3 - Duty disability retirement (incl. survivors)

 - 5 Survivor payment duty death in service
- 6 Survivor payment non-duty death in service
- 7 Retirees with supplemental benefits for early retirement incentive factors
 - 8 Retirees with reduced benefits for early retirement reduction factors

**Selected Option

Opt. A - 100% survivor option Reg. - Straight life allowance

Opt. B - 50% survivor option

Opt. C - 75% survivor option

Opt. E - Social Security equated

Opt. E1 - Social Security equated w/100% survivor

Opt. E2 - Social Security equated w/50% survivor option

Schedule of Average Benefit Payments

Retirement Effective Dates			Year	s Cı	redited Se	ervi	ce					
	0-5	5-10	10-15		15-20		20-25	25-30	30+	-	Total	
Period 10/1/94 to 9/30/95:												
Average Monthly Benefit	\$ 288	\$ 333	\$ 358	\$	549	\$	765	\$ 1,015	\$ 1,284	\$	793	
Average Final Average Salary	13,523	25,006	20,192		22,356		24,419	26,336	27,548		24,115	
Number of Active Retirants	313	414	5,939		6,198		5,575	5,075	7,048		30,562	
Period 10/1/95 to 9/30/96:												
Average Monthly Benefit	\$ 316	\$ 343	\$ 375	\$	571	\$	793	\$ 1,045	\$ 1,340	\$	825	
Average Final Average Salary	12,260	25,997	21,206		23,275		25,383	27,175	28,936		25,142	
Number of Active Retirants	341	429	5,977		6,311		5,636	5,149	7,250		31,093	
Period 10/1/96 to 9/30/97:												
Average Monthly Benefit	\$ 367	\$ 357	\$ 400	\$	632	\$	877	\$ 1,272	\$ 1,536	\$	971	
Average Final Average Salary	11,007	26,932	22,665		25,373		27,707	32,426	33,096		28,415	
Number of Active Retirants	396	440	6,207		6,947		6,410	7,030	8,693		36,123	
Period 10/1/97 to 9/30/98:												
Average Monthly Benefit	\$ 373	\$ 369	\$ 414	\$	651	\$	901	\$ 1,298	\$ 1,571	\$	996	
Average Final Average Salary	10,322	28,458	23,509		26,087		28,395	33,076	33,906		29,148	
Number of Active Retirants	411	449	6,246		6,906		6,389	7,074	8,710		36,185	
Period 10/1/98 to 9/30/99:												
Average Monthly Benefit	\$ 375	\$ 379	\$ 433	\$	673	\$	926	\$ 1,329	\$ 1,600	\$	1,018	
Average Final Average Salary	9,939	29,279	24,597		26,881		29,163	33,685	34,435		29,846	
Number of Active Retirants	432	457	6,328		6,939		6,421	7,091	8,678		36,346	
Period 10/1/99 to 9/30/00:												
Average Monthly Benefit	\$ 398	\$ 390	\$ 453	\$	694	\$	952	\$ 1,388	\$ 1,656	\$	1,053	
Average Final Average Salary	9,908	30,734	25,784		27,734		29,943	34,218	35,149		30,620	
Number of Active Retirants	450	454	6,476		6,984		6,488	7,145	8,708		36,705	

10 Year History of Membership Fiscal Years Ended September 30

