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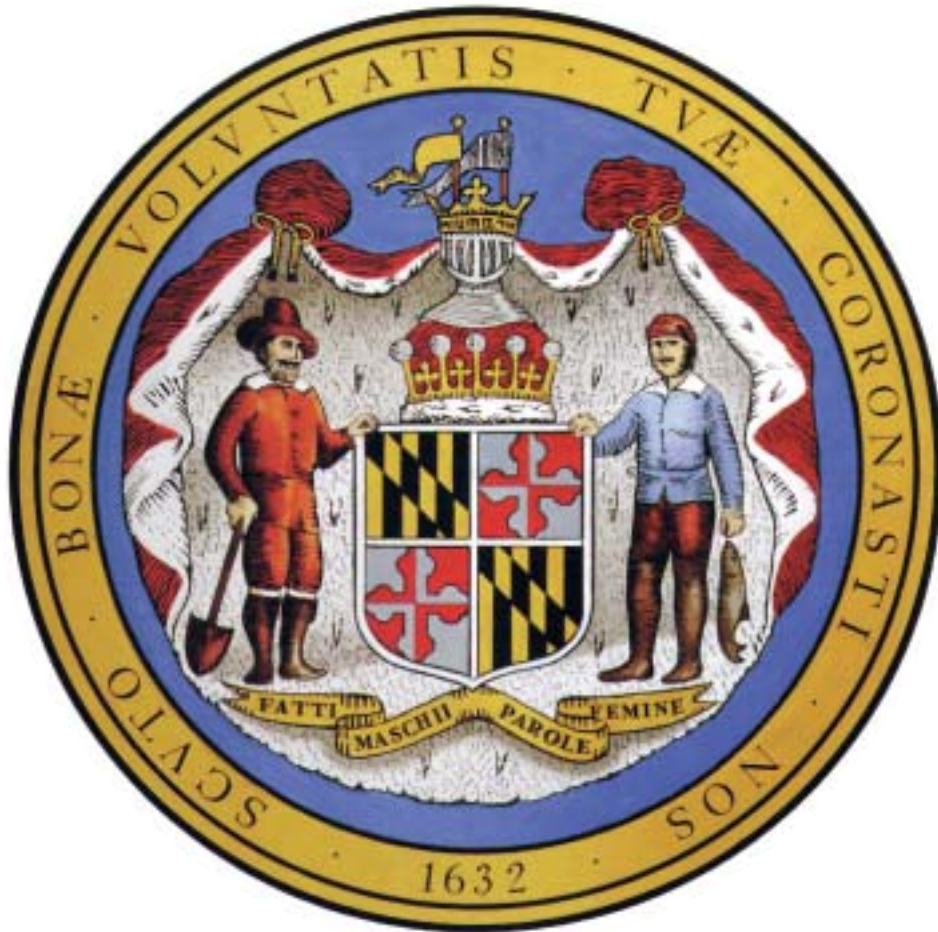
## MISSION STATEMENT

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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.

STATE RETIREMENT AND PENSION SYSTEM OF MARYLAND  
**COMPREHENSIVE ANNUAL FINANCIAL REPORT**  
A PENSION TRUST FUND OF THE STATE OF MARYLAND



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FOR THE YEAR ENDED JUNE 30, 2002

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*Prepared by:*  
State Retirement Agency of Maryland  
120 East Baltimore Street  
Baltimore, Maryland 21202

*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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LETTER OF TRANSMITTAL

STATE RETIREMENT AND PENSION SYSTEM OF MARYLAND  
STATE RETIREMENT AGENCY

120 EAST BALTIMORE STREET  
BALTIMORE, MARYLAND 21202  
TELEPHONE: 410-825-5555  
1-800-492-5909

PETER VAUGHN  
EXECUTIVE DIRECTOR  
SECRETARY TO THE BOARD



BOARD OF TRUSTEES

WILLIAM DONALD SCHAEFER  
Chairman

Nancy K. Kopp  
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T. Eloise Foster  
Dr. Nancy S. Grasmick  
G. Bruce Harrison  
Debra B. Humphries  
Major Morris L. Krome  
Carl D. Lancaster  
Col. David B. Mitchell  
David A. Rakes  
George R. Tydings

December 15, 2002

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, 2002. We believe this report fairly reflects the results achieved during 2002.

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-five 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 more than 87,000 retirees and beneficiaries, and is an essential element of the future financial security for over 190,000 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 85.

This Comprehensive Annual Financial Report contains six sections. The Introductory Section includes this letter of transmittal, along with information about the administrative 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**

As was the case during fiscal year 2001, the lackluster economic environment during fiscal year 2002 presented another significant challenge to public pension funds. The ensuing market corrections again 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 ahead of schedule with regard to its long-standing funding goals.



## **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**

During the past two years, the Agency has improved its ability to offer System benefits to employees of local jurisdictions by admitting to membership in the Combined Systems four new participating governmental units. During the coming year, the Agency will endeavor to continue to make progress in this area by actively marketing its services to county and local government employees throughout the State.

## **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 2002, investment earnings were a negative \$2.2 billion, while revenues from employer and member contributions were \$581 million and \$199 million, respectively. For fiscal year 2002, 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 2002, totaling \$1,390 million. Of this amount, the System disbursed \$1,372 million as retirement allowances to members and beneficiaries. The remaining \$18 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 \$128 million disbursed during fiscal year 2002 to manage the investment portfolio and to administer the System, \$108 million was paid for investment management, portfolio custody and securities lending services while only \$20 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 that existed at June 30, 2000 will continue to be amortized over the remaining 18-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, 2002, the System's actuarial accrued liability was \$34.1 billion. With the actuarial value of assets accumulated to pay the liability at \$32.3 billion, the System now stands at 94.7 percent funded.

## **Investments**

The entire \$2.2 billion unrealized investment loss for fiscal year 2002, was attributable to temporary market value declines stemming from a slowing economy. Partially offsetting the effects of such market declines was approximately \$776 million represented 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.

**Certificate of Achievement  
for Excellence in Financial Reporting**

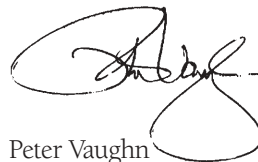
The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the State Retirement and Pension System of Maryland for its comprehensive annual financial report for the fiscal year ended June 30, 2001. This was the thirteenth consecutive year (1989 through 2001) the State Retirement and Pension System of Maryland has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a governmental unit

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.

A Certificate of Achievement is valid for a period of one year only. We believe our current comprehensive annual financial 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.

**Acknowledgments**

This annual report reflects the dedicated efforts of the System's staff under the steady direction of the Board of Trustees. We extend our sincere gratitude to each member of the Board of Trustees, the Agency's staff, the Board's advisors and the many people who worked so hard to make fiscal year 2002 a success.



Peter Vaughn  
*Executive Director &  
Secretary to the Board*



Ricky L. Harrison, CPA  
*Chief Financial Officer*

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# STATE RETIREMENT AND PENSION SYSTEM OF MARYLAND

## STATE RETIREMENT AGENCY

120 EAST BALTIMORE STREET  
BALTIMORE, MARYLAND 21202  
TELEPHONE: 410-625-5555  
1-800-492-5909

PETER VAUGHN  
EXECUTIVE DIRECTOR  
SECRETARY TO THE BOARD



### BOARD OF TRUSTEES

WILLIAM DONALD SCHAEFER  
Chairman

Nancy K. Kopp  
Vice Chairman

Dr. Ali A. Alemi  
William D. Brown  
Arthur N. Caple, Jr.  
T. Eloise Foster  
Dr. Nancy S. Grasmick  
G. Bruce Harrison  
Debra B. Humphries  
Major Morris L. Krome  
Carl D. Lancaster  
Col. David B. Mitchell  
David A. Rakes  
George R. Tyclings

Dear Members and Beneficiaries:

The fiscal year ending June 30, 2002 was another difficult and challenging one for the financial markets. Public and private pension systems throughout the country have all been affected by the recession, occurrences of corporate fraud, and terrorism of the past several years. Total investment return of the Maryland Retirement and Pension System (MRPS) for fiscal 2002 was a negative 7.6% compared with a negative 9.4% reported for fiscal 2001. Total fund assets totaled \$26.5 billion at the close of fiscal 2002 versus \$29.5 billion in 2001.

Remember, that despite the fluctuations of the financial markets, your benefits, both current and future, are safe and secure, guaranteed by the Maryland state government.

When we became presiding officers of the State Retirement and Pension System of Maryland on June 30, 2002, we told members of the Board that we would focus on five issues during the coming year. First, our primary mission would be to make money for the retirees prudently. Second, we would attempt, whenever practical, to favor managers and investments with a Maryland presence. Third, there would be a firm and uncompromising policy that money managers who do not perform to their expected standard will be terminated. Fourth, although board members may represent different constituencies, we would work with commonality for the benefit of all the active and retired members of the System. And finally, we would review the administration of the System as currently structured, to assure that it is being run as effectively and efficiently as possible. While we are making progress to date on each of these issues, we recognize we have only just begun.

It is our intention to communicate with you on a regular basis regarding the Retirement System. However, if you have concerns at any time, please call our toll free number 1-800-492-5909 or e-mail us at [sra@sra.state.md.us](mailto:sra@sra.state.md.us) or write to the address on the back cover. We pledge that each of your inquiries and comments will be promptly and fully handled.

Each of the trustees has a deep sense of obligation and commitment to you and your families. The Board is confident that the strategic course we are on is correct. We view our fiduciary responsibility to you as a trust and will act with a sense of urgency in all matters concerning your pension System.

Sincerely,

Handwritten signature of William Donald Schaefer in black ink.

WILLIAM DONALD SCHAEFER  
Chairman

Handwritten signature of Nancy K. Kopp in black ink.

NANCY K. KOPP  
Vice Chairman



BOARD OF TRUSTEES



**WILLIAM DONALD SCHAEFER, *Chairman***  
**State Comptroller**

Ex Officio since January 25, 1999  
Member, Investment Committee  
Member, Real Estate Subcommittee



**NANCY K. KOPP, *Vice Chairman***  
**State Treasurer**

Ex Officio since February 14, 2002  
Member, Investment Committee  
Member, Executive Committee



**DR. ALI A. ALEMI**

August 1, 1999 – July 31, 2003  
Member, Executive Committee  
Member, Audit Committee



**WILLIAM D. BROWN**

August 1, 1997 – July 31, 2005  
Chairman, Executive Committee  
Chairman, Audit Committee



**ARTHUR N. CAPLE, JR.**

August 1, 1985 – July 31, 2005  
Chairman, Investment Committee



**DAVID A. RAKES**

November 20, 2001 – June 30, 2006  
Member, 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

**BOARD OF TRUSTEES**



**G. BRUCE HARRISON**  
August 1, 1997 – July 31, 2005  
Member, Investment Committee  
Member, Real Estate Subcommittee  
Member, Audit Committee



**DEBRA B. HUMPHRIES**  
August 1, 1997 – July 31, 2005  
Member, Real Estate Subcommittee  
Member, Investment Committee



**MAJOR MORRIS L. KROME**  
August 1, 1998 – July 31, 2006  
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**  
May 31, 1994 – June 30, 2003  
Member, Investment Committee

**PUBLIC ADVISORS TO THE INVESTMENT COMMITTEE**



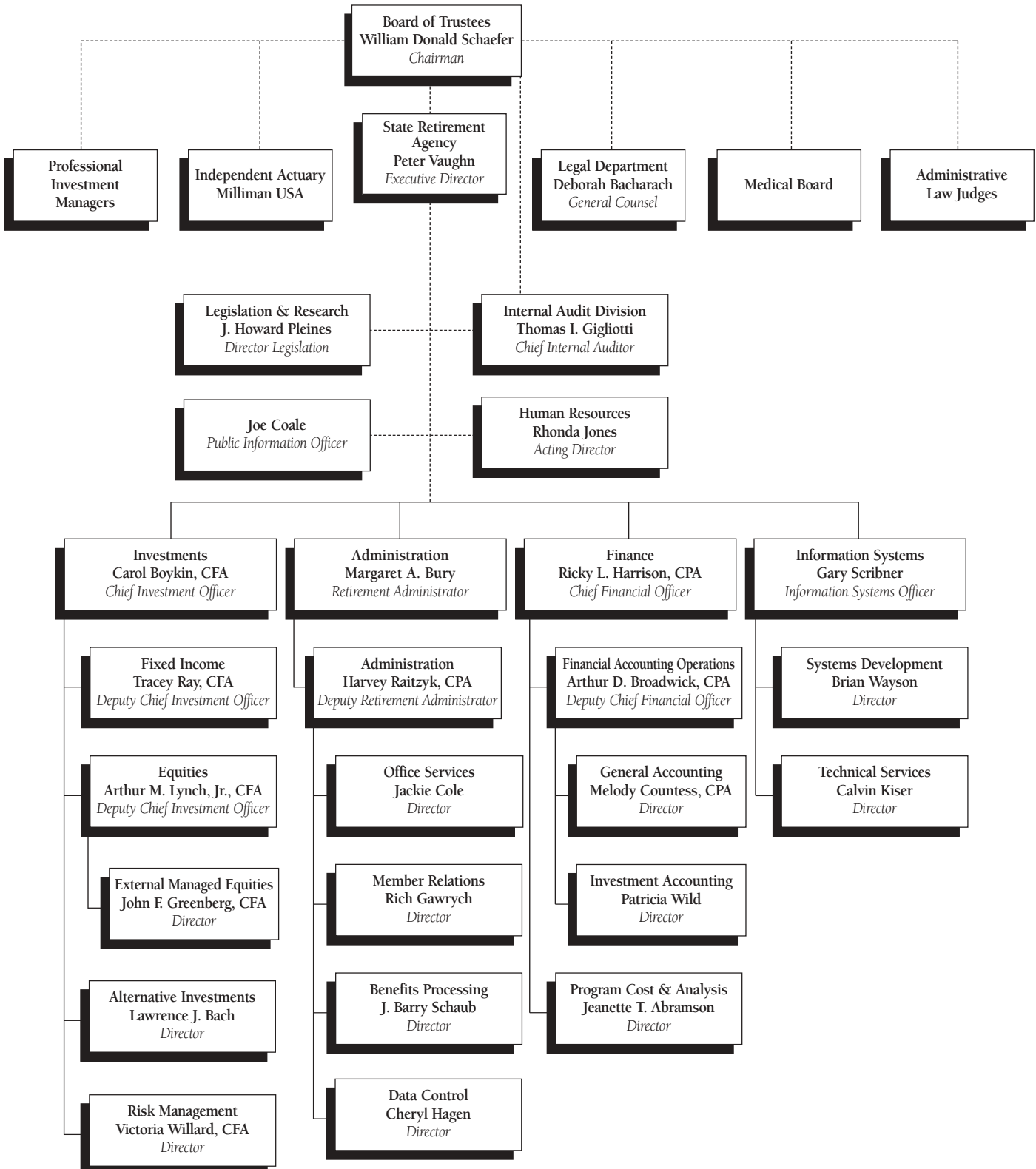
**ROBERT W. SCHAEFER**



**WAYNE H. SHANER**

**ORGANIZATIONAL CHART**

(December, 2002)



**CONSULTING, PROFESSIONAL & INVESTMENT MANAGEMENT SERVICES**

**EQUITY INVESTMENT MANAGERS**

Abbott Capital Management, LLC  
*Boston, Massachusetts*

Deutsche Asset Management  
*New York, New York*

Maryland Venture Capital Trust  
*Baltimore, Maryland*

Adams Street Partners, LLC  
*Chicago, Illinois*

Dimensional Fund Advisors, Inc.  
*Santa Monica, California*

Progress Investment Management Company  
*San Francisco, California*

Advent Capital Management  
*New York, New York*

The Edgar Lomax Company  
*Springfield, Virginia*

Relational Investors, LLC  
*San Diego, California*

Ariel Capital Management, Inc.  
*Chicago, Illinois*

GEM Capital Management, Inc.  
*New York, New York*

Robert W. Torray & Co., Inc.  
*Bethesda, Maryland*

Bank of Ireland Asset Management Limited  
*Dublin, Ireland*

Greenway Partners, L.P.  
*New York, New York*

State Street Global Advisors  
*Boston, Massachusetts*

Brown Capital Management, Inc.  
*Baltimore, Maryland*

HarbourVest Partners, LLC  
*Boston, Massachusetts*

T. Rowe Price Associates, Inc.  
*Baltimore, Maryland*

Brown Investment Advisory & Trust Company  
*Baltimore, Maryland*

J. & W. Seligman & Co., Inc.  
*New York, New York*

Templeton Investment Counsel, Inc.  
*Fort Lauderdale, Florida*

Capital Guardian Trust Company  
*Washington, D.C.*

The Kenwood Group, Inc.  
*Chicago, Illinois*

Trust Company of the West  
*Los Angeles, California*

Credit Suisse Asset Management, LLC  
*New York, New York*

Legg Mason Capital Management, Inc.  
*Baltimore, Maryland*

**INDEPENDENT ACTUARY**

Milliman USA  
*Baltimore, Maryland*

**GLOBAL CUSTODIAL BANK**

State Street Bank and Trust Company  
*Boston, Massachusetts*

W.R. Huff Asset Management Co., LLC  
*Morristown, New Jersey*

**INDEPENDENT AUDITOR**

Office of Legislative Audits  
*Baltimore, Maryland*

**INDEPENDENT INVESTMENT CONSULTANT**

Ennis Knupp & Associates  
*Chicago, Illinois*

**ASSET & INCOME VERIFICATION SERVICES**

Financial Control Systems, Inc.  
*Chadds Ford, Pennsylvania*

**HEARING OFFICERS**

Office of Administrative Hearings  
*Baltimore, Maryland*

**SECURITY LENDING**

State Street Bank and Trust Company  
*Boston, Massachusetts*

**REAL ESTATE INVESTMENT MANAGERS**

J.P. Morgan Investment Management, Inc.  
*New York, New York*

**MEDICAL BOARD**

John J. Fahey, M.D.  
Norman Freeman, Jr., M.D.  
Arthur Hildreth, M.D.  
Bruce Z. Kohn, M.D.  
William B. Russell, M.D.  
Claudia Thomas, M.D.  
Alfred Wiedmann, M.D.

**FIXED INCOME INVESTMENT MANAGERS**

Fountain Capital Management, LLC  
*Overland Park, Kansas*  
Lazard Asset Management  
*New York, New York*  
Morgan Stanley Dean Witter Investment Management  
*West Conshohocken, Pennsylvania*  
Pacific Investment Management Company  
*Newport Beach, California*

LaSalle Investment Management, Inc.  
*Baltimore, Maryland*

LaSalle Investment Management Securities, LLP.  
*Baltimore, Maryland*

Lubert-Adler Management, Inc.  
*Philadelphia, Pennsylvania*

Sentinel Real Estate Corporation  
*New York, New York*

TimesSquare Real Estate Investors  
*Hartford, Connecticut*

**OPERATIONAL BANKING SERVICES**

Allfirst Financial, Inc.  
*Baltimore, Maryland*  
The Harbor Bank of Maryland  
*Baltimore, Maryland*

# 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, 2001

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.



*Imelda Druwe*  
President

*Jeffrey L. Esler*  
Executive Director