Annual Financial Report Summary

for the Fiscal Year Ended June 30, 2014

State Employees' Retirement System

BOARD OF TRUSTEES

(as of February 1, 2015)

Leslie Geissler Munger
Chairperson

Danny Silverthorn
Appointed
by Governor

Harold Sullivan Jr.
Appointed
by Governor

Thomas Allison
Appointed
by Governor

Renee Friedman
Appointed
by Governor

Lori Laidlaw
Elected
Employee

Patricia Ousley
Elected
Employee

David Morris
Elected
Employee

Robert Fierstein
Elected
Employee

Shirley Byrd
Elected
Annuitant

Alan Latoza
Elected
Annuitant

Yasmine Bates-Brown
Appointed
by Governor

Vacant
Appointed
by Governor

INTRODUCTION

Dear Participants and Annuitants:

This inaugural Popular Annual Financial Report (PAFR) summarizes the financial condition, investments, and statistical information of the State Employees' Retirement System (SERS) for fiscal year 2014. This report is intended to summarize the most pertinent information contained in the FY2014 Comprehensive Annual Financial Report (CAFR).

Financial Condition at June 30, 2014

Based on the market value of assets, the SERS funded ratio at the end of fiscal year 2014 was 34.98 percent, with $27.1 billion in net pension liability. The System's $14.3 billion in invested assets are managed by the Illinois State Board of Investment. In fiscal year 2014, the rate of return on the System's assets totaled 17.9%, equating to $2.169 billion. For this year, most of the System's asset classes exceeded the applicable benchmark. For the three, five, and ten year period, the compounded annual rate of return equaled 10.4%, 12.3%, and 6.7%, respectively.

Pension Reform

In December 2013, Public Act 98-599 was passed to eliminate the SERS unfunded liability by 2045 in order to stabilize the finances of the system. The law was to take effect on June 1, 2014, but a court injunction was issued a month before that date effectively delaying the implementation of that law. On November 21, 2014, the Circuit Court ruled that this law was unconstitutional and void in its entirety. The State swiftly filed an appeal directly to the Supreme Court.

SERS Operations

SERS delivers benefits and services to over 153,000 active and inactive participants. The Board and staff believe all participants deserve timely, accurate, and cost effective service. To that end, in Fiscal Year 2014 the System continued to modernize and strengthen the information technology system in order to improve customer service, increase efficiency and improve data security. Examples of those efforts include the redesign of retiree and active statements, website improvements, and disaster recovery planning and testing.

In April 2014 the Board of Trustees of SERS adopted a more conservative investment return assumption of 7.25% in order to help ensure the long-term financial viability of SERS. The low funded ratio and overall poor financial condition of SERS necessitates the use of conservative actuarial assumptions in order to mitigate some of the long-term insolvency risk associated with this poor financial condition.

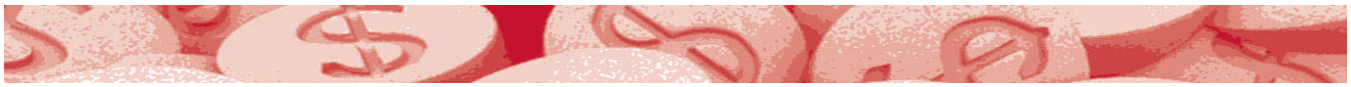
SERS remains a trusted, low-cost provider of service as our administrative operating expenses were 0.1% of the System's total net position. The SERS staff appreciates the strong support of the SERS Trustees and all external stakeholders. We remain committed to providing quality customer service in a safe and efficient manner in the coming years.

FISCAL YEAR 2014 FINANCIAL HIGHLIGHTS

- The SERS fiduciary net position at June 30, 2014 was $14.581 billion, representing an increase of $2.181 billion over the previous fiscal year.
- Contributions from employees and employing state agencies totaled $1.968 billion, an increase of $188.6 million over the previous fiscal year.
- The System's return on investments, net of investment management fees, was 17.9% correlating to $2.169 billion. This represents an increase of $668.1 million over the previous fiscal year.
- Benefit and refund payments totaled $1.940 billion, an increase of $115.8 million compared to the previous year. Of that amount, $1.720 billion covered retirement annuity payments, $114.2 million was paid for survivor annuities, $64.8 million covered disability benefits, $23.1 million went towards refunds, and $17.3 million was paid for lump sum benefits.

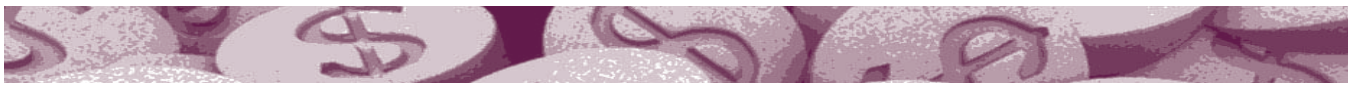
Condensed Comparative Statements of Fiduciary Net Position as of June 30
(rounded to the nearest hundred)

	2014	Change	2013	Change	2012
Cash	$200,752,200	$54,398,100	$146,354,100	$12,395,100	$133,959,000
Receivables	$101,401,700	($44,038,900)	$145,440,600	($15,366,500)	$160,807,100
Investments at Fair Value	$14,286,499,000	$2,110,039,800	$12,176,459,200	$1,500,686,900	$10,675,772,300
Securities Lending Collateral	$84,013,000	($29,156,000)	$113,169,000	$40,302,000	$72,867,000
Property & Equip., net	$4,122,800	$1,330,200	$2,792,600	$69,200	$2,723,400
Total Assets	$14,676,788,700	$2,092,573,200	$12,584,215,500	$1,538,086,700	$11,046,128,800
Liabilities	$95,222,400	($88,692,600)	$183,915,000	$98,474,000	$85,441,000
Total Fiduciary plan net position	$14,581,566,300	$2,181,265,800	$12,400,300,500	$1,439,612,700	$10,960,687,800



Condensed Comparative Statements of Changes in Fiduciary Net Position for the Years Ended June 30 *(rounded to the nearest hundred)*

	2014	Change	2013	Change	2012
Participant Contributions	$269,232,200	$21,062,500	$248,169,700	($10,953,200)	$259,122,900
Employer Contributions	$1,699,447,800	$167,515,700	$1,531,932,100	$140,515,700	$1,391,416,400
Investment Income	$2,169,346,300	$668,108,100	$1,501,238,200	$1,495,652,800	$5,975,400
Total Additions	$4,138,026,300	$856,686,300	$3,281,340,000	$1,624,825,300	$1,656,514,700
Benefits	$1,917,062,600	$117,097,000	$1,799,965,600	$172,592,000	$1,627,373,600
Refunds	$23,082,800	($1,207,600)	$24,290,400	$790,100	$23,500,300
Administrative Expenses	$16,615,100	($856,200)	$17,471,300	$1,765,700	$15,705,600
Total Deductions	$1,956,760,500	$115,033,200	$1,841,727,300	$175,147,800	$1,666,579,500
Net Increase/Decrease in fiduciary net position	$2,181,265,800	$741,653,100	$1,439,612,700	$1,449,677,500	($10,064,800)



INVESTMENTS

In fiscal year 2014, investors benefited from positive returns in multiple equity markets, fixed income, real estate, and alternative investments. All SERS asset classes produced positive returns within this environment as the Illinois State Board of Investment's (ISBI) total fund was up 17.9% for fiscal year 2014, net of expenses. The FY 2014 rate of return exceeded its policy benchmark of 16.3%, as well as the assumed actuarial rate of return of 7.75%.

ISBI Investment Performance (net of fees)

	1 year	3 years	5 years	10 years
Rate of Return	17.9%	10.4%	12.3%	6.7%

The ISBI operates under a strategic investment policy as the objective of the total portfolio is to maximize the rate of return on investments within a prudent level of risk. To achieve this objective, the ISBI invests in different types of assets and uses multiple managers to ensure diversification. The investment policy of the ISBI establishes asset allocation targets and ranges for each asset class, selected to achieve overall risk and return objectives. The plan is implemented by allocating capital to multiple managers across the various asset classes, which allows the portfolio to achieve broad exposure to the market while minimizing overall risk.

Fiscal Year 2014 Asset Allocation

Asset Class	Actual Allocation	Policy Target
U.S. Equity	30%	30%
U.S. Equity Hedge Funds	10%	10%
International Equity	16%	20%
Commingled Funds	5%	–
Fixed Income	16%	16%
Bank Loans	5%	4%
Real Estate	10%	10%
Private Equity	4%	5%
Real Assets	3%	5%
Cash	1%	–
Total	100%	100%

FUNDING

On an annual basis, the System's actuary prepares a valuation of the liabilities and assets of the System in order to calculate the required employers' contribution payable by the state, which is then certified by the Board. The employers' contribution amount, together with members' contributions, investment income, and any other income received by the System, shall be sufficient to meet the cost of maintaining and administering the System on a funded basis in accordance with the requirements prescribed by 40 ILCS 5/14-131. These requirements were contained in Public Act 88-0593, which passed the Illinois General Assembly in 1994. This Act, which took effect on July 1, 1995, provides a 50-year schedule of State contributions to the System designed to achieve a 90% funded ratio by fiscal year 2045. This statutory funding plan consisted of two parts: (i) a ramp-up period of required contributions from 1996 to 2010 and (ii) starting in 2011, annual contributions equal to a level percentage of the payroll of active members that will allow the total actuarial value of assets to reach 90% of the total Actuarial Accrued Liability by the end of fiscal year 2045.

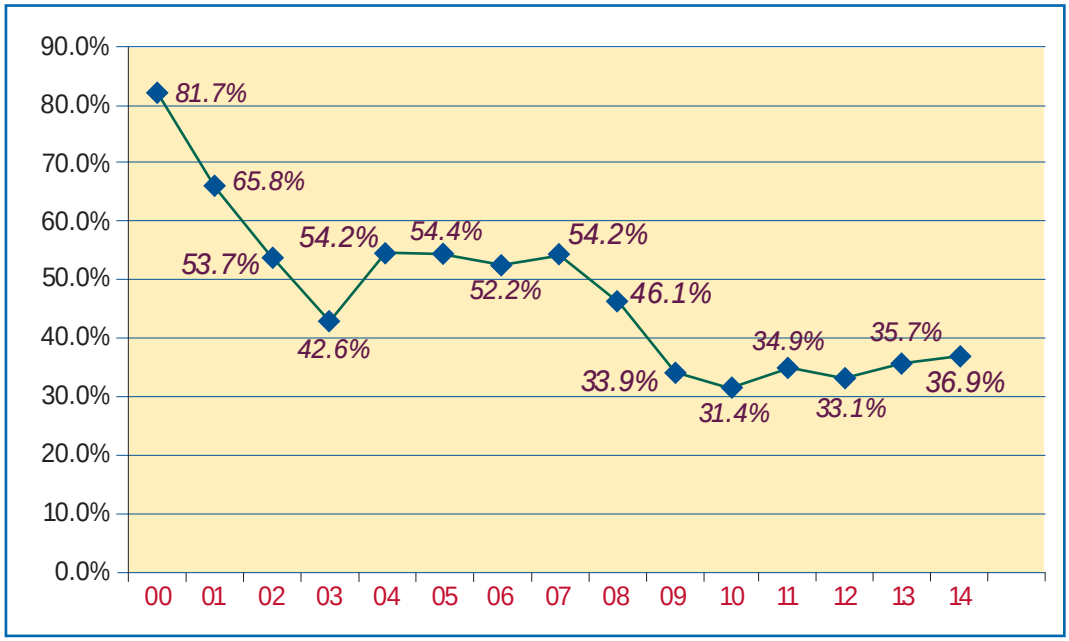
Schedule of Employer Contributions ($ millions)

Fiscal Year	Total ARC*	Member Contributions	Net ER/State ARC	Actual ER/State Contributions	State Contributions as % of Net ARC	Total Contributions as % of Total ARC
2004	$776.0	$199.8	$576.2	$1,864.7	323.6%	266.0%
2005	$936.7	$209.3	$727.4	$427.4	58.8%	67.0%
2006	$841.7	$214.1	$672.6	$210.5	31.3%	50.4%
2007	$1,048.5	$224.7	$823.8	$358.8	43.6%	55.7%
2008	$1,236.4	$250.0	$986.4	$587.7	59.6%	67.8%
2009	$1,245.6	$242.2	$1,003.4	$774.9	77.2%	81.7%
2010	$1,423.5	$246.2	$1,177.3	$1,095.5	93.1%	94.3%
2011	$1,543.2	$254.2	$1,289.0	$1,127.9	87.5%	89.6%
2012	$1,873.9	$259.1	$1,614.8	$1,391.4	86.2%	88.0%
2013	$1,989.5	$248.2	$1,741.3	$1,531.9	88.0%	89.4%
2014	$2,226.0**	$269.2	$1,956.8**	$1,699.5	86.9%	88.4%

** Annual Required Contribution as defined in GASB Statement No. 25, Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans.*

*** Actuarially Determined Contribution as defined in GASB Statement No. 67, Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans.*

Historical Funding Ratios (Market Value)



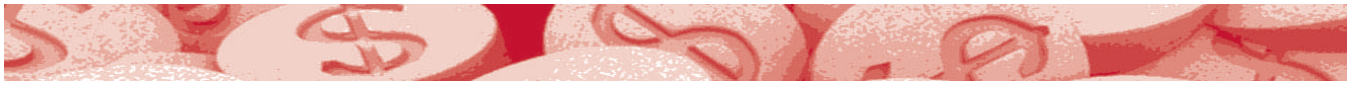
Financial Markets History of Funded Ratios

In addition to state contributions, the funded status for the System is greatly impacted by the global financial markets. The System's portfolio is exposed to the various markets and the funded status fluctuates along with the performance of the markets. As the chart above illustrates, the funding ratio experienced a downturn in fiscal years 2001-2003. This is a reflection of the global financial markets at the time as there was a mild, short-lived recession.

In response to this decline, the legislature approved the issuance of $10 billion in Pension Obligation bonds intended to bolster the assets of the state retirement systems in order to improve the funded ratios and to stabilize the financial condition of the systems. SERS received approximately $1.4 billion from the bond proceeds, which is why the funded ratio improved significantly in Fiscal Year 2004.

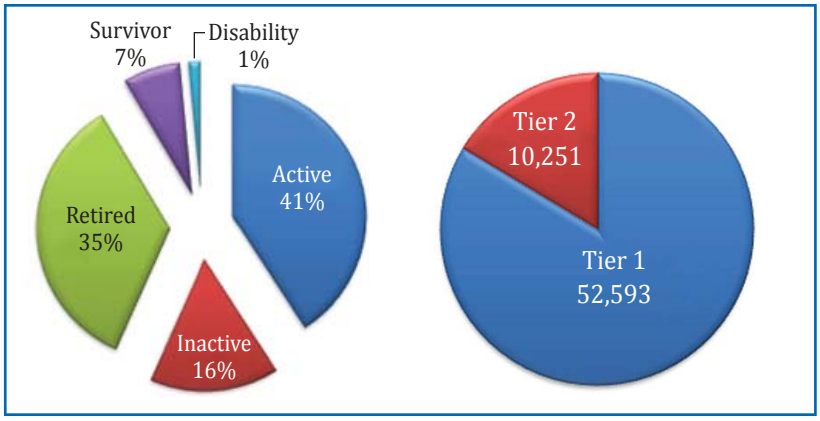
In 2008, the global economy experienced the worst downturn in over 75 years, which negatively impacted virtually all investors, including SERS. During this unprecedented period, the System experienced back-to-back fiscal years of negative returns on investments. As the graph indicates, the funded ratio experienced significant declines. However, strong performance in recent years is gradually improving the funded ratio of the System.

It should also be mentioned that prior to Fiscal Year 2010, the formula used to determine the state's contribution was still in the ramp-up period. Credit rating agencies have consistently opined that ramp-up funding plans are inadequate in eliminating unfunded liabilities. This component also significantly contributed to the declining funded ratio through Fiscal Year 2010.



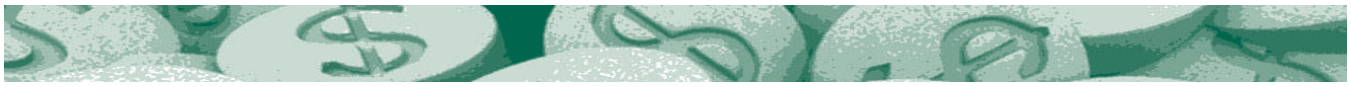
STATISTICAL

Retirees	Average Annual Pension	Average Age
53,478	$32,178	69 years



Fiscal Year	Retirement	Survivors	Disability	Total Recurring Benefit Payments	Active Employees
2005	42,649	10,041	2,138	54,828	69,163
2006	42,676	10,036	2,156	54,868	68,075
2007	42,979	10,074	2,212	55,265	67,699
2008	43,781	10,104	2,226	56,111	66,237
2009	44,566	10,236	2,297	57,099	65,599
2010	45,659	10,325	2,408	58,392	64,143
2011	47,002	10,428	2,356	59,786	66,363
2012	50,000	10,502	2,286	62,788	62,732
2013	51,994	10,669	2,387	65,050	61,545
2014	53,478	10,819	2,312	66,609	62,844

SERS 2014 Comprehensive Annual Financial Report (CAFR)

The information presented here is a reader-friendly summary of the more detailed 2014 Comprehensive Annual Financial Report (CAFR), which is prepared and presented in conformity with Generally Accepted Accounting Principles. The PAFR is not intended to supplement the CAFR; rather, it is a concise summary of the financial health, investment performance and key accomplishments of the State Employees' Retirement System throughout fiscal year 2014. Please visit our website at *https://www.srs.illinois.gov/SERS/annreports_sers.htm* to access the complete CAFR.

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