

Introductory Section - part 2



The Honorable Ruth Ann Minner
and
Members of the 141st General Assembly
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Changes in Plan Net Assets

(Dollar values expressed in thousands)

Fiscal Years Ending June 30,	2002	2001	Increase/ (Decrease) Amount	Increase/ (Decrease) Percent
Additions:				
Employer Contributions	\$ 82,469	\$ 75,025	\$ 7,444	9.9%
Transfer of Contributions from PRI Fund	32,322	38,526	(6,204)	(16.1%)
Transfer of Assets from Outside the System	4,685	3,239	1,446	44.6%
Member Contributions	37,731	35,550	2,181	6.1%
Other Income	7	21	(14)	(66.7%)
Net Investment Losses	(313,816)	(287,086)	(26,730)	(9.3%)
Total Additions	<u>\$ (156,602)</u>	<u>\$ (134,725)</u>	<u>\$ (21,877)</u>	<u>(16.2%)</u>
Deductions:				
Transfer of Contributions from PRI Fund	\$ 32,322	\$ 38,526	\$ (6,204)	(16.1%)
Transfer of Assets Outside the System	6,232	2,710	3,522	130.0%
Benefit Payments	216,353	195,971	20,382	10.4%
Refunded Contributions	2,698	2,610	88	3.4%
Group Life Payments	4,080	3,710	370	10.0%
General Administrative Expenses	4,134	3,623	511	14.1%
PRIDE Project Expenses	--	379	(379)	(100.0%)
eCRIS Project Expenses	478	--	478	100.0%
Health Liability Study	--	45	(45)	(100.0%)
Office Relocation Expenses	22	925	(903)	(97.6%)
Total Deductions	<u>\$ 266,319</u>	<u>\$ 248,499</u>	<u>\$ 17,820</u>	<u>7.2%</u>
(Decrease) in Plan Net Assets:	<u>\$ (422,921)</u>	<u>\$ (383,224)</u>	<u>\$ (39,697)</u>	<u>(10.4%)</u>

On the expense side, benefit payments increased 10.4% as legislation raised the pension multiplier in the State Employees' Pension Plan and a post-retirement increase was granted. Total administrative expenses (including general administrative, PRIDE project, eCRIS project, health liability study, and office relocation) decreased 6.8% to approximately \$4.6 million. General administrative expenses rose 14.1% as lease payments for a new location commenced, casual employees were replaced with full-time employees, health care costs increased, and scheduled data processing upgrades were implemented.

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Investments and Economic Climate

For Fiscal 2002, investments had a (6.3%) rate of return. The total System's annualized rate of return over the last five and ten years was 6.4% and 10.6%, respectively. This performance placed the System slightly below the median public fund return for the fiscal year and in the top 10% of public funds for the five and ten year periods.

System investments are managed to control the downside risk to which assets are exposed while maximizing long-term gain potential. This positions the System to limit the impact of adverse market conditions such as those experienced during the fiscal year. In the 12 months ending June 30, 2002, equity markets in general declined; the S&P500 index declined 18.0% while the broad market Russell 3000 return was (17.2%). International equities measured by the EAFE index also declined 9.5%. The importance of a diversified portfolio was again demonstrated as equity declines were partially offset by increased bond and cash holdings as the Lehman Aggregate Bond Index rose 8.2% and 91-day Treasury Bills returned 2.2%. For a further discussion of portfolio diversification and investment strategy, see the Investment Section beginning on page 49 of this report.

The System's investment activity is governed by the "prudent person rule," a fiduciary standard which applies to anyone with System authority. Fiduciaries must discharge their duties solely in the interest of System participants and beneficiaries and with the degree of diligence, care, and skill which prudent men and women would ordinarily exercise under similar circumstances.

The Board has established the investment policy shown on page 53. Investment constraints are outlined, including the appropriate degree of risk. Investment managers are hired to execute the investment policy. They have full discretion for investment decisions within statutory authority, Board policy, and their respective guidelines. A list of the investment managers under contract with the System as of June 30, 2002, may be found on page 57 of this report. A summary of the total System's asset allocation can be found on page 56.

Events of this past fiscal year -- terrorist attacks, global political events, and revelations of corporate malfeasance -- have caused a continuing decline in the equity markets worldwide. Investment strategy reflects return expectations that continue to be significantly more modest than those achieved during the period of the 1990's.



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Funding Status

A pension plan is well funded when it has sufficient assets invested to meet all expected future obligations to participants. The greater the level of funding, the larger the ratio of assets to actuarial accrued liability. Seven plans included in the System are essentially fully funded based on market valuations. The two remaining plans are not totally funded, but annual contributions are being made at the actuarially determined rate to reach full funding. The Notes to Trend Data Schedule presented on page 44 provides detailed information on each plan's remaining amortization period. The actuarial method for calculating accrued liability for all plans is Entry Age Normal with the objective of maintaining employer contributions approximately level as a percent of member payroll. A detailed discussion of funding method is provided in the Actuarial Section of this report on page 70.

Legislation granting increased pensions for those retiring on or after July 1, 2001, coupled with a second year of negative performance has reduced the funding status of the State Employees' Pension Plan from 112.4% to 109.6%.

Internal Control

System internal accounting controls are designed to provide reasonable assurance regarding the safekeeping of assets and the reliability of financial records. Control procedures and responsibilities are well documented both in writing and with graphic flowcharts. These are reviewed and updated annually.

The Audit Committee, a committee appointed by the Board, monitors operations and controls throughout the year. The System is audited annually by both the Delaware Auditor of Accounts and the independent auditing firm of Ernst & Young LLP.

Professional Services

Professional consultants are appointed by the Board to perform services essential to the effective and efficient operation of the System. A joint opinion from the certified public accountant, Ernst & Young LLP, and the State Auditor, as well as an opinion from the actuary, Milliman USA, are included in this report. Ashford Capital Management, Inc., serves as the investment advisor.

Acknowledgments

The preparation of this report reflects the combined efforts of the System staff under the direction of the Board of Trustees. Specific sections and overall editing include contributions from various Board committees and professional consultants.

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It is with deep regret that we report the death of Edward F. Gliwa, M.D. During his seven years of professional and dedicated service, Dr. Gliwa's advice as a Medical Committee member was invaluable. We will miss Dr. Gliwa and extend our grateful appreciation in his memory.

A. Dale Stratton resigned from the Board on June 25, 2002, after eleven years as a member and chair. We are indebted for her generous commitment of time and effort. Her dedicated leadership is reflected by the outstanding financial health of the System, the significant improvements in pensioner benefits, and enhanced productivity efforts through new and innovative technology underway in the System administration.

The Board would also like to thank Dana Jefferson, Ph.D., Acting State Personnel Director, for her contributions to the Board during Lisa Blunt-Bradley's absence. Lisa was on loan to the country of Jordan where she participated in a program funded by the United States Agency for International Development to develop a national poverty alleviation strategy and implementation plan. She returned to Delaware in August 2002. Welcome back, Lisa!

The Board thanks the many people who work so diligently to assure the successful operation and financial soundness of the Delaware Public Employees' Retirement System. These include the Pension Office staff, the State Personnel Director who provides administrative supervision to the Pension Office; other State support personnel; professional consultants; members of the Investment, Medical, and Audit Committees; and the Pension Advisory Council.

Respectfully submitted,



Ralph J. Adkins, Chairman
Board of Pension Trustees



Board of Pension Trustees, Board Committees, & Professional Consultants

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Chairman and Former CEO
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President
Allen Petroleum

Keith Dorman
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Colonial School District, New Castle County

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State Secretary of Finance

Dana Jefferson, Ph.D.
Acting State Personnel Director

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Member, Delaware State Education Assoc.

Consulting Actuary

Milliman USA

Investment Advisor

Ashford Capital Management, Inc.

Auditors

Ernst & Young LLP
State Auditor of Accounts

Custodial Bank

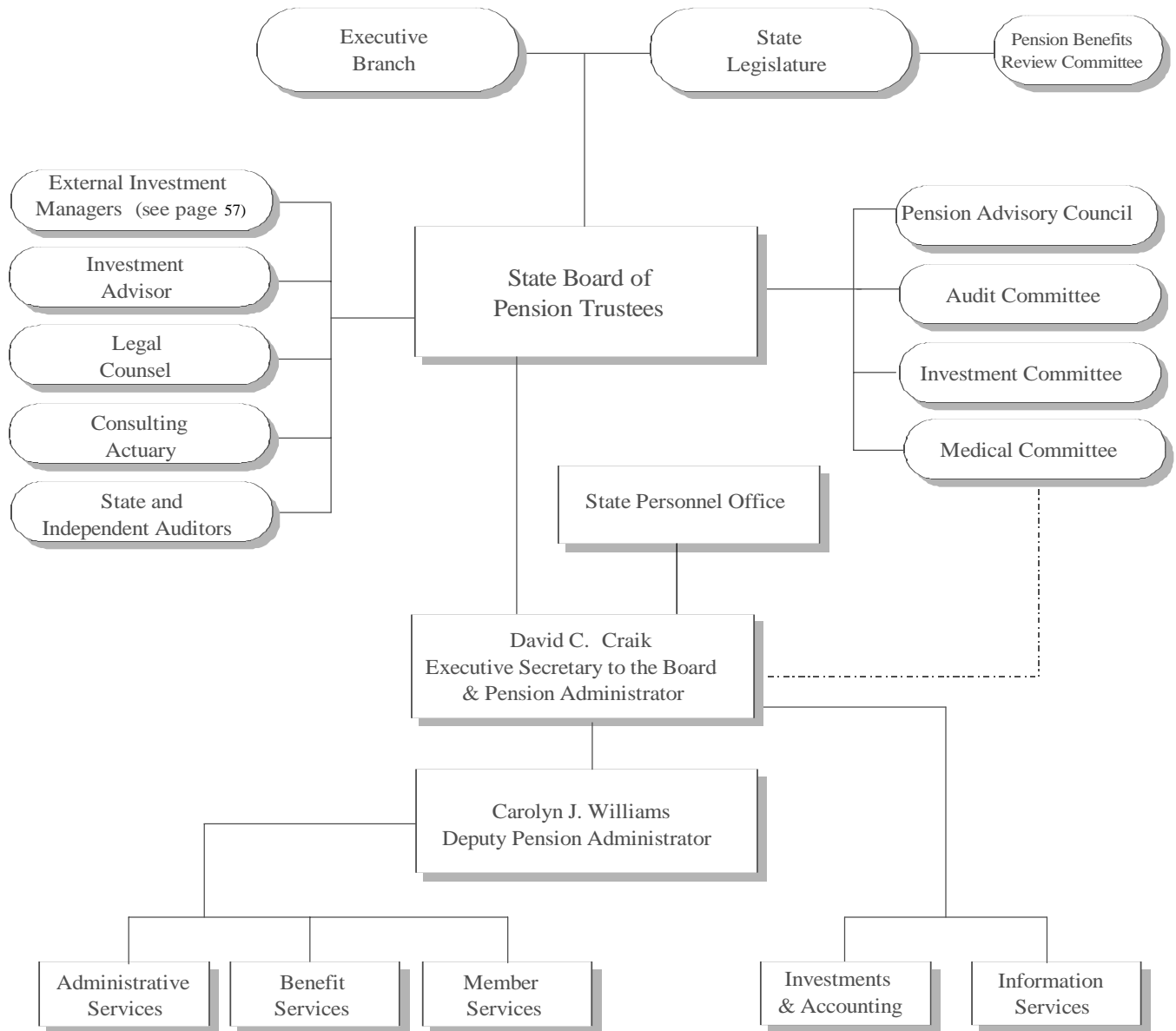
Mercantile-Safe Deposit & Trust Co.

Sub-Custodial Bank

State Street Bank & Trust Co.



Organizational Chart



MANAGEMENT TEAM

Administrative Services
 Benefit Services
 Member Services
 Investments & Accounting
 Information Services

Christy L. Ulmer, Office Manager
 Linda H. Hinkle, Acting Fiscal Administrative Officer
 Kimberly S. Vincent, Human Resource Manager
 Alice L. Simon, Pension Financial Manager
 John T. McCartney, SPO Information Systems Manager
 and W. Ray Johnson, Human Resource Manager



Highlights of Board Activities

The Board of Pension Trustees (Board) -- comprised of five (5) members appointed by the Governor and confirmed by the Senate, and two (2) ex-officio members -- is responsible for the general administration of these pension plans:

- State Employees' Pension Plan.
- Special Pension Plan.
- New State Police Pension Plan.
- Judiciary Pension Plans (Closed and Revised).
- County & Municipal Police/Firefighters' Pension Plans.
- County & Municipal Other Employees' Pension Plan.
- Volunteer Firemen's Pension Plan.
- Diamond State Port Corporation Pension Plan.
- Closed State Police Pension Plan.

In addition to its general administrative responsibilities, the Board is responsible for these specific functions:

- Maintain and oversee the investment of the Delaware Public Employees' Retirement System.
- Appoint an independent actuary to perform annual actuarial valuations used as the basis for contributions to the Delaware Public Employees' Retirement System.
- Control and manage State pension payments.
- Hear appeals from State Pension Office decisions regarding eligibility for pension benefits.
- Adopt rules and regulations for the general administration of State pension plans.
- Prepare and publish an annual report to the Governor and General Assembly.
- Execute contracts with State agencies and others for assistance in pension plan administration and pension investment.
- Determine interest rates to be credited to members' contributions and rates to be charged on repayment of contributions previously withdrawn.

The day-to-day administration of these pension plans is performed by the State Pension Office, which also determines the eligibility of individual employees for pension benefits. The Pension Administrator reports to the State Personnel Director and also serves as Executive Secretary to the Board.

The Medical Committee of the Board is now comprised of nine (9) medical doctors, all in private practice. It evaluates and makes recommendations concerning the medical condition of applicants for and recipients of disability pensions. The Medical Committee meets each month prior to the regular monthly meeting of the Board.

The four-person Audit Committee of the Board monitors operations and internal controls throughout the year to identify issues requiring Board and Pension Office action. They are responsible for interfacing with the Delaware Auditor of Accounts and the independent auditing firm to assure System compliance with generally accepted accounting practices and procedures.

Highlights of Board Activities *(continued)*

The Board retains the firm of Milliman USA to provide professional actuarial and consulting services. Such services include the preparation of comprehensive actuarial valuations and reports, analysis of the costs and other aspects of proposed changes in pension provisions, general consulting advice, and background information on other public pension plans.

The Department of Justice assigns a Deputy Attorney General to serve as legal advisor to the Board. The Deputy deals with legal questions involving interpretations and administration of pension laws, advises the Board in connection with appeals hearings, works with the Board on drafting legislation and regulations, and negotiates contracts.

The following retirement funds have been established under the custody of the Board of Pension Trustees for investment purposes only:

- County & Municipal Police/Firefighters' COLA Fund.
- Post-Retirement Increase Fund.
- Delaware Local Government Retirement Investment Pool.
- Post-Retirement Health Insurance Premium Fund.

The Board retains Ashford Capital Management, Inc., as investment advisor for the System. Ashford Capital Management provides a variety of services to the System including investment manager and custody contract negotiations, investment manager searches, performance analysis/attribution, investment policy, and asset allocation recommendations. The firm is prohibited by contract terms from managing any of the System's assets. A list of investment managers under contract with the System as of June 30, 2002, may be found on page 57 of this report.

The major activities of the Board and its committees during the 12-month period July 2001 through June 2002 were:

- Held regular monthly meetings and met with representatives of investment management firms and custodian banks on a regular basis.
- Held hearings for individual plan members who appealed decisions of the Pension Office or questioned the Board's interpretation of State pension laws.
- Held hearings on the eligibility of individual employees for disability pension benefits.
- Participated in meetings with the Governor's staff, members of the General Assembly, officials of State agencies and school districts, the Pension Advisory Council, representatives of employee organizations, and other interested parties.



2002 Legislation Affecting Pensions

H.Substitute 1 for
H. B. 385 with Senate
Amendment 1
(73 Del. Laws, C396)

In the Closed State Police Pension Plan, reinstates survivors' benefits effective July 1, 2002 to those who have remarried.

H. B. 451 with House
Amendment 1
(73 Del. Laws, C373)

Allows police officers who subsequently become members of the New State Police Pension Plan to buy-in other police service at their own expense.

S. B. 403
(73 Del. Laws, C415)

Ensures that all salary that is paid to an employee for all days worked will be used in the calculation of their final average compensation.

S. B. 426
(73 Del. Laws, C419)

Allows tax-deferred rollovers in the State Employees' Pension Plan, the County & Municipal Other Employees' Pension Plan, and the County & Municipal Police/Firefighters' Pension Plan for the purpose of repaying previously forfeited service or the purchase of credited service.

S. B. 434 -- Budget Bill
(73 Del. Laws, C312
Section 58)

Allows the excess funding in the Special Pension Plan to be used to fund benefits in the Closed State Police Plan.

S. B. 439
(73 Del. Laws, C430)

Allows pensioners under the State Employees' Pension Plan to be employed by the State in a temporary, casual, seasonal, or substitute position without any earnings limitations or without affecting their current pension benefits.