Financial Section

10-26-00

Bulging pension funds

■ **State workers:** *Thanks to stock market, pension system now fully funded — 20 years ahead of time.*

NEARLY 300,000 state workers, teachers and retirees can rest easy: Their pensions are now fully secured. There's enough in state retirement accounts to handle future pension obligations.

That's a stunning change from 16 years ago, when the state faced a $16 billion unfunded liability. Actuaries last week announced state pension accounts contain 101 percent of what is needed to pay all retirement costs. That's 20 years ahead of schedule.

How did it happen? First, the legislature in 1984 reduced pensions for new workers. Second, Wall Street produced record returns. Third, pension trustees listened to the state treasurer and plunged into the stock market.

Since 1996, Treasurer Richard N. Dixon has advocated greater pension investments in equities. Today, 72 percent of the pension system's portfolio is in stocks vs. 33 percent five years ago.

There has been a handsome payoff. Total pension-fund assets have soared in five years from $18.5 billion to $33.1 billion. State contributions, once more than $750 million a year, are now under $450 million.

For Gov. Parris N. Glendening, this is good news: The state's contribution rate will drop $87 million next year. This is on top of another large surplus in this year's budget.

But the governor would be making a mistake if he used this money to increase employee benefits. That would be premature.

Equity investments can be volatile. For instance, the state's stock-market holdings aren't worth as much this week as they were a month ago. Also, the large teachers pension account still has a 3-percent gap that must be filled.

And finally, Mr. Dixon warns this is a time for caution. Let the pension fund build up its assets even further.

Maryland's pension officials have turned a yawning deficit into surplus. Now is the time to fortify this position, giving soon-to-be retirees more assurance that the money will be there when they start drawing benefits.

Teachers' Retirement & Pension Systems

The Teachers' Retirement System was established by the General Assembly in 1927 and is the oldest plan administered by the State Retirement and Pension System of Maryland. Equally important to the retirement security of state and local teachers is the Teachers' Pension System which was established in 1980. Today, the Teachers' Retirement and Pension Systems comprise state and local teachers of the public school systems, as well as certain employees of boards of education, public libraries and community colleges. Active membership involves over 90,000 participants. The combined systems provide survivor, disability and retirement benefits to plan members.

Department of Legislative Services
Office of Legislative Audits
Maryland General Assembly

Karl S. Aro
Executive Director

Bruce A. Myers, CPA
Legislative Auditor

INDEPENDENT AUDITOR'S REPORT

Board of Trustees
State Retirement and
Pension System of Maryland

We have audited the accompanying statements of plan net assets of the State Retirement and Pension System of Maryland as of June 30, 2000 and 1999, and the related statements of changes in plan net assets for the years then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit 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 financial position of the State Retirement and Pension System of Maryland as of June 30, 2000 and 1999, and the results of its operations for the years then ended, in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 25, 2000 on our consideration of the State Retirement and Pension System of Maryland's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, rules, regulations and contracts.

Our audits were made for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying required supplementary information and other supplementary information are presented for purposes of additional analysis and are not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in our audits of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

The other data included in this report have not been audited by us and, accordingly, we express no opinion on such data.

Bruce A. Myers

Bruce A. Myers, CPA
Legislative Auditor

October 25, 2000

301 West Preston Street • Room 1202 • Baltimore, Maryland 21201
410-946-5900/301-970-5900 • FAX 410-946-5999/301-970-5999
Other areas in Maryland 1-877-486-9964

Statements of Plan Net Assets
as of June 30, 2000 and 1999
(Expressed in Thousands)

	2000	1999
Assets:		
Cash and cash equivalents (note 3)	**$ 1,862,211**	$ 943,107
Receivables:		
Contributions:		
Employers	**10,143**	6,114
Members	**3,068**	2,915
Accrued investment income	**113,047**	121,688
Investment sales proceeds	**613,214**	280,274
Other receivables	**—**	12,300
Total receivables	**739,472**	423,291
Investments, at fair value (notes 2 & 3)**:**		
U.S. Government obligations	**2,330,615**	2,788,318
Domestic corporate obligations	**2,503,630**	2,460,543
International obligations	**144,240**	700,289
Domestic stocks	**16,503,957**	14,340,191
International stocks	**6,867,162**	6,070,162
Mortgages & mortgage related securities	**2,326,361**	2,299,749
Real estate	**661,143**	611,986
Alternative investments	**34,848**	809
Collateral for loaned securities	**2,179,954**	1,891,273
Total investments	**33,551,910**	31,163,320
Total assets	**36,153,593**	32,529,718
Liabilities:		
Accounts payable & accrued expenses	**42,961**	29,501
Investment commitments payable	**819,089**	623,395
Obligation for collateral for loaned securities	**2,179,954**	1,891,273
Other liabilities	**899**	—
Total liabilities	**3,042,903**	2,544,169
Net assets held in trust for pension benefits	**$ 33,110,690**	$ 29,985,549

(A schedule of funding progress is presented on page 26)

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

Statements of Changes in Plan Net Assets
for the Fiscal Years Ended June 30, 2000 and 1999
(Expressed in Thousands)

	2000	1999
Additions:		
Contributions (note 4):		
Employers	$ 264,083	$ 252,337
Members	182,507	162,342
Other	418,339	441,016
Total contributions	864,929	855,695
Investment income:		
Net appreciation in fair value of investments	2,790,906	1,500,247
Interest	495,173	485,792
Dividends	235,951	264,351
Real estate operating net income	19,548	14,355
Income before securities lending activity	3,541,578	2,264,745
Gross income from securities lending activity	120,664	118,311
Securities lending borrower rebates	(110,776)	(107,362)
Securities lending agent fees	(2,382)	(2,712)
Net income from securities lending activity	7,506	8,237
Total investment income	3,549,084	2,272,982
Less investment expenses (note 2f)	(61,362)	(47,584)
Net investment income	3,487,722	2,225,398
Total additions	4,352,651	3,081,093
Deductions:		
Benefit payments	1,190,954	1,115,086
Refunds (note 5)	16,805	16,898
Administrative expenses (note 2f)	19,751	24,742
Total deductions	1,227,510	1,156,726
Net increase in plan assets	3,125,141	1,924,367
Net assets held in trust for pension benefits:		
Beginning of the fiscal year	29,985,549	28,061,182
End of the fiscal year	$ 33,110,690	$ 29,985,549

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

Notes to the Financial Statements

1. General Description of the System

a. Organization

The State Retirement Agency (the "Agency") is the administrator of the State Retirement and Pension System of Maryland (the "System"), an agent multiple-employer public employee retirement system. The System was established by the State Personnel and Pensions Article of the Annotated Code of Maryland to provide retirement allowances and other benefits to State employees, teachers, police, judges, legislators and employees of participating governmental units. Responsibility for the System's administration and operation is vested in a 14-member Board of Trustees.

The State of Maryland is the statutory guarantor for the payment of all pensions, annuities, retirement allowances, refunds, reserves and other benefits of the System. The Agency is legally authorized to use all assets accumulated for the payment of benefits to pay such obligations to any plan member or beneficiary as defined by the terms of the plan. Consequently, the System is accounted for as a single plan as defined in Governmental Accounting Standards Board (GASB) Statement No. 25, "*Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*." Additionally, the System is fiscally dependent on the State by virtue of the legislative and executive controls exercised with respect to its operations, policies and administrative budget. Accordingly, the System is included in the State's reporting entity and disclosed in its financial statements as a pension trust fund.

The System comprises the Teachers' Retirement and Pension Systems, Employees' Retirement and Pension Systems, State Police Retirement System, Judges' Retirement System, Law Enforcement Officers' Pension System and the Local Fire and Police System.

b. Covered Members

The Teachers' Retirement System was established on August 1, 1927 to provide retirement allowances and other benefits to teachers in the State. Effective January 1, 1980, the Teachers' Retirement System was closed to new members and the Teachers' Pension System was established. As a result, teachers hired after December 31, 1979 become members of the Teachers' Pension System as a condition of employment. Members remaining in the Teachers' Retirement System have the opportunity to irrevocably elect to transfer to the Teachers' Pension System. For those transferring, all prior service credit and member contributions on earnings above the social security wage base are transferred from the Teachers' Retirement System to the Teachers' Pension System, with member contributions on earnings up to the social security wage base being refunded (see note 5).

On October 1, 1941, the Employees' Retirement System was established to provide retirement allowances and other benefits to State employees, elected and appointed officials and the employees of participating governmental units. Effective January 1, 1980, the Employees' Retirement System was essentially closed to new members and the Employees' Pension System was established. As a result, State employees (other than correctional officers) and employees of participating governmental units hired after December 31, 1979 become members of the Employees' Pension System as a condition of employment, while all State correctional officers and members of the Maryland General Assembly continue to be enrolled as members of the Employees' Retirement System. State employees and employees of participating governmental units remaining in the Employees' Retirement System have the opportunity to irrevocably elect to transfer to the Employees' Pension System. For those transferring, all prior service credit and member contributions on earnings above the social security wage base are transferred from the Employees' Retirement System to the Employees' Pension System with member contributions on earnings up to the social security wage base being refunded (see note 5). Currently, 123 governmental units participate in the Employees' Systems.

The State Police Retirement System was established on July 1, 1949 to provide retirement allowances and other benefits to any police employee or cadet of the Maryland State Police.

The Judges' Retirement System was established on June 30, 1969 to provide retirement allowances and other benefits for State and local, appointed or elected judges.

The Law Enforcement Officers' Pension System was established on July 2, 1990 to provide retirement allowances and other benefits for certain State and local law enforcement officers. This System includes both retirement plan and pension plan provisions which are applicable to separate portions of this System's membership. The retirement plan provisions are only applicable to those members who, on the date they elected to participate in this System, were members of the Employees' Retirement System. This System's pension plan provisions are applicable to all other participating law enforcement officers.

The Local Fire and Police System was established on July 1, 1989 to provide retirement allowances and other benefits for law enforcement officers and fire fighters employed by participating governmental units. This

System includes both retirement plan and pension plan provisions which are applicable to separate portions of this System's membership. The retirement plan provisions are only applicable to those officers and fire fighters who, on the date they elected to participate in this System, were members of the Employees' Retirement System. This System's pension plan provisions are applicable to all other participating governmental unit law enforcement officers and fire fighters.

The following table presents a summary of membership by system as of June 30, 2000, with comparative 1999 totals:

	Inactive & Deferred Vested	Retirees & Beneficiaries	Active Plan Participants		
			Vested	Non-vested	Total
Teachers' Retirement & Pension Systems	16,717	38,145	59,955	30,973	90,928
Employees' Retirement & Pension Systems	25,706	40,730	57,728	27,697	85,425
Judges' Retirement System	13	285	283	—	283
State Police Retirement System	22	1,388	1,239	397	1,636
Local Fire and Police System	20	19	129	55	184
Law Enforcement Officers' Pension System	36	206	904	226	1,130
Totals as of June 30, 2000	42,514	80,773	120,238	59,348	179,586
Totals as of June 30, 1999	39,665	77,478	121,788	52,886	174,674

c. Summary of Significant Plan Provisions

All plan benefits are specified by the State Personnel and Pensions Article of the Annotated Code of Maryland. Retirement allowances are computed using both the highest three years' average final salary (AFS) and the actual number of years of accumulated creditable service. Pension allowances are computed using both the highest three consecutive years' AFS and the actual number of years of accumulated creditable service. Various retirement options are available under each system which ultimately determine how a retiree's benefit allowance will be computed. Some of these options require actuarial reductions based on the retiree's and/or designated beneficiary's attained age and similar actuarial factors. A brief summary of the retirement eligibility requirements of, and the benefits available under, the various systems follows:

Service Retirement Allowances

A member of either the Teachers' or Employees' Retirement System is generally eligible for full retirement benefits upon the earlier of attaining age 60 or accumulating 30 years of eligibility service regardless of age. The annual retirement allowance equals 1/55 (1.8%) of the member's AFS multiplied by the number of years of accumulated creditable service.

A member of either the Teachers' or Employees' Pension System is eligible for full retirement benefits upon the earlier of attaining age 62, with specified years of eligibility service, or accumulating 30 years of eligibility service regardless of age. Generally, the annual pension allowance for a member of either the Teachers' or Employees' Pension System equals 1.2% of the member's AFS, multiplied by the number of years of creditable service accumulated prior to July 1, 1998, plus 1.4% of the member's AFS, multiplied by the number of years of creditable service accumulated subsequent to June 30, 1998. However, the annual pension allowance for a member of the Employees' Pension System, who is employed by a participating governmental unit that does not provide the enhanced pension benefits, equals 0.8% of the member's AFS up to the social security integration level (SSIL), plus 1.5% of the member's AFS in excess of the SSIL, multiplied by the number of years of accumulated creditable service. For the purpose of computing pension allowances, the SSIL is the average of the social security wage bases for the past 35 calendar years ending with the year the retiree separated from service.

A member of the State Police Retirement System is eligible for full retirement benefits upon the earlier of attaining age 50 or accumulating 22 years of eligibility service regardless of age. The annual retirement allowance equals 2.55% of the member's AFS multiplied by the number of years of accumulated creditable service and may not exceed 71.4% of the member's AFS.

A member of the Judges' Retirement System is eligible for full retirement benefits upon attaining age 60. The annual retirement allowance for a member with at least 16 years of accumulated creditable service equals 2/3 (66.7%) of the salary of an active judge holding a comparable position. The annual retirement allowance is prorated if the member retires with fewer than 16 years of accumulated creditable service.

A member of the Law Enforcement Officers' Pension System is eligible for full retirement benefits upon the earlier of attaining age 50 or accumulating 25 years of eligibility service regardless of age. The annual retirement allowance for a member who is covered under the retirement plan provisions equals 1/50 (2.0%) of the member's AFS multiplied by the number of years of accumulated creditable service up to 30 years, plus 1/100 (1.0%) of the member's AFS multiplied by the number of years of accumulated creditable service in excess of 30 years. The annual pension allowance for a member who is covered under the pension plan provisions equals 1.0% of the member's AFS up to the SSIL, plus 1.7% of the member's AFS in excess of the SSIL, multiplied by the number of years of accumulated creditable service. A member retiring prior to age 62 receives a service pension allowance of 1.7% of the member's AFS for each year of accumulated creditable service, until attaining age 62.

A member of the Local Fire and Police System who is covered under the retirement plan provisions is eligible for full retirement benefits upon the earlier of attaining age 60 or accumulating 25 years of eligibility service regardless of age. The annual retirement allowance equals 1/50 (2.0%) of the member's AFS multiplied by the number of years of accumulated creditable service up to 30 years, plus 1/100 (1.0%) of the member's AFS multiplied by the number of years of accumulated creditable service in excess of 30 years. A member who is covered under the pension plan provisions is eligible for full pension benefits upon the earlier of attaining age 62 or accumulating 25 years of eligibility service regardless of age. The annual pension allowance equals 1.0% of the member's AFS up to the SSIL, plus 1.5% of the member's AFS in excess of the SSIL, multiplied by the number of years of accumulated creditable service.

Vested Allowances

Any member (other than a judge) who terminates employment before attaining retirement age but after accumulating 5 years of eligibility service is eligible for a vested retirement allowance. Judges have no minimum service requirements prior to vesting. A member who terminates employment prior to attaining retirement age and before accumulating 5 years of eligibility service receives a refund of all member contributions and interest.

Early Service Retirement

A member of either the Teachers' or Employees' Retirement System may retire with reduced benefits after completing 25 years of eligibility service. Benefits are reduced by 0.5% per month for each month remaining until the retiree either attains age 60 or would have accumulated 30 years of eligibility service, whichever is less. The maximum reduction for a Teachers' or Employees' Retirement System member is 30%. A member of either the Teachers' or Employees' Pension System may retire with reduced benefits upon attaining age 55 with at least 15 years of eligibility service. Benefits are reduced by 0.5% per month for each month remaining until the retiree attains age 62. The maximum reduction for a Teachers' or Employees' Pension System member is 42%. Members of the State Police, Judges', Law Enforcement Officers' and Local Fire and Police Systems are not eligible for early service benefits.

Disability and Death Benefits

Generally, a member covered under retirement plan provisions who is permanently disabled after 5 years of service receives a service allowance based on a minimum percentage (usually 25%) of the member's AFS. A member covered under pension plan provisions who is permanently disabled after accumulating 5 years of eligibility service receives a service allowance computed as if service had continued with no change in salary until the retiree attained age 62. A member (other than a member of the Maryland General Assembly or a judge, both of which are ineligible for accidental disability benefits) who is permanently and totally disabled as the result of an accident occurring in the line of duty receives 2/3 (66.7%) of the member's AFS plus an annuity based on all member contributions and interest. Death benefits are equal to a member's annual salary as of the date of death plus all member contributions and interest.

Adjusted Retirement Allowances

Retirement and pension allowances are increased annually to provide for changes in the cost of living according to prescribed formulae. Such adjustments for retirees are based on the annual change in the consumer price index. Generally, for Teachers' and Employees' Pension System retirees, the pension allowance adjustments are limited to 3% of the preceding year's allowance. However, annual increases to pension allowances for Employees' Pension System retirees who were employed by a participating governmental unit that does not provide enhanced pension benefits are limited to 3% of the initial allowance. Retirement allowances for legislators and judges are recalculated when the salary of an active member holding a comparable position is increased.

2. Summary of Significant Accounting Policies

a. Basis of Accounting

The System's financial statements are prepared on the accrual basis of accounting. Accordingly, investment purchases and sales are recorded as of their respective trade dates and all contributions, benefits and refunds are recognized in the period when due. In accordance with GASB Statement No. 20, *"Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting,"* the System has elected to apply all applicable GASB pronouncements and only Financial Accounting Standards Board Statements and Interpretations, Accounting

Principles Board Opinions and Accounting Research Bulletins issued on or before November 30, 1989.

b. Investment Limitations

The State Personnel and Pensions Article of the Annotated Code of Maryland authorizes the System to invest plan assets in stocks, bonds, notes, certificates of indebtedness, mortgage notes, real estate, debentures or other obligations, subject to the terms, conditions, limitations and restrictions imposed by the Board of Trustees of the State Retirement and Pension System of Maryland. As such, no more than 25% of the assets invested in common stocks may be invested in non-dividend paying common stocks. In addition, no investment in any one organization may constitute more than 5% of the net plan assets available for pension benefits. The System did not exceed either of these investment limits.

c. Portfolio Valuation Method

The System investments are reported at fair value. For fixed income securities, fair value is based on quoted market prices provided by independent pricing services. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Mortgages and mortgage related securities are valued on the basis of future principal and interest payments and are discounted at prevailing interest rates for similar instruments. Fair value for real estate investments is based on estimated current values and independent appraisals. Fair value for alternative investments and mutual funds (other than those funds traded on a national or international exchange) is based on information provided by the applicable fund managers.

d. Securities Lending

The System's investment policies, as approved by the Board of Trustees, permit the System's custodial bank to lend System securities to broker-dealers and other entities. During fiscal year 2000, the System's custodial bank loaned securities of the type on loan at year-end for collateral in the form of cash (see note 3b), other securities, or letters of credit of at least 102% of the fair value of domestic securities and international fixed income securities and 105% of the fair value of international equity securities. Collateral is marked-to-market daily. If the market value of the pledged collateral falls below the specified levels, additional collateral is required to be pledged by the close of the next business day. Each such loan was executed with a simultaneous agreement to return the collateral for the same securities in the future. Securities on loan at year-end for cash collateral are presented as uncategorized in the schedule of custodial credit risk (see note 3). Securities on loan at year-end for collateral other than cash are categorized according to the custodial credit risk category applicable to the collateral received. In the event of a borrower's default, the System's custodial bank is obligated to indemnify the System if, and to the extent that, the fair value of collateral is insufficient to replace the loaned securities. Similarly, in the event of a borrower's failure to remit income distributions declared by the issuers of securities on loan, the System's custodial bank is obligated to indemnify the System for any portion of such distributions not recoverable from the borrower's collateral. The System has not experienced any loss due to credit or market risk on security lending activity since inception of the program. Further, as of June 30, 2000, the System had no credit risk exposure to borrowers because the fair value of collateral held exceeded the fair value of securities loaned.

Although the average term of the System's security loans is one week, each loan can be terminated at will by either the System or the borrower. Cash collateral is invested in two of the lending agent's short-term investment pools, which at June 30, 2000 had interest rate sensitivity durations of seventy-nine and sixty-six days. Because the relationship between the maturities of the investment pools and the System's security loans is affected by the maturities of the loans made by other entities that use the agent's pools, the System cannot match maturities. The System cannot pledge or sell collateral securities received unless and until a borrower defaults. Investments made with cash received as collateral and the corresponding liabilities are reported in the Statements of Plan Net Assets.

At June 30, 2000, the fair value of loaned securities and the related collateral were as follows *(expressed in thousands)*:

	Fair Value	Collateral	Percent Collateralized
International equity securities	$ 844,489	$ 878,203	104.0 %
Domestic & international fixed securities	1,335,343	1,362,199	102.0
Totals	$ 2,179,832	$ 2,240,402	

e. Derivatives

The System may invest in derivatives as permitted by guidelines established by the Board of Trustees. Compliance with these guidelines is monitored by Agency staff. Pursuant to such authority, the System invests in foreign currency forward contracts, options, futures, collateralized mortgage obligations, mortgage related securities, interest-only and principal-only securities. No derivatives were purchased with borrowed funds.

Derivatives are generally used to hedge against foreign currency risk and changes in interest rates, improve yield and adjust the duration of the System's fixed income portfolio. These securities are subject to changes in value due to changes in interest rates or currency valuations. Additionally, mortgage related securities are subject to prepayment risk when interest rates are falling. Credit risk for derivatives results from the same considerations as other counterparty risk assumed by the System, which is the risk that the counterparty might be unable to meet its obligations.

The System invests in foreign currency forward contracts to hedge the currency risk in its international and global portfolios. Because the fair value of foreign currency forward contracts is not included in the fair value of investments reported on the Statements of Plan Net Assets, the following schedule is presented to summarize the fair value of all foreign currency forward contracts outstanding as of June 30, 2000 *(expressed in thousands)*:

Purchases			Sales		
Currency	Amount (local currency)	Fair Value	Currency	Amount (local currency)	Fair Value
Euro currency	202,609	$ 194,386	Australian dollar	3,859	$ 2,318
New Zealand dollar	4,843	2,280	Canadian dollar	17,009	11,486
Polish zloty	11,200	2,425	Euro currency	149,438	143,317
U.S. dollar	250,816	250,816	Japanese yen	9,999,513	95,262
			New Zealand dollar	8,376	3,943
			Pound sterling	2,206	3,343
			Swedish krona	166	19
			U.S. dollar	187,839	187,839
Total purchases		$ 449,907	Total sales		$ 447,527

f. Administrative and Investment Expenses

All of the System's administrative and investment expenses (e.g., salaries of Agency employees, investment advisory fees) are incurred centrally and charged to each individual retirement or pension system on the basis of its percentage ownership in the System's net assets. All of the System's administrative and investment expenses are funded from investment income. See pages 29 and 30 for detailed schedules of administrative and investment expenses, respectively.

g. Federal Income Tax Status

During the fiscal years ended June 30, 2000 and 1999, the System qualified under Section 401(a) of the Internal Revenue Code and was exempt from federal income taxes under Section 501(a) of the Code.

h. Reclassifications

Certain reclassifications were made to the 1999 financial statements to conform to the 2000 financial statement presentation.

3. Cash Deposits and Investments

Cash and cash equivalents totaled $1,862,211,000 and $943,107,000 as of June 30, 2000 and 1999, respectively. Included as cash equivalents for financial statement presentation purposes were certain short-term investments (e.g., commercial paper, repurchase agreements) which are categorized in note 3b for custodial credit risk purposes as investments. These cash equivalent investments totaled $1,770,674,000 and $897,070,000 as of June 30, 2000 and 1999, respectively.

a. Cash Deposits

Cash deposits are categorized to give an indication of the level of custodial credit risk assumed by the System. Category 1 includes deposits insured or collateralized with securities held by the System or its agent in the System's name. Category 2 includes deposits collateralized with securities held by the pledging financial institution's trust department or agent in the System's name. Category 3 includes deposits which are uncollateralized. As of June 30, 2000, the carrying amount of both the System's uninsured and uncollateralized deposits and bank balance was $91,537,000 and comprises the System's Category 3 assets.

b. Investments

The System's investments are categorized to give an indication of the level of custodial credit risk assumed by the System. Category 1 includes investments insured or registered or for which the securities are held by the System's custodial bank in the System's name. Category 2 includes uninsured and unregistered investments for which the securities are held by a counterparty's trust department or agent in the System's name. Category 3 includes uninsured and unregistered investments for which the securities are held by a counterparty, its trust department or its agent, but not in the System's name.

All of the System's investments that are eligible for categorization meet the criteria of Category 1. All other investments are not categorized because they are not evidenced by securities that exist in physical or book entry form.

The following table presents a summary of the System's investments, by category of custodial credit risk as of June 30, 2000, with comparative 1999 totals *(expressed in thousands)*:

		Carrying Value	
	Category 1	**2000**	**1999**
Investments			
Commercial paper	$ 995,165	$ 995,165	$ 285,410
Repurchase agreements	10,017	10,017	10,354
U.S. Government obligations	1,540,681	1,540,681	1,968,024
Domestic corporate obligations	2,461,484	2,461,484	2,390,075
Mortgage related securities	2,322,529	2,322,529	2,295,599
Domestic stocks	11,513,233	11,513,233	10,201,558
International obligations	17,552	17,552	543,857
International stocks	4,900,107	4,900,107	4,142,311
Total investments to be categorized	$ 23,760,768	23,760,768	21,837,188
Mutual funds		5,790,193	5,279,121
Real estate		661,143	611,986
Mortgages		3,832	4,150
Alternative investments		34,848	809
Global pooled short-term investments		765,492	601,306
Investments held by borrowers under securities loans with cash collateral:			
U.S. Government obligations		789,934	820,294
Domestic corporate obligations		42,146	41,700
Domestic stocks		463,957	298,388
International obligations		—	12,763
International stocks		830,317	661,412
Collateral for loaned securities		2,179,954	1,891,273
Total invested assets		$ 35,322,584	$ 32,060,390

4. Contributions

The State Personnel and Pensions Article requires both active members and their respective employers to make contributions to the System. Rates for required contributions by active members are established by law. Members of the Teachers' and Employees' Retirement Systems are required to contribute 7% or 5% of earnable compensation depending upon the retirement option selected. Members of the State Police and Judges' Retirement Systems are required to contribute 8% and 6% of earnable compensation, respectively. Generally, members of the Teachers' and Employees' Pension Systems are required to contribute 2% of earnable compensation. However, members of the Employees' Pension System who are employed by a participating governmental unit that does not provide the enhanced pension benefits are required to contribute 5% of earnable compensation in excess of the social security taxable wage base.

Contribution rates for employer and other "non-employer" contributing entities are established by annual actuarial valuations using the entry age normal cost method with projection and other actuarial assumptions adopted by the Board of Trustees. These contribution rates have been established as the rates necessary to fund normal costs and amortize the unfunded actuarial accrued liability over a 40-year period (as provided by law) from July 1, 1980.

The State of Maryland (which is also a non-employer contributor to the Teachers' Retirement and Pension Systems and the Judges' Retirement System), the Maryland Automobile Insurance Fund, the Injured Workers' Insurance Fund and 123 participating governmental units make all of the employer and other (non-employer) contributions to the System.

5. Refunds

Member contributions plus interest may be refunded to a member who withdraws from the System, or to the designated beneficiary following a member's death. In addition, members of the Teachers' and Employees' Retirement Systems who elect to transfer to the corresponding pension system receive refunds of all or part (if earnings have been greater than the social security taxable wage base) of their contributions plus interest. That portion of any member's contributions not refunded is transferred with credited interest to the applicable pension system. Employer contributions may also be refunded with interest to any participating governmental unit electing to withdraw from the System. For the fiscal years ended June 30, 2000 and 1999, refunds to members and withdrawing employers were as follows (*expressed in thousands*):

	2000	1999
Member refunds	$ 14,476	$ 12,634
Employer refunds	2,329	4,264
Total refunds	$ 16,805	$ 16,898

Required Supplementary Information

Schedule of Funding Progress

(Expressed in Thousands)

Actuarial Valuation Date June 30,	Actuarial Value of Assets a	Actuarial Accrued Liability (AAL) b	Unfunded AAL (UAAL) (b - a)	Funded Ratio (a / b)	Covered Payroll c	UAAL as a Percentage of Covered Payroll [(b - a) / c]
1991	$ 13,400,926	$ 19,767,885	$ 6,366,959	67.79 %	$ 5,093,708	125 %
1992	14,381,367	20,002,773	5,621,406	71.90	5,023,781	112
1993	15,684,924	21,175,256	5,490,332	74.07	5,064,529	108
1994	16,272,577	21,875,463	5,602,886	74.39	5,246,249	107
1995	17,666,582	23,092,537	5,425,955	76.50	5,532,150	98
1996	19,455,280	24,240,883	4,785,603	80.26	5,640,834	85
1997	21,920,696	25,383,206	3,462,510	86.36	5,657,385	61
1998	24,850,355	27,416,935	2,566,580	90.64	6,148,300	42
1999*	27,646,579	28,475,380	828,801	97.09	6,388,973	13
2000	30,649,380	30,279,866	(369,514)	101.22	6,796,240	(5)

** The 1999 actuarial accrued liability does not include an additional $153 million liability due to municipal employers voluntarily electing enhanced benefits during the period July 1, 1999 to December 31, 1999.*

Schedule of Contributions from Employers and Other Contributing Entity

(Expressed in Thousands)

Fiscal Year Ended June 30,	Annual Required Contributions	Percentage Contributed
1991	$ 633,995	100 %
1992	659,128	100
1993	667,553	100
1994	657,429	100
1995	689,342	100
1996	721,615	100
1997	740,258	100
1998	735,788	100
1999	693,353	100
2000	682,422	100

Notes to the Required Supplementary Information

1. Description of Schedule of Funding Progress

The Schedule of Funding Progress summarizes the actuarial value of the System's assets and actuarial accrued liability as of June 30, 2000 and each of the nine preceding fiscal years. The data presented in the schedule were obtained from the System's independent actuary's annual valuation report for each year presented.

The schedule is presented to provide a consistent basis for measuring the System's annual progress toward funding its actuarial accrued liability in accordance with its actuarial funding method. The primary measure of funding progress is the System's funded ratio (i.e., actuarial value of assets expressed as a percentage of the actuarial accrued liability). An increase in the funded ratio indicates improvement in the System's ability to pay all projected benefits as they become due. The System is fully funded if the funded ratio is greater than or equal to 100 percent. During the year ended June 30, 2000, the System's funded ratio increased from 97.09 percent to 101.22 percent.

The Schedule of Funding Progress also discloses the relationship between the System's covered payroll (i.e., all elements included in compensation paid to active members on which contributions are based) and the unfunded actuarial accrued liability. This relationship, expressed as a ratio, is a measure of the significance of the unfunded actuarial accrued liability relative to the capacity to pay all contributions required to fund the liability. A decrease in this ratio indicates improvement in the System's strength. During the year ended June 30, 2000, the System's ratio of the unfunded actuarial accrued liability to its covered payroll went from 13 percent to (5) percent.

2. Actuarial Methods and Assumptions

a. Funding Method

The System uses the entry age normal cost method with projection to determine the actuarial accrued liability on which future employer contribution rates will be based. Under this funding method, a total contribution rate is determined which consists of two elements, the normal cost rate and the unfunded actuarial liability rate.

The unfunded actuarial accrued liability is being amortized, as a level percentage of projected payroll, over a closed 40-year period (as provided by law). The liquidation period for the unfunded actuarial accrued liability is 20 years from June 30, 2000.

b. Asset Valuation Method

Assets are valued for funding purposes using a simplified three-year moving average. Under this method, the year end actuarial asset value equals 1/3 of the current fiscal year end fair value, as reported in the financial statements, plus 2/3 of the "expected market value." For purposes of this calculation, the "expected market value" is the preceding fiscal year's actuarial asset value, adjusted for the current fiscal year's cash flows with interest accumulated at the actuarial assumed rate of return on investments.

c. Actuarial Assumptions

The assumptions used for the actuarial valuation were recommended by the System's independent actuary, based upon periodic analyses of the System's experience, and adopted by the Board of Trustees. Differences between assumed and actuarial experience (i.e., actuarial gains and losses) are part of the unfunded actuarial liability. The following significant assumptions were used in the actuarial valuation as of June 30, 2000:

- a rate of return on investments of 8 percent compounded annually (adopted June 30, 1998);
- projected salary increases of 5 percent compounded annually, attributable to inflation (adopted June 30, 1988);
- additional projected salary increases ranging from 0.94 percent to 6.82 percent per year attributable to seniority and merit (adopted June 30, 1988);
- post-retirement benefit increases ranging from 3 percent to 6 percent per year depending on the system (adopted June 30, 1982);
- rates of mortality, termination of service, disablement and retirement based on actual experience during the period from 1981 through 1996 (adopted June 30, 1998); and
- the aggregate active member payroll is assumed to increase by 5 percent annually (adopted June 30, 1988).

Other Supplementary Information

Fund Balance Accounts

As provided by law, all System assets must be credited, according to the purpose for which they are held, to either the Annuity Savings Fund, the Accumulation Fund or the Expense Fund. These funds are classified as accounts for financial reporting purposes and are further explained as follows

a. Annuity Savings Fund:

Members' contributions together with interest thereon, at statutory interest rates, are credited to the Annuity Savings Fund. Upon retirement, members' accumulated contributions and interest are transferred from the Annuity Savings Fund to the Accumulation Fund.

b. Accumulation Fund:

Contributions made by employers, other contributions and investment income are credited to the Accumulation Fund. All retirement, disability and death benefits are paid from this Fund.

c. Expense Fund:

All expenses for the administration and operation of the System are recorded in the Expense Fund. During the year, funds are transferred from the Accumulation Fund to the Expense Fund to cover expenses incurred.

Schedule of Fund Balances
for the Fiscal Year Ended June 30, 2000 (with Comparative 1999 Totals)

(Expressed in Thousands)

	Annuity Savings Fund	Accumulation Fund	Expense Fund	Totals 2000	Totals 1999
Fund balances, beginning of year	$ 1,580,529	$ 28,405,020	$ —	$ 29,985,549	$ 28,061,182
Additions:					
Net investment income	—	3,549,084	(61,362)	3,487,722	2,225,398
Contributions (note 4)					
Employers	—	264,083	—	264,083	252,337
Members	182,507	—	—	182,507	162,342
Other	—	418,339	—	418,339	441,016
Deductions:					
Benefit payments	—	(1,190,954)	—	(1,190,954)	(1,115,086)
Refunds (note 5)	(14,476)	(2,329)	—	(16,805)	(16,898)
Administrative expenses (note 2f)	—	—	(19,751)	(19,751)	(24,742)
Transfers:					
From the Accumulation Fund to the Annuity Savings Fund for interest credited to members' accounts	68,201	(68,201)	—	—	—
To the Accumulation Fund from the Annuity Savings Fund for contributions of retiring members	(154,365)	154,365	—	—	—
From the Accumulation Fund to the Expense Fund for administrative and investment expenses	—	(81,113)	81,113	—	—
Net changes in fund balances	81,867	3,043,274	—	3,125,141	1,924,367
Fund balances, end of year	$ 1,662,396	$ 31,448,294	$ —	$ 33,110,690	$ 29,985,549

Schedule of Administrative Expenses
for the Fiscal Years Ended June 30, 2000 and 1999

(Expressed in Thousands)

	2000	1999
Personnel services:		
Staff salaries	$ 7,231	$ 6,197
Fringe benefits	1,963	1,697
Total personnel services	9,194	7,894
Professional and contractual services:		
Actuarial	265	359
Legal and financial	150	185
Data processing	7,584	12,950
Other contractual services	390	372
Total professional and contractual services	8,389	13,866
Miscellaneous:		
Communications	879	839
Rent	636	273
Equipment and supplies	372	217
Legal settlement	—	1,150
Other	281	503
Total miscellaneous	2,168	2,982
Total administrative expenses	$ 19,751	$ 24,742

Schedule of Investment Expenses
for the Fiscal Years Ended June 30, 2000 and 1999

(Expressed in Thousands)

	2000	1999
Investment advisors:		
Equity managers	$ 46,239	$ 32,957
Fixed managers	7,208	7,450
Real estate managers	6,784	6,037
Total investment advisory fees	60,231	46,444
Other investment service fees:		
Master custody	541	650
Income verification services	254	249
Other investment expenses	336	241
Total other investment service fees	1,131	1,140
Total investment expenses	$ 61,362	$ 47,584

Transfer Refund Rate

Members of the Teachers' and Employees' Retirement Systems who elect to transfer to the corresponding pension systems receive transfer refunds. Such refunds include interest calculated using the transfer refund rate in effect for the calendar year in which the transfer becomes effective. The transfer refund rate is determined at the end of each fiscal year for the upcoming calendar year in accordance with Title 22 of the State Personnel and Pensions Article of the Annotated Code of Maryland and the related regulations. Accordingly, the refund interest rate is required to be calculated using realized investment income and total investments valued at their historical cost.

The transfer refund rates in effect for calendar years 2000 and 1999 were 11.2 and 10.8 percent, respectively. For purposes of computing the 2000 and 1999 transfer refund rates, the following cost basis financial data, in addition to certain preceding years' cost basis financial data, were used *(expressed in thousands)*:

	Fiscal year 1999 data	**Fiscal year 1998 data**
Realized investment income	$ 2,709,935	$ 2,655,056
Cost basis of investments	24,108,110	21,770,897

Schedule of Plan Net
as of
(Expressed in Thousands)

	Teachers' Retirement and Pension Systems	Employees' Retirement and Pension Systems
Assets:		
Cash and cash equivalents (note 3)	$ 1,141,457	$ 616,421
Receivables:		
Contributions:		
Employers	1	8,987
Members	224	2,546
Accrued investment income	69,953	38,363
Investment sales proceeds	360,436	215,799
Total receivables	430,614	265,695
Investments, at fair value (notes 2 & 3)**:**		
U.S. Government obligations	1,472,951	783,322
Domestic corporate obligations	1,581,397	841,645
International obligations	87,399	49,200
Domestic stocks	9,708,532	5,798,945
International stocks	4,026,798	2,426,152
Mortgages & mortgage related securities	1,475,769	780,837
Real estate	423,695	196,405
Alternative investments	20,434	12,312
Collateral for loaned securities	1,285,485	750,363
Total investments	20,082,460	11,639,181
Total assets	21,654,531	12,521,297
Liabilities:		
Accounts payable & accrued expenses	26,704	13,872
Investment commitments payable	491,381	281,833
Obligation for collateral for loaned securities	1,285,485	750,363
Other liabilities	530	314
Total liabilities	1,804,100	1,046,382
Net assets held in trust for pension benefits	$ 19,850,431	$ 11,474,915

(A schedule of funding progress is presented on page 26)

Assets by System
June 30, 2000

Judges' Retirement System	State Police Retirement System	Local Fire and Police System	Law Enforcement Officers' Pension System	Total
$ 23,330	$ 63,846	$ 1,716	$ 15,441	$ 1,862,211
258	94	—	803	10,143
2	284	—	12	3,068
755	3,581	39	356	113,047
4,363	29,543	174	2,899	613,214
5,378	33,502	213	4,070	739,472
13,382	55,358	669	4,933	2,330,615
14,515	59,962	730	5,381	2,503,630
1,414	5,497	87	643	144,240
112,303	801,477	4,316	78,384	16,503,957
44,648	336,151	1,510	31,903	6,867,162
12,500	52,223	601	4,431	2,326,361
10,133	24,895	947	5,068	661,143
226	1,706	8	162	34,848
26,881	102,579	1,749	12,897	2,179,954
236,002	1,439,848	10,617	143,802	33,551,910
264,710	1,537,196	12,546	163,313	36,153,593
453	1,780	12	140	42,961
7,086	34,600	393	3,796	819,089
26,881	102,579	1,749	12,897	2,179,954
7	43	—	5	899
34,427	139,002	2,154	16,838	3,042,903
$ 230,283	$ 1,398,194	$ 10,392	$ 146,475	$ 33,110,690

Schedule of Changes in
for the Fiscal Year
(Expressed in Thousands)

	Teachers' Retirement and Pension Systems	Employees' Retirement and Pension Systems	Judges' Retirement System
Additions:			
Contributions (note 4):			
Employers	$ 17,369	$ 219,653	$ 14,456
Members	102,758	71,278	1,375
Other	418,065	—	274
Total contributions	538,192	290,931	16,105
Investment income:			
Net appreciation in fair value of investments	1,635,740	986,540	18,001
Interest	308,071	167,836	3,757
Dividends	140,627	81,124	1,889
Real estate operating net income	12,535	5,801	306
Income before securities lending activity	2,096,973	1,241,301	23,953
Gross income from securities lending activity	71,174	41,524	1,522
Securities lending borrower rebates	(65,341)	(38,121)	(1,398)
Securities lending agent fees	(1,405)	(819)	(30)
Net income from securities lending activity	4,428	2,584	94
Total investment income	2,101,401	1,243,885	24,047
Less investment expenses:			
Investment advisory fees	(35,982)	(20,962)	(412)
Other investment expenses	(680)	(390)	(8)
Total investment expenses	(36,662)	(21,352)	(420)
Net investment income	2,064,739	1,222,533	23,627
Transfers from other systems	1,458	1,891	2
Total additions	2,604,389	1,515,355	39,734
Deductions:			
Benefit payments	731,409	400,353	14,507
Refunds (note 5)	9,783	6,764	4
Administrative expenses (note 2f)	11,895	6,800	134
Transfers to other systems	2,193	20,289	5
Total deductions	755,280	434,206	14,650
Net increase in plan assets	1,849,109	1,081,149	25,084
Net assets held in trust for pension benefits:			
Beginning of the fiscal year	18,001,322	10,393,766	205,199
End of the fiscal year	$ 19,850,431	$ 11,474,915	$ 230,283

** Intersystem transfers have been eliminated in the financial statements.*

Plan Net Assets by System
Ended June 30, 2000

State Police Retirement System	Local Fire and Police System	Law Enforcement Officers' Pension System	Subtotal	Eliminations*	Total
$ 1,075	$ 987	$ 10,543	$ 264,083	$ —	$ 264,083
6,652	11	433	182,507	—	182,507
—	—	—	418,339	—	418,339
7,727	998	10,976	864,929	—	864,929
138,122	598	11,905	2,790,906	—	2,790,906
13,719	236	1,554	495,173	—	495,173
11,083	102	1,126	235,951	—	235,951
729	29	148	19,548	—	19,548
163,653	965	14,733	3,541,578	—	3,541,578
5,667	100	677	120,664	—	120,664
(5,202)	(92)	(622)	(110,776)	—	(110,776)
(112)	(2)	(14)	(2,382)	—	(2,382)
353	6	41	7,506	—	7,506
164,006	971	14,774	3,549,084	—	3,549,084
(2,633)	(17)	(225)	(60,231)	—	(60,231)
(49)	—	(4)	(1,131)	—	(1,131)
(2,682)	(17)	(229)	(61,362)	—	(61,362)
161,324	954	14,545	3,487,722	—	3,487,722
32	1	19,259	22,643	(22,643)	—
169,083	1,953	44,780	4,375,294	(22,643)	4,352,651
40,226	313	4,146	1,190,954	—	1,190,954
241	—	13	16,805	—	16,805
847	5	70	19,751	—	19,751
13	5	138	22,643	(22,643)	—
41,327	323	4,367	1,250,153	(22,643)	1,227,510
127,756	1,630	40,413	3,125,141	—	3,125,141
1,270,438	8,762	106,062	29,985,549	—	29,985,549
$ 1,398,194	$ 10,392	$ 146,475	$ 33,110,690	$ —	$ 33,110,690

This page intentionally left blank.