# STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

## 1985 ANNUAL REPORT

STATE EMPLOYEES'
RETIREMENT SYSTEM
OF ILLINOIS

2815 West Washington Street
P.O. Box 4064 · Springfield, Illinois 62708

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## Financial Condition

As of June 30, 1985, net assets of the State Employees' Retirement System of Illinois were $1.707 billion. The System's total actuarial accrued liability amounted to $2.868 billion resulting in an unfunded liability as of the end of the fiscal year of $1.161 billion. A comparison of the System's funding status as of June 30, 1985 and 1984 follows:

| Fiscal Year | 1985 (Billions) | 1984 (Billions) |
|---|---|---|
| Total Actuarial Liability | $2.868 | $3.127 |
| Net Assets | 1.707 | 1.581 |
| Unfunded Liability | 1.161 | 1.546 |
| Percentage Funded | 59.5% | 50.6% |

The substantial improvement in the System's financial condition as reflected in the above exhibit results almost entirely from changes made during FY-85 to the economic assumptions utilized for valuation purposes. At the recommendation of the actuary, the interest assumption, which reflects anticipated future investment return, was increased from 7½% to 8%. At the same time, the level of increase in the future salaries of plan participants was assumed to decrease from 7½% to 6½% per year reflecting a lower level of future inflation. The effect of both of these changes decreased the actuarial accrued liability to such an extent as to result in a significant improvement in the System's funded status even though excess revenues over expenditures decreased between 1984/85 from $172.5 million to $126.0 million.

During the year, total revenues decreased $36.1 million from $310.1 million to $274.0 million. This decrease was due primarily to a net realized loss on the sale of investments of $14.8 million as compared to a gain of $44.8 million during FY-84. Total expenses increased $10.4 million during the year to a level of $148.0 million. Benefit payments made to terminated/retired/disabled state employees and their survivors amounted to $145.5 million representing 98.3% of the System's total expenses.

## Employer Financing

During FY-85 the System received a total of $94.5 million from the state of Illinois as compared to $86.4 million during FY-84. Regular contributions made for funding purposes amounted to $89.5 million for 5.7% of active member payroll. In addition, $2.4 million was received as the System's share of distributions from the unclaimed property fund. A special appropriation of $2.6 million represented the third installment called for by Joint Resolution 33 passed by the General Assembly as a result of midyear reduction in state contributions made during 1983.

Adequate funding of the five state-financed retirement systems was once again one of the primary issues before the legislative and executive branches of state government. Legislation identical to that vetoed by the Governor last year was reintroduced in the General Assembly and debated extensively during the 1985 spring session. These bills were held on third reading in both chambers, apparently based on action taken by the Governor to establish a special task force made up of representatives from both the public and private sectors to study the funding issue. The task force report is scheduled to be submitted to the Governor prior to the end of the calendar year. It is assumed after consideration by the Governor, that the task force recommendation or some variation thereof, will be submitted to the General Assembly for their consideration in the spring of 1986.

As stated in prior years, it is believed that the adoption of a long range funding program based on the ultimate obligations of the System is essential to assure future financial stability, as well as equitable apportionment of plan costs to each generation of taxpayers.

## Investments

As of the end of the fiscal year, investment holdings of the System under management of the Illinois State Board of Investment had a market value of $1.729 billion. Book value as measured on a cost basis was $1.688 billion. This represents an increase of $329.6 million and $124.0 million measured on a market and cost basis. During the year the System earned net income of $115.8 million and transmitted contributions to the Board for long term investment in the net amount of $23 million.

In reviewing performance over the past three and five year periods, the Board has produced an annualized rate of return of 18.5% and 11.6% during those respective periods; substantially exceeding the System's actuarial assumption of 8%. Total rate of return achieved during FY-85 was 22.0%. The compound rate of growth since inception of the Investment Board in 1970 is 8.1%.

During the past 12 months the Investment Board engaged in a major portfolio restructuring concentrated in the equity area. After receiving input from an outside consultant, a two-styled investment approach was adopted which involves a combination of both external and internal management. As a result of these changes, the Board anticipates better diversification and a lessening of volatility of the fund's equity portfolio thus creating an environment that may enhance future investment performance.

## Benefits

The primary purpose of the System as contained in State statute is to provide an orderly means whereby aged or disabled employees may be retired from active service without prejudice or hardship. While total achievement of this goal is dependent upon many factors, the program which has evolved since establishment of the System in 1944 provides a comprehensive package benefiting not only retired and disabled State employees, but their families as well.

As of June 30, 1985, there were 20,969 retirement annuity recipients. The average retirement annuity was $396.60 per month and was based on an average of 244 months of service. The average annuity for 1,819 state employees retiring during FY-85 was $544.61 based on service of 242 months.

Of the more than 20,000 individuals receiving retirement annuities, 2,522 retirees had reciprocal service with other Illinois public retirement funds and used this service in conjunction with their state employment in computing their monthly benefit. In addition, 4,049 retirees received noncontributing service credit for periods of state service rendered prior to establishment of the Retirement System.

Surviving spouses, children and dependent parents of deceased members totalled 7,626 as of June 30, 1985. These include claims resulting from both occupational and nonoccupational deaths.

Disability benefits are provided by the System for both occupational and nonoccupational illnesses and injuries. Occupational disability benefits include 524 continuous payments averaging $336.85 per month. In addition, claims for short-term disabilities resulting from occupational illnesses and injuries totalled 590. Nonoccupational disability benefits on a continuous basis averaged $604.78 per month and were made to 1,210 individuals. Short-term nonoccupational disability benefits paid during FY-85 totalled 715.

## Membership Services

An essential element of any employee benefit program is a coordinated and timely approach to communicating information to plan participants. This function has in the past and will continue in the future to have priority commitment of both time and financial resources.

The System's Field Services Program is a comprehensive approach consisting of various written publications and informational seminars designed to communicate the basic benefit program as well as introduce other issues of importance to active and retired members. During FY-85, annual statements of account which include benefit projections, social security estimates and beneficiary information were mailed directly to the residence of over 90,000 active and inactive members. Two separate newsletters containing information of a current events nature were also published twice during the year and furnished separately to active members and benefit recipients.

While the importance of written communications cannot be understated, the opportunity to question areas of uncertainty and expand understanding is best served by direct person-to-person contact. This opportunity is provided in the form of group seminars conducted at work locations throughout the state and consists of an audio-visual presentation with a question and answer period which follows. During the year, over 5,200 state employees attended these seminars which were presented in 191 locations.

Recognizing that the transition from active employment to retirement can be traumatic without proper planning, the System offers a two-day Preretirement Workshop which deals in depth with the planning process. This program is targeted for state employees who are from five to ten years away from retirement. During FY-85, 22 separate Preretirement Workshops were conducted and attended by 962 employees.

During FY-86, the System will update and republish the basic benefits booklet "Your Retirement System." A booklet will also be developed and distributed to both existing and new benefit recipients which will contain important information regarding their monthly payment. In addition, a new one-day Preretirement Program will be introduced which is specifically designed for employees who are within one or two years of retirement and have not had the opportunity to attend the two-day workshop. This new program will emphasize the financial aspects of preretirement planning as they may be applied over a short time horizon.

## Legislation

While most of the legislation introduced during the

1985 spring session of the Illinois General Assembly affected the System's benefit program, the single biggest issue addressed again involved the investment of System assets in corporations doing business in South Africa. Several bills pertaining to this issue were introduced and although two bills reached the floor of the House, a vote was never taken. Although passage of some form of legislation addressing South Africa at the national level is possible, it must be assumed short of a federal preemption that the issue will again come before the Illinois General Assembly.

Several bills of an administrative nature were passed by the General Assembly and approved by the Governor. Two significant proposals were also signed into law. The first involving security employees of the Department of Corrections places these employees under the alternative formula, however, phases in the special early retirement ages over a five year period. The second proposal which also applies to individuals covered under the alternative formula provides for application of the 3% cost of living allowance commencing as early as age 55.

Legislation was introduced to increase the basic retirement formula for general employees participating in the System in an attempt to address inadequacies as set forth in the FY-84 Annual Report. A hearing was conducted on this bill before the Senate Insurance Committee, however, the proposal fell one vote short of approval. It is recommended that this or a similar proposal be pursued in future years.

## Administration and Reporting

Administrative operations of the System are under the direction of the Executive Secretary assisted by a staff of 64 full-time employees, excluding Social Security Division personnel.

All funds of the System required for current operations are held by the Treasurer of the State of Illinois. Receipts to and disbursements from the System's trust fund are accomplished through the Comptroller of the State of Illinois according to rules and regulations issued under statutory authority by the Comptroller and the Treasurer.

The annual audit for the 1985 fiscal year was conducted under the direction of the Auditor General by the firm of Peat, Marwick, Mitchell & Co. Actuarial services for the System were performed by The Wyatt Company.

## Acknowledgement

The following sections of this report present detailed financial, actuarial and statistical information pertaining to the operations of the System during the 1985 and prior fiscal years. The report has been prepared through the efforts and cooperation of the administrative staff and the System's professional consultants. Special acknowledgement is given to Robert E. Doolen, the System's Chief Fiscal Officer, who will be retiring in January of 1986 after more than 16 years of faithful service.

Respectfully submitted,

Michael L. Mory
Executive Secretary

**PEAT MARWICK**

**Peat, Marwick, Mitchell & Co.**
Certified Public Accountants
Peat Marwick Plaza
303 East Wacker Drive
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312-938-1000

Honorable Robert G. Cronson
Auditor General
State of Illinois

Board of Trustees
State Employees' Retirement
System of Illinois:

We have examined the balance sheets of the State Employees' Retirement System Trust Fund of Illinois as of June 30, 1985 and 1984 and the related statements of revenue and expenses, changes in reserve balances, and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and the standards for financial audits contained in the U.S. General Accounting Office's Standards for Audit of Governmental Organizations, Programs, Activities, and Functions and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the aforementioned financial statements present fairly the financial position of the State Employees' Retirement System Trust Fund of Illinois at June 30, 1985 and 1984 and the results of its operations, changes in its reserve balances, and changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

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

Peat Marwick Mitchell & Co.

October 17, 1985

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# STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

## State Employees' Retirement System Trust Fund

### Balance Sheets • June 30, 1985 and 1984

| Assets | 1985 | 1984 |
|---|---|---|
| Cash | $ 11,216,376 | $ 9,100,232 |
| Receivables: | | |
| Contributions receivable: | | |
| Participants | 3,262,619 | 3,773,980 |
| Employing state agencies (net of allowance for uncollectible accounts of $11,632,320 in 1985 and $9,798,225 in 1984) (note 3) | 6,066,216 | 5,708,196 |
| Other accounts receivable | 470,992 | 441,324 |
| | 9,799,827 | 9,923,500 |
| Investments - held in the Illinois State Board of Investment | | |
| Commingled Fund at cost (Market value: 1985, $1,729,173,899; 1984, $1,399,637,496) | 1,688,252,032 | 1,564,277,185 |
| | $1,709,268,235 | $1,583,300,917 |
| **Liabilities and Reserves** | | |
| Benefits payable | 1,198,724 | 1,058,411 |
| Refunds payable | 265,059 | 522,695 |
| Administrative expenses payable | 156,036 | 186,295 |
| Participant's deferred service credit accounts | 366,222 | 246,722 |
| | 1,986,041 | 2,014,123 |
| Reserves: | | |
| Actuarially determined accrued benefit cost (note 4) | 2,868,639,632 | 3,127,247,588 |
| Less unfunded accrued benefit cost representing an obligation of the State of Illinois | 1,161,357,438 | 1,545,960,794 |
| Funded reserves | 1,707,282,194 | 1,581,286,794 |
| | $1,709,268,235 | $1,583,300,917 |

See accompanying notes to financial statements.

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# STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

## State Employees' Retirement System Trust Fund
## Statements of Revenue and Expenses

Years ended June 30, 1985 and 1984

| | 1985 | 1984 |
|---|---|---|
| Revenue: | | |
| Contributions: | | |
| Participants | $ 77,059,593 | $ 72,755,819 |
| Employing state agencies | 89,482,193 | 81,358,279 |
| State Pension Fund appropriation | 2,378,500 | 2,378,000 |
| Supplemental state contribution (note 3) | 2,596,000 | 2,728,000 |
| | 171,516,286 | 159,220,098 |
| Net investments income | 115,786,690 | 104,658,329 |
| Repayment of contributions refunded | 239,737 | 224,568 |
| Interest earned on cash balances | 780,084 | 729,266 |
| Interest received from participants | 531,476 | 461,809 |
| Net realized gain (loss) on sale of investments | (14,811,843) | 44,782,720 |
| | 274,042,430 | 310,076,790 |
| Expenses: | | |
| Benefits: | | |
| Retirement annuities | 95,965,469 | 86,651,697 |
| Survivors' annuities | 17,086,453 | 16,114,837 |
| Disability benefits | 14,164,732 | 13,985,426 |
| Lump-sum death benefits | 5,099,824 | 4,244,111 |
| | 132,316,478 | 120,996,071 |
| Refunds | 13,229,773 | 14,145,496 |
| Administrative expenses | 2,490,226 | 2,428,623 |
| Transfers to reciprocating retirement systems | 10,553 | – |
| | 148,047,030 | 137,570,190 |
| Excess of revenue over expenses | $125,995,400 | $172,506,600 |

See accompanying notes to financial statements.

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# STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

## State Employees' Retirement System Trust Fund
## Statements of Changes in Reserve Balances

### Years ended June 30, 1985 and 1984

| | Reserve for future operations | | | |
|---|---|---|---|---|
| | Participants' contributions | Interest accumulations | Other future benefits | Total funded reserves |
| Balance at June 30, 1983 | $482,983,107 | 140,222,364 | 785,574,723 | 1,408,780,194 |
| Add (deduct): | | | | |
| Excess of revenue over expenses | 56,630,071 | – | 115,876,529 | 172,506,600 |
| Reserve transfers: | | | | |
| Accumulated contributions of members who retired during the year, less contributions of annuitants returning to active status | (22,604,912) | – | 22,604,912 | – |
| Interest credited to members' accounts | – | 25,525,757 | (25,525,757) | – |
| Balance at June 30, 1984 | $517,008,266 | 165,748,121 | 898,530,407 | 1,581,286,794 |
| Add (deduct) | | | | |
| Excess of revenue over expenses | 61,384,011 | – | 64,611,389 | 125,995,400 |
| Reserve transfers: | | | | |
| Accumulated contributions of members who retired during the year, less contributions of annuitants returning to active status | (23,569,425) | – | 23,569,425 | – |
| Interest credited to members' accounts | – | 27,905,325 | (27,905,325) | – |
| Balance at June 30, 1985 | $554,822,852 | 193,653,446 | 958,805,896 | 1,707,282,194 |

See accompanying notes to financial statements.

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# STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

## State Employees' Retirement System Trust Fund

## Statements of Changes in Financial Position

Years ended June 30, 1985 and 1984

| | 1985 | 1984 |
|---|---|---|
| Sources of working capital: | | |
| Working capital provided by operations — excess of revenue over expenses | $125,995,400 | $172,506,600 |
| Add (deduct) item not providing working capital — net realized (gain) loss on sale of investments | 14,811,843 | (44,782,720) |
| Total sources of working capital | 140,807,243 | 127,723,880 |
| Uses of working capital — investment purchases: | | |
| Amounts transmitted by SERS | 23,000,000 | 18,900,000 |
| Reinvested earnings | 115,786,690 | 104,658,329 |
| Total uses of working capital | 138,786,690 | 123,558,329 |
| Net increase in working capital | $2,020,553 | $4,165,551 |
| Elements of net increase (decrease) in working capital: | | |
| Cash | 2,116,144 | 1,880,758 |
| Receivables | (123,673) | 1,939,136 |
| Benefits payable | (140,313) | 313,325 |
| Refunds payable | 257,636 | 192,683 |
| Administrative expenses payable | 30,259 | (50,687) |
| Participants' deferred service credit accounts | (119,500) | (109,664) |
| Net increase in working capital | $ 2,020,553 | $ 4,165,551 |

See accompanying notes to financial statements.

## (1) Description of System Trust Fund

The State Employees' Retirement System (System) of Illinois is a multiple-employer public employee retirement system established to provide its members with benefits at retirement, disability or death. Operation of the System Trust Fund and the direction of its policies is the responsibility of the Board of Trustees.

### (a) Eligibility and Membership

Membership is automatic for most state employees who are not eligible for another state-sponsored retirement plan. All persons entering state service, except those in positions subject to membership in other state-sponsored retirement systems, persons employed after June 30, 1979 as public service employment program participants under the Federal CETA program, and enrollees in the Illinois Young Adult Conservation Corps, become members of the System upon completion of six months service. Administrative Code officers appointed by the Governor may elect to become members of the System.

### (b) Contributions

Participating members contribute specified percentages of their salaries for retirement annuities and survivors' annuities. Contributions are excluded from gross income for Federal and State income tax purposes. The total contribution rates are 4% if coordinated with Social Security and 8% if not coordinated, except that the rate of 5½% or 9½% is used for members in certain employment categories who are eligible for benefits under alternative formulas. Participants' contributions are fully refundable, without interest, upon withdrawal from state employment. The State of Illinois is obligated by statute to contribute, through department appropriations, the funds not otherwise provided which are necessary to meet the cost of maintaining and administering the System on a funded basis in accordance with actuarial requirements.

### (c) Benefits

The System is governed by Article 14 of the Illinois Pension Code and benefits under the System are defined in the Code. Employees who retire at or after age 60 (or at age 55 with at least 30 years of credited service with reduced benefits) with 8 years of credited service are entitled to an annual retirement benefit, payable monthly for life, in an amount based upon final average compensation and credited service. Employees with 35 years of credited service may retire at any age with full benefits.

## (2) Summary of Significant Accounting Policies and Investments

### (a) Basis of Accounting

The financial transactions of the System are recorded on the accrual basis of accounting and in conformity with generally accepted accounting principles. Employee and employer contributions are recognized as revenues in the period in which employee services are performed. Investment income is recognized as earned.

### (b) Investments

Investments are reported at cost subject to adjustment for market declines judged to be other than temporary. Investments are managed by the Illinois State Board of Investment (ISBI) pursuant to Article 22A of the Illinois Pension Code and are held in the ISBI Commingled Fund. Such investments are valued at the cost of the System's units of participation in the ISBI Commingled Fund.

### (c) Office Equipment

Expenditures for equipment are charged to administrative expense as incurred. The equipment acquisitions are also recorded in property control records at cost for accountability purposes.

### (d) Actuarial Experience Review

In accordance with Illinois Revised Statutes, an actuarial experience review is to be performed at least once every five years to determine the adequacy of actuarial assumptions regarding the mortality, retirement, disability, employment, turnover, interest and earnable compensation of the members and beneficiaries of the System. An experience review was performed as of June 30, 1985.

### (e) Administrative Expenses

Expenses related to the administration of the System are paid from the retirement trust fund. The funds budgeted for this function are approved by the System's Board of Trustees.

### (f) Reclassification

Certain financial statement items presented in prior years' statements have been reclassified in the current year to enhance comparability between reporting periods.

## (3) System Revenue

### (a) Employer Contributions

The System generates revenue based upon percentage of payrolls for employee and employer contributions. The System's funding policy provides for periodic employer contributions at rates that, expressed as percentages of annual covered payroll, are sufficient to provide resources to pay benefits when due without being increased for future generations of taxpayers. These rates are approved by the System's Board of Trustees based upon recommendations provided by the actuary. Appropriations by the state may differ from the rate adopted by the Board. In the fiscal years ended June 30, 1985 and 1984, respectively, the Board approved rates were 5.8% and 6.4% while the state appropriated rates were 5.6% and 5.4%.

The revenue recognized by the System based upon Board approved funding rates is in excess of the actual revenue received due to actual Agency remittances being based upon lower state appropriations. The difference between the two rates results in a receivable, the collectibility of which is subject to resolution by the State Court of Claims. Therefore, this uncollected amount is fully reserved for on a current basis. Additions to the allowance for uncollectible accounts amounted to $1,834,095 and $9,798,225 in fiscal years ended June 30, 1985, and 1984, respectively.

### (b) Supplemental State Contribution

The System recognizes revenue representing supplemental state funding on a current basis. This funding is the result of reduced appropriations to the System for the year ended June 30, 1983. The amount of the reduction in that period amounted to $11,000,000. The state has agreed to repay the under-appropriation and interest at the rate of six percent over the succeeding five fiscal years. The System does not record unpaid amounts as an asset because repayment in any given year is subject to state appropriation of funds, which is subject to numerous conditions. Consequently, repayment of principal and interest are recognized in the current year only upon receipt in the three month lapse period subsequent to the end of the fiscal period.

Payments recognized in fiscal years ended June 30, 1985 and 1984 amounted to $2,596,000 and $2,728,000, respectively. The balance of unpaid underappropriations is $4,707,417 as of June 30, 1985.

## (4) Accrued Benefit Cost

The calculations of accrued benefit cost (actuarial liability) were made by the consulting actuaries on the basis of the "entry age normal" cost method. The significant assumptions underlying the actuarial computations are as follows:

| | |
|---|---|
| Rate of return on investments | 8% in 1985, 7½% in 1984 |
| Average age at retirement | 65 years, except age 60 was used for those individuals employed in the uniform services |
| Rate of turnover without vested benefits | A high scale at younger age levels, becoming progressively lower as age advances - consistent with the System's experience |
| Mortality basis | 1971 Group Annuity Mortality Table projected to 1986 |
| Salary increases | 6½% annual increase in 1985, 7½% annual increase in 1984 |
| Performance of duty | |
| Death | 5% of all deaths among active employees duty related |
| Disability | 15% of all disabilities among active employees duty related |

Included in the actuarially determined accrued benefit cost of $2,868,639,632 is the amount of $1,182,671,463 for retirement and survivor annuities in force.

The actuarial valuation for the year ended June 30, 1985 reflects the increase in the interest assumption from 7½% to 8% and the decrease in the level of increase of future salaries from 7½% to 6½%. The effects of these changes decreased the actuarial accrued liability by $636,903,125 at June 30, 1985.

The current valuation also reflects the impact of Public Act 84-162. This legislation extended the alternative formula to the non-coordinated Correctional employees, changed the commencement age for the automatic increase to age 55 for employees who retire under the alternative formula, and granted a one time increase to those employees who retired under the alternative formula before the effective date of the legislation. These changes accounted for a $65,609,601 increase in the unfunded accrued liability at June 30, 1985 which showed a total decrease of $384,603,356 in the current year.

## (5) Income Tax Status

The Internal Revenue Service has issued a favorable letter of determination on the System, thereby exempting it from Federal income taxes under provisions of the Internal Revenue Code.

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# STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

## State Employees' Retirement System Trust Fund
## Schedule of Administrative Expenses

Years ended June 30, 1985 and 1984

| | 1985 | 1984 |
|---|---|---|
| Personal services | $1,162,168 | $1,100,631 |
| Retirement contributions | 67,796 | 70,718 |
| Social Security contributions | 71,496 | 64,427 |
| Group insurance | 55,353 | 53,696 |
| Contractual services | 492,727 | 494,191 |
| Travel | 21,131 | 24,024 |
| Printing | 21,639 | 39,765 |
| Commodities | 13,418 | 21,749 |
| Equipment | 16,082 | 15,949 |
| Telecommunications | 28,366 | 23,995 |
| Electronic Data Processing | 534,390 | 513,522 |
| Automotive | 5,660 | 5,956 |
| Total | $2,490,226 | $2,428,623 |

## REVENUES:

Total revenues of $274.0 for FY 1985 was $36.1 million below the FY 1984 level of $310.1 million. Although net income from investments was up by $11.1 million, the net realized loss on sale of investments of $14.8 million in FY 1985 as compared to a net realized gain in FY 1984 of $44.7 million resulted in a net investment income of $101.8 million for FY 1985 as compared to the FY 1984 investment income of $150.2 million. The $48.4 million decrease in investment income was partially offset by increases in member contributions and contributions by the State.

| Revenue Source | FY 85 (Millions) | FY 84 (Millions) | Increase/(Decrease) Amount | Percentage |
|---|---|---|---|---|
| Member Contributions | $ 77.8 | $ 73.4 | $ 4.4 | 6.0% |
| State Contributions | 94.4 | 86.5 | 7.9 | 9.1% |
| Investment Income | 101.8 | 150.2 | (48.4) | (32.2%) |
| Total | $274.0 | $310.1 | ($36.1) | (11.6%) |

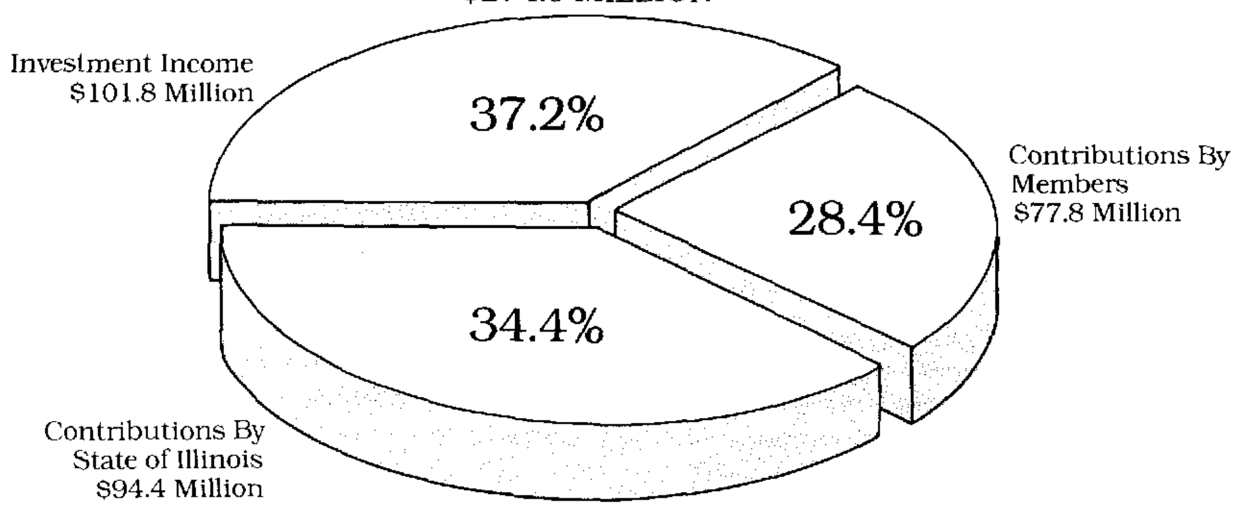
There were 2,672 more active members as of June 30, 1985 than on June 30, 1984. This increase of 3.9% in membership and average wage increases of 5% resulted in an increase of 9.2% in wages subject to retirement contributions. State contributions show an increase of 9.1% ($7.9 million), consistent with the total wage increase. Member contributions were only $4.4 million (6.0%) higher than for FY 1984 due to an ever increasing number of employees who contribute to both retirement and social security. As shown in the table below, the average rate of contributions by members in FY 1985 was 4.95% compared to 5.10% in FY 1984.

| Active Membership | FY 85 | FY 84 | Increase/(Decrease) Number/Amount | Percentage |
|---|---|---|---|---|
| Coordinated Members | 60,346 | 56,945 | 3,401 | 6.0% |
| Noncoordinated Members | 11,301 | 12,030 | (729) | (6.1%) |
| Total Active Members | 71,647 | 68,975 | 2,672 | 3.9% |
| Earnings Reported | | | | |
| All Members (Millions) | $1,569.5 | $1,437.5 | $132.0 | 9.2% |
| Average Rate of Contributions | | | | |
| All Members | 4.95% | 5.10% | | |

## REVENUES BY SOURCE 1985

TOTAL REVENUES

$274.0 MILLION

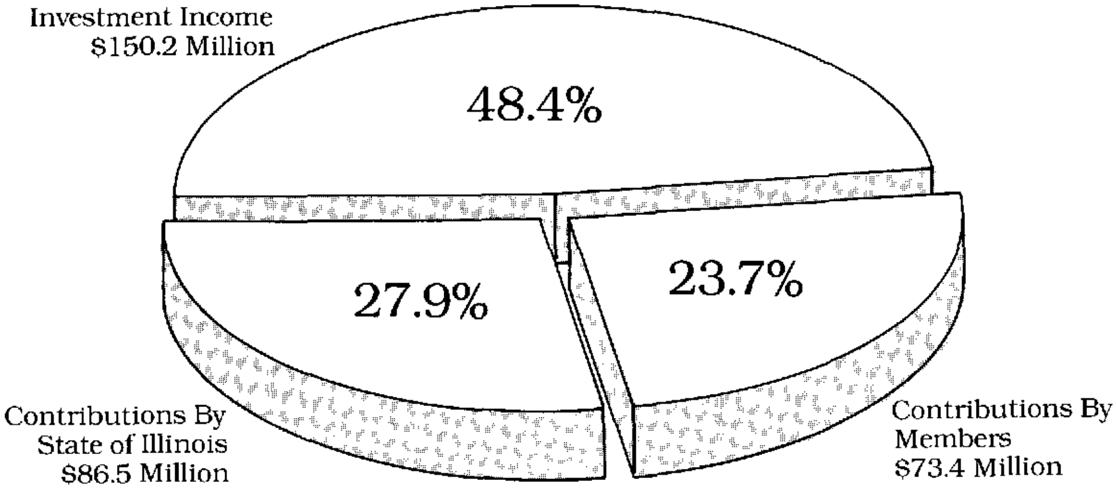


Net investment income for 1985 of $116,582,885, less the Investment Board's administrative expenses of $796,195, and the net realized loss on sale of investments amounting to $14,811,843, resulted in net revenue from investments of $100,974,847. Transfers of funds to the Illinois State Board of Investment amounted to $27,000,000 and transfers from the Board of $4,000,000 resulted in a net transfer for investments of $23,000,000. Balance of investments at cost increased by $100,974,847 plus $23,000,000, or $123,974,847, from June 30, 1984 thru June 30, 1985. The following table shows a comparison of investment operations for FY 1985 and FY 1984.

| | 1985 | 1984 | Increase/(Decrease) Amount | Increase/(Decrease) Percentage |
|---|---|---|---|---|
| Balance at beginning | | | | |
| of year, at cost | $1,564,277,185 | $1,395,936,136 | $168,341,049 | 12.1% |
| Cash remitted for investment (net) | 23,000,000 | 18,900,000 | 4,100,000 | 21.7% |
| Investment income: | | | | |
| Commingled Fund income | 116,582,885 | 105,321,675 | 11,261,210 | 10.7% |
| Less expenses | (796,195) | (663,346) | 132,849 | 20.0% |
| Distributed net realized gain/ | | | | |
| (Loss) on sale of investments | (14,811,843) | 44,782,720 | (59,594,563) | (133.1%) |
| Net investment income | 100,974,847 | 149,441,049 | (48,466,202) | (32.4%) |
| Balance at end | | | | |
| of year, at cost | $1,688,252,032 | $1,564,277,185 | $(123,974,847) | 7.9% |
| Market value | $1,729,173,899 | $1,399,637,496 | $329,536,403 | 23.5% |

Interest on the average balance in the System's operating fund for FY 1985 was $780,084, compared to $729,266 during FY 1984 due to higher operating revenues received from contributions by members and the State of Illinois.

REVENUES BY SOURCE
1984
TOTAL REVENUES
$310.1 MILLION



Revenues were used to pay current expenses or credited to the appropriate reserve accounts as shown below:

| Distribution of Revenues - FY 85 | Contribution by Members | Contributions by State | Investment Income | Totals |
|---|---|---|---|---|
| Reserve - Future Operations | $ 0.5 | $ — | $ 64.1 | $ 64.6 |
| Reserve - Member Contributions | 61.4 | | | 61.4 |
| Benefit Payments | 2.7 | 91.9 | 37.7 | 132.3 |
| Refunds | 13.2 | | | 13.2 |
| Administrative Expense | | 2.5 | | 2.5 |
| TOTAL | $77.8 | $94.4 | $101.8 | $274.0 |

## EXPENSES:

The number of members receiving retirement annuities on June 30, 1985 was 4.0% above the June 30, 1984 level reflecting the normal pattern of increase during the past 10 years, however, the cost of these annuities increased by 10.7% over the FY 1984 level. Higher salary levels for current retirees and post retirement increases granted each January 1 result in costs rising at a more rapid pace than the number of annuitants. Survivor annuities increased at a near normal rate of 3.5% in number with a 6.3% increase in dollar costs. Continued review of disability recipient eligibility helped reduce the number of recurring benefit payments for disability by 3.6%, while rising salary rates increased the dollar amount of payments by 0.7%.

| | FY 85 (Millions) | FY 84 (Millions) | Increase/(Decrease) Amount | Percentage |
|---|---|---|---|---|
| Retirement Benefits | $ 96.0 | $ 86.7 | $ 9.3 | 10.7% |
| Survivors Benefits | 17.1 | 16.1 | 1.0 | 6.3% |
| Disability Benefits | 14.1 | 14.0 | 0.1 | 0.7% |
| Lump Sum Death Benefits | 5.1 | 4.2 | 0.9 | 21.4% |
| Contribution Refunds | 13.2 | 14.2 | (1.0) | (0.7)% |
| Administrative Expenses | 2.5 | 2.4 | 0.1 | 4.0% |
| TOTAL EXPENSES | $148.0 | $137.6 | $10.4 | 7.6% |

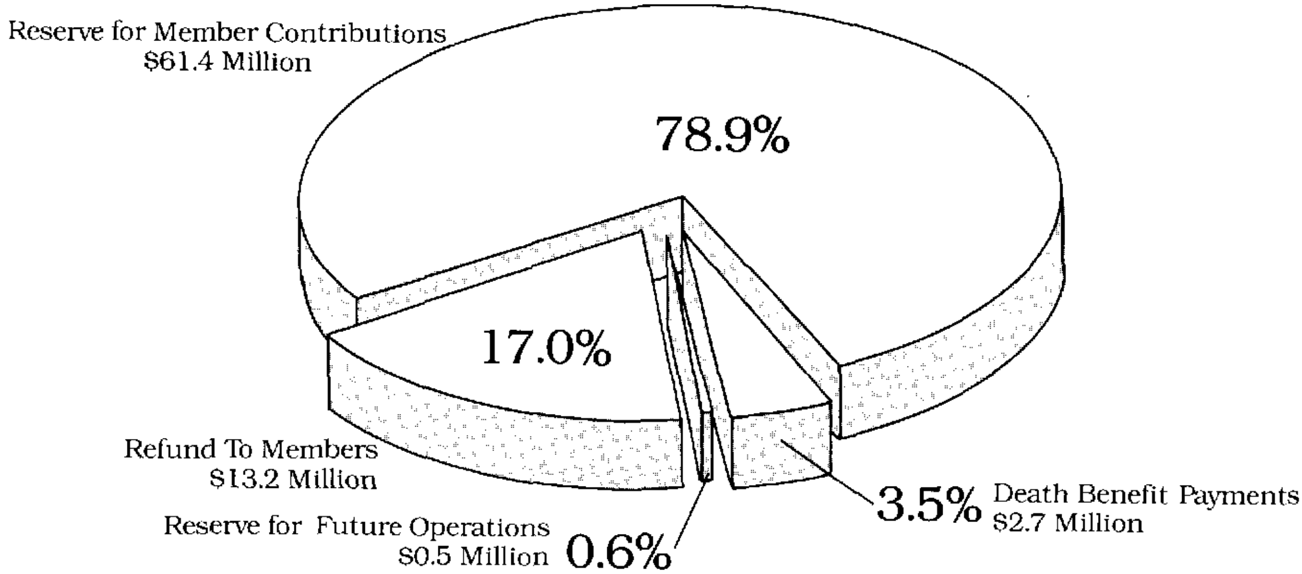
## NUMBER OF RECURRING BENEFIT PAYMENTS:

| | FY Ended June 30, 1984 | New Claims Processed During FY 85 | Benefits Ceased During FY 85 | FY Ended June 30, 1985 | Increase/(Decrease) Amount | Percentage |
|---|---|---|---|---|---|---|
| Retirement | 20,157 | 1,639 | 827 | 20,969 | 812 | 4.0% |
| Survivors | 7,371 | 568 | 313 | 7,626 | 255 | 3.5% |
| Disability | 1,799 | 2,182 | 2,247 | 1,734 | (65) | (3.6%) |
| TOTALS | 29,327 | 4,389 | 3,387 | 30,329 | 1,002 | 3.4% |

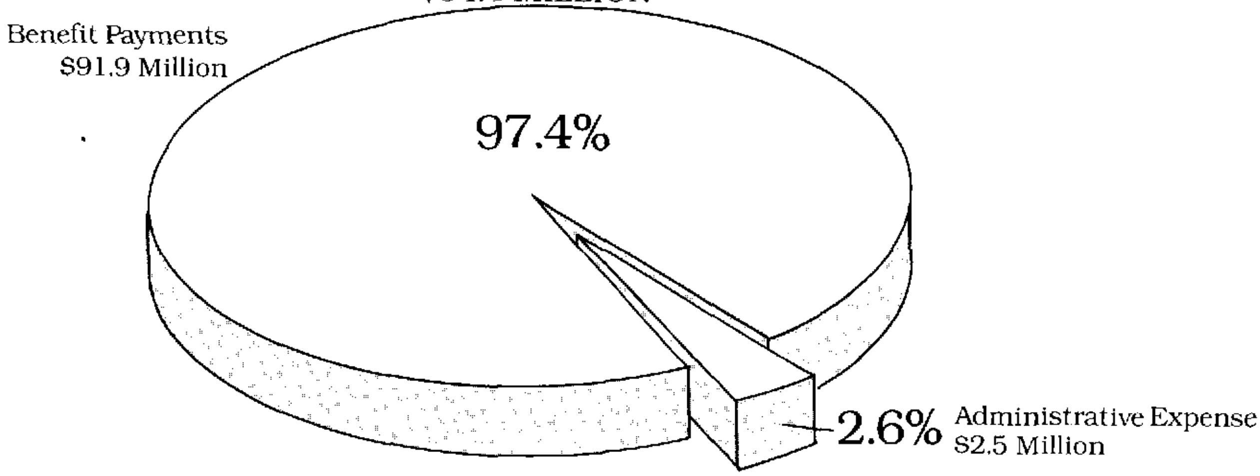
Lump sum death benefits are primarily refunds of member contributions and will vary from year to year. Refunds to members have shown a marked decline from 10,252 in FY 1983 and 7,664 in FY 1984 to 5,638 in FY 1985. This drop in the number of refunds is due primarily to the 6 month qualifying period required of new employees since January, 1984. The short term employees who never become members and, therefore, no refund is required upon termination, do not greatly affect the dollar amount of refunds which was down only $1.0 million from the 1984 level to $13.2 million in FY 1985.

# REVENUES FY 1985 – HOW THEY WERE USED

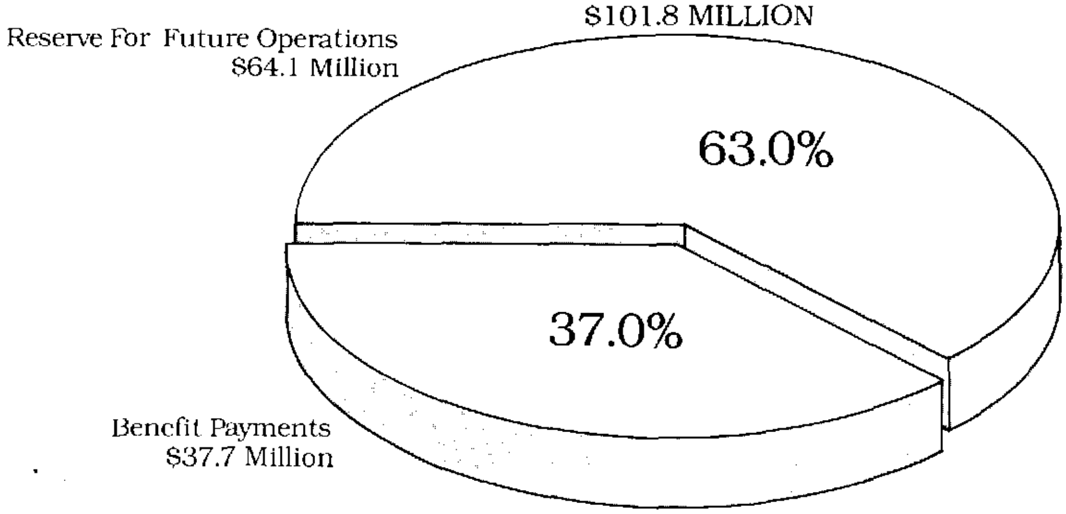
## MEMBER CONTRIBUTIONS
## $77.8 MILLION




## CONTRIBUTIONS BY STATE OF ILLINOIS
## $94.4 MILLION




## INVESTMENT INCOME
## $101.8 MILLION



Administrative expenses increased only 4.0% from FY 1984 to $2.5 million in FY 1985. Normal increases in costs for personal services and data processing were partially offset by decreases in printing and commodities due to member booklets, file folders and other miscellaneous items purchased in FY 1984 which were not required in FY 1985.

## RESERVES:

As of June 30, 1985, the funds available for payment of current and future benefits were $1,707.2 million as shown in the following schedule:

| Assets | FY-85 (Millions) | FY-84 (Millions) | Increase (Decrease) |
|---|---|---|---|
| Cash | $ 11.2 | $ 9.1 | $ 2.1 |
| Receivables (less payables) | 7.8 | 7.9 | (0.1) |
| Investments | 1,688.2 | 1,564.2 | 124.0 |
| NET ASSETS | $1,707.2 | $1,581.2 | $126.0 |

Total revenues for FY 1985 of $274.0 million less expenditures of $148.0 million resulted in a net increase to reserves of $126.0 million.

| Reserves | FY-85 (Millions) | FY-84 (Millions) | Net Increase |
|---|---|---|---|
| Member Contributions | $ 554.8 | $ 517.0 | $ 37.8 |
| Future Operations | 1,152.4 | 1,064.2 | 88.2 |
| TOTAL RESERVES | $1,707.2 | $1,581.2 | $126.0 |

Member contributions transferred to the Reserve for Future Operations due to retirement or death of active members during the year amounted to $23.5 million.

## SOCIAL SECURITY:

On September 15, 1953, the State of Illinois and the Federal Government signed an agreement making social security coverage available to public employees in Illinois. The System, as State Administrator, collects and transmits social security contributions to the U.S. Department of Health and Human Services for approximately 1,500 towns, villages and other political entities. Members of two retirement systems in the state, the Illinois Municipal Retirement Fund (IMRF) and the State Employees' Retirement System (SERS), are also covered by social security. During fiscal year 1985 contributions collected and transmitted for the political entities amounted to $32.5 million for approximately 25,000 employees, and for the SERS, $174.6 million for 75,140 members. Since semi-monthly deposits of FICA contributions are now required, the IMRF is transmitting directly to the Federal Government. Auditing of FICA contributions of political entities reporting through IMRF is performed by this office.

The Social Security Division has a staff of five full-time employees. Data processing and accounting services are performed by other divisions of the System on a contractual basis. Expenses are appropriated by the General Assembly and subsequently recovered from the reporting entities on a pro-rata basis for deposit in the General Revenue Fund.

The contribution rate in 1985 was 7.05% for the employee and 7.05% for the employer on maximum wages of $39,600. Collections and transmittals are administered through a State Trust Fund in custody of the Treasurer of the State of Illinois.

THE Wyatt COMPANY

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## ACTUARIAL CERTIFICATION

We have completed an actuarial valuation of the assets and liabilities of the State Employees' Retirement System of Illinois as of June 30, 1985. This valuation was made using actuarial assumptions which were changed from the prior year.

Pursuant to the law establishing the system, we reviewed the experience under the system for the last five years as it relates to the actuarial assumptions used in the valuation. Based on the results of this study, we proposed and the Board adopted a revised set of assumptions. This new set of assumptions includes more optimistic economic assumptions; the investment return assumption was raised to 8 percent per annum from 7-1/2 percent, and the salary increase assumption was lowered to 6-1/2 percent per annum from 7-1/2 percent. These changes reflect both actual experience under the system and trends which we expect to continue. Certain other changes were made to the demographic assumptions (turnover and disability rates) to better reflect experience.

For purposes of determining contribution rates, assets have been valued at Cost as reported by the Illinois State Board of Investment. The liabilities have been valued based on employee data supplied by the staff of the System and based on the revised actuarial assumptions.

In our opinion, the following schedule of valuation results fairly presents the financial condition of the State Employees' Retirement System of Illinois as of June 30, 1985 and the contribution rate complies with the applicable law in force as of the valuation date.

THE WYATT COMPANY

By S. Lynn Hill
S. Lynn Hill
Actuarial Assistant

By
Lloyd L. Nordstrom
Fellow of the Society of Actuaries

By
Robert L. Barnes
Fellow of the Society of Actuaries

Chicago, Illinois

# ACTUARIAL COST METHOD AND SUMMARY OF MAJOR ACTUARIAL ASSUMPTIONS

The System utilizes the entry age normal cost method. Under this method, the projected pensions at retirement age are first determined and the values thereof at the individual member's entry age or hire age are determined. The values so determined are divided by the value at entry age of all future compensation payable to the member to determine the normal cost as a level percentage of covered pay. The normal cost for a particular year is that percentage of covered compensation for the year.

The actual liability at any point in time is the value of the projected pensions at that time, less the value of future normal costs.

For ancillary benefits for active members, in particular disability benefits, death and survivor benefits, termination benefits and the post-retirement increments, the same procedure as outlined above is followed except that the entry age is the age at the later of hire date or June 30, 1980.

As stated by the actuary in their certification letter, the actuarial valuation prepared as of June 30, 1985, reflects a material change in assumptions. A description of the actuarial assumptions utilized for FY-85 and FY-84 follows:

| | | |
|---|---|---|
| Mortality: | | 1986 Projected Experience Table, a table based on experience under-lying the 1971 Group Annuity Mortality Table, without margins, with a projection for mortality improvements to 1986. Five percent of deaths amongst active employees are assumed to be in the performance of their duty. |
| Interest: | 8% | 7½% per annum, compounded annually. |
| Termination: | | Illustrative rates follow. It is assumed that terminated employees will not be rehired. |

| Age | Rate Males/Females | | Rate Males/Females |
|---|---|---|---|
| 20 | .605 | .397 | .374 |
| 25 | .178 | .164 | .249 |
| 30 | .112 | .116 | .174 |
| 35 | .077 | .092 | .124 |
| 40 | .064 | .076 | .073 |
| 45 | .054 | .061 | .047 |
| 50 | .044 | .048 | .020 |
| 55 | .000 | .000 | — |

| | | |
|---|---|---|
| Salary Increases: | 6½% | 7½% per annum, compounded annually. |
| Retirement Rates: | | Retirement was assumed to occur at age 65 except for "uniform services" which were assumed to retire at age 60. |
| Assets: | | Assets available for benefits are valued at cost. |
| Expenses: | | As estimated and advised by SERS staff, based on current expenses with an allowance for expected increases. |
| Marital Status: | | 85% of employees are assumed to be married. |
| Spouse's Age: | | The spouses of eligible employees were assumed to be three years younger than the employees. |

In addition to the above, other assumptions used included disability incidence, recovery from disability, mortality of disabled lives, remarriage rates, ages and numbers of children and Social Security benefit levels.

| Actuarial Liability (Reserves) | FY-85 | FY-84 |
|---|---|---|
| For Annuitants: | | |
| For Benefit Recipients: | | |
| Retirement Annuities | $ 978,074,174 | $ 939,228,187 |
| Survivor Annuities | 139,250,458 | 137,894,263 |
| Disability Annuities | 59,601,343 | 78,584,198 |
| Deferred: | | |
| Retirement Annuities | 1,479,840 | 1,241,794 |
| Survivor Annuities | 4,265,648 | 4,949,158 |
| Total | $1,182,671,463 | $1,161,897,600 |
| For Inactive Members: | | |
| Eligible for Deferred Vested Pension Benefits | 51,337,300 | 53,941,666 |
| Eligible for Return of Contributions Only | 7,046,502 | 7,114,083 |
| Total | $ 58,383,802 | $ 61,055,749 |
| For Active Members: | $1,627,584,367 | $1,904,294,239 |
| Total | $2,868,639,632 | $3,127,247,588 |
| Assets (Cost Value) | $1,707,282,194 | $1,581,286,794 |
| Unfunded Actuarial Liability | $1,161,357,438 | $1,545,960,794 |

## SHORT-TERM SOLVENCY TEST

A short-term solvency test is one means of checking a system's progress under its funding program. In a short-term solvency test, the plan's present assets (cash and investments) are compared with: 1) active member contributions on deposit; 2) the liabilities for future benefits to present retired lives; 3) the liabilities for service already rendered by active members. In a system that has been following level percent of payroll financing, the liabilities for active member contributions on deposit (liability 1) and the liabilities for future benefits to present retired lives (liability 2) should generally be covered by present assets. In addition, the liabilities for service already rendered by active members (liability 3) should be partially covered by the remainder of present assets. If the system continues using level cost financing, the funded portion of liability 3 will increase over time, although it is very rare for a system to have its liability 3 fully funded.

The State of Illinois, however, has funded the System based on benefit payout, a level which increases over time reflecting a larger work force and higher salary levels. Consequently, it can be expected that none of liability 3 has been funded to date. It should also be noted that the improvement reflected in FY-85 results primarily from the change in actuarial assumptions previously described.

## Computed Actuarial Values

(in thousands of dollars)

| Fiscal Year | Member Contributions (1) | Current Retirants and Beneficiaries (2) | Active and Inactive Members, Employer Financed Portion (3) | Net Assets Available For Benefits | Percentage of Actuarial Values Covered by Net Assets Available (1) | (2) | (3) |
|---|---|---|---|---|---|---|---|
| 1976 | $251,773 | $ 400,427 | $ 652,255 | $ 581,531 | 100 | 82.4 | 0 |
| 1977 | 272,658 | 511,579 | 645,130 | 650,282 | 100 | 73.8 | 0 |
| 1978 | 316,877 | 552,317 | 672,962 | 730,016 | 100 | 74.8 | 0 |
| 1979 | 347,173 | 598,170 | 684,422 | 799,803 | 100 | 75.7 | 0 |
| 1980 | 378,468 | 791,289 | 764,297 | 934,864 | 100 | 70.3 | 0 |
| 1981 | 413,773 | 819,272 | 960,085 | 1,081,805 | 100 | 81.5 | 0 |
| 1982 | 448,908 | 914,281 | 1,144,618 | 1,200,142 | 100 | 82.2 | 0 |
| 1983 | 482,983 | 1,049,972 | 1,270,744 | 1,408,780 | 100 | 88.2 | 0 |
| 1984 | 517,008 | 1,161,897 | 1,448,342 | 1,581,287 | 100 | 91.6 | 0 |
| 1985 | 554,823 | 1,182,671 | 1,131,145 | 1,707,282 | 100 | 97.4 | 0 |

## ANALYSIS OF FUNDING

In an inflationary economy, the value of dollars decreases. This environment results in employees' pay and retirement benefits increasing in dollar amounts resulting in unfunded accrued liabilities which increase in dollar amounts, all at a time when the actual substance of these items may be decreasing. Looking at just the dollar amounts of unfunded accrued liabilities can be misleading. The ratio of the unfunded accrued liabilities to active employee payroll provides an index which clarifies understanding. The smaller the ratio of unfunded liabilities to active member payroll, the stronger the system. Observation of this relative index over a period of years will give an indication of whether the system is becoming financially stronger or weaker. It should be noted that the improvement reflected in the following schedule for FY-85 results primarily from a change in actuarial assumptions previously described.

(in thousands of dollars)

| Fiscal Year | Total Actuarial Liability | Net Assets | Net Assets as a % of Actuarial Liability | Total Unfunded Actuarial Liability | Member Payroll | Unfunded Actuarial Liability as a % Member Payroll |
|---|---|---|---|---|---|---|
| 1976 | $1,304,455 | $ 581,531 | 44.6% | $ 722,924 | $ 864,154 | 84% |
| 1977 | 1,429,367 | 650,282 | 45.5% | 779,084 | 884,493 | 88% |
| 1978 | 1,542,156 | 730,016 | 47.3% | 812,140 | 925,094 | 88% |
| 1979 | 1,629,766 | 799,803 | 49.1% | 829,962 | 1,069,886 | 78% |
| 1980 | 1,934,054 | 934,864 | 48.3% | 999,190 | 1,137,668 | 88% |
| 1981 | 2,193,130 | 1,081,805 | 49.3% | 1,111,325 | 1,253,016 | 89% |
| 1982 | 2,507,807 | 1,200,142 | 47.9% | 1,307,665 | 1,334,262 | 98% |
| 1983 | 2,803,699 | 1,408,780 | 50.2% | 1,394,919 | 1,378,735 | 101% |
| 1984 | 3,127,248 | 1,581,287 | 50.6% | 1,545,961 | 1,437,546 | 108% |
| 1985 | 2,868,640 | 1,707,282 | 59.5% | 1,161,357 | 1,569,532 | 74% |

## RECONCILIATION OF UNFUNDED ACTUARIAL LIABILITY

| | FY-85 | FY-84 |
|---|---|---|
| Unfunded Liability Beginning of FY | $1,545,960,794 | $1,394,918,983 |
| Contributions Due | | |
| Interest on the Unfunded Liability | 115,947,060 | 104,618,924 |
| Total Normal Cost | 161,628,041 | 153,455,741 |
| Interest on Normal Cost | 12,122,103 | 11,509,181 |
| Total Due | $ 289,697,204 | $ 269,583,846 |
| Contributions Paid | | |
| Participants | $ 77,059,593 | $ 72,755,819 |
| Employing State Agencies | 92,078,193 | 84,086,279 |
| State Pension Fund | 2,378,500 | 2,378,000 |
| Interest on Contributions | 6,072,218 | 5,970,754 |
| Total Paid | $177,588,504 | $165,190,852 |
| Increase (Revenue) in the Unfunded Liability | 112,108,700 | 104,392,994 |
| Actuarial (Gains) Losses | | |
| From Investment Return (Greater) Lesser Than 7½% | 16,840,742 | (44,386,306) |
| From Salary Increases (Greater) Lesser Than 7½% | (3,925,773) | $28,564,414 |
| From Other Sources | 61,666,499 | (14,047,838) |
| Total Actuarial (Gains) Losses | $ 74,581,468 | ($ 29,869,730) |
| (Decrease) Due to New Actuarial Assumptions | (636,903,125) | — |
| Plan Amendments | 65,609,601 | 76,518,547 |
| Total Increase (Decrease) in Actuarial Liability | (384,603,356) | 151,041,811 |
| Unfunded Liability End of FY | $1,161,357,438 | $1,545,960,794 |