



ANNUAL FINANCIAL REPORT SUMMARY

FOR THE FISCAL YEAR ENDED JUNE 30, 2012





December 19, 2012

Dear TRS Members:

This report summarizes the financial condition, investments, actuarial conclusions and statistical information about members, school districts, revenues and benefits for TRS during the past fiscal year. Additionally, a *Comprehensive Annual Financial Report*, which contains 120 pages of detailed information about TRS, is available online at <http://trs.illinois.gov>. We continue to celebrate the contributions our 366,000 members make to children and communities throughout Illinois.

This report shows that TRS is a strong retirement fund for the near term. The long-term sustainability of the retirement system, however, remains uncertain due to the bleak fiscal condition of the State of Illinois. We are further tested by an underperforming economy that creates political and fiscal challenges. Going forward, unless changes are made, these factors will further undermine the state's responsibility to fully fund teacher pensions annually and to keep retirement promises to TRS members first established in 1939.

In 2012, TRS helped shape the public pension debate with warnings about the serious consequences of two trends on a collision course: pension debt growing faster than state revenues and the consistent failure of state government to provide actuarially adequate funding to pay down that debt.

With only 40.6 percent of the market-value assets required to pay long-term benefits on hand on June 30, 2012, TRS and the other Illinois pension systems comprise the worst-funded major pension plan in the country. TRS's unfunded liability alone stands at \$52 billion. This means we have only half of the assets needed to pay the benefits due to members who are already retired. If there was a clear path forward to solve this vexing problem we could be less strident in our call for action, but that clear path has yet to emerge.

Our members and Illinois taxpayers deserve a solution that puts TRS on permanently sound financial footing. There are no magic answers awaiting discovery, only tough choices. In response to this situation, the TRS Board of Trustees in 2012 approved a resolution that acknowledged the threat of insolvency due to these fiscal challenges. The resolution established a five-point foundation to guide any reform of the pension code:

1. Require the use of standard actuarial practices to determine funding instead of alternate calculations required by state law that artificially lower state contributions.
2. Require a guarantee in state law that ensures full funding of TRS and the state's other public pension funds.
3. Fix a serious financial inequity in Tier II pensions that penalizes those members and creates future funding imbalances.
4. Require that any changes in pensions do not undermine the professional, efficient and fair administration of TRS benefits.
5. Require that any changes to the pension code adhere to Article 13, Section 5 of the Illinois Constitution – the pension protection clause.

TRS is a promise keeper. Our fiduciary duty to ensure the long-term stability of the System means that we must be certain that the retirement promises made by Illinois to educators can be kept for every one of our members – to retired teachers, those in the midst of their careers and those just starting out in education.

Richard Ingram
Executive Director

Jana Bergschneider, CPA
Director of Administration

BOARD OF TRUSTEES

As of December 1, 2012



Front row, left to right: Janice Reedus; Cinda Klickna; President Christopher A. Koch, Ed. D.; Jan Cleveland; and Cynthia O'Neill

Back row, left to right: Vice President Molly Phalen; Michael Busby; Sharon Leggett; Marcia Campbell; Sonia Walwyn; Bob Lyons; and Executive Director Dick Ingram

Shown at right: Enrique Vasquez



Enrique Vasquez

EXECUTIVE STAFF MEMBERS

As of December 1, 2012



Front row, left to right: Executive Assistant Sue Billington; Senior Assistant General Counsel Cynthia Fain; Director of Research Kathleen Farney, CEBS; Director of Communications Dave Urbanek; and Director of Administration Jana Bergschneider, CPA

Back row, left to right: Director of Member Services Sally Sherman; Director of Internal Audit Stacy Smith, CPA, CIDA; Director of Human Resources Gina Larkin; General Counsel Tom Gray; Chief Investment Officer Stan Rupnik, CFA; Executive Director Dick Ingram; Communications Manager Kathy Pearce; Information Systems Officer Ed Mabie; and Assistant to the Executive Director Tammy Green

Shown at right: Director of Outreach Rich Frankenfeld



Director of
Outreach
Rich Frankenfeld

FISCAL YEAR 2012 FINANCIAL HIGHLIGHTS

- TRS net assets at June 30, 2012 were \$36.5 billion.
- During fiscal year 2012, TRS net assets decreased \$954 million. Net assets are determined by subtracting liabilities from total assets. Most TRS liabilities involve securities transactions.
- Contributions from members, employers, and the state were \$3,479 million, an increase of \$243 million or 7.5 percent for the fiscal year. The increase in fiscal year 2012 was mainly due to the additional fiscal year 2009 losses recognized in the fiscal year 2010 actuarial value of assets that were used to determine fiscal year 2012 funding requirements.
- Total investment gain was \$224 million, compared to investment gain of \$7,235 million in fiscal year 2011, a decrease of \$7,011 million.
- Benefits and refunds paid to members and annuitants were \$4,638 million, an increase of \$333 million or 7.7 percent compared to fiscal year 2011.
- Total actuarial accrued liability was \$90.0 billion at June 30, 2012.
- The unfunded actuarial accrued liability increased from \$43.5 billion at June 30, 2011 to \$52.1 billion at June 30, 2012. The unfunded liability is the difference between the value of future pension benefits accrued minus the actuarial value of assets. The actuarial value of assets are calculated using a smoothed value of assets, as required under Public Act 96-0043.
- The funded ratio decreased from 46.5 percent at June 30, 2011 to 42.1 percent at June 30, 2012.

Condensed Comparative Statement of Plan Net Assets as of June 30

	2012	Percentage Change	2011	Percentage Change	2010
Cash	\$17,092,564	(53.6%)	\$36,799,319	209.8%	\$11,878,310
Receivables and prepaid expenses	325,464,952	84.2	176,673,155	3.6	170,460,327
Investments	36,782,104,053	(2.6)	37,748,341,891	19.9	31,482,144,166
Invested securities lending collateral	2,617,763,246	(15.7)	3,104,528,064	(12.2)	3,535,698,706
Capital assets	4,331,011	8.5	3,992,703	(1.0)	4,032,313
Total assets	39,746,755,826	(3.2)	41,070,335,132	16.7	35,204,213,822
Total liabilities	3,229,930,487	(10.3)	3,599,067,938	(7.3)	3,880,429,608
Net assets	<u>\$36,516,825,339</u>	(2.5%)	<u>\$37,471,267,194</u>	19.6%	<u>\$31,323,784,214</u>

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

	2012	Percentage Change	2011	Percentage Change	2010
Contributions	\$3,478,920,430	7.5%	\$3,235,605,731	2.7%	\$3,151,550,632
Total investment income	224,106,719	(96.9)	7,234,539,490	96.6	3,679,642,960
Total additions	3,703,027,149	(64.6)	10,470,145,221	53.3	6,831,193,592
Benefits and refunds	4,638,457,105	7.7	4,304,870,170	7.9	3,988,188,142
Administrative expenses	19,011,899	6.9	17,792,071	5.0	16,950,679
Total deductions	4,657,469,004	7.7	4,322,662,241	7.9	4,005,138,821
Net increase/(decrease) in net assets	(954,441,855)		6,147,482,980		2,826,054,771
Net assets beginning of year	37,471,267,194	19.6	31,323,784,214	9.9	28,497,729,443
Net assets end of year	<u>\$36,516,825,339</u>	(2.5%)	<u>\$37,471,267,194</u>	19.6%	<u>\$31,323,784,214</u>

ACTUARIAL

State Funding Requirements

The state's liability for benefits earned by active and inactive teachers and retirees is called the actuarial accrued liability. It is based on current benefit provisions and the retirement system's long-term economic and demographic assumptions. Dividing the accrued liability by assets yields the funded ratio, an indication of how much of the liability is covered by assets. The difference between the accrued liability and assets is the unfunded liability.

Every five years, an experience analysis is conducted to see how well the actuarial assumptions for investment returns, salary increases, mortality, turnover, disability, and so on compare to what has actually happened during the period. A study conducted in 2012 resulted in lowered assumptions for investment returns (from 8.5 percent to 8.0 percent) and salary increases (from an average of 7.0 percent to 6.0 percent). Mortality rates improved and are expected to continue improving over future generations. The combined effect of these and other changes was to increase the accrued liability by \$4.6 billion. The TRS Board of Trustees resolved to conduct the next experience analysis in three years due to more rapidly changing economic conditions.

Actuarial Valuation (\$ in thousands)

	Years Ended June 30	
	2012	2011
Total actuarial accrued liability	\$90,024,945	\$81,299,745
Less actuarial value of assets*	37,945,397	37,769,753
Unfunded liability	\$52,079,548	\$43,529,992
Funded ratio	42.1%	46.5%

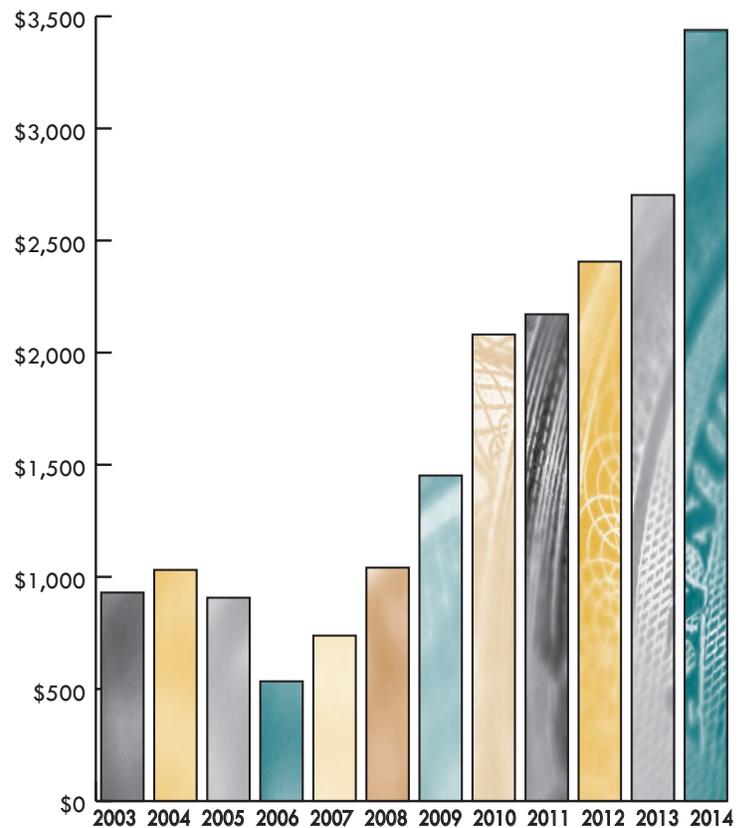
*The actuarial value of assets smoothes differences between actual and expected investment earnings over five years.

The actuarial valuation is used to determine the state funding requirements for the coming fiscal year. The objective of the current statutory funding plan is to achieve a 90 percent funded ratio by the end of fiscal year 2045. The main reasons for the increase in the fiscal year 2014 state contribution are continued recognition of lower than expected investment returns and the additional liability added by the experience analysis.

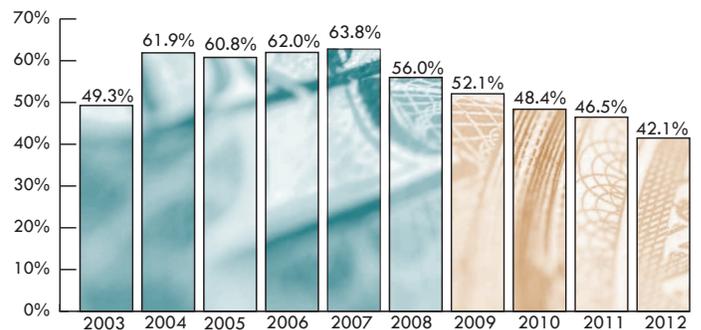
State Funding Amounts Under Current Statutory Plan

	Fiscal Year 2014	Fiscal Year 2013
Benefit Trust Reserve	\$3,437,478,000	\$2,702,278,000
Minimum benefit reserve	1,100,000	1,200,000
Total state funding amount	\$3,438,578,000	\$2,703,478,000

Annual State Appropriations (\$ in millions)



Funded Ratio



The funded ratio declined in recent years, even though a smoothed value of assets has been used to calculate the funded ratio since 2009. Although smoothing spreads out the effect of investment returns that are higher or lower than expected, the effects of the 2009 worldwide economic collapse are still being phased in and outweigh fluctuations in other years. In 2012, the additional \$4.6 billion in liability for changes in actuarial assumptions caused a further decrease in the funded ratio.

Historical Underfunding

The main component of the TRS unfunded liability is historical underfunding. State appropriations have never been based on generally-accepted actuarial principles. For this reason, the TRS Board of Trustees certified a second state funding requirement for fiscal year 2014 based on a standard actuarial calculation. The fiscal year 2014 amount below would cover the state's portion of the cost of benefits earned by active teachers (the state share of employer normal cost) and amortize the current unfunded liability over 30 years. The fiscal year 2013 amount is presented for comparative purposes.

State Funding Amount Under Generally Accepted Actuarial Standards

	Fiscal Year 2014	Fiscal Year 2013
Benefit Trust Reserve	\$4,379,437,000	\$3,755,948,000
Minimum benefit reserve	1,100,000	1,200,000
Total state funding amount	<u>\$4,380,537,000</u>	<u>\$3,757,148,000</u>

Under this calculation, contributions are higher in the short term because the unfunded liability is being paid down more quickly. However, long-term financing costs are lower because the additional assets would earn additional investment income.

STATISTICAL

Member Statistics

Full and Part-time Active Members

Average age	42
Average years of service	12
Average annual salary	\$66,696
Oldest full-time teacher	81

Retired Members

Average age	70
Average service	28
Average annual benefit	\$48,216
Oldest retired teacher	108

INVESTMENTS

Global financial markets experienced significant volatility through the fiscal year ended June 30, 2012. Investor concerns were largely focused on global economic conditions and the recurring Euro-based sovereign debt crisis. Following a very weak first fiscal quarter, the fund produced steady gains through the middle of the fiscal year before experiencing a modest decline in the final quarter as macroeconomic issues again impacted investor behavior. Within this climate, all TRS asset classes were able to manage positive returns with the exception of the sharp 11.7 percent decline in international stocks. On the positive side, real estate and fixed income led the portfolio with 9.9 percent and 5.7 percent gains, respectively. Overall, the TRS investment portfolio posted a modest positive result, returning 1.3 percent, gross of fees, for the fiscal year ended June 30, 2012.

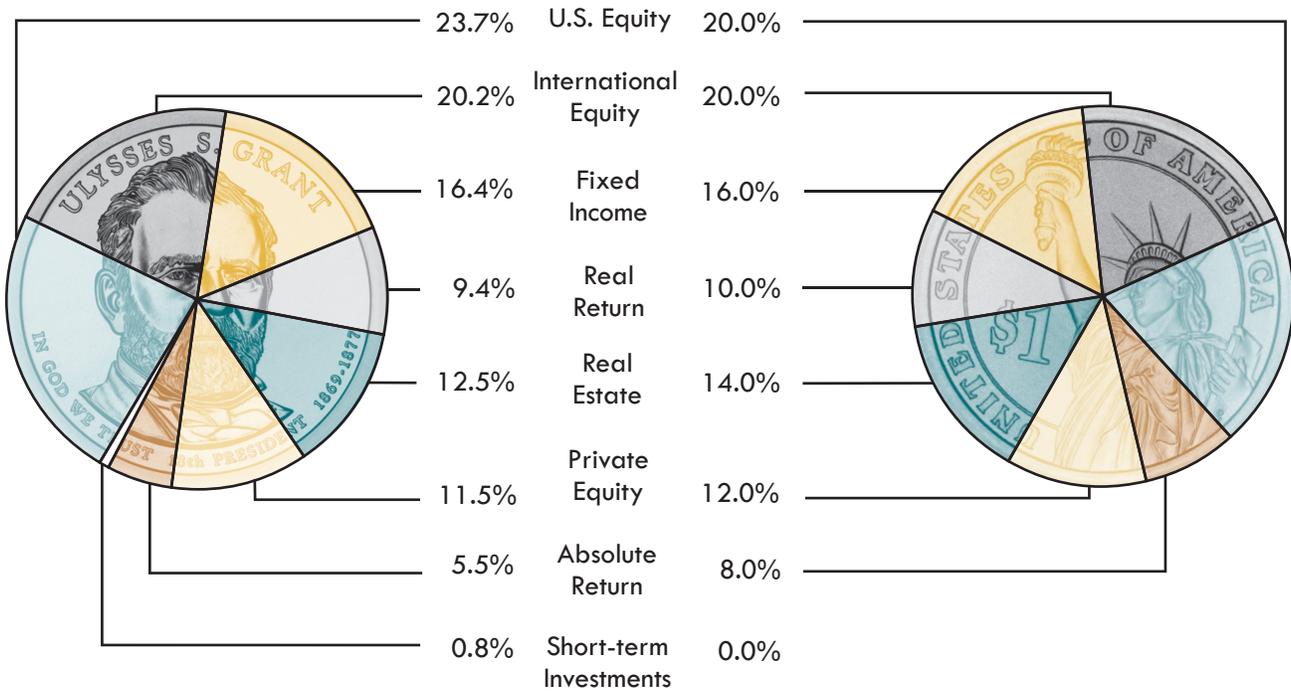
The TRS portfolio remains fully diversified across different asset classes. A number of investment managers are utilized within each asset class to ensure the appropriate mixture across the various investment styles, allowing the portfolio to achieve broad exposure to the market while minimizing overall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

TRS Investment Performance (net of fees)

	1 year	3 years	5 years	10 years
Rate of return	0.8%	12.0%	0.7%	6.4%

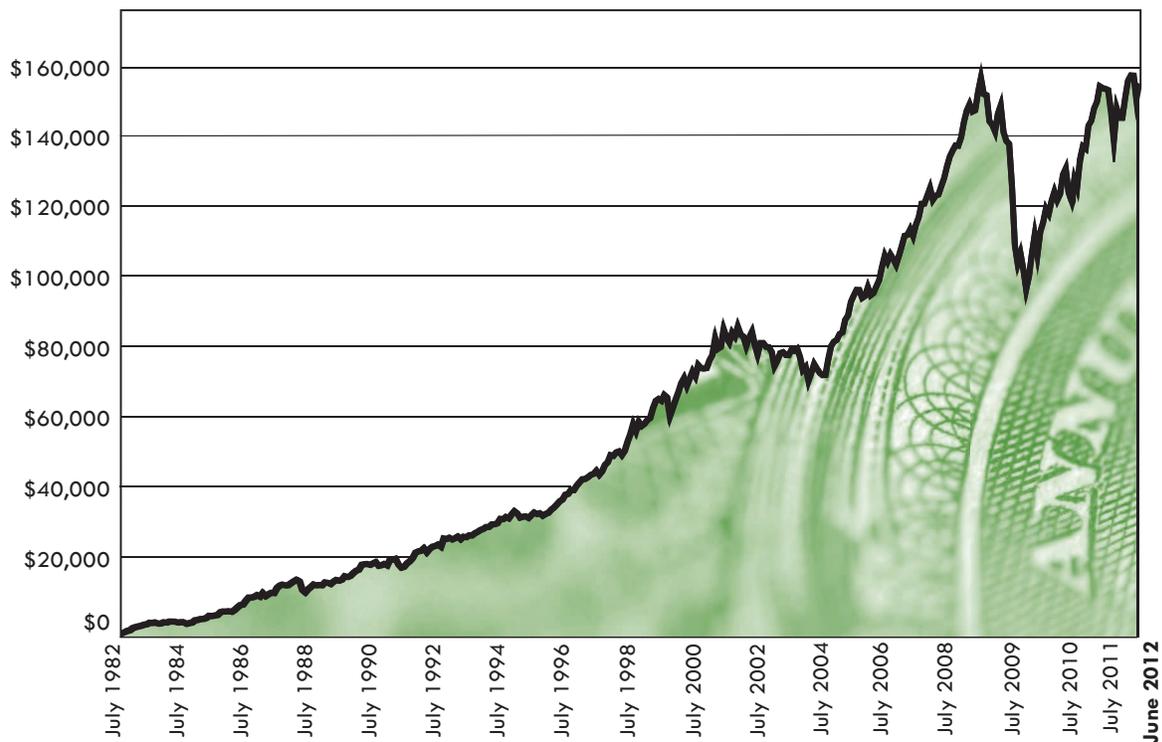
Fiscal Year 2012 Asset Allocation

Long-term Target Allocation



Growth of \$10,000

Over the years, TRS's asset allocation has provided consistent overall returns, as represented by the following chart showing the growth of \$10,000 over the last 30 years. Despite market fluctuations, the overall trend line is favorable.



FISCAL YEAR HIGHLIGHTS

	2012	2011
Active contributing members	162,217	166,013
Inactive noncontributing members	99,052	94,820
Benefit recipients*	105,447	101,288
Total membership	<u>366,716</u>	<u>362,121</u>
Actuarial accrued liability (AAL)	\$90,024,945,000	\$81,299,745,000
Less actuarial value of assets (smoothed assets)	37,945,397,000	37,769,753,000
Unfunded actuarial accrued liability (UAAL)	<u>\$52,079,548,000</u>	<u>\$43,529,992,000</u>
Funded ratio (% of AAL covered by assets, based on smoothed assets)	42.1%	46.5%
Total fund investment return, net of fees	0.8%	23.6%
Expenses		
Benefits paid	\$4,553,822,073	\$4,228,282,978
Refunds paid	84,635,032	76,587,192
Administrative expenses	19,011,899	17,792,071
Total expenses	<u>\$4,657,469,004</u>	<u>\$4,322,662,241</u>
Income		
Member contributions	\$917,661,328	\$909,577,109
Employer contributions	154,894,946	155,110,133
State of Illinois contributions	2,406,364,156	2,170,918,489
Total investment income	224,106,719	7,234,539,490
Total income	<u>\$3,703,027,149</u>	<u>\$10,470,145,221</u>

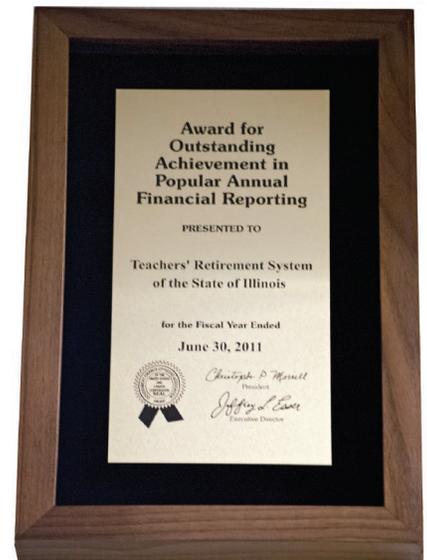
* Benefit recipients includes retiree, disability, and survivor beneficiaries.

TRS RECEIVES GFOA AWARD

The Government Finance Officers Association of the United States and Canada (GFOA) has given an Award for Outstanding Achievement in Popular Annual Financial Reporting to the Teachers' Retirement System of the State of Illinois (TRS) for its Popular Annual Financial Report for the fiscal year ended June 30, 2011. The Award for Outstanding Achievement in Popular Annual Financial Reporting is a prestigious national award recognizing conformance with the highest standards for preparation of state and local government popular financial reports.

In order to receive an Award for Outstanding Achievement in Popular Annual Financial Reporting, a government unit must publish a Popular Annual Financial Report, whose contents conform to program standards of creativity, presentation, understandability, and reader appeal.

An Award for Outstanding Achievement in Popular Annual Financial Reporting is valid for a period of one year only. TRS has received a Popular Award for the last 12 consecutive years. We believe this June 30, 2012 report also conforms to the Popular Annual Financial Reporting requirements, and we are submitting it to GFOA.



This publication is a summary of the *Comprehensive Annual Financial Report* for the fiscal year ended June 30, 2012. The comprehensive report is available online, <http://trs.illinois.gov>.