



TEACHERS' PENSION AND ANNUITY FUND OF NEW JERSEY

1998 ANNUAL REPORT

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DEPARTMENT OF
THE TREASURY
James A. DiEleuterio, Jr.,
State Treasurer

DIVISION OF PENSIONS
AND BENEFITS
Margaret M. McMahon, *Director*



STATE OF NEW JERSEY
DIVISION OF PENSIONS AND BENEFITS
PO Box 295 • Trenton, NJ 08625-0295

TEACHERS' PENSION
AND ANNUITY FUND
OF NEW JERSEY

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as of June 30, 1998

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TO THE HONORABLE
CHRISTINE TODD WHITMAN
GOVERNOR of the STATE OF NEW JERSEY

Dear Governor Whitman:

The Board of Trustees of the

TEACHERS' PENSION AND ANNUITY FUND

is pleased to present the Fiscal Year 1998 Annual
Report in accordance with the provisions of N.J.S.A.
18A:66-59.

Respectfully submitted,

A handwritten signature in cursive script that reads "Harry Baldwin".
HARRY BALDWIN
Chairperson

SIGNIFICANT LEGISLATION

Chapter 332, Public Laws of 1997

allows plan beneficiaries of the Teachers' Pension and Annuity Fund (TPAF) or the Public Employees' Retirement System (PERS) to opt for the deduction of their dental insurance premiums from their retirement allowances.

Upon receiving a written request from a TPAF or PERS beneficiary, the Division will make deductions from the beneficiary's retirement allowance for the payment of premiums for the beneficiary's dental insurance plan, and transmit the sums deducted to the designated insurance plan carrier. The bill extends this deduction authorization subject to the condition that at least 1,000 beneficiaries covered by a dental plan make such a request before the Division would be required to make deductions for that plan.

This law was approved January 12, 1998.

Chapter 397, Public Laws of 1997

permits a retiree from a State-administered retirement system who is also receiving a pension based on public employment in another state and who was ineligible for enrollment in a State-administered retirement system prior to September 10, 1991 because of eligibility to receive a pension based on public employment in another state may apply, within 30 days of the effective date of the bill, to the board of trustees of the retirement system to purchase up to 10 years of credit for the service which had been rendered in any position covered by the retirement system for which the person has received no credit.

September 10, 1991, was the date on which P.L. 1991, c.276 took effect permitting pension fund members who were retirees from out-of-state public pension systems to be enrolled in a State-administered retirement system and to purchase credit for prior service.

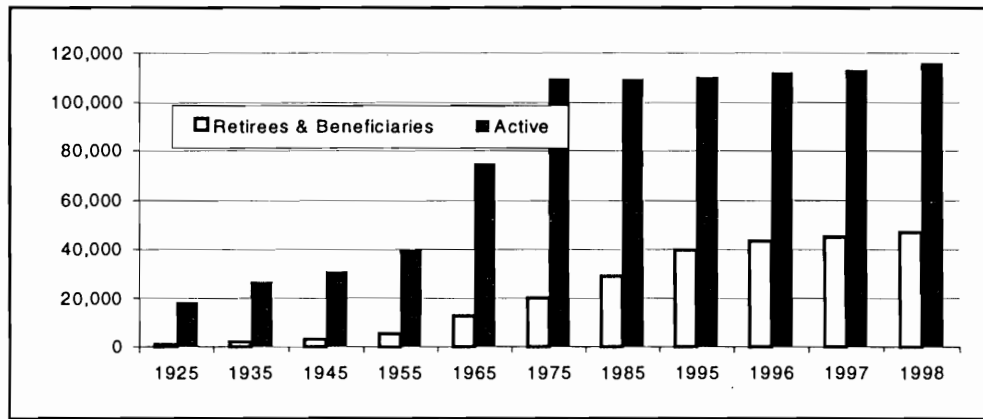
The retiree may purchase all or a portion of the service credit by paying into the annuity savings fund the amount required by applying the factor, supplied by the actuary, applicable to the retiree's age at the time of the purchase to the highest annual compensation for service in this State for which contributions were made during any prior fiscal year of membership. The retiree is not liable for the costs of the enhanced pension adjustment benefits and post-retirement medical benefits. The purchase would have to be made in a lump sum and the retiree's retirement allowance and pension adjustment benefits will be recalculated to reflect the purchased service credit.

This was approved on January 19, 1998.

MEMBERSHIP

- As of June 30, 1998, the active membership of the system totaled 115,811*.
- There were 46,585 retirees and beneficiaries receiving annual pensions totaling \$956,513,397. (This includes benefits paid under the provisions of the Pension Adjustment Act).
- Beneficiaries of deceased active and retired members received lump sum death benefits in the amount of \$48,925,363.
- The system's assets totaled \$29,169,418,485 at the close of the fiscal year 1998.

*Total Inactive Membership as of June 30, 1998 was 9,050.



MEMBERSHIP ACTIVITY

During fiscal year 1998, the following transactions were processed by the Division of Pensions and Benefits on behalf of the membership of the Teachers' Pension and Annuity Fund of New Jersey.

- **LOANS** - 23,048 loans were issued to members. The total loans receivable as of June 30, 1998 is \$207,255,522.
- **RETIREMENT** - 2,948 members retired under the following retirement types:

| <u>TYPE OF RETIREMENT</u> | | <u>OPTION SELECTION</u> | |
|---------------------------|--------------|-------------------------|--------------|
| Service | 1,236 | Maximum | 1,239 |
| Early | 1,169 | Option 1 | 495 |
| Deferred | 130 | Option 2 | 551 |
| Ordinary Disability | 174 | Option 3 | 642 |
| Accidental Disability | 1 | Option 4 | 24 |
| Veteran | 238 | TOTAL | 2,948 |
| TOTAL | 2,948 | | |

KPMG PEAT MARWICK
Princeton Pike Corporate Center
P.O. Box 7348
Princeton, NJ 08543-07348

INDEPENDENT AUDITORS' REPORT

Board of Trustees
State of New Jersey
Teachers' Pension and Annuity Fund:

We have audited the accompanying statement of plan net assets of the State of New Jersey Teachers' Pension and Annuity Fund as of June 30, 1998 and 1997, and the related statement of changes in plan net assets for the year then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the State of New Jersey Teachers' Pension and Annuity Fund as of June 30, 1998 and 1997, and the changes in its plan net assets for the years then ended in conformity with generally accepted accounting principles.

Our audits were made for the purpose of forming an opinion on the financial statements taken as a whole. The schedule of changes in plan net assets by fund is presented for purposes of additional analysis and is not a required part of the financial statements of the State of New Jersey Teachers' Pension and Annuity Fund. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly presented in all material respects in relation to the financial statements taken as a whole.

The supplementary information included in the schedule of funding progress and schedule of employer contribution are not a required part of the financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consist principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit this information and express no opinion on it.

September 11, 1998

/s/ KPMG Peat Marwick

STATE OF NEW JERSEY
TEACHERS' PENSION AND ANNUITY FUND

Statements of Plan Net Assets

June 30, 1998 and 1997

| | 1998 | | | 1997 | | |
|--|-----------------------|------------------------------|-----------------------|-----------------------|------------------------------|-----------------------|
| | PENSION FUND | POST-RETIREMENT MEDICAL FUND | TOTAL | PENSION FUND | POST-RETIREMENT MEDICAL FUND | TOTAL |
| Assets: | | | | | | |
| Investments, at fair value: | | | | | | |
| Cash Management Fund | \$ 1,099,036,979 | 251,406,132 | 1,350,443,111 | 2,124,020,796 | 230,078,808 | 2,354,099,604 |
| Bonds | 183,785,321 | — | 183,785,321 | 205,864,239 | — | 205,864,239 |
| Common Pension Fund A | 14,186,719,269 | — | 14,186,719,269 | 11,573,999,117 | — | 11,573,999,117 |
| Common Pension Fund B | 6,195,382,819 | — | 6,195,382,819 | 4,983,085,216 | — | 4,983,085,216 |
| Common Pension Fund D | 5,837,854,077 | — | 5,837,854,077 | 4,245,976,164 | — | 4,245,976,164 |
| Mortgages | 727,974,687 | — | 727,974,687 | 720,115,412 | — | 720,115,412 |
| Total investments | 28,230,753,152 | 251,406,132 | 28,482,159,284 | 23,853,060,944 | 230,078,808 | 24,083,139,752 |
| Receivables: | | | | | | |
| Contributions: | | | | | | |
| Members | 62,961,837 | — | 62,961,837 | 68,628,037 | — | 68,628,037 |
| Employers | 263,925,561 | — | 263,925,561 | 254,866,291 | — | 254,866,291 |
| Accrued interest and dividends | 147,985,554 | — | 147,985,554 | 141,288,262 | — | 141,288,262 |
| Members' loans | 210,031,623 | — | 210,031,623 | 196,643,201 | — | 196,643,201 |
| Other | 2,354,626 | — | 2,354,626 | 1,919,213 | — | 1,919,213 |
| Total receivables | 687,259,201 | — | 687,259,201 | 663,345,004 | — | 663,345,004 |
| Total assets | 28,918,012,353 | 251,406,132 | 29,169,418,485 | 24,516,405,948 | 230,078,808 | 24,746,484,756 |
| Liabilities: | | | | | | |
| Accounts payable and accrued expenses | 7,372,544 | — | 7,372,544 | 8,366,599 | — | 8,366,599 |
| Retirement benefits payable | 81,605,467 | — | 81,605,467 | 75,340,262 | — | 75,340,262 |
| Death benefits payable | 1,667,872 | — | 1,667,872 | 1,566,676 | — | 1,566,676 |
| Cash overdraft | 1,054,841 | — | 1,054,841 | 5,972,720 | — | 5,972,720 |
| Total liabilities | 91,700,724 | — | 91,700,724 | 91,246,257 | — | 91,246,257 |
| Net assets held in trust for pension and post-retirement health benefits | | | | | | |
| | \$28,826,311,629 | 251,406,132 | 29,077,717,761 | 24,425,159,691 | 230,078,808 | 24,655,238,499 |

See accompanying notes to financial statements.

STATE OF NEW JERSEY
TEACHERS' PENSION AND ANNUITY FUND

Statements of Changes in Plan Net Assets

Years ended June 30, 1998 and 1997

| | 1998 | | | 1997 | | |
|---|--------------------------|------------------------------|-----------------------|-----------------------|------------------------------|-----------------------|
| | PENSION FUND | POST-RETIREMENT MEDICAL FUND | TOTAL | PENSION FUND | POST-RETIREMENT MEDICAL FUND | TOTAL |
| Additions: | | | | | | |
| Contributions: | | | | | | |
| Members | \$ 340,170,481 | — | 340,170,481 | 327,980,876 | — | 327,980,876 |
| Employers | 2,316,858 | 99,308,910 | 101,625,768 | 1,619,542,148 | 127,459,410 | 1,747,001,558 |
| Other | 4,155 | — | 4,155 | 7,395 | — | 7,395 |
| Total contributions | 342,491,494 | 99,308,910 | 441,800,404 | 1,947,530,419 | 127,459,410 | 2,074,989,829 |
| Investment income: | | | | | | |
| Net appreciation in fair value of investments | 4,186,226,925 | — | 4,186,226,925 | 3,195,239,330 | — | 3,195,239,330 |
| Interest | 708,212,958 | 20,131,896 | 728,344,854 | 568,053,281 | 17,408,303 | 585,461,584 |
| Dividends | 195,450,546 | — | 195,450,546 | 197,390,554 | — | 197,390,554 |
| | 5,089,890,429 | 20,131,896 | 5,110,022,325 | 3,960,683,165 | 17,408,303 | 3,978,091,468 |
| Less investment expense | 2,359,331 | — | 2,359,331 | 2,009,347 | — | 2,009,347 |
| Net investment income | 5,087,531,098 | 20,131,896 | 5,107,662,994 | 3,958,673,818 | 17,408,303 | 3,976,082,121 |
| Total additions | 5,430,022,592 | 119,440,806 | 5,549,463,398 | 5,906,204,237 | 144,867,713 | 6,051,071,950 |
| Deductions: | | | | | | |
| Benefit payments | 1,005,438,760 | 98,113,482 | 1,103,552,242 | 932,378,725 | 113,740,941 | 1,046,119,666 |
| Refunds of contributions | 16,040,964 | — | 16,040,964 | 16,617,620 | — | 16,617,620 |
| Administrative expenses | 7,390,930 | — | 7,390,930 | 7,586,486 | — | 7,586,486 |
| Total deductions | 1,028,870,654 | 98,113,482 | 1,126,984,136 | 956,582,831 | 113,740,941 | 1,070,323,772 |
| Net increase before cumulative effect of change in accounting method | 4,401,151,938 | 21,327,324 | 4,422,479,262 | 4,949,621,406 | 31,126,772 | 4,980,748,178 |
| Cumulative effect of change in accounting method (note 2) | — | — | — | 4,559,102,179 | — | 4,559,102,179 |
| Net increase | 4,401,151,938 | 21,327,324 | 4,422,479,262 | 9,508,723,585 | 31,126,772 | 9,539,850,357 |
| Net assets held in trust for pension and post-retirement health benefits: | | | | | | |
| Beginning of year | 24,425,159,691 | 230,078,808 | 24,655,238,499 | 14,916,436,106 | 198,952,036 | 15,115,388,142 |
| End of year | \$ 28,826,311,629 | 251,406,132 | 29,077,717,761 | 24,425,159,691 | 230,078,808 | 24,655,238,499 |

See accompanying notes to financial statements.

STATE OF NEW JERSEY
TEACHERS' PENSION AND ANNUITY FUND

Notes to Financial Statements

June 30, 1998 and 1997

(1) Description of the Fund

The Teachers' Pension and Annuity Fund (the Fund) is a single-employer contributory defined benefit plan which was established as of January 1, 1955, under the provisions of N.J.S.A. 18A:66. The Fund is included along with other state-administered pension trust and agency funds in the general purpose financial statements of the State of New Jersey.

The Fund's designated purpose is to provide retirement benefits, death, disability and medical benefits to certain qualified members. Membership in the Fund is mandatory for substantially all teachers or members of the professional staff certified by the State Board of Examiners, and employees of the Department of Education who have titles that are unclassified, professional and certified. The Fund's Board of Trustees is primarily responsible for the administration of the Fund.

According to the State of New Jersey Administrative Code, all obligations of the Fund will be assumed by the State of New Jersey should the Fund terminate.

Vesting and benefit provisions

The vesting and benefit provisions are set by N.J.S.A. 18A:66. The Fund provides retirement, death and disability benefits, as well as medical benefits for certain qualified members. All benefits vest after ten years of service, except for medical benefits, which vest after 25 years of service. Retirement benefits for age and service are available at age 60 and are generally determined to be 1/60 of final average salary for each year of service credit, as defined. Final average salary equals the average salary for the final three years of service prior to retirement (or highest three years' compensation if other than the final three years). Members may seek early retirement after achieving 25 years service credit, as defined, or they may elect deferred retirement after achieving ten years of service credit, in which case benefits would begin the first day of the month after the member attains normal retirement age.

The Fund provides specific medical benefits for members who retire after 25 years of qualified service, as defined, or under the disability provisions of the Fund.

Members are always fully vested for their own contributions and, after three years of service credit, become vested for 2% of related interest earned on the contributions. In the case of death before retirement, members' beneficiaries are entitled to full interest credited to the members' accounts.

Eligible retirees receiving monthly benefits are entitled to cost-of-living increases equal to 60% of the change in the average consumer price index for the calendar year in which the pensioner retired as compared to the average consumer price index for a 12-month period ending with each August 31st immediately preceding the year in which the adjustment becomes payable. The regular retirement allowance is multiplied by the 60% factor as developed and results in a dollar amount of the adjustment payable. Retired members become eligible for pension adjustment benefits (COLA) after 24 months of retirement.

State of New Jersey
 Teachers' Pension and Annuity Fund
 Notes to Financial Statements, Continued
 June 30, 1998 and 1997

(1) Description of the System, Continued

Membership

Membership in the Fund consisted of the following at March 31:

| | 1997 | |
|---|---------------------|--|
| | PENSION BENEFITS | POST-RETIREMENT MEDICAL BENEFITS |
| Retirees and beneficiaries currently receiving benefits and employees entitled to benefits but not yet receiving them | 46,690 | 29,087 * |
| Active members: | | |
| Vested | 75,245 | 23,739 |
| Nonvested | 43,565 | 95,071 |
| Total active members | 118,810 | 118,810 |
| Total | 165,500 | 147,897 |

| | 1996 | |
|---|---------------------|--|
| | PENSION BENEFITS | POST-RETIREMENT MEDICAL BENEFITS |
| Retirees and beneficiaries currently receiving benefits and employees entitled to benefits but not yet receiving them | 45,102 | 27,356** |
| Active members: | | |
| Vested | 74,252 | 21,929 |
| Nonvested | 43,414 | 95,737 |
| Total active members | 117,666 | 117,666 |
| Total | 162,768 | 145,022 |

* As of June 30, 1997.

** As of June 30, 1996. Estimated figure.

(2) Summary of Significant Accounting Policies

Basis of Accounting

The financial statements of the Fund are prepared on the accrual basis of accounting. Employer

State of New Jersey
Teachers' Pension and Annuity Fund

Notes to Financial Statements, Continued

June 30, 1998 and 1997

(2) Summary of Significant Accounting Policies, Continued

contributions are recognized when payable to the Fund. Benefits and refunds are recognized when due and payable in accordance with the terms of the Fund.

The Fund adopted the provisions of Governmental Accounting Standards Board (GASB) Statements No. 25, "Financial Reporting for Defined Benefit Plans and Note Disclosures for Defined Contribution Plans" and No. 26, "Financial Reporting for Postemployment Healthcare Plans Administered By Defined Benefit Pension Plans" in 1997. GASB Statement No. 25 requires that plan assets, plan liabilities and plan net assets be recorded at fair value. Prior to the adoption of GASB Statement No. 25, investments were recorded at cost or amortized cost. The cumulative effect of this change in accounting method, as of June 30, 1997, of \$4,559,102,179, is reported in the accompanying Statement of Changes in Plan Net Assets for the year ended June 30, 1997. The effects of the adoption of GASB Statement No. 26 were immaterial to the financial statements of the State of New Jersey Teachers' Pension and Annuity Fund.

Investment Valuation

Investments, including short-term investments (State of New Jersey Cash Management Funds), are reported at fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Mortgages are valued on the basis of future principal and interest payments, and are discounted at prevailing interest rates for similar instruments. The fair value of real estate investments is based on independent appraisals. Investments that do not have an established market are reported at estimated fair value.

The State of New Jersey Division of Investment, under the jurisdiction of the State Investment Council, has the investment responsibility for all funds administered by the State of New Jersey Division of Pensions and Benefits. All investments must conform to standards set by state law.

The State of New Jersey Division of Investment administers three common pension funds which are utilized by the Fund. A brief description of each common pension fund is as follows:

Common Pension Fund A - The operations of the Common Pension Fund are governed by the provisions of Article 62 of the State of New Jersey Investment Council regulations for the purpose of investing in corporate common stocks, securities convertible into corporate common stocks or covered call options.

Common Pension Fund B - The operations of the Common Pension Fund are governed by the provisions of Article 63 of the State of New Jersey Investment Council regulations for the purpose of investing in fixed income and debt securities.

Common Pension Fund D - The operations of the Common Pension Fund are governed by the provisions of Article 67 of the State of New Jersey Investment Council regulations for the purpose of investing in international debt and equity securities, currencies, currency futures, and options.

The State of New Jersey, Department of the Treasury, Division of Investment, issues publicly available

State of New Jersey
Teachers' Pension and Annuity Fund

Notes to Financial Statements, Continued

June 30, 1998 and 1997

(2) Summary of Significant Accounting Policies, Continued

financial reports that include the financial statements of the State of New Jersey Cash Management Funds, Common Pension Fund A, Common Pension Fund B and Common Pension Fund D. The financial reports may be obtained by writing to the State of New Jersey, Department of the Treasury, Division of Investment, P.O. Box 290, Trenton, New Jersey 08625.

The purchase, sale, receipt of income, and other transactions affecting investments are governed by custodial agreements between the Fund, through the State Treasurer, and custodian banks as agents for the Fund. State laws and policies set forth the requirements of such agreements and other particulars as to the size of the custodial institutions, amount of the portfolio to be covered by the agreements, and other pertinent matters.

GASB Statement No. 3 requires disclosure of the level of risk assumed by the Fund. Category 1 includes investments that are insured or registered or for which the securities are held by the Fund or its agent in the Fund's name. As of June 30, 1998 and 1997, all investments held by the Fund are classified as Category 1.

Federal securities are maintained at Federal Reserve Banks in Philadelphia and New York through the custodian banks in trust for the Fund. A significant portion of corporate equity and debt securities are maintained by the Depository Trust Company (DTC) through the custodian banks in trust for the Fund. The custodian banks, as agents for the Fund, maintain internal accounting records identifying the securities maintained by the Federal Reserve Banks and the DTC as securities owned by or pledged to the Fund.

Securities not maintained by the Federal Reserve Banks or DTC are in the name of a designated nominee representing the securities of the Fund, which establishes the Fund's unconditional right to the securities.

Member Loans

Members can borrow up to 50% of their accumulated member contributions. To obtain a loan, a member must have at least three years of service credit in the Fund. Repayment of loan balances is deducted from payroll checks and bears an interest rate of 4%. Generally, outstanding loans must be satisfied before benefits are paid from the Fund.

Administrative Expenses

The Fund is administered by the State of New Jersey Division of Pensions and Benefits. Administrative expenses are paid by the Fund to the State of New Jersey, Department of the Treasury, and are included in the accompanying Statements of Changes in Plan Net Assets.

Legislative Changes

During the year ended June 30, 1997, legislation was enacted (Chapter 114, P.L. 1997) authorizing the New Jersey Economic Development Authority (the "Authority") to issue bonds, notes or other obligations for the purpose of financing, in full or in part, the State of New Jersey's portion of the unfunded accrued liability under the State of New Jersey retirement systems. On June 30, 1997, the

State of New Jersey
Teachers' Pension and Annuity Fund
Notes to Financial Statements, Continued
June 30, 1998 and 1997

(2) Summary of Significant Accounting Policies, Continued

Authority issued bonds pursuant to this legislation and \$1,547,688,633 from the proceeds of the bonds were deposited into the Fund's investment accounts. Such proceeds are included in employer contributions in the accompanying Statement of Changes in Plan Net Assets for the year ended June 30, 1997. Employer contributions exceeded the annual required contributions as of June 30, 1997 as a result of this enactment.

As a result of additional legislation enacted during the year ended June 30, 1997 (Chapter 115, P.L. 1997), the asset valuation method was changed from market related value to full-market value for the valuation report dated March 31, 1996. The actuarial value of assets reverted back to market-related value of assets effective with the March 31, 1997 valuation. This legislation also contained a provision to reduce the employee contribution rate by 1/2 of 1% to 4.5% for calendar years 1998 and 1999, and to allow for a reduction in the employee's rate after calendar year 1999, providing excess valuation assets are available. The legislation also provided that the State of New Jersey may reduce its normal contributions to the Fund based on the revaluation of assets, and fund such contributions from excess assets not needed to cover the costs of all accrued benefits. In addition, the legislation required that the normal contribution to be made to the Fund for the year ended June 30, 1997 shall be no less than \$54,000,000 excluding the post-retirement medical contribution.

(3) Contributions

The contribution policy is set by N.J.S.A. 18:66 and Chapter 62, P.L. 1994 and Chapter 115, P.L. 1997, and requires contributions by active members and contributing employers. Plan member and employer contributions may be amended by State of New Jersey legislation. Members contribute at a uniform rate. From July 1, 1996 to December 31, 1997, the contribution rate was 5% of base salary. In accordance with Chapter 115, P.L. 1997, the member rate was lowered to 4.5% effective January 1, 1998. Employers are required to contribute at an actuarially determined rate. The annual employer contribution includes funding for basic retirement allowances, cost-of-living adjustments and non-contributory death benefits. The State of New Jersey's contribution also includes funding for the cost of medical premiums after retirement for qualified retirees. In accordance with Chapter 62, P.L. 1994, post-retirement medical benefits are funded on a pay-as-you-go basis plus an additional contribution that will ensure an increase in the Post-Retirement Medical Reserve Fund equal to 1/2 of 1% of the salary of active employees.

As a result of Chapter 115, P.L. 1997, referred to in Note 2, the State of New Jersey's contribution to the Fund for the year ended June 30, 1998 was limited to funding for postretirement medical benefits and benefits under the early retirement incentive program. Excess valuation assets were used to fund the normal contribution for basic benefits and active COLA benefits. For the year ended June 30, 1997, as a result of the above legislation and the recognition of bond proceeds under Chapter 114, P.L. 1997, the State's contribution to the Fund was limited to \$54,000,000, the minimum normal contribution required under Chapter 115, plus funding for postretirement medical benefits.

State of New Jersey
Teachers' Pension and Annuity Fund
Notes to Financial Statements, Continued
June 30, 1998 and 1997

(4) Reserves

This Fund maintains the following legally required reserves, which are fully funded:

Members' Annuity Savings and Accumulative Interest Fund

The Members' Annuity Savings Fund is credited with all contributions made by active members of the Fund. Interest earned on member contributions is credited to the Accumulated Interest Fund. The annual rate of interest on member contributions, as required by Chapter 62, P.L. 1994, is 8.75%.

Contingent Reserve Fund

The Contingent Reserve Fund is credited with the contributions of employers other than post-retirement medical contributions. Interest earnings, after crediting the Accumulated Interest Fund, Retirement Reserve Fund, and Special Reserve Fund, are credited to this account. Additionally, payments for life insurance premiums are made from this Fund.

Retirement Reserve Fund

The Retirement Reserve Fund is the account from which retirement benefits other than life insurance premiums, contributory group insurance premiums, and post-retirement medical premiums, including cost-of-living benefits and medical benefits for certain retirees, are paid. Upon retirement of a member, accumulated contributions, together with accumulated regular interest, are transferred to the Retirement Reserve Fund from the Annuity Savings Fund. Any additional reserves needed for the retirement and cost-of-living benefits are transferred from the Contingent Reserve Fund. Annually, interest as determined by the State Treasurer (8.75% for 1998 and 1997) is credited to the Retirement Reserve Fund.

Special Reserve Fund

The Special Reserve Fund is the fund to which excess interest earnings and gains from sales and maturities of investments are transferred and against which any losses from the sales of securities are charged. The maximum limit on the accumulation of this account is 1% of the market value of the investments allocated to the System, excluding Cash Management Fund investments and bonds allocated to the Contributory Group Insurance Premium Fund which amounted to \$64,002,512 and \$62,126,942 as of June 30, 1998 and 1997, respectively. Amounts in excess of 1% are credited to the Contingent Reserve Fund.

Contributory Group Insurance Premium Fund

The Contributory Group Insurance Premium Fund represents the accumulation of member group insurance contributions in excess of premiums disbursed to the insurance carrier since the inception of the contributory death benefit program plus reserves held by the insurance carrier. Members are required by statute to participate in the contributory group insurance plan in the first year of membership and may cancel the contributory coverage thereafter. The current contribution rate for active members is 0.4 of 1% of salary, as defined.

Post-Retirement Medical Fund

The Post-Retirement Medical Fund is credited with employer contributions for post-retirement medi-

State of New Jersey
Teachers' Pension and Annuity Fund
Notes to Financial Statements, Continued
June 30, 1998 and 1997

(4) Reserves, Continued

cal benefits, interest earnings on post-retirement medical reserves, and from which post-retirement medical premiums are paid.

(5) Income Tax Status

Based on a 1986 declaration of the Attorney General of the State of New Jersey, the Fund is a qualified plan as described in Section 401(a) of the Internal Revenue Code.

(6) Year 2000 (Unaudited)

The Fund is aware of the issues associated with the programming code in existing computer systems as the millennium (year 2000) approaches. The "year 2000" problem is pervasive and complex as virtually every computer operation will be affected in some way by the rollover of the two-digit year value to 00. The issue is whether computer systems will properly recognize date-sensitive information when the year changes to 2000. Computer systems that do not properly recognize such information could generate erroneous data or cause a system to fail.

The Fund has utilized both internal and external resources to identify, correct or reprogram, and test the computer systems for the year 2000 compliance. It is anticipated that all reprogramming efforts will be complete by March 31, 1999, allowing adequate time for testing. To date, confirmations have been received from the Fund's primary processing vendors that plans are being developed to address processing of transactions in the year 2000. However, there can be no assurance that the computer systems of other entities on which the Fund's computer systems rely also will be timely converted or that any such failure to convert by another entity would not have an adverse effect on the Fund's systems.

14.

New Jersey Division of Pensions and Benefits • Teachers' Pension and Annuity Fund

State of New Jersey
 Teachers' Pension and Annuity Fund
 Required Supplementary Information
 Schedule of Funding Progress

| ACTUARIAL VALUATION DATE | ACTUARIAL VALUE OF ASSETS (a) | ACTUARIAL ACCRUED LIABILITY (b) | UNFUNDED (OVERFUNDED) ACTUARIAL ACCRUED LIABILITY (b - a) | FUNDED RATIO (a / b) | COVERED PAYROLL (c) | UNFUNDED (OVERFUNDED) ACTUARIAL ACCRUED LIABILITY AS A PERCENTAGE OF COVERED PAYROLL ((b - a) / c) |
|--------------------------------|--|--|--|----------------------------|---------------------------|--|
| March 31, 1995 | \$16,942,637,259 | \$18,410,393,538 | \$1,467,756,279 | 92.0% | \$ 5,358,893,876 | 27.4% |
| March 31, 1996 | 20,843,247,418 | 19,828,428,735 | (1,014,818,683) | 105.1 | 5,594,150,132 | (18.1) |
| March 31, 1997 | 22,045,481,579 | 21,224,484,588 | (820,996,991) | 103.9 | 5,771,763,164 | (14.2) |

State of New Jersey
Teachers' Pension and Annuity Fund

Required Supplementary Information, Continued
Schedule of Funding Progress — Additional Actuarial Information

Significant actuarial methods and assumptions used in the March 31, 1997 and 1996 actuarial valuations included the following:

| | March 31, 1997 | March 31, 1996 |
|--------------------------------------|---------------------------------|-----------------------|
| Actuarial cost method | Projected unit credit | Projected unit credit |
| Asset valuation method | 5 years average of market value | Market value |
| Amortization method | Level percent, closed | Level percent, closed |
| Payroll growth rate for amortization | 5.00% | 5.00% |
| Remaining amortization period | 35 years | 36 years |
| Actuarial assumptions: | | |
| Interest rate | 8.75% | 8.75% |
| Salary range | 5.95% | 5.95% |
| Cost-of-living adjustments | 2.40% | 2.40% |

In accordance with Chapter 115, P.L. 1997, the actuarial value of assets reverted back to market-related value of assets effective with the March 31, 1997 valuation.

The actuarial assumptions used in the March 31, 1997 and 1996 valuations were developed on the basis of a three year experience investigation for the period ended March 31, 1991. The additional cost attributable to the revised assumptions developed from the 1991 experience investigation was phased in over a five year period beginning with the March 31, 1993 valuation. The March 31, 1997 valuation reflects full recognition of these assumption changes.

Annual covered payroll is an estimate based upon annualizing one quarter's actual payroll.

Due to the recognition of the bond proceeds and the change in the asset valuation method as a result of enactment of Chapters 114 and 115, all unfunded accrued liabilities were eliminated as of March 31, 1996, except for the unfunded liability for local early retirement incentive benefits.

State of New Jersey
Teachers' Pension and Annuity Fund
 Required Supplementary Information, Continued
 Schedule of Employer Contributions

| YEAR ENDED JUNE 30, | ANNUAL REQUIRED CONTRIBUTION | EMPLOYER CONTRIBUTIONS(3) | PERCENTAGE CONTRIBUTED |
|---------------------------|------------------------------------|------------------------------|---------------------------|
| 1997 | \$372,060,546 | \$1,601,688,633 (1) | 430.5% |
| 1998 | 297,219,482 | 0 (2) | 0.0 |

Notes to Schedule

- (1) For the year ended June 30, 1997, the employer contributions exceeded the annual required contributions as a result of legislation that was enacted (Chapter 114, P.L. 1997) authorizing the New Jersey Economic Development Authority to issue bonds, notes or other obligations for the purpose of financing, in full or in part, the State of New Jersey's portion of the unfunded accrued liability under the State of New Jersey retirement systems.
- (2) For year ended June 30, 1998, employee contributions were offset by excess valuation assets in accordance with Chapter 115, P.L. 1997.
- (3) Excludes post-retirement medical contributions and contributions received from other State of New Jersey retirement systems or funds for certain members who transferred their eligible prior service credit to the Teachers' Pension and Annuity Fund.

STATE OF NEW JERSEY
TEACHERS' PENSION AND ANNUITY FUND

Schedule of Changes in Plan Net Assets by Fund

Year ended June 30, 1998

| | MEMBERS' ANNUITY SAVINGS AND ACCUMULATIVE INTEREST FUND | CONTINGENT RESERVE FUND | RETIREMENT RESERVE FUND | SPECIAL RESERVE FUND | CONTRIBUTORY GROUP INSURANCE PREMIUM FUND | POST- RETIREMENT MEDICAL FUND | OTHER | TOTAL |
|---|--|-------------------------------|-------------------------------|----------------------------|--|--|-------|----------------|
| Additions: | | | | | | | | |
| Contributions: | | | | | | | | |
| Members | \$ 316,531,939 | — | — | — | 23,638,542 | — | — | 340,170,481 |
| Employers | — | 2,316,858 | — | — | — | 99,308,910 | — | 101,625,768 |
| Other | — | — | — | — | — | — | 4,155 | 4,155 |
| Total contributions | 316,531,939 | 2,316,858 | — | — | 23,638,542 | 99,308,910 | 4,155 | 441,800,404 |
| Distribution of net investment income | 316,555,465 | 3,920,063,114 | 797,718,943 | 49,300,556 | 3,893,020 | 20,131,896 | — | 5,107,662,994 |
| Total additions | 633,087,404 | 3,922,379,972 | 797,718,943 | 49,300,556 | 27,531,562 | 119,440,806 | 4,155 | 5,549,463,398 |
| Deductions: | | | | | | | | |
| Benefit payments | — | 23,341,729 | 956,509,242 | — | 25,583,634 | 98,113,482 | 4,155 | 1,103,552,242 |
| Refunds of contributions | 15,637,911 | 403,053 | — | — | — | — | — | 16,040,964 |
| Administrative expenses | — | 7,390,930 | — | — | — | — | — | 7,390,930 |
| Total deductions | 15,637,911 | 31,135,712 | 956,509,242 | — | 25,583,634 | 98,113,482 | 4,155 | 1,126,984,136 |
| Net increase (decrease) before transfers among reserves | 617,449,493 | 3,891,244,260 | (158,790,299) | 49,300,556 | 1,947,928 | 21,327,324 | — | 4,422,479,262 |
| Transfers among reserves: | | | | | | | | |
| Retirements | (204,510,621) | (607,101,170) | 811,611,791 | — | — | — | — | — |
| Other | 5,858 | (333,071,416) | 333,065,558 | — | — | — | — | — |
| Net increase | 412,944,730 | 2,951,071,674 | 985,887,050 | 49,300,556 | 1,947,928 | 21,327,324 | — | 4,422,479,262 |
| Net assets held in trust for pension benefits: | | | | | | | | |
| Beginning of year | 3,870,175,696 | 11,474,638,189 | 8,783,630,992 | 234,881,011 | 61,833,803 | 230,078,808 | — | 24,655,238,499 |
| End of year | \$ 4,283,120,426 | 14,425,709,863 | 9,769,518,042 | 284,181,567 | 63,781,731 | 251,406,132 | — | 29,077,717,761 |

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Contacting the Division of Pensions and Benefits

The Division of Pensions and Benefits **INTERNET HOME**

PAGE address (URL) is <http://www.state.nj.us/treasury/pensions>

You can send **E-mail** to the Division of Pensions and Benefits through our

HOME PAGE or directly to NJ-pensions@tre.state.nj.us

You can **CONTACT CLIENT SERVICES** of

the Division of Pensions and Benefits at (609) 292-7524
on Monday through Friday
from 9:00 am until 4:00 pm

The telephone number for individuals who are hearing impaired and use a

TELECOMMUNICATION DEVICE FOR THE DEAF (TDD) is (609) 292-7718

You can hear personalized information about loans, withdrawals, retirement benefits, purchase costs, and your account within the retirement system. This system is available 24 hours a day, seven days a week. You will need your social security number and a touch phone.

AUTOMATED INFORMATION SYSTEM (609) 777-1777

You can **WRITE** to the Division of

Pensions and Benefits at **Division of Pensions and Benefits**
P.O. Box 295
Trenton, NJ 08625-0295

You can **VISIT** the Division of Pensions and Benefits, without appointment,

on the third floor at **50 West State Street**
in downtown Trenton, New Jersey
on Monday through Friday
from 8:40 am until 4:00 pm.

We are on the corner of West State and Barracks Streets, a block east of the State House. **DIRECTIONS** to our location can be downloaded from our Internet

web site or obtained by calling our **Benefit Information Library**
at (609) 984-7109
seven days a week, 24 hours a day

TEACHERS' PENSION AND ANNUITY FUND
OF NEW JERSEY

1998 ANNUAL REPORT

STATE OF NEW JERSEY
DEPARTMENT OF THE TREASURY
DIVISION OF PENSIONS AND BENEFITS
PO BOX 295
TRENTON, NJ 08625-0295
(609) 292-7524

