

1809 - 2009

LINCOLN'S BICENTENNIAL CELEBRATION

SHARING LINCOLN'S PRINCIPLES

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

Annual Financial Report Summary
for the fiscal year ended June 30, 2008



December 17, 2008

Dear TRS Members:

We are pleased to present the *Annual Financial Report Summary* for the Teachers' Retirement System of the State of Illinois (TRS) for the fiscal year ended June 30, 2008. This year's report commemorates Abraham Lincoln and the upcoming bicentennial of his birthday in February 2009.

Lincoln said in his first political announcement on March 9, 1832 at New Salem:

"Upon the subject of education... I can only say that I view it as the most important subject which we as a people can be engaged in. That everyone may receive at least a moderate education appears to be an objective of vital importance."

TRS may share a "hometown" with this great man, but our members share Lincoln's values in their professions. His desire for an education is widely published. Lincoln, who had less than one year of formal education, would be appreciative of the extensive public education system in Illinois. We believe that he would also recognize how fortunate today's students are to have dedicated teachers as instructors and mentors.

As the "Great Emancipator," Lincoln's leadership has made him an iconic role model for generations of Americans. As present role models, teachers have the powerful ability to be mentors and leaders to students who will contribute to our upcoming society. Our members' influence in the classroom will, in part, be measured by their students' future successes.

Two TRS employees, **Julie Dailey** and **Jael Bietsch**, created the Lincoln artwork that appears in the report. Julie's pencil and graphite drawing appears on the cover; Jael's digitally-altered photography appears within the report. In displaying the artistic talents of our staff, we also are consciously depicting Lincoln throughout his life in Illinois. We hope you find this year's theme both educational and inspirational.

This report is intended to summarize financial, investment, actuarial, and statistical information in a single publication. Information for this report was gathered by and reflects the combined efforts of TRS staff under the leadership of the Board of Trustees and the executive director. We hope all recipients of this report find it informative and useful. The *Comprehensive Annual Financial Report*, which contains more detailed information, and this report are also available to the general public on our Web site, trs.illinois.gov.

We would like to take this opportunity to express our gratitude to staff, professional consultants, and others who have worked so diligently to ensure TRS's successful operation.

Sincerely,

Jon Bauman
Executive Director

Jana Bergschneider, CPA
Director of Administration

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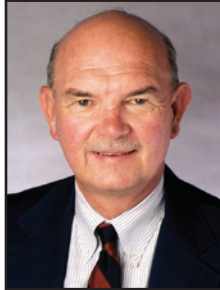
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Fiscal Year 2008 Financial Highlights

- TRS net assets at June 30, 2008 were \$38.4 billion.
- During FY08, TRS net assets decreased \$3.5 billion. Net assets are determined by subtracting liabilities from total assets. Most TRS liabilities involve securities transactions.
- Contributions from members, employers, and the State of Illinois were \$2,037 million, an increase of \$357 million or 21.3 percent for the fiscal year.
- Total investment loss was \$2,015 million, compared to investment income of \$6,831 million in FY07, a difference of \$8,846 million.
- Benefits and refunds paid to members and annuitants were \$3,484 million, an increase of \$312 million or 9.9 percent compared to FY07.
- Total actuarial accrued liability was \$68.6 billion at June 30, 2008.
- The unfunded actuarial accrued liability increased from \$23.7 billion at June 30, 2007 to \$30.2 billion at June 30, 2008. The unfunded liability is the difference between the value of future pension benefits accrued minus the net assets currently available to pay these future benefits.
- The funded ratio decreased from 63.8 percent at June 30, 2007 to 56.0 percent at June 30, 2008.



Digitally-altered photography by Joel Bietsch, TRS employee

Condensed Comparative Statement of Plan Net Assets as of June 30

	2008	2007	Percentage Change
Cash	\$3,668,043	\$3,548,548	3.4%
Receivables and prepaid expenses	404,110,007	385,352,096	4.9
Investments	39,209,046,996	41,953,080,943	(6.5)
Invested securities lending collateral	4,445,553,283	5,020,184,465	(11.4)
Capital assets	2,548,814	2,391,619	6.6
Total assets	44,064,927,143	47,364,557,671	(7.0)
Total liabilities	5,634,203,856	5,455,239,920	3.3
Net assets	<u>\$38,430,723,287</u>	<u>\$41,909,317,751</u>	(8.3%)

Condensed Comparative Statement of Changes in Plan Net Assets for the Year Ended June 30

	2008	2007	Percentage Change
Contributions	\$2,037,188,622	\$1,679,834,675	21.3%
Total investment income (loss)	(2,014,902,366)	6,831,324,436	(129.5)
Total additions	22,286,256	8,511,159,111	(99.7)
Benefits and refunds	3,484,267,356	3,171,484,584	9.9
Administrative expenses	16,613,364	15,246,203	9.0
Total deductions	3,500,880,720	3,186,730,787	9.9
Net increase (decrease) in net assets	(3,478,594,464)	5,324,428,324	
Net assets beginning of year	41,909,317,751	36,584,889,427	14.6
Net assets end of year	<u>\$38,430,723,287</u>	<u>\$41,909,317,751</u>	(8.3%)

State Funding

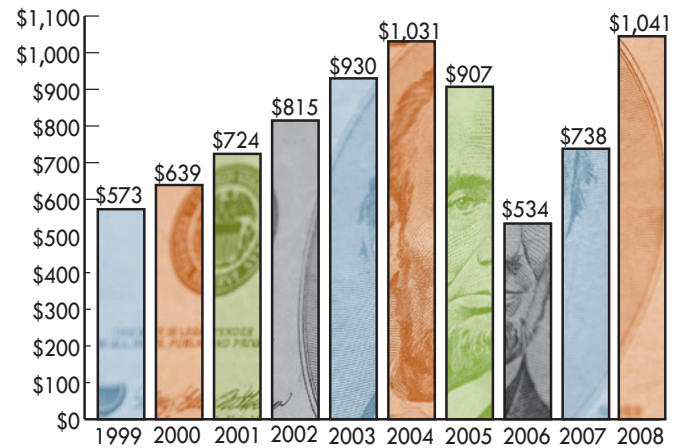
The State of Illinois is the major source of employer contributions. Beginning in 1996, the state adhered to a 50-year funding plan for nine successive fiscal years. In fiscal year 2005, the appropriation was reduced to recognize pension obligation bond proceeds. As shown on the accompanying chart, the funding plan changes resulted in a reduction in the contributions for fiscal year 2005.

State contributions for fiscal years 2006 and 2007 were set by law, not based on actuarial funding requirements. In both years, state appropriations were about half the amounts that would have been required under the 50-year funding plan, resulting in sharply higher funding requirements in future years. In fiscal year 2008, state contributions returned to the statutory funding schedule.

In fiscal year 2009, \$1,452 million is the amount required under the law. However, the actual 2009 state appropriation is \$255 million lower than the funding requirement, so TRS will use a special provision under the funding law that mandates that the required contribution be paid automatically.

In fiscal year 2010, the state contribution requirement increases to \$2,089 million. First, investment losses and asset sales in fiscal year 2008 are driving up state funding requirements in fiscal year 2010 and beyond. Just as unusually high investment returns lowered state

State Appropriations (\$ in millions)



contribution requirements in previous years, investment losses in fiscal year 2008 have the opposite effect.

Second, fiscal year 2010 is the final year of the 15-year phase-in (or “ramp”) to actuarial funding. When the funding law first went into effect in fiscal year 1996, the difference between where state appropriations had been and a standard actuarial funding method was so large that a long ramp was proposed to increase appropriations very gradually. However, the length of the ramp increased the ultimate “target” rate, and the funding reductions in fiscal years 2006 and 2007 increased the target even more.

The ultimate funding plan goal is to achieve a 90 percent funding level by the year 2045.

Investments

The TRS investment portfolio declined 4.5 percent, gross of fees, for the fiscal year ending June 30, 2008 as the United States and global markets entered an unprecedented period of economic uncertainty. The loss follows strong FY07 performance of 19.6 percent, gross of fees, with total fund assets falling from a peak of \$42.0 billion to \$39.2 billion.

Slowing global growth, inflationary pressures, and credit market turmoil were especially challenging to the global equity markets with U.S. and international stocks falling 15.1 percent and 7.7 percent, respectively. Helping to offset these losses somewhat was the strong performance of TRS’s new real return asset class which was added to the retirement system’s asset allocation at the beginning of the fiscal year as a means to

protect the portfolio in an inflationary environment. As the inflation rate increased through the year, the TRS real return asset class produced a 20.5 percent return.

The TRS investment portfolio continued to rank highly against its peers. Over the past 10 years, TRS ranks in the top 15 percent of the large public funds in the Wilshire Trust Universe Comparison Service (TUCS).

The TRS portfolio remains fully diversified across different asset classes. A number of investment managers are utilized within each asset class to ensure the appropriate mixture across the various investment styles, allowing the portfolio to achieve broad exposure to the market while minimizing overall risk. This broad diversification serves as the best defense against the uncertainty of volatile global markets.



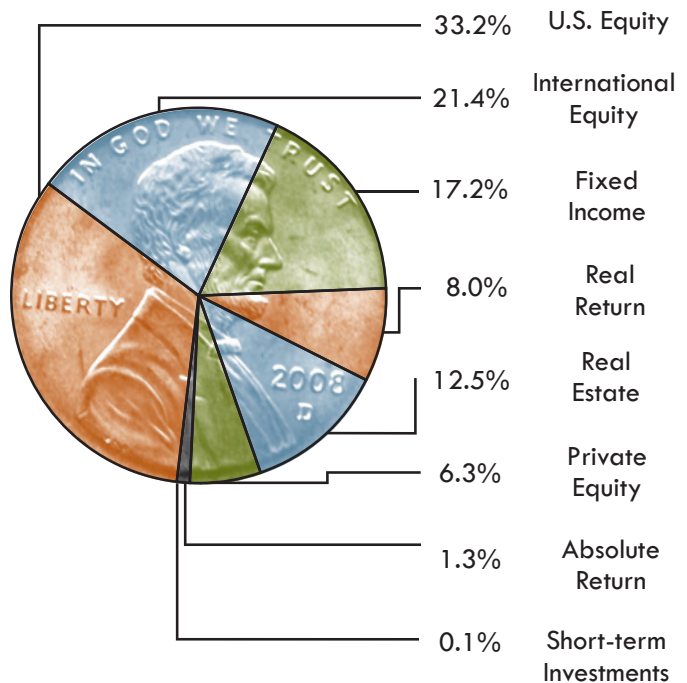
Investment Portfolio

Total TRS investments, including accrued income, decreased by approximately \$2.7 billion during the year ended June 30, 2008. This represents the first loss following five years of positive returns. The TRS investment portfolio is well-diversified as shown as of June 30, 2008, on the Fiscal Year 2008 Asset Allocation chart below. By investing in a broad range of asset classes, TRS minimizes risk and achieves more consistent investment returns.

TRS Investment Performance (net of fees)

	1 year	3 years	5 years	10 years
Rate of return	(5.0%)	8.2%	10.3%	6.9%

Fiscal Year 2008 Asset Allocation

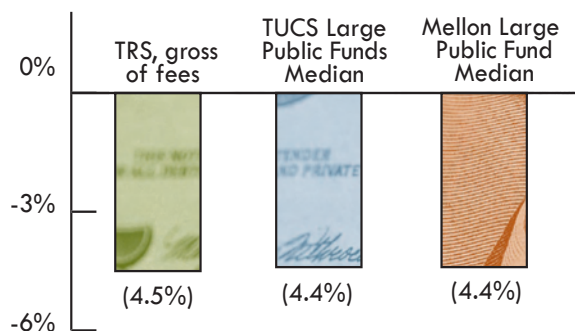


Top 10 U.S. Equity Holdings at June 30, 2008

Firm	Market Value
Exxon Mobil Corp.	\$192,968,479
Microsoft Corp.	125,530,111
Chevron Corp.	124,225,850
Hewlett-Packard Co.	117,597,583
Apple, Inc.	105,733,169
General Electric Co.	104,156,391
Google, Inc.	101,212,141
Cisco Systems, Inc.	94,122,544
Wal-Mart Stores, Inc.	90,348,244
Gilead Sciences, Inc.	79,285,212
Total	\$1,135,179,724

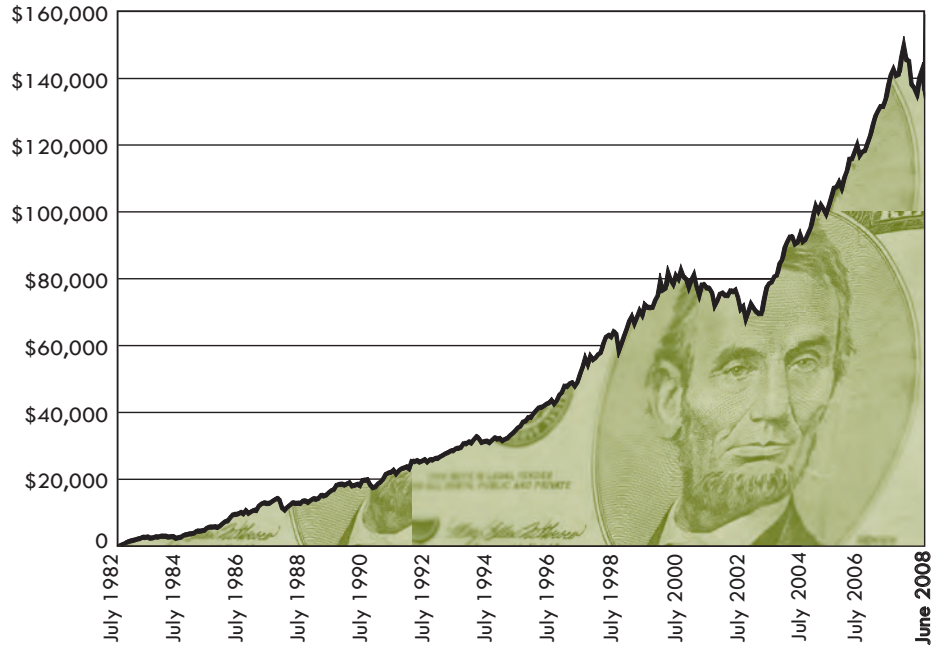
Source: The Northern Trust Company

TRS Returns Compared to Other Large Public Funds



Growth of \$10,000

Over the years, TRS's asset allocation has provided consistent overall returns, as represented by the following chart showing the growth of \$10,000 over the last 26 years. Despite market fluctuations, the overall trend line is solidly favorable.



Actuarial

Every year, TRS's actuarial firm estimates the value of all of the benefits earned by members and retirees that have not already been paid. This value is known as the actuarial accrued liability. Based on the estimated cost of benefits that will be earned during the coming fiscal year and the portion of the accrued liability not covered by TRS assets, the annual state funding requirement is determined.

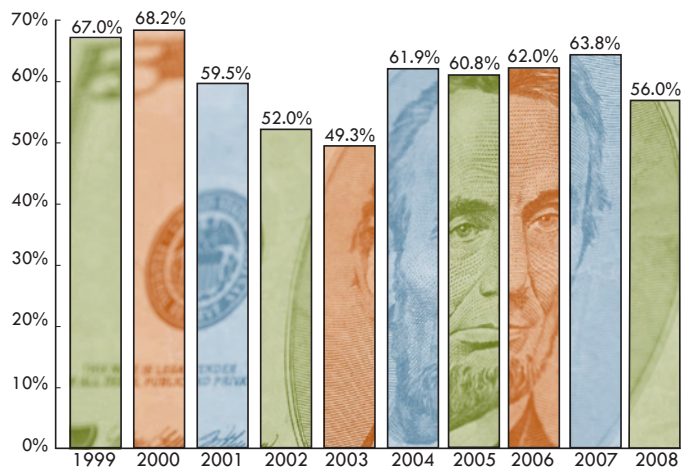
In 2008, TRS experienced an increase in unfunded liability mainly because turbulent domestic and foreign markets resulted in investment losses in most of the TRS portfolio. Also, investment holdings were liquidated to cover benefit payments, adding to the decline in asset levels by the end of the year.

Listed below are the key results of the current actuarial valuation compared to the prior year's valuation:

Actuarial Valuation with Market Value Assets (\$ in thousands)

	Years Ended June 30	
	2008	2007
Total actuarial accrued liability	\$68,632,367	\$65,648,395
Net assets at market value	38,430,723	41,909,318
Unfunded liability	\$30,201,644	\$23,739,077
Funded ratio	56.0%	63.8%

Funded Ratio



Statistical

Member Statistics

Full and Part-time Active Members

Average age	41
Average years of service	12
Average annual salary	\$60,254
Oldest full-time teacher	87

Retired Members

Average age	69
Average service	29
Average annual benefit	\$41,532
Oldest retired teacher	107

Fiscal Year Highlights

	2008	2007
Active contributing members	165,572	160,317
Inactive noncontributing members	98,550	94,879
Benefit recipients	91,462	89,236
Total membership	355,584	344,432
Actuarial accrued liability (AAL)	\$68,632,367,000	\$65,648,395,000
Less net assets held in trust for pension benefits	38,430,723,000	41,909,318,000
Unfunded actuarial accrued liability (UAAL)	\$30,201,644,000	\$23,739,077,000
Funded ratio (actuarial value of assets/AAL)	56.0%	63.8%
Total fund investment return (loss), net of fees	(5.0%)	19.2%
Expenses		
Benefits paid	\$3,423,981,732	\$3,111,752,675
Refunds paid	60,285,624	59,731,909
Administrative expenses	16,613,364	15,246,203
Total	\$3,500,880,720	\$3,186,730,787
Income		
Member contributions	\$865,400,168	\$826,249,007
Employer contributions	130,673,629	115,915,040
State of Illinois contributions	1,041,114,825	737,670,628
Total investment income (loss)	(2,014,902,366)	6,831,324,436
Total	\$22,286,256	\$8,511,159,111

This publication is a summary of the Comprehensive Annual Financial Report for the fiscal year ended June 30, 2008. The comprehensive report, which has more detailed information, is available on our Web site, trs.illinois.gov, or by calling (800) 877-7896.



Digitally-altered photography by Jael Bietsch, TRS employee