In Memoriam:

Frank P. Casula

March 28, 1920 to October 21, 2001

Member, Board of Trustees of the State Retirement and Pension System of Maryland
1986 - 2001

Chairman of the Real Estate Subcommittee
Member of the Investment Committee

During his distinguished 30-year career in Public Office, Mr. Casula dedicated his life to the service of the citizens of Maryland. From 1986 until his untimely death, Mr. Casula was a strong advocate for the rights and benefits of the participants of the State Retirement and Pension System. His absence will be felt greatly by the Board, the staff of the State Retirement Agency, and the membership of the System.
STATE RETIREMENT AND PENSION SYSTEM OF MARYLAND

COMPREHENSIVE ANNUAL FINANCIAL REPORT

A Pension Trust Fund of the State of Maryland

For the Year Ended June 30, 2001

prepared by:
State Retirement Agency of Maryland
301 W. Preston Street
Baltimore, Maryland 21201

We gratefully acknowledge the State Archives of the State of Maryland for their permission in reprinting the Great Seal of Maryland.
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Honorable Chairman & Members of the Board of Trustees:

We are pleased to submit the Comprehensive Annual Financial Report for the State Retirement and Pension System of Maryland (the "System") for the fiscal year ended June 30, 2001. We believe this report fairly reflects the results achieved during 2001.

The System is charged with the fiduciary responsibility for properly administering the retirement and pension allowances and other benefits, while striving to keep employer contribution rates as affordable as possible while maximizing investment returns and minimizing the risks inherent in any investment program. Members covered by the plans include State employees, teachers, law enforcement officers, legislators, judges, as well as local government employees and fire fighters whose employers have elected to participate in the System.

Seventy-four years ago, the first statewide retirement plan in Maryland (the Teachers’ Retirement System) was established. Fourteen years later, in 1941, the Employees’ Retirement System was established. Together these two plans comprise the majority of the System’s membership. The System now provides monthly allowances to 84,000 retirees and beneficiaries, and is an essential element of the future financial security for over 184,600 active participating members. Descriptions of the membership requirements of, and benefits provided by, each plan administered by the System are included in the Plan Summary Section starting on page 81.

This Comprehensive Annual Financial Report contains six sections. The Introductory Section includes this letter of transmittal, along with information about the administration structure of the System. The Financial, Actuarial and Investment Sections provide a comprehensive review of the System’s financial position, the results of its operations and its funded status. Viewed separately, each of these three sections provides information about a different aspect of the System’s long-standing record of stewardship and financial stability. In this regard, the Financial Section contains the report from the System’s independent auditor, the combined financial statements and supplementary financial data. The Actuarial Section contains the independent actuary’s certification, as well as the results of the System’s annual actuarial valuation. The Investment Section includes a report from the System’s Chief Investment Officer highlighting the past year’s performance in addition to various summary level portfolio composition and performance data. The Plan Summary and Statistical Sections provide detailed descriptions of the various plans’ provisions and the demographic composition of the membership segments affected by each plan.

Economic Environment

For the first time in many years, the slowing economic environment during fiscal year 2001 presented a significant challenge to public pension funds. The ensuing market corrections resulted in reduced investment earnings and a decrease in the System’s overall funded status. However, despite this temporary downturn, the System remains financially strong and very near its goal of being fully funded.
Investment Strategies

Under the experienced direction of its Board of Trustees, the System plans to continue following its steady course toward maximizing investment returns while minimizing its exposure to risk. In the months ahead, the System will continue to deploy assets at home as well as throughout the expanding global markets in an effort to maintain an appropriate portfolio balance.

Major Issues and Initiatives

In May 1998, the System signed a contract for the development and implementation of a fully integrated, state-of-the-art data processing and document management system. During fiscal year 2001, the system development project progressed into the integration and system testing phases. With implementation and system integration expected to be completed by the end of fiscal year 2003, the System should be well positioned to enter the 21st century as an industry leader.

During 2001, the System adopted a new actuarial funding methodology to help reduce the potential for contribution rate volatility as the System continues to mature. In this regard, Senate Bill 222 was signed into law by the Governor to modify certain actuarial assumptions used in the annual actuarial valuation of the System’s liabilities and funded status. Specifically, the legislation required the System to continue to amortize the liabilities existing as of June 30, 2001 over the remaining 19-year period to June 30, 2020. However, all liabilities accrued after June 30, 2001 will be amortized over a layered 25-year period commencing in the year in which they arise. Additionally, the System’s Board of Trustees adopted a new actuarial asset valuation method that increases the asset “smoothing” period from 3 to 5 years.

Financial Information

Because System management is responsible for the information contained in this report, we have committed the resources necessary to maintain an internal control structure which provides reasonable assurance that assets are adequately safeguarded and that the financial records are consistently and accurately maintained. Accordingly, we are confident that the financial statements, supporting schedules and statistical tables included in this report fairly present the System’s financial condition and the results of its operations in all material respects.

Accounting System and Reports

The System reports its transactions on the accrual basis of accounting, under which revenues are reported in the accounting period in which they are earned and become measurable and expenses are reported when the related liability is incurred. Investments are reported at fair value at fiscal year end. Investment purchases and sales are reported in the accounting period in which the related trade dates occur.

Revenues

The reserves necessary to finance retirement allowances and other benefits are accumulated through investment earnings and the collection of employer and member contributions. During fiscal year 2001, investment earnings were a negative $3.1 billion, while revenues from employer and member contributions were $625 million and $190 million, respectively. For fiscal year 2001, member contribution rates remained unchanged, while employer rates increased slightly.

Expenses

The System’s expenses consist of monthly retirement allowances, refunds of contributions to terminated and transferring members and withdrawing employers, and the administrative cost of System operations. As expected, payments to retirees, beneficiaries and transferring or withdrawing members and employers continued to be the System’s primary disbursements during 2001, totaling $1,290 million. Of this amount, the System disbursed $1,273 million as retirement allowances to members and beneficiaries. The remaining $17 million was paid to members and withdrawing employers as a result of employment terminations, system transfers or withdrawal.

Administrative and investment expenses are entirely funded through investment income. Of the $227 million disbursed during fiscal year 2000 to manage the investment portfolio and to administer the System, $202 million was paid for investment management, portfolio custody and securities lending services while only $25 million was used to fund the System’s administrative operations.
Funding and Reserves

Funds, derived from the excess of revenues over expenses, are accumulated by the System in order to meet benefit obligations to both current and future retirees and beneficiaries. The Annotated Code of Maryland requires participating employers to make periodic contributions which, as a level percentage of payroll, will fund the employers’ "normal costs" over the members’ average active service period, and the System’s accrued unfunded liability in separate annual layers. Specifically, the unfunded actuarial liability which existed at June 30, 2001 will continue to be amortized over the remaining 19-year period to June 30, 2020, whereas each subsequent annual liability layer will be amortized over a 25-year period. Each year the Board of Trustees certifies the required employer contribution rates based on the actuary’s annual valuation and recommendations.

At June 30, 2001, the System’s actuarial accrued liability was $32.5 billion. With the actuarial value of assets accumulated to pay the liability at $31.9 billion, the System now stands at 98.3 percent funded.

Investments

The entire $3.1 billion unrealized investment loss for fiscal year 2001, was attributable to temporary market value declines stemming from a slowing economy. Partially offsetting the effects of such market declines was approximately $822 million representing interest, dividends, securities lending net income and real estate operating net income.

Professional Services

The System contracts for the services of various independent consulting, investment advisory and financial professionals to assist the Board in carrying out its fiduciary responsibility to efficiently and effectively manage the System. For example, actuarial services were provided by Milliman USA and independent financial statement audit services were provided by the State of Maryland’s Office of Legislative Audits. The System’s asset custody and portfolio accounting services are provided by the State Street Bank & Trust Company under a multi-year, master custody arrangement. A complete listing of the System’s professional consultants and external investment advisors is presented on page 11.
Dear Members and Beneficiaries:

On behalf of the Board of Trustees, I am pleased to present the Comprehensive Annual Financial Report on the operations of the State Retirement and Pension System of Maryland for the fiscal year ended June 30, 2001. It was prepared and submitted by the management of the Retirement Agency and accepted by the Board of Trustees on December 18, 2001. The report is divided into several sections, providing an in-depth review of the financial, actuarial, investment and administrative functions of the System we manage for your exclusive benefit.

After more than a decade of extraordinary portfolio returns, fiscal year 2001 was a negative year for nearly all types and styles of equity investments and your fund. As a result, the portfolio gave back some of the large gains we achieved in prior years. This year was only the second time in the last 17 years that the System did not meet or exceed its' assumed rate of return.

It is important to note that we were not the only one affected by this poor investment climate. All pension funds, both public and private, defined benefit as well as defined contribution plans were similarly affected.

Despite this downturn, we remain very strong financially with $29.5 billion in assets with a funding ratio of 98.3% at year end.

As prudent long term investors, we continue to believe that equity returns will outpace all other types of asset classes over the long term. History has demonstrated this fact time and time again. We will continue to prudently diversify the portfolio to accumulate the assets necessary to pay retirement benefits.

Sincerely,

Richard N. Dixon
State Treasurer
Chairman of the Board
Board of Trustees

Richard N. Dixon, Chairman
State Treasurer
Ex Officio since February 1, 1996
Member, Investment Committee
Member, Executive Committee

William Donald Schaefer, Vice Chairman
State Comptroller
Ex Officio since January 25, 1999
Member, Investment Committee
Member, Real Estate Subcommittee

Dr. Ali A. Alemi
August 1, 1999 – July 31, 2003
Member, Executive Committee
Member, Audit Committee

William D. Brown
August 1, 2001 – July 31, 2005
Chairman, Executive Committee
Chairman, Audit Committee

Arthur N. Caple, Jr.
August 1, 2001 – July 31, 2005
Chairman, Investment Committee

T. Eloise Foster
Ex Officio since June 1, 2000
Member, Investment Committee
Member, Executive Committee

Dr. Nancy S. Grasmick
Ex Officio since September 16, 1991
Member, Executive Committee
**Introduction**

**Board of Trustees**

- **G. Bruce Harrison**
  - August 1, 2001 – July 31, 2005
  - Member, Investment Committee
  - Member, Audit Committee

- **Debra B. Humphries**
  - August 1, 2001 – July 31, 2005
  - Member, Investment Committee

- **Major Morris L. Krome**
  - August 1, 1998 – July 31, 2002
  - Vice Chairman, Executive Committee

- **Carl D. Lancaster**
  - August 1, 1987 – July 31, 2003
  - Vice Chairman, Investment Committee
  - Member, Real Estate Subcommittee

- **Col. David B. Mitchell**
  - Ex Officio since January 18, 1995
  - Member, Executive Committee

- **George R. Tydings**
  - Member, Investment Committee

**Public Advisors to the Investment Committee**

- **Robert W. Schaefer**
- **Wayne H. Shaner**
- **Robert H. Patzwall, Jr.**
## Consulting, Professional and Investment Management Services

### Equity Investment Managers

<table>
<thead>
<tr>
<th>Company Name</th>
<th>City, State</th>
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<tbody>
<tr>
<td>Abbott Capital Management, LLC</td>
<td>Boston, Massachusetts</td>
</tr>
<tr>
<td>Advent Capital Management</td>
<td>New York, New York</td>
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<tr>
<td>Bank of Ireland Asset Management Limited</td>
<td>Dublin, Ireland</td>
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<tr>
<td>Adams Street Partners, LLC</td>
<td>Chicago, Illinois</td>
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<tr>
<td>Brown Capital Management, Inc.</td>
<td>Baltimore, Maryland</td>
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<tr>
<td>Brown Investment Advisory &amp; Trust Company</td>
<td>Baltimore, Maryland</td>
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<tr>
<td>Capital Guardian Trust Company</td>
<td>Washington, D.C.</td>
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<tr>
<td>Chapman Capital Management, Inc.</td>
<td>Baltimore, Maryland</td>
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<tr>
<td>Credit Suisse Asset Management, LLC</td>
<td>New York, New York</td>
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<tr>
<td>Dimensional Fund Advisors, Inc.</td>
<td>Santa Monica, California</td>
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<td>The Edgar Lomax Company</td>
<td>Springfield, Virginia</td>
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<tr>
<td>GEM Capital Management, Inc.</td>
<td>New York, New York</td>
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<tr>
<td>Greenway Partners, L.P.</td>
<td>New York, New York</td>
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<td>Harbor International Fund</td>
<td>Toledo, Ohio</td>
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<td>Harbour Vest Partners, LLC</td>
<td>Boston, Massachusetts</td>
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<td>Legg Mason Capital Management, Inc.</td>
<td>Baltimore, Maryland</td>
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<td>Maryland Venture Capital Trust</td>
<td>Baltimore, Maryland</td>
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<td>Progress Investment Management Company</td>
<td>San Francisco, California</td>
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<tr>
<td>Relational Investors, LLC</td>
<td>San Diego, California</td>
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<tr>
<td>Robert W. Torray &amp; Co., Inc.</td>
<td>Bethesda, Maryland</td>
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<tr>
<td>State Street Global Advisors</td>
<td>Boston, Massachusetts</td>
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<td>T. Rowe Price Associates, Inc.</td>
<td>Baltimore, Maryland</td>
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<tr>
<td>Templeton Investment Counsel, Inc.</td>
<td>Fort Lauderdale, Florida</td>
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<tr>
<td>Trust Company of the West</td>
<td>Los Angeles, California</td>
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<td>Zurich Scudder Investments</td>
<td>New York, New York</td>
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### Independent Actuary

<table>
<thead>
<tr>
<th>Company Name</th>
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<tr>
<td>Milliman USA</td>
<td>Baltimore, Maryland</td>
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### Independent Auditor

<table>
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<tr>
<th>Office Name</th>
<th>City, State</th>
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<tr>
<td>Office of Legislative Audits</td>
<td>Baltimore, Maryland</td>
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### Hearing Officers

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<tr>
<th>Office Name</th>
<th>City, State</th>
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<tr>
<td>Office of Administrative Hearings</td>
<td>Baltimore, Maryland</td>
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### Medical Board

<table>
<thead>
<tr>
<th>Name</th>
<th>City, State</th>
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<tbody>
<tr>
<td>John J. Fahey, M.D.</td>
<td>Baltimore, Maryland</td>
</tr>
<tr>
<td>Norman Freeman, Jr., M.D.</td>
<td>Baltimore, Maryland</td>
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<tr>
<td>Arthur Hildreth, M.D.</td>
<td>Baltimore, Maryland</td>
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<tr>
<td>Bruce Z. Korn, M.D.</td>
<td>Baltimore, Maryland</td>
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<tr>
<td>William B. Russell, M.D.</td>
<td>Baltimore, Maryland</td>
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<tr>
<td>Claudia Thomas, M.D.</td>
<td>Baltimore, Maryland</td>
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<tr>
<td>Alfred Wiedman, M.D.</td>
<td>Baltimore, Maryland</td>
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### Operational Banking Services

<table>
<thead>
<tr>
<th>Company Name</th>
<th>City, State</th>
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<tr>
<td>Allfirst Financial, Inc.</td>
<td>Baltimore, Maryland</td>
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<tr>
<td>The Harbor Bank of Maryland</td>
<td>Baltimore, Maryland</td>
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### Global Custodial Bank

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<tr>
<th>Company Name</th>
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<tbody>
<tr>
<td>State Street Bank and Trust Company</td>
<td>Boston, Massachusetts</td>
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### Security Lending

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<th>Company Name</th>
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<tr>
<td>State Street Bank and Trust Company</td>
<td>Boston, Massachusetts</td>
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### Fixed Income Investment Managers

<table>
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<th>Company Name</th>
<th>City, State</th>
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<tbody>
<tr>
<td>Fountain Capital Management, LLC</td>
<td>Overland Park, Kansas</td>
</tr>
<tr>
<td>Lazard Asset Management</td>
<td>New York, New York</td>
</tr>
<tr>
<td>Morgan Stanley Dean Witter Investment Management</td>
<td>West Conshohocken, Pennsylvania</td>
</tr>
<tr>
<td>Pacific Investment Management Company</td>
<td>Newport Beach, California</td>
</tr>
<tr>
<td>Standish, Ayer &amp; Wood, Inc.</td>
<td>Boston, Massachusetts</td>
</tr>
<tr>
<td>W.R. Huff Asset Management Co., LLC</td>
<td>Morristown, New Jersey</td>
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### Asset & Income Verification Services

<table>
<thead>
<tr>
<th>Company Name</th>
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<tbody>
<tr>
<td>Financial Control Systems, Inc.</td>
<td>Chadds Ford, Pennsylvania</td>
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### Real Estate Investment Managers

<table>
<thead>
<tr>
<th>Company Name</th>
<th>City, State</th>
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<tbody>
<tr>
<td>AEW Cipital Management, L.P.</td>
<td>Boston, Massachusetts</td>
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<tr>
<td>J.P. Morgan Investment Management, Inc.</td>
<td>New York, New York</td>
</tr>
<tr>
<td>LaSalle Investment Management, Inc.</td>
<td>Baltimore, Maryland</td>
</tr>
<tr>
<td>LaSalle Investment Management Securities, L.P.</td>
<td>Baltimore, Maryland</td>
</tr>
<tr>
<td>Lubert-Adler Management, Inc.</td>
<td>Philadelphia, Pennsylvania</td>
</tr>
<tr>
<td>Sentinel Real Estate Corporation</td>
<td>New York, New York</td>
</tr>
<tr>
<td>TimesSquare Real Estate Investors</td>
<td>Hartford, Connecticut</td>
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Certificate of Achievement for Excellence in Financial Reporting

Presented to

State Retirement and Pension System of Maryland

For its Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2000

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.

[Signatures]

President

Executive Director
Introduction

Mission Statement

The Board of Trustees of the State Retirement and Pension System of Maryland (System) is charged with the fiduciary responsibility for administering the survivor, disability and retirement benefits of the System’s participants, and to ensure that sufficient assets are available to fund the benefits when due. To accomplish this mission the System has established the following key goals:

- To prudently invest System assets in a well diversified manner to optimize long-term returns, while controlling risk through excellence in execution of the investment objectives and strategies of the System.

- To effectively communicate with all retirement plan participants to inform them about the benefits provided by the System, and to educate them about planning and preparing for all aspects of their future retirement.

- To accurately and timely pay retirement allowances provided by State pension law to the System’s retirees and their beneficiaries.

- To implement an automated, comprehensive and integrated pension administration and electronic document management system.

- To efficiently collect the required employer and member contributions necessary to fund the System.
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