

2006 Supplemental Budget Information

Prepared for the House Appropriations Committee





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Chairman

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February 17, 2006

Members of the House Appropriations Committee

Dear Members:

On behalf of the State Employees' Retirement System, I am pleased to provide you with the following supplemental information, which we believe may be helpful to you in your budget deliberations.

We are pleased to report, as detailed at Tab 9, that SERS recorded another year of outstanding investment performance in 2005. Our net return of 14.9% is double the 7.55% median return of public pension funds nationally. This marks the third consecutive year of stellar returns for SERS. Over the past decade, and despite the historic bear market, SERS net compounded returns have been in excess of 10% per year.

I also would direct your attention to Tab 7, Funding and Actuarial Soundness of the Plan. Here we report on the plan's current status, which at 96% funded is far superior to the 83% average funding level of major state pension plans nationwide.

SERS' strong investment performance has helped keep employer contributions well below the normal rate - even dropping to zero for two years - saving the Commonwealth more than \$2 billion over the past decade. You will find a comparison of actual and normal employer rates at Tab 7, page 33.

That same chart also provides a look ahead to the system's future funding needs. As you are aware, the combination of benefit enhancements followed by the bear market created an actuarial shortfall. Act 2003-40 deferred the immediate impact by revising the statutory schedule for the amortization of liabilities. In doing so, however, Act 40 effectively created a "balloon payment" that will come due in 2012. Based on the 2004 actuarial valuation, we project that in 2012 the employer contribution rate, currently 3%, will jump to 23.5%. Sustained exceptional investment performance could help moderate that spike, but we see no scenario under which the balloon payment created by Act 40 can be avoided.

Clearly, an employer rate of that magnitude would have a serious impact on the Commonwealth's budget and will require advanced planning. SERS stands ready to cooperate fully with the Legislature as you consider how to deal with this significant fiscal issue.

Additional tabs offer information on, among other topics, member services and demographics, Pennsylvania investments and the Commonwealth's Deferred Compensation Program, which the SERS Board also administers.

If you have any questions regarding any of the information in this booklet, please contact Executive Director Eric Henry. Thank you in advance for your consideration of SERS 2006-07 budget request.

Sincerely,

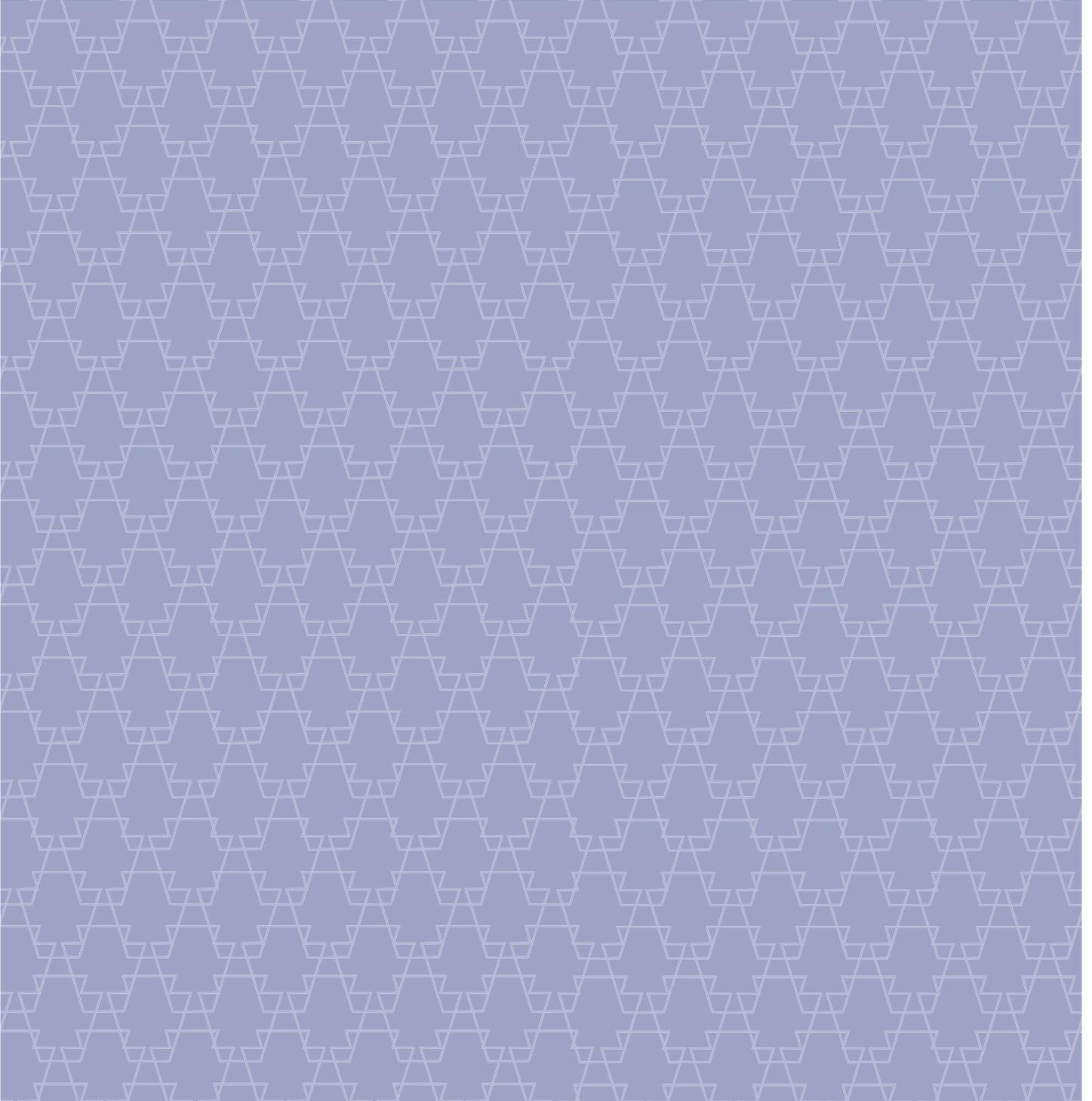
Nicholas J. Maiale
Chairman

Attachment

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Organizational Overview



Mission, Vision & Goals

Established in 1923, the Pennsylvania State Employees' Retirement System (SERS) is one of the nation's oldest and largest statewide retirement plans for public employees, with more than 200,000 members. SERS is among the largest of public and corporate pension funds, with assets of approximately \$28.8 billion as of December 31, 2005.

SERS is responsible for administering the State Employees' Retirement Code in accordance with the expressed intent of the General Assembly and bears a fiduciary obligation to the state employees and retirees who are the plan beneficiaries.

State law provides that the administration of the SERS fund and the fiduciary responsibility for its management be vested in an 11-member Board. The management of SERS is the responsibility of the Executive Director who, with the approval of the Board, contracts for professional services and employs the staff needed to operate the system. The SERS Fund is administered under a Mission and Vision, working to accomplish timed goals.

Mission

The mission of SERS is to provide retirement benefits and services to our members through sound administration and prudent investments.

Vision

By 2008, SERS will be prepared for membership and employee shifts brought about by the Baby Boom generation (while providing retirement benefits and services).

GOALS

- By June 30, 2006 document and implement a comprehensive SERS Security Plan to include physical and building security, information security and business continuity plans.
- By June 30, 2006, develop a comprehensive Membership Communications Plan.
- By June 30, 2006, mask the display of Social Security numbers on member communication pieces.
- By December 31, 2006, develop a comprehensive SERS-specific career-development training program to include a continuous curriculum and individual training plans for all SERS staff.
- By December 31, 2006, evaluate the effectiveness of the SERS Leadership Development Program.
- By December 31, 2006, complete an agency-wide review of operations with recommendations to improve efficiencies.
- By December 31, 2006, develop and implement the necessary modifications to the Investment Data Warehouse (IDW) to meet user needs.
- By December 31, 2006, develop enterprise taxonomy and implement a Content Management System (CMS) in the Member Services and Legal offices.
- By December 31, 2006, complete death benefits re-engineering to include documentation and programming.
- By December 31, 2006, develop a plan to re-engineer the remaining member service processes and to clear the remaining State Employee Retirement Information System (SERIS) problem logs.
- By December 31, 2007, complete a review and generate recommendations on the viability of paperless member input and data retrieval.

Organization & Operations

The agency's various program functions are administered by staff in SERS' Harrisburg Central Office and through a statewide network of seven Regional Retirement Counseling Centers. Assignment of major agency functions is as follows:

Executive Office: Supports the Executive Director who is the agency's senior staff administrator. Provides direct service to the Chairman of the SERS Board and Board members. Makes arrangements for and conducts administrative functions for all Board meetings. Conducts research and provides agency direction on organizational development, strategic planning, pending retirement issues and actuarial considerations. Includes the **Communications and Policy Office**, which serves a variety of communication-related support functions. These include preparation and dissemination of retirement-related information and publications, tracking and reporting on retirement legislation, and handling inquiries from the media, state Legislature and the public.

Office of Finance and Administration: Provides the accounting structure for SERS's \$28.8 billion Fund; oversees all transactions, including payment of member benefits, purchase and sale of investment securities, receipt of employer and employee contributions and investment income, and administration of the agency operational budget. The office also manages agency operations and disaster recovery planning, while reporting to the SERS Board on management of the approximately \$1.5 billion state employee Deferred Compensation Program.

Investment Office: Working closely with the SERS Board, this office monitors the management of Fund assets and determines investment policy for directing the allocation of Fund resources. The office works in tandem with the Fund's outside investment managers and consultants, performs research on investment products and investment managers, and recommends an investment program for review/approval by the Board.

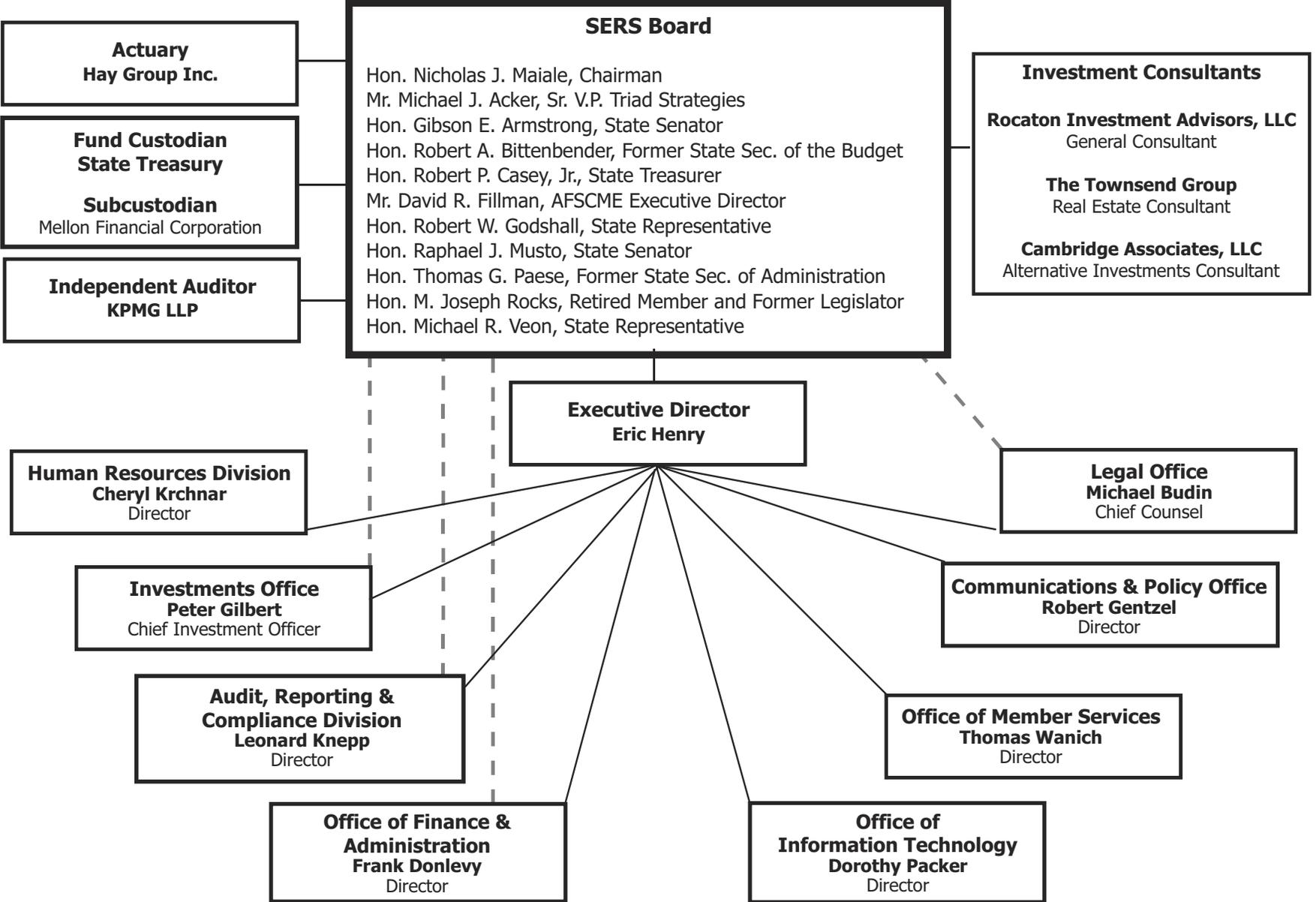
Legal Office: Provides counsel to the SERS Board and the agency, including handling administrative hearings involving SERS members, reviewing investment and non-investment-related contracts, and providing legal advice.

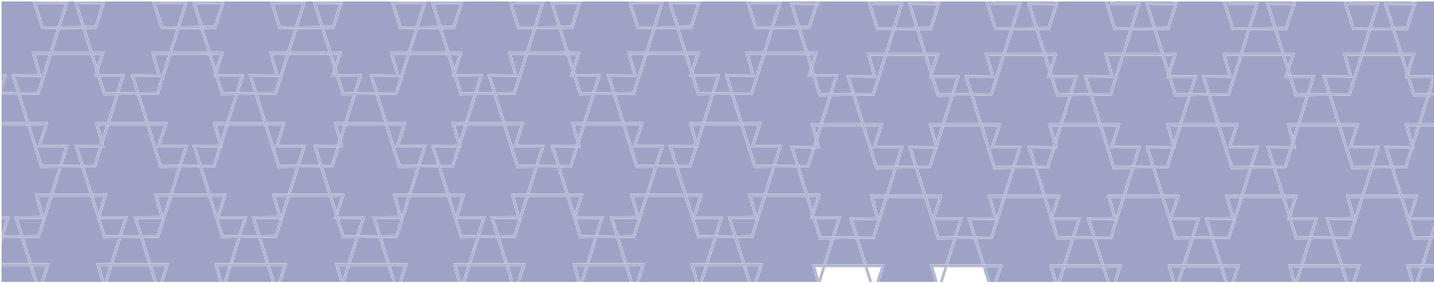
Audit, Reporting and Compliance Division: Performs internal audits of business processes to determine adequacy, effectiveness and efficiency of operations; coordinates audits performed at SERS by external agencies and auditors. Prepares agency financial and investment reports, performs analysis and compliance reviews of investments and other programs.

Human Resources Division: Responsible for management and development of human resources.

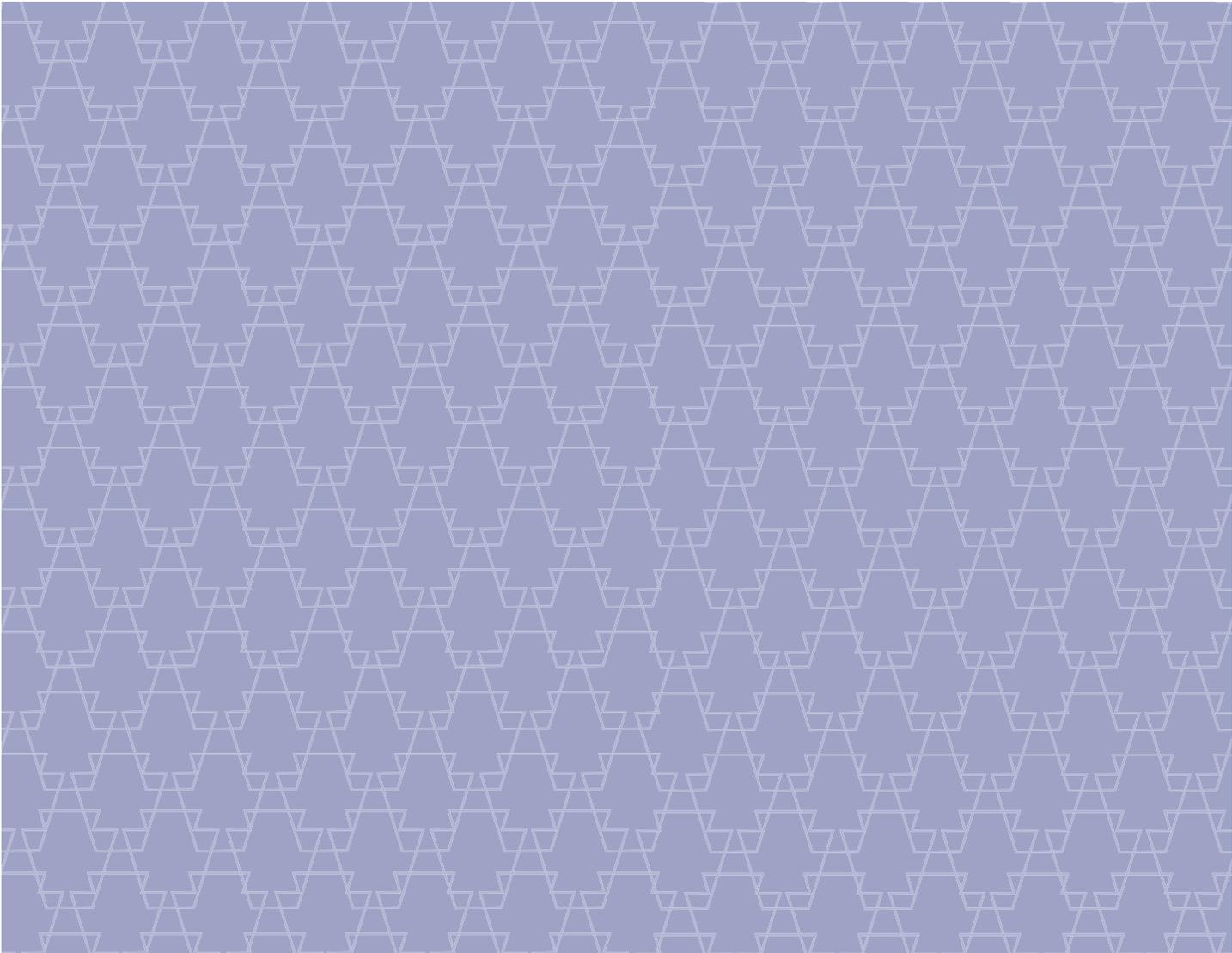
Office of Information Technology: Provides all computer and technical support for SERS operations, including a Wide Area Network linking the agency's seven Regional Retirement Counseling Centers.

Office of Member Services: Provides individualized counseling and retirement-related seminars through SERS' statewide system of seven Regional Retirement Counseling Centers. Processes member and member-survivor benefit payments and provides membership account services. Researches and benchmarks issues in public pension programs, recommends adoption of new strategies, and performs special retirement-related functions.



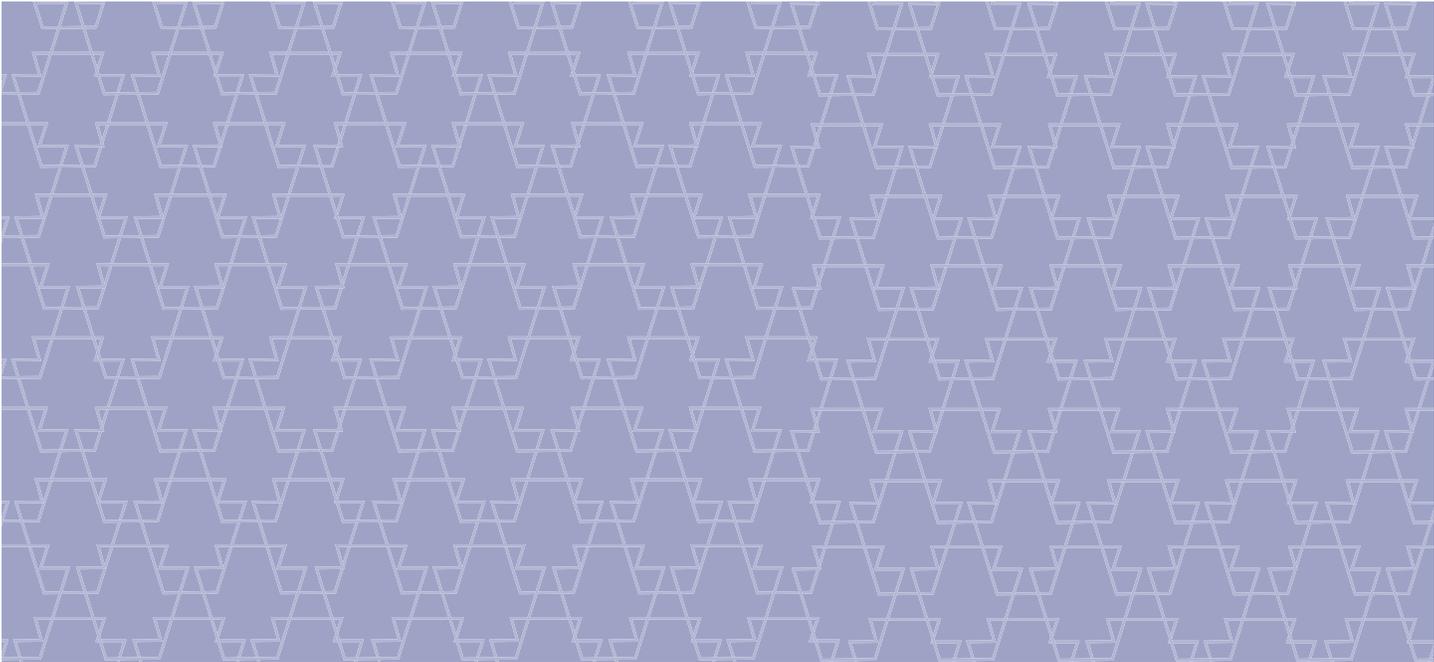


2006 - '07 Budget - Board Submission

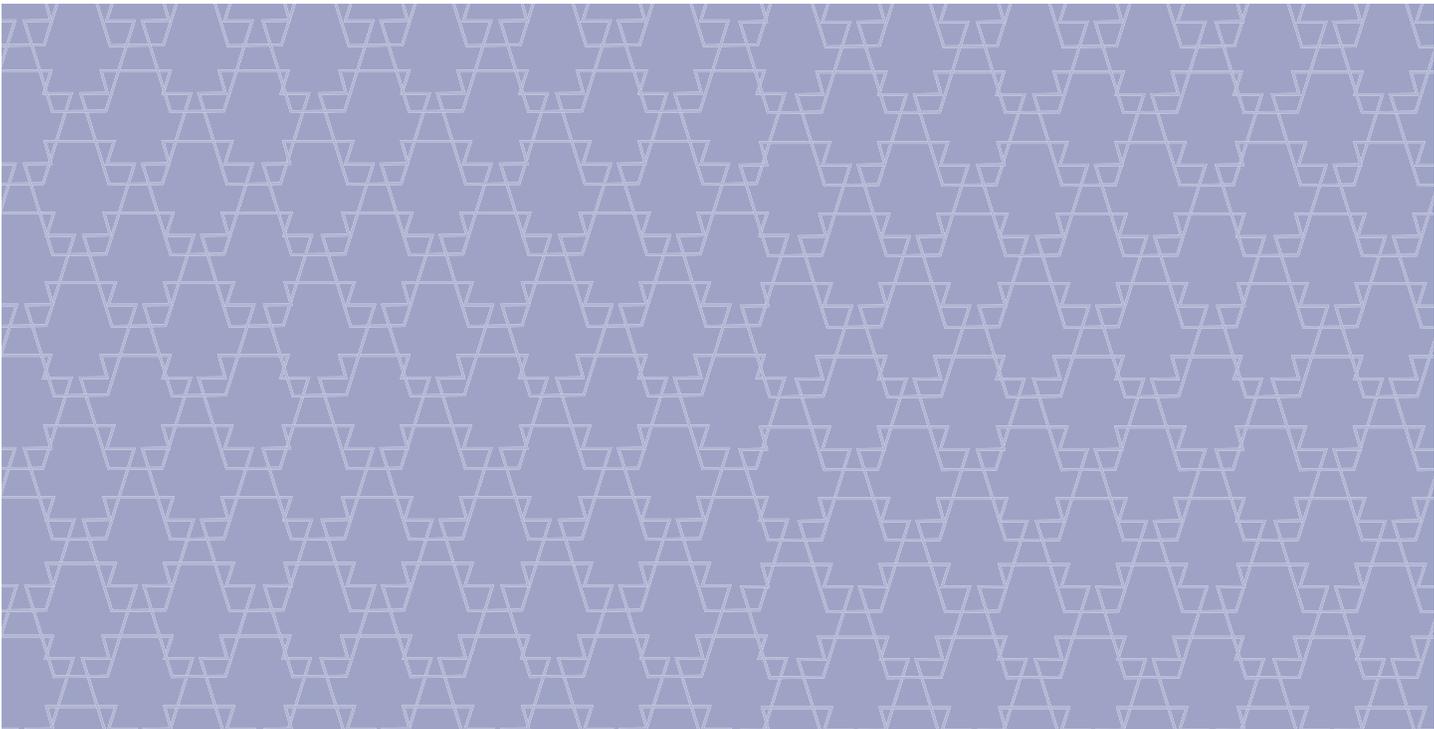


SERS Budget 2006-'07

	Budget 2002-03	Budget 2003-04	Budget 2004-05	Budget 2005-06	Budget Request 2006-07
Personnel Services	\$12,976,000	\$13,604,877	\$13,797,455	\$14,374,963	\$15,113,000
Operational Expenses:					
Travel	193,715	254,300	187,860	225,713	230,000
Training	7,550	129,175	119,080	219,985	204,750
Telecomm-Rec	324,970	333,325	269,640	272,530	279,840
Telecomm-NR	5,100	950	1,800	11,700	650
Consultant Svc-Non-EDP	563,195	640,705	2,513,832	3,718,437	2,755,020
Legal Services/Fees	80,000	60,000	131,896	95,775	90,000
Specialized Services	467,600	490,469	1,120,935	990,805	1,369,000
Advertising	2,150	2,150	-	-	-
Cont EDP Svc-Vnd Prov	1,159,875	1,525,475	1,653,881	554,576	857,000
Cont Maint Sv-EDP	249,850	161,100	81,680	86,850	105,500
Cont Maint-Non-EDP	33,410	22,180	24,065	25,475	19,530
Cont Repairs-Non-EDP	3,110	3,000	-	-	-
Cont Repairs-Mot Eq	2,100	2,150	855	805	-
EDP	798,000	958,482	841,304	1,103,446	1,145,500
Real Estate	1,333,644	1,417,753	1,490,784	1,491,553	1,538,000
Vehicles	59,800	62,450	71,050	82,900	84,700
Office Equipment	-	-	-	-	5,000
Other Rentals/Leases	123,500	125,959	118,235	103,860	133,000
Office Supplies	356,606	259,600	743,144	420,406	139,630
Educational Supplies	3,500	4,100	2,680	1,900	1,100
Oth Computer Eq	-	-	-	-	386,000
Motorized Equipment	5,600	5,900	5,860	9,600	6,600
Postage	406,650	416,900	420,365	434,321	450,000
Freight	10,000	8,100	10,600	7,000	5,000
Printing	152,075	156,250	184,720	239,550	187,000
Subscriptions	14,650	13,200	15,285	19,645	20,000
Membership Dues	40,000	47,500	47,750	57,280	60,000
Conference Exp		7,250	6,750	20,050	45,000
Purchasing Card Purc	241,150	222,700	273,494	195,975	203,430
Insur/Sur/Fid Bonds	5,000	5,000	5,000	5,000	5,300
Oth Op Exp	656,200	775,000	200,000	326,900	395,450
Total Operational	7,299,000	8,111,123	10,542,545	10,722,037	10,722,000
Fixed Assets	594,000	446,000	150,000	90,000	90,000
Total Budget	\$20,869,000	\$22,162,000	\$24,490,000	\$25,187,000	\$25,925,000



Investment Advisory and Consultant Fees



Investment Advisory & Consultant Fees

Calendar Year 2005

Advisory Fees

Asset Class	Fees (in \$) ^{1/}	Fees (in basis points) ^{2/}
Stocks	\$90,262,853	35.9
Fixed Income	16,387,581	36.8
Real Estate ^{3/}	33,436,823	152.0
Alternative Investments	84,959,271	163.0
Inflation Protection	6,124,249	30.6
Total Fund	\$231,170,777	58.9

^{1/}Fees paid and accrued by SERS during the period from January 1, 2005, through December 31, 2005, according to SERS records maintained by the Office of Finance and Administration (OFA).

^{2/}The fee data from OFA was divided by SERS's total fund and asset class average values during calendar year 2005 to arrive at the basis point calculations. Alternative Investments were determined based on committed capital during the active investment stage of the partnership, and on market value during the maturity stage of the partnership to most accurately reflect the calculation of fees for those management services. In addition, the basis points for currency overlay fees and the S&P 500 equitization fees in the alpha transport strategies, (both of which are imbedded in the stock asset class), were calculated based on the average of the notional exposures under management. The adjustments to reflect these costs were included in the total fund.

^{3/}Fees for Real Estate include an adjustment in 2005 for incentive fees. Incentive fees are determined every three years based on the appraisal cycle and increased fees approximately 55 basis points for the Real Estate asset class and 3 basis points for the Total Fund.

Fees and average basis points for 2001-2005 are as follows:

Calendar Year ^{4/}	Fees (\$ mil)	Basis Points
2001	147.9	50.0
2002	153.7	54.6
2003	184.4	57.4
2004	195.1	50.5
2005	231.2	58.9

^{4/}(Calendar years 2003 and 2004 have been restated to conform with the current year's presentation and to more accurately reflect the equitization costs associated with the alpha transport strategies)

The consultants under contract with SERS and fees paid during calendar year 2005 include:

Firm	Status	Fees
Cambridge Associates	Venture Capital	\$1,033,333
Rocaton Investment Advisors	General	426,667
The Hay Group, Inc.	General	278,986
The Townsend Group	Real Estate	218,800
Pension Consulting Alliance	General	70,308

Fees to Managers (Non-Budget Appropriation)

SERS employs outside investment managers. Active management by private-sector investment professionals has generated returns, after fees, that exceeded passive benchmarks. In 2005 SERS earned 14.9 percent, or more than \$3.8 billion, on its investment portfolio, performance that placed it among the top 10 percent of all pension funds nationwide.

The following agreements related to the management of the SERS investment portfolio are paid through a non-budget appropriation. They are treated as a reduction of the investment revenue of the fund rather than as a direct administrative expense.

			2005
<u>Domestic Equity</u>			
Artemis Investment Management	New York	NY	509,651
AXA Rosenberg Investment Management LLC	Orinda	CA	1,586,925
Barclays Global Investors, N.A. - Alpha Tilt	San Francisco	CA	856,059
Barclays Global Investors, N.A. - Index Fund P	San Francisco	CA	79,806
Blackstone Alternative Asset Management	New York	NY	15,574,604
Emerald Advisers Inc.	Lancaster	PA	904,486
First Quadrant, L.P.	Pasadena	CA	605,043
Iridian Asset Management, LLC	Westport	CT	1,598,736
Martingale Asset Management, L.P.	Boston	MA	692,406
Mellon Equity Associates, LLP (PA Fund)	Pittsburgh	PA	201,723
Mellon Equity Associates, LLP (Special Portfolio)	Pittsburgh	PA	220,344
Mesirow Advanced Strategies	Chicago	IL	10,082,244
Morgan Stanley Alternative Investments Partners, L.P.	West Conshohocken	PA	5,781,836
MSAIP (Domestic Equitization Program)	West Conshohocken	PA	1,104,519
Pacific Alternative Asset Management	Irvine	CA	10,845,364
Provident Investment Counsel, Inc. - Stellar Fund	Pasadena	CA	1,868,955
Provident Investment Counsel, Inc.	Pasadena	CA	372,471
The Boston Company Asset Management, LLC	Boston	MA	819,708
OFI Institutional Asset	Bellefonte	PA	1,470,211
Twin Capital Management, Inc.	McMurray	PA	550,655
<u>Commodities</u>			
NISA Investment Advisors, LLC	St. Louis	MO	2,327,523
Wellington	Boston	MA	3,796,726
<u>International Equity</u>			
Artisan Partners Limited Partnership	Milwaukee	WI	2,886,875
Bernstein Emerging Markets	New York	NY	402,985
Capital International Inc.	Los Angeles	CA	950,458
GAM International Management, Ltd.	New York	NY	943,930
Harris Associates L.P.	Chicago	IL	2,204,495
J. P. Morgan Investment Management, Inc.	New York	NY	1,353,606
Marathon Asset Management, Ltd.	London	UK	2,608,241
Marvin & Palmer Emerging Markets Equity, L.P.	Wilmington	DE	571,857
Merrill Lynch Investment Managers	New York	NY	2,090,691

2005 Fees to Managers (Non-Budget Appropriation) *continued*

Morgan Stanley, Dean Witter Inv. Mgt., Inc. - Asia ex. Japan	New York	NY	468,091
Morgan Stanley, Dean Witter Investment Mgt., Inc. - EAFE	London	UK	2,757,929
Oaktree Cap. Mgt, LLC - Emerging Mkt. Feeder Fund (2004)	Los Angeles	CA	323,771
Oaktree Cap. Mgt, LLC - Emerging Mkt. Feeder Fund (2003)	Los Angeles	CA	2,375,905
Pictet International Management, Ltd. (Small Cap)	London	UK	1,045,688
Pictet International Management, Ltd. (Emerging Markets)	London	UK	946,720
Rexiter Emerging Markets	Boston	MA	254,850
Scottish Widows Investment Management, Ltd.	Princeton	NJ	1,172,946
State Street Global Advisors - Europe	Boston	MA	69,907
Templeton Investment Counsel, LLC	Fort Lauderdale	FL	1,913,654
Templeton TIFI - Emerging Markets Series	Fort Lauderdale	FL	3,566,557
Templeton Strategic Emerging Market Fund	Fort Lauderdale	FL	1,012,864
Templeton Strategic Emerging Market Fund II	Fort Lauderdale	FL	1,643,836
Walter Scott & Partners Limited	Edinburgh		335,360
<u>Currency Overlay</u>			
Pareto Partners	New York	NY	1,367,770
Record Treasury Management, Ltd.	Berkshire	UK	1,268,121
<u>Fixed Income</u>			
Berwind Financial Group, Inc.	Philadelphia	PA	200,572
Fidelity Management & Research Co.	Boston	MA	1,766,070
Goldman Sachs Asset Management	New York	NY	563,184
Gramercy Advisors, LLC	Greenwich	CT	998,538
Greylock Capital Management, LLC	New York	NY	1,872,762
Legg Mason Real Estate Advisors	Philadelphia	PA	104,527
MDL Capital Management	Pittsburgh	PA	143,639
Morgan Stanley Dean Witter (Domestic)	West Conshohocken	PA	1,357,977
Morgan Stanley Dean Witter (Global)	West Conshohocken	PA	28,161
NISA Investment Advisors, LLC	St. Louis	MO	560,419
Oaktree Capital Management, LLC - Mezzanine Fund	Los Angeles	CA	604,624
Pacific Investment Management Co. (PIMCO)	Newport Beach	CA	1,090,291
PNC Equity Management Corporation	Pittsburgh	PA	81,992
Salomon Brothers Asset Management	New York	NY	4,398,531
Standish Mellon (Mellon Bond Associates)	Philadelphia	PA	186,154
Taplin, Canida & Habacht	Miami	FL	258,919
W. R. Huff Asset Management	Morristown	NJ	2,171,221
<u>Real Estate</u>			
Apollo Real Estate Investment Fund III	New York	NY	314,122
Berwind Property Group Fund IV	Philadelphia	PA	71,971
Berwind Property Group Fund V	Philadelphia	PA	202,534
Berwind Property Group Fund VI	Philadelphia	PA	296,260
Berwind Property Group Fund VII	Philadelphia	PA	111,987
Blackstone Real Estate Partners II	New York	NY	44,837
Blackstone Real Estate Partners III	New York	NY	165,042
Blackstone Real Estate Partners IV TE. 2 L.P.	New York	NY	22,204

2005 Fees to Managers (Non-Budget Appropriation) *continued*

Cliffwood Partners, LLC	Los Angeles	CA	960,764
CRA Real Estate Securities	Radnor	PA	1,398,119
Eastern Retail Holdings, LP	Radnor	PA	296,768
Forest Investment Associates	Atlanta	GA	2,093,255
Goldman Sachs & Co. (Whitehall V and VI)	New York	NY	43,503
Goldman Sachs & Co. (Whitehall VII and VIII)	New York	NY	65,984
Goldman Sachs & Co. (Whitehall V-S and VI-S)	New York	NY	10,698
Heitman Capital Management, Inc.	Chicago	IL	301,368
LaSalle Advisors Limited	Baltimore	MD	4,580,677
Legg Mason Real Estate Advisors, Inc.	Radnor	PA	3,705,549
Lowe Enterprises Investment Management, Inc.	Los Angeles	CA	7,012,586
Lubert Adler Management II	Philadelphia	PA	119,017
Lubert Adler Management III	Philadelphia	PA	293,240
Lubert Adler Management IV	Philadelphia	PA	375,000
Miller Global Fund III, L.P.	Denver	CO	2,828
Oaktree Capital Management - Fund A	New York	NY	139,452
Oaktree Capital Management - Opportunity Fund II	New York	NY	42,260
Oaktree Capital Management - Opportunity Fund III	Los Angeles	CA	312,196
Oxford Real Estate Advisors, Inc.	Pittsburgh	PA	328,192
Prudential Senior Housing Partners I	Atlanta	GA	56,848
Prudential Senior Housing Partners II	Atlanta	GA	165,210
Rockpoint Real Estate Fund I	Dallas	TX	313,962
Rockpoint Real Estate Fund II	Dallas	TX	225,822
Sentinel Corporation	New York	NY	680,083
Starwood Opportunity - Fund IV	Greenwich	CT	142,471
Starwood Opportunity - Fund V	Greenwich	CT	282,186
Starwood Opportunity - Fund VI	Greenwich	CT	624,940
Starwood Opportunity - Fund VII	Greenwich	CT	443,036
Trust Company of the West - Fund VI	Los Angeles	CA	3,940,270
UBS Realty Investors	Hartford	CT	1,951,173
Urdang Investment Management	Plymouth Meeting	PA	240,535
Westbrook Real Estate L.P. - Fund II	New York	NY	73,886
Westbrook Real Estate L.P. - Fund III	New York	NY	265,810
Westbrook Real Estate L.P. - Fund IV	New York	NY	362,211
Westbrook Real Estate L.P. - Fund V	New York	NY	357,967
<u>Venture Capital</u>			
Abingworth Bioventures IV L.P.	London	UK	500,000
Accel Europe	Princeton	NY	250,000
Adams Capital Management - Fund II	Sewickley	PA	660,000
Adams Capital Management - Fund III	Sewickley	PA	660,000
Advanced Technology Ventures- Fund VI	Waltham	MA	225,000
Advanced Technology Ventures- Fund VII	Waltham	MA	607,500
Alloy Ventures 2002	Palo Alto	CA	610,782
APA Excelsior - Fund VI	King of Prussia	PA	805,000
Apex - Fund V	Chicago	IL	450,000
Atlas Venture - Fund IV	Boston	MA	318,245
Atlas Ventures - Fund V	Boston	MA	753,300

2005 Fees to Managers (Non-Budget Appropriation) *continued*

Atlas Ventures - Fund VI	Boston	MA	558,000
Austin Ventures - Fund VIII	Austin	TX	492,467
Bachow Investment Partners - Fund III	Bala Cynwyd	PA	82,465
Birchmere Ventures Fund III	Pittsburgh	PA	203,925
Charles River - Fund XI	Waltham	MA	196,508
Clearstone Venture Partners IIIA	Santa Monica	CA	603,450
Cross Atlantic Technology Fund	Radnor	PA	295,511
Cross Atlantic Technology - Fund II	Radnor	PA	575,751
Draper Fisher Jurvetson - Fund VI	Redwood City	CA	200,000
Draper Fisher Jurvetson - Fund VII	Redwood City	CA	500,000
Draper Triangle Capital Fund	Pittsburgh	PA	350,000
Draper Triangle Capital Fund II	Pittsburgh	PA	240,000
Edison Ventures - Fund III	Lawrenceville	NJ	206,278
Fairview Capital - Fund I	Farmingham	CT	99,004
Fairview Capital - Fund II	Farmingham	CT	74,696
Frazier Healthcare - Fund III	Seattle	WA	297,096
Frazier Healthcare - Fund IV	Seattle	WA	600,000
Frazier Healthcare - Fund V	Seattle	WA	641,524
Grotech Partners - Fund V	Timonium	MD	481,480
Halpern Denny & Co- Fund II	Boston	MA	603,497
Halpern Denny & Co - Fund III	Boston	MA	469,038
Harbourvest Partners, LLC - Fund VI	Boston	MA	1,999,984
Harbourvest Partners, LLC - Fund VII	Boston	MA	733,518
Healthcare Ventures - Fund V	Princeton	NJ	332,253
Healthcare Ventures - Fund VI	Princeton	NJ	492,779
Healthcare Ventures - Fund VII	Princeton	NJ	698,441
Healthcare Ventures - Fund VIII	Princeton	NJ	255,978
Highland Capital Partners - Fund VI	Boston	MA	545,505
I. P. - Fund II	Bellevue	WA	167,938
I. P. - Fund III	Bellevue	WA	40,817
Interwest Partners - Fund VIII	Menlo Park	CA	623,151
Interwest Partners - Fund IX	Menlo Park	CA	96,467
J. H. Whitney & Co. Equity Partners - Fund IV	Stamford	CT	200,000
J. H. Whitney & Co. Equity Partners - Fund V	Stamford	CT	75,066
JMI Equity Fund V	Wilmington	DE	251,445
JP Morgan Investment Management - Fund I	New York	NY	1,085,656
JP Morgan Investment Management - Fund II	New York	NY	1,100,000
Keystone Ventures - Fund IV	Philadelphia	PA	35,408
Keystone Ventures - Fund V	Philadelphia	PA	72,784
Kline Hawkes Pacific	Los Angeles	CA	296,037
Knightbridge Venture Capital Fund VI	Bartlesville	OK	197,943
Meritech Cap Partners - Fund II	Menlo Park	CA	208,520
Mid-Atlantic Venture - Fund III	Bethlehem	PA	225,300
Mid-Atlantic Venture - Fund IV	Bethlehem	PA	752,055
Morgenthaler Partners	Cleveland	OH	588,844
New Enterprise Associates - Fund VI	Baltimore	MD	156,172
New Enterprise Associates - Fund VII	Baltimore	MD	187,367

2005 Fees to Managers (Non-Budget Appropriation) *continued*

New Enterprise Associates - Fund IX	Baltimore	MD	166,528
New Enterprise Associates - Fund X	Baltimore	MD	153,498
New Enterprise Associates - Fund XI	Baltimore	MD	179,065
Nova Vita	Radnor	PA	150,026
Oak Investment Partners	Westport	CT	424,825
PA Early Stage Fund III	Wayne	PA	200,000
Patricof & Co. Ventures Inc.- P/A Fund I	King of Prussia	PA	240,000
Patricof & Co. Ventures Inc.- P/A Fund III	King of Prussia	PA	1,687,496
Pitango Venture Capital Fund IV	Herzbya	Israel	556,570
Polaris Venture Partners - Fund I	Seattle	WA	185,116
Polaris Venture Partners - Fund II	Seattle	WA	522,476
Polaris Venture Partners - Fund III	Seattle	WA	1,250,000
Polaris Venture Partners - Fund IV	Seattle	WA	1,250,000
Quaker BioVentures, L.P.	Greenville	DE	500,000
Sprout Group - Fund VII	New York	NY	84,756
Summit Accelerator	Boston	MA	158,936
Summit Partners - Fund IV	Boston	MA	221,714
Summit Partners - Fund V	Boston	MA	431,840
T Rowe Price	Baltimore	MD	668,263
TA Associates - Advent VII	Boston	MA	6,837
TA Associates - Advent VIII	Boston	MA	412,749
TA Associates - Advent IX	Boston	MA	962,756
Technology Leaders - TL Ventures III	Wayne	PA	37,390
Technology Leaders - TL Ventures IV	Wayne	PA	242,611
Technology Leaders - TL Ventures V	Wayne	PA	800,000
Three Arch Partners	Wayne	PA	500,000
Three Arch Partners IV	Wayne	PA	500,000
U.S. Venture Fund VII	Menlo Park	CA	151,169
U.S. Venture Fund VIII	Menlo Park	CA	513,604
Weston Presidio Capital - Fund III	San Francisco	CA	437,500
Weston Presidio Capital - Fund IV	San Francisco	CA	700,000
Weston Presidio Capital - Fund V	San Francisco	CA	65,753
Worldview Technology Partners	Palo Alto	CA	400,027

Alternative Investments

ABRY Mezzanine Partners, Inc.	Boston	MA	339,946
ABRY Broadcast Partners III	Boston	MA	148,333
ABRY Broadcast Partners IV	Boston	MA	326,721
ABRY Broadcast Partners V	Boston	MA	936,962
ABS Capital Partners III, L.P.	Baltimore	MD	442,741
ABS Capital Partners IV, L.P.	Baltimore	MD	611,055
ABS Capital Partners V, L.P.	Baltimore	MD	12,365
AG Capital Recovery Partners II, L.P.	New York	NY	22,132
AG Capital Recovery Partners III, L.P.	New York	NY	14,591
AG Capital Recovery Partners IV, L.P.	New York	NY	625,000
Alpha Private Equity Fund IV	Paris	FR	916,397
APAX Partners & Co. Germany - Fund II	Munich	GR	103,968
APAX Partners & Co. UK Ventures - Fund VI	London	UK	68,270

2005 Fees to Managers (Non-Budget Appropriation) *continued*

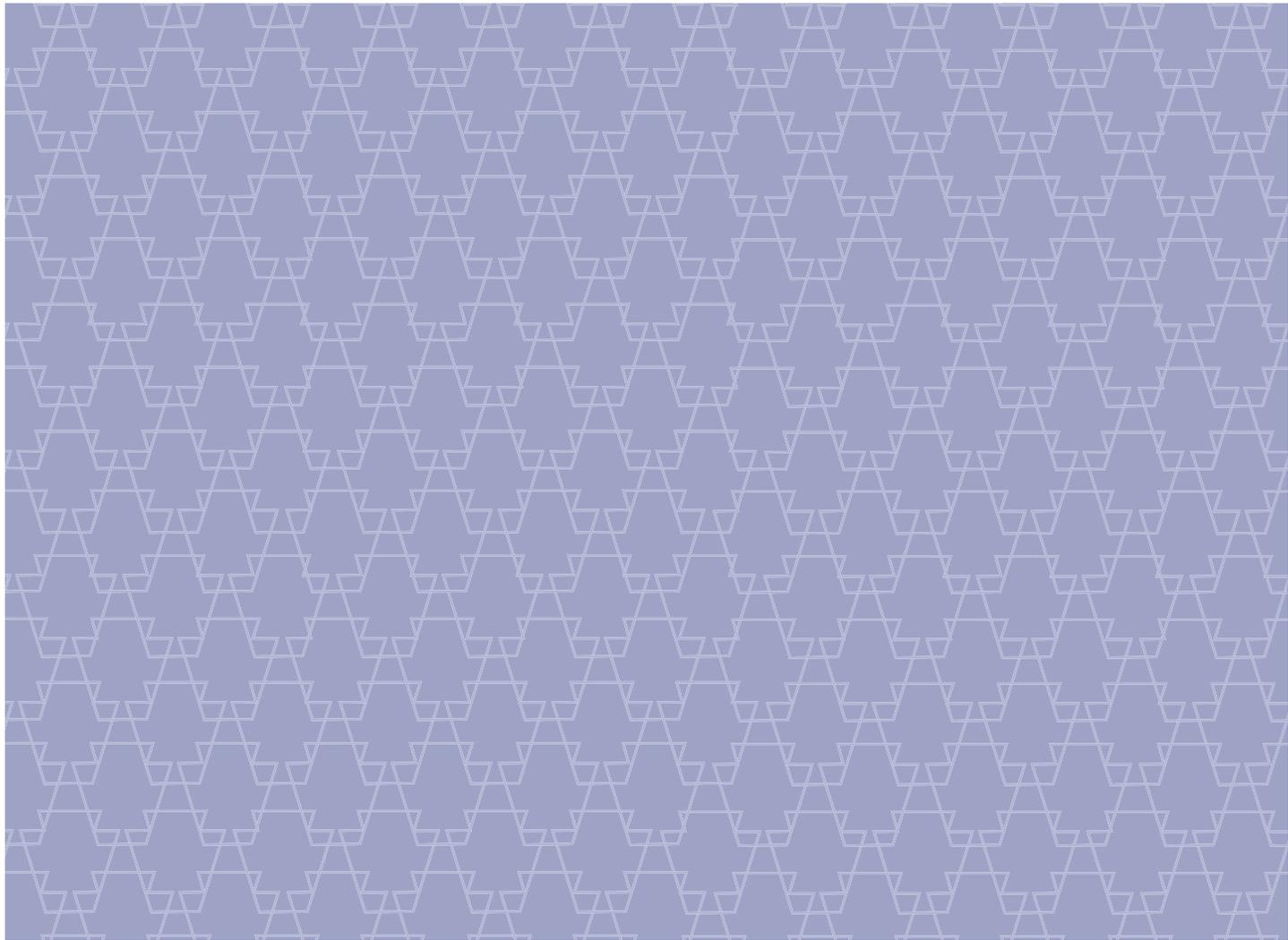
APAX Partners & Co. UK Europe - Fund IV	London	UK	485,638
APAX Partners & Co. UK Europe - Fund V	Munich	GR	657,976
APAX Partners & Co. UK Europe - Fund VI	London	UK	301,694
Apollo Management, L.P. - Fund IV	New York	NY	235,027
Asia Pacific - Fund III	San Francisco	CA	128,129
Audax Group	Boston	MA	694,655
Audax Private Equity Fund II	Boston	MA	294,706
Avenue Special Situation Fund III	Boston	MA	750,000
AXA Secondary Fund III - 1, L.P.	Channel Islands		520,000
AXA Secondary Fund III - 2, L.P.	Channel Islands		280,000
Bain Capital Inc. - Fund VII	Boston	MA	812,364
Bain Capital Inc. - Fund VIII-E	Boston	MA	90,480
BC European Capital - Fund VII	New York	NY	553,415
BC European Capital - Fund VII Top Up	New York	NY	158,242
Berkshire Fund VI	Boston	MA	408,608
Blackstone Communication Partners	New York	NY	237,913
Blackstone Group - Fund II	New York	NY	32,782
Blackstone Group - Fund III	New York	NY	31,056
Blackstone Group - Fund IV	New York	NY	11,879
Brynwood Partners V	Greenwich	CT	124,536
Cerberus Capital Management, L.P.	New York	NY	191,985
Cerberus Capital Management, L.P. - Series II	New York	NY	295,818
Cerberus Capital Management, L.P. - Series III	New York	NY	525,000
Charterhouse Equity Partners - Fund III	New York	NY	646,247
Charterhouse Equity Partners - Fund VII	New York	NY	977,909
Clayton, Dubilier & Rice V	New York	NY	48,877
Code, Hennessy & Simmons L.P. Fund III	Chicago	IL	182,027
Code, Hennessy & Simmons L.P. Fund IV	Chicago	IL	781,835
DLJ Merchant Banking - Fund II	New York	NY	94,346
DLJ Merchant Banking - Fund III	New York	NY	709,294
Electra European Fund II	London	UK	298,166
Elevation Partners	Menlo Park	CA	583,924
Energy Spectrum Partners Fund IV	Dallas	TX	880,952
Eureka II	Yardley	PA	252,106
First Reserve Fund X	Greenwich	CT	334,589
Francisco Partners	San Francisco	CA	554,413
Frontenac Company - Fund VII	Chicago	IL	480,000
Golder, Thoma, Cressey & Rauner- Fund V	Chicago	IL	80,849
Golder, Thoma, Cressey & Rauner- Fund VII	Chicago	IL	567,790
Golder, Thoma, Cressey & Rauner- Fund VIII	Chicago	IL	913,541
Great Hill Partners	Boston	MA	532,813
Great Hill Partners - Fund II	Boston	MA	752,969
Gryphon Partners - Fund II	San Francisco	CA	48,811
Gryphon Partners - Fund III	San Francisco	CA	255,233
HarbourVest International Private Equity Partners - Fund II	Boston	MA	195,140
HarbourVest International Private Equity Partners - Fund III	Boston	MA	360,000
HarbourVest International Private Equity Partners - Fund IV	Boston	MA	392,484

2005 Fees to Managers (Non-Budget Appropriation) *continued*

Hellman & Friedman - Fund III	San Francisco	CA	57,659
Hellman & Friedman- Fund V	San Francisco	CA	1,200,000
Invemed Catalyst Fund	New York	NY	99,412
JP Morgan US Corporate Fin. Inst. Inv. II	New York	NY	450,000
JW Childs Equity Partners III	Boston	MA	693,052
Kelso & Company - Fund V	New York	NY	50,703
Kelso & Company - Fund VII	New York	NY	623,810
Landmark Partners Inc. - Fund IV	New York	NY	21,654
Landmark Partners Inc. - Fund V	New York	NY	16,906
Leeds Weld Equity Partners IV, L.P.	New York	NY	553,673
Lexington Capital Partners - Fund II	New York	NY	167,574
Lexington Capital Partners - Fund III	New York	NY	160,406
Lexington Capital Partners - Fund V	New York	NY	575,767
Lexington Capital Partners - Fund VI	New York	NY	201,591
Lime Rock Partners III	Westport	CT	252,441
Lime Rock Resources	Westport	CT	174,247
LLR Equity Partners	Philadelphia	PA	456,038
LLR Equity Partners II	Philadelphia	PA	500,000
Madison Dearborn Capital Partners - Fund I	Chicago	IL	54,375
Madison Dearborn Capital Partners - Fund II	Chicago	IL	244,548
MatlinPatterson Global Opportunities Partners L.P.	New York	NY	437,500
MatlinPatterson Global Opportunities Partners II L.P.	New York	NY	398,651
Media/Communications Partners - Fund III	Boston	MA	280,652
Media/Communications Partners - Fund IV	Boston	MA	159,652
Media/Communications Partners - Fund V	Boston	MA	524,522
Meridian Venture Partners II	Radnor	PA	1,124,854
Newbridge Asia III	San Francisco	CA	117,048
Newbridge Asia IV	San Francisco	CA	246,393
Nordic Capital V, L.P.	Channel Islands		772,883
Oakhill Capital Management Inc.	Menlo Park	CA	189,431
Oaktree Capital Management, LLC - Opportunities Fund I	Los Angeles	CA	6,111
Oaktree Capital Management, LLC - Opportunities Fund II	Los Angeles	CA	51,862
Oaktree Capital Management, LLC - Opportunities Fund III	Los Angeles	CA	82,028
Oaktree Capital Management, LLC - Opportunities Fund IV	Los Angeles	CA	122,932
Oaktree Capital Management, LLC - Opportunities Fund V	Los Angeles	CA	579,670
Oaktree Capital Mgt, LLC - Principal Opportunities Fund	Los Angeles	CA	61,775
Oaktree Capital Mgt, LLC - Principal Opportunities Fund II	Los Angeles	CA	306,011
OCM/GFI Power Opportunities II	Los Angeles	CA	131,415
Palamon Capital Partners, L.P.	London	UK	241,450
Palamon European Equity Fund II	London	UK	395,931
Parthenon Investments II	Boston	MA	333,634
Providence Equity Partners IV	Providence	RI	123,408
Permira European - Fund I	London	UK	320,554
Permira European - Fund II	London	UK	893,138
Permira European - Fund III	London	UK	1,348,225
Permira UK - Fund IV	London	UK	169,354
RRZ Capital Group Inc. - Private Equity Fund	Pittsburgh	PA	500,000

2005 Fees to Managers (Non-Budget Appropriation) *continued*

SCP Private Equity Partners - Fund II	Wayne	PA	500,000
Shoreview Capital Partners	Minneapolis	MN	791,243
Sterling Capital Partners	Northbrook	IL	272,629
Sterling Capital Partners II	Northbrook	IL	74,271
Summit Partners - Venture VI	Boston	MA	412,106
Trust Company of the West - Special Credits V	Los Angeles	CA	1,124,897
Thomas Lee Company - Equity IV	New York	NY	152,449
TPG Partners L.P. Fund II	Fort Worth	TX	27,758
TPG Partners L.P. Fund IV	Fort Worth	TX	46,377
UMS Partners I	Philadelphia	PA	100,000
Vestar Capital Partners - Fund III	New York	NY	178,082
Vestar Capital Partners - Fund IV	New York	NY	1,654,566
Vestar Capital Partners - Fund V	New York	NY	45,804
	TOTAL		231,170,777

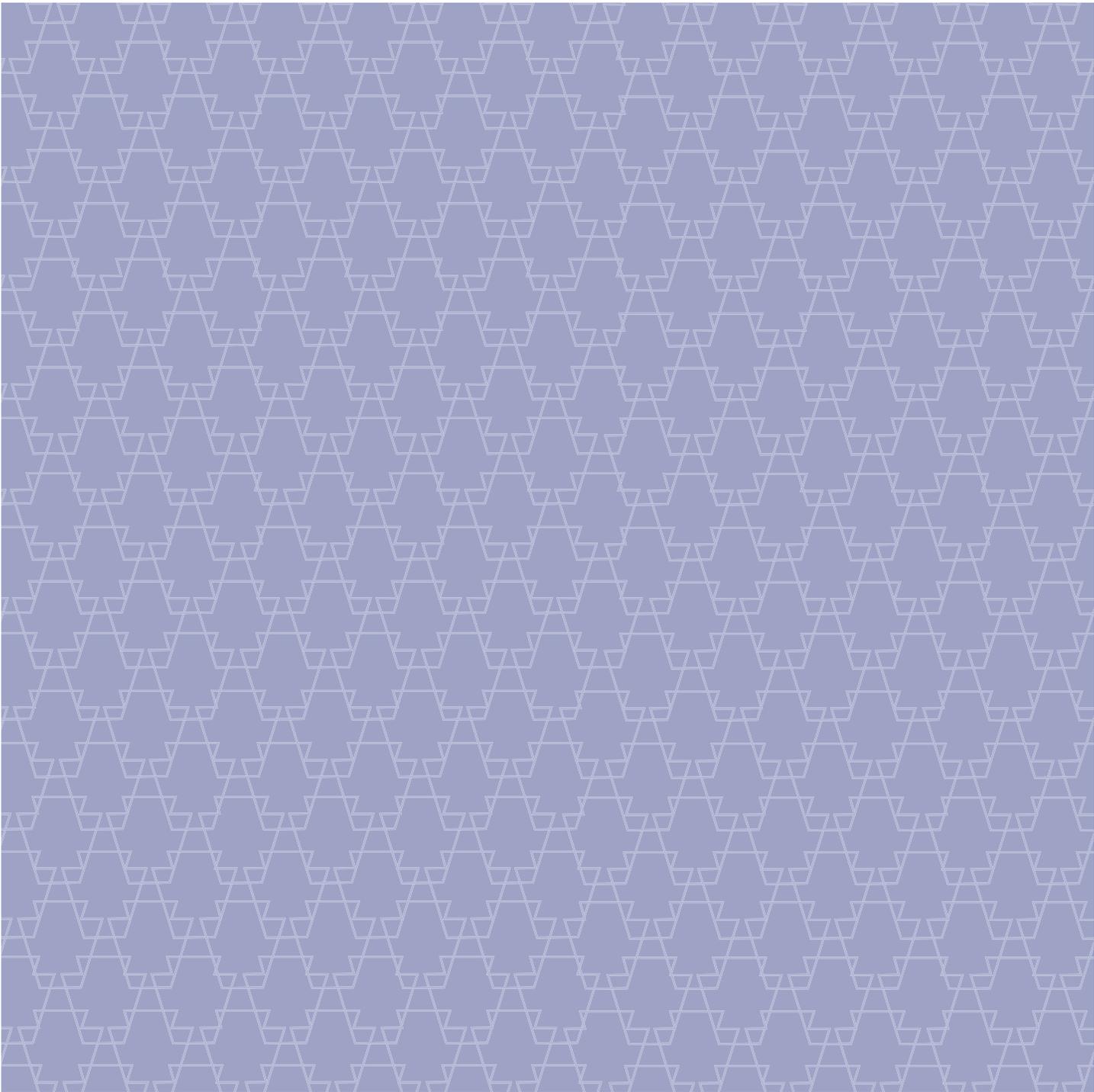


Directed Commissions



Directed Commissions

	FY 2005-06 Budget	FY 2006-07 Budget
<i>Revenue</i>		
Beginning Balance	\$2,548,085	\$2,298,085
Directed Commissions	<u>750,000</u>	<u>750,000</u>
Total Available	\$3,298,085	\$3,048,085
<i>Investment Consultants Expenses</i>		
	<u>\$1,000,000</u>	<u>\$1,000,000</u>
Ending Balance	\$2,298,085	\$2,048,085



Member Services and Demographics

Member Services

The Bureau of Member Services provides a variety of services to SERS active members and annuitants. Following are lists of services provided through the seven Regional Retirement Counseling Centers.

Services to Active Members

- Calculate retirement and vesting estimates upon request
- Make counseling available to member beneficiaries and survivors
- Conduct Question & Answer, Pre-Retirement and Vestee Seminars
- Serve as a resource speaker to groups
- Conduct research, provide estimates and counsel new members on multiple-service and creditable state and non-state service purchases
- Provide information on eligibility for state health benefits

Services to Retired Members

- Provide direct-deposit forms, federal income tax withholding forms, beneficiary forms and change-of-address forms
- Process change of dependent information for Retired Employees Health Program coverage
- Serve as a resource speaker for groups
- Receive and process notification of annuitant death and serve as contact for beneficiaries and survivors
- Receive and process notification of the death of or divorce from a designated survivor
- Provide counseling on change of monthly annuity, when applicable

Regional Retirement Counseling Centers

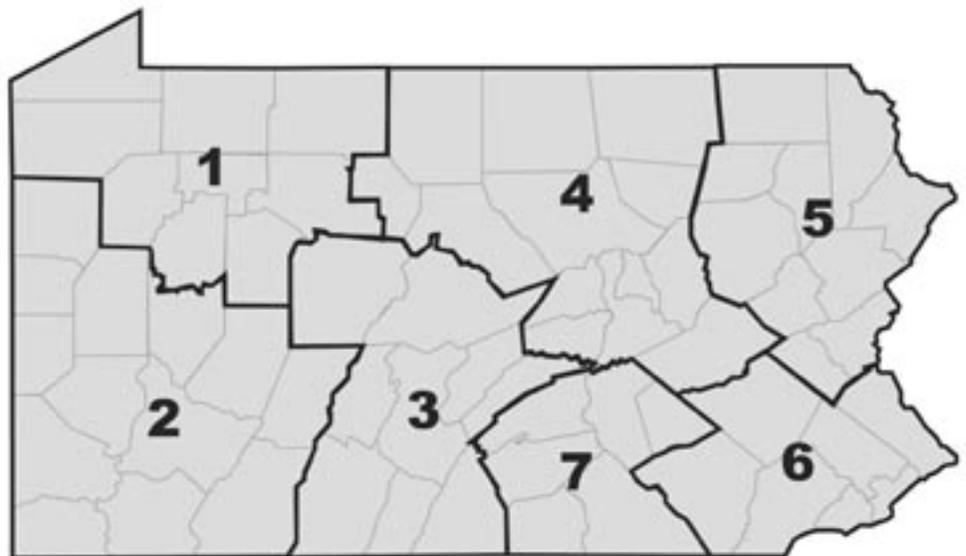
Region 1 Seneca Office Serving Clarion, Crawford, Elk, Erie Forest, Jefferson, McKean, Venango and Warren counties.

Region 2 Pittsburgh Office Serving Allegheny, Armstrong, Beaver, Butler, Cambria, Fayette, Greene, Indiana, Lawrence, Mercer, Somerset, Washington, and Westmoreland counties.

Region 3 State College Office Serving Bedford, Blair, Centre, Clearfield, Franklin, Fulton, Huntingdon, Juniata, Mifflin counties, and active members who are employees of Shippensburg University of Pennsylvania in Cumberland County.

Region 4 Montoursville Office Serving Bradford, Cameron, Clinton, Columbia, Lycoming, Montour, Northumberland, Potter, Schuylkill, Snyder, Sullivan, Tioga and Union counties.

Region 5 Hazleton Office Serving Carbon, Lackawanna, Lehigh, Luzerne, Monroe, Northampton, Pike, Susquehanna, Wayne and Wyoming counties.

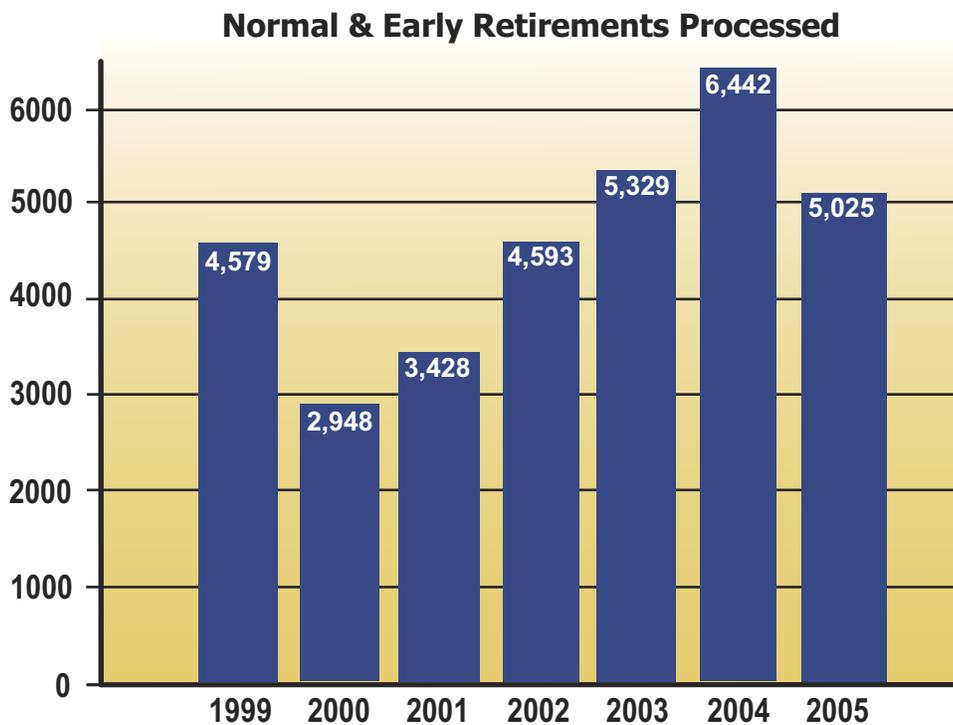
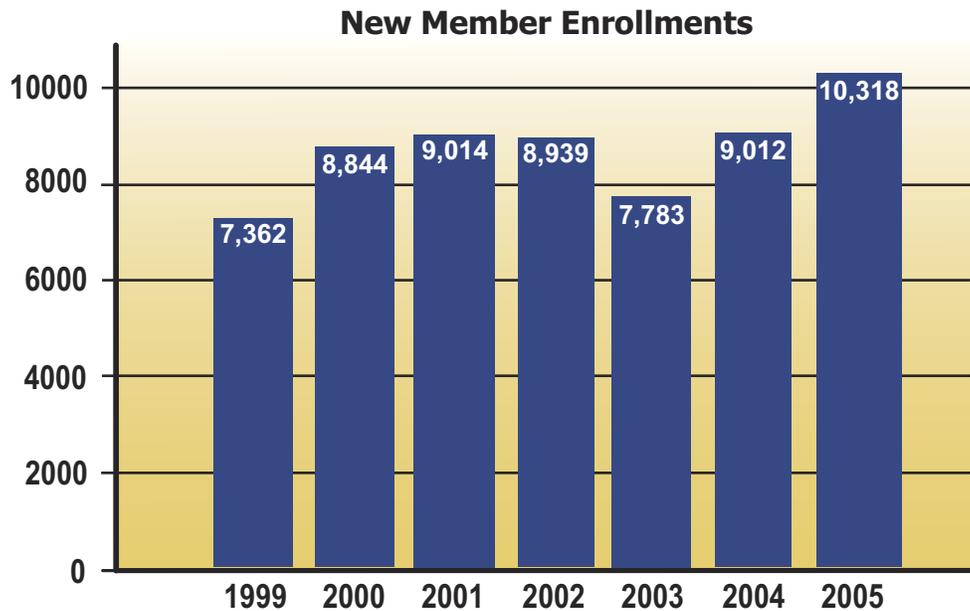


Region 6 Bensalem Office Serving Berks, Bucks, Chester, Delaware, Lancaster and Montgomery counties and Philadelphia.

Region 7 Harrisburg Office Serving Adams, Cumberland (except active members who are employees of Shippensburg University of Pennsylvania), Dauphin, Lebanon, Perry and York counties.

Benefit Processing

The following charts illustrate the work of the bureau of Member Services and Benefit Administration in member counseling and processing of benefit payments to members and their beneficiaries and survivors. Included are the numbers of new member enrollments and normal and early retirements processed in 1999 through 2005.



SERS Member Demographics

Year Ending December 31	Total Members	Active Employees	Annuitants & Beneficiaries
2005	211,140	109,981	101,159
2004	207,132	108,405	98,727
2003	203,430	109,018	94,412
2002	202,287	111,059	91,228
2001	198,933	109,716	89,217
2000	197,861	109,469	88,392
1999	196,078	108,035	88,043
1998	194,727	108,893	85,834
1997	194,141	108,684	85,457
1996	194,008	110,922	83,086
1995	193,841	112,637	81,204
1994	194,955	114,120	80,835

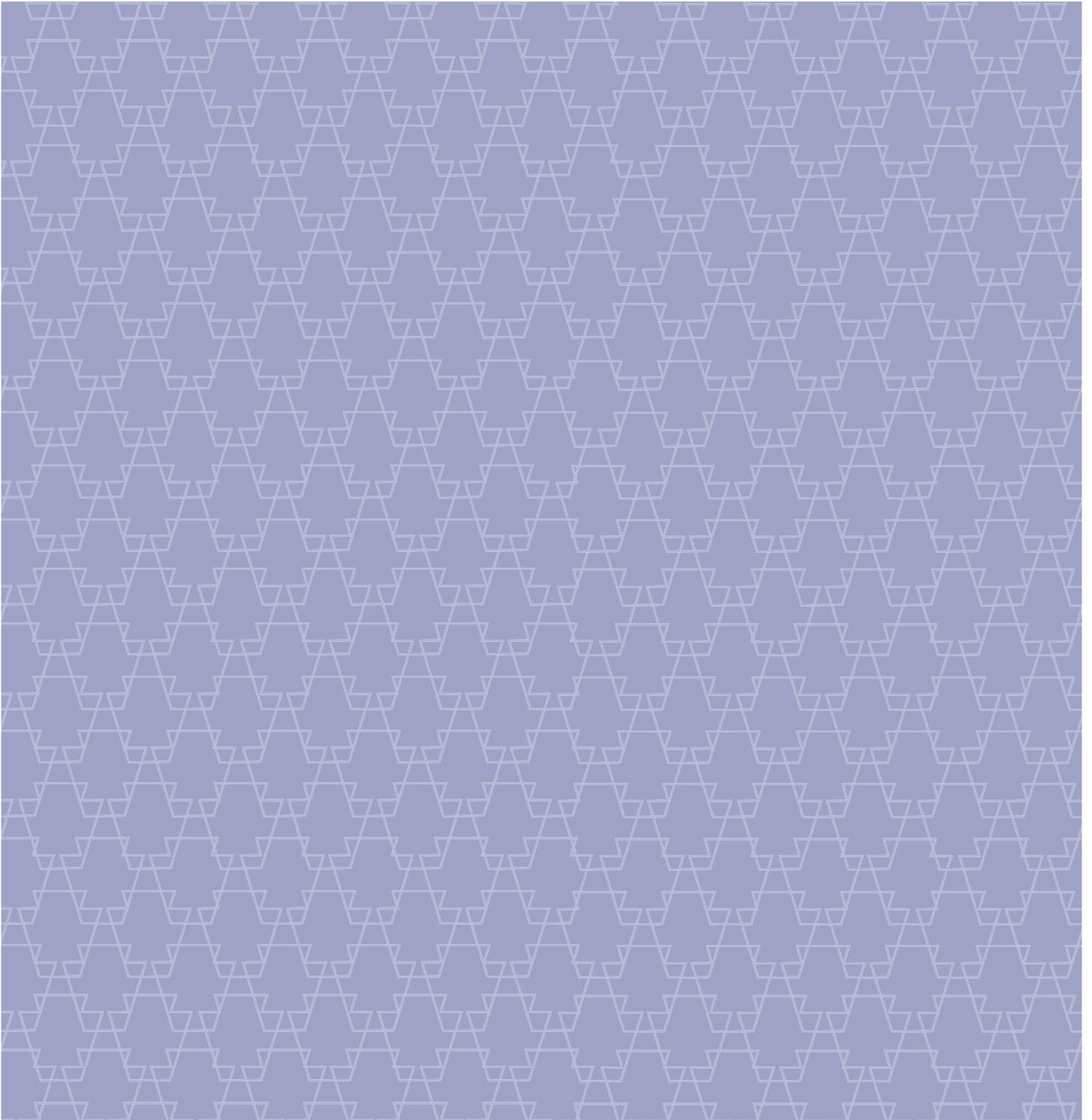
Active Employee Age and Service (as of December 31, 2005)

Average Age:	46.26
Average Years of Service:	12.86

Profile of Annuitants, Beneficiaries and Survivor Annuitants as of December 31, 2003, 2004 and 2005

	Average Age			Average Annual Pension		
	2003	2004	2005	2003	2004	2005
Superannuation Annuitants	73.9	73.5	73.3	\$17,192	\$18,414	\$19,372
Early Retirees	60.4	60.6	60.9	\$12,006	\$12,966	\$13,408
Disabled Annuitants	59.9	60.0	60.1	\$11,466	\$11,989	\$12,333
Beneficiary/Survivors	75.3	75.1	74.9	\$7,072	\$7,549	\$7,981

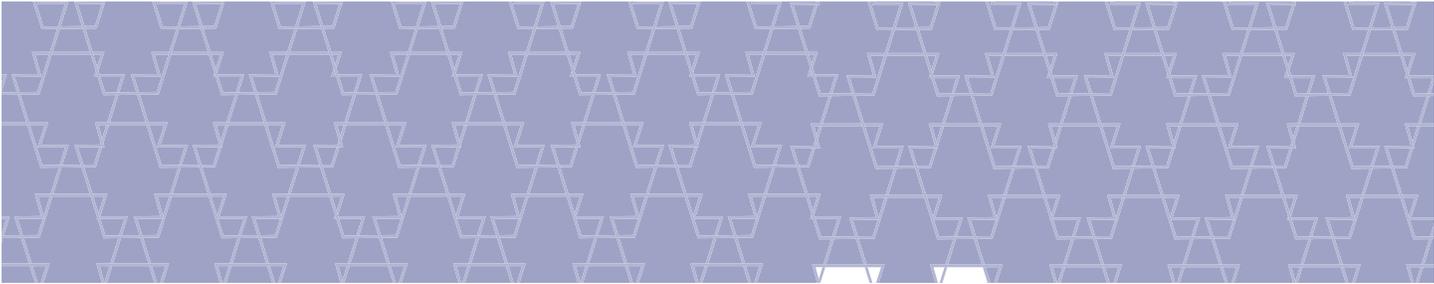
Legislation



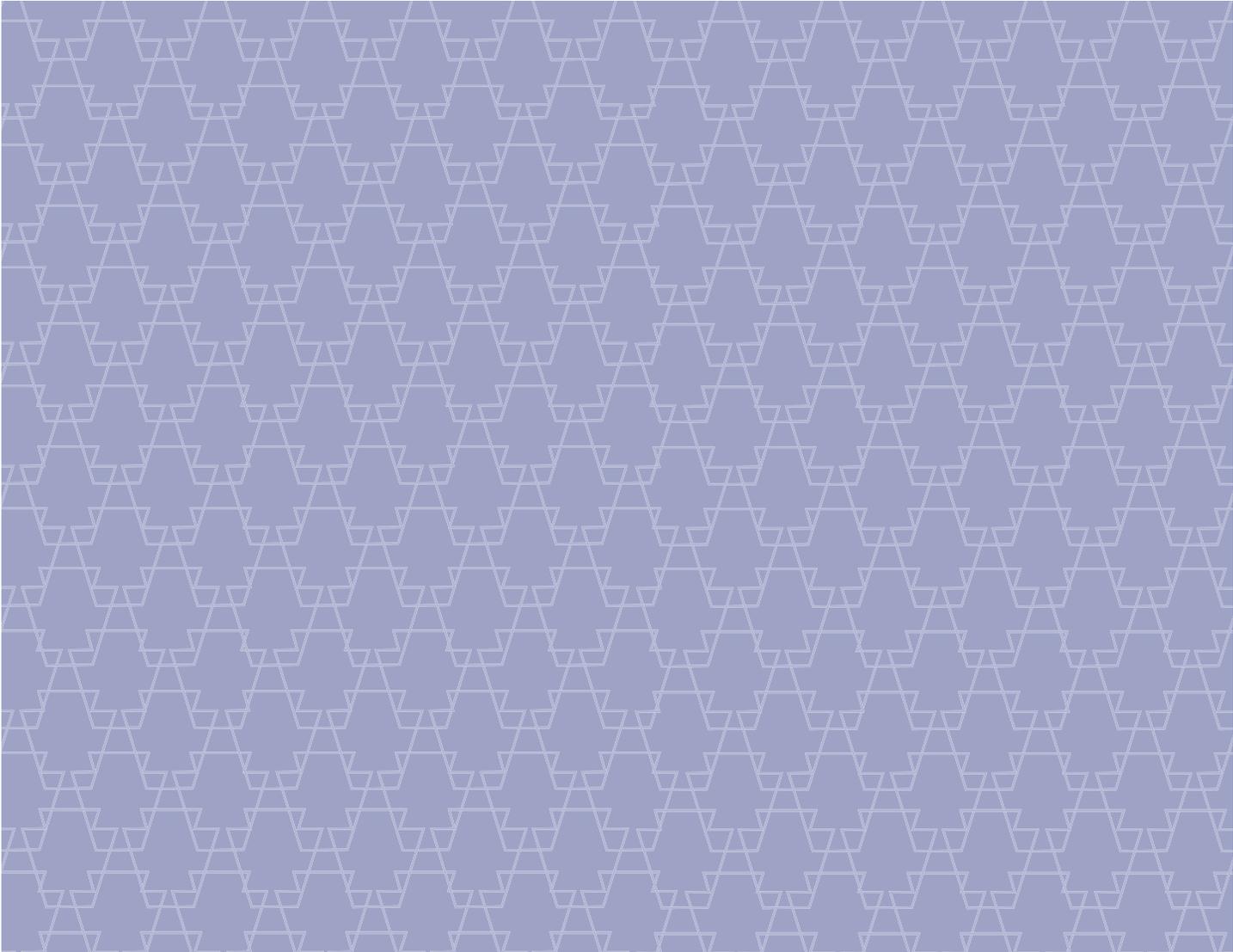
Legislation

Legislation Enacted During 2005

No amendments to the Retirement Code (Title 71) became law during 2005. The Legislature did adopt HB 603, granting "enforcement officers" status to Game Commission officers, but that bill was vetoed by Governor Rendell.



Funding Process and Actuarial Status



Funding Process & Actuarial Status

February 17, 2005

SERS administers a defined benefit plan (Retirement Fund), which, by statute, is funded through three sources: (1) investment earnings, (2) employer contributions, and (3) employee contributions. This report summarizes the actuarial processes SERS applies to the Retirement Fund, focusing on the investment earnings and employer contributions sources. It concludes with an explanation of supplemental annuity ("Cost Of Living Adjustment" or "COLA") funding. See illustration *Sources of SERS' Funding* on page 30.

What is a Defined Benefit Pension Plan?

A *defined benefit* pension plan provides benefits that are determined by a fixed benefit formula that takes into account the employee's length of service, age and compensation, and a legislatively determined accrual rate. Actuarial calculations are used to establish the amount of contributions required to provide those benefits. The law that created SERS, the State Employees' Retirement Code (Retirement Code), provides that the Commonwealth of Pennsylvania must guarantee payment of SERS benefits.

In contrast, the Commonwealth's Deferred Compensation plan (Internal Revenue Code Section 457 plan) is a *defined contribution* plan, which provides supplemental benefits based on the member's account balance at retirement or time of distribution. Participation in the Deferred Compensation plan is voluntary, and employers do not contribute to it. While this report primarily discusses the funding of SERS' defined benefit plan, you will find additional information on the Deferred Compensation plan in Tab 12.

Actuarial Process

The ultimate cost of the Retirement Fund is determined by the total benefits to be paid to retired employees throughout their lives and to beneficiaries of deceased members. This cost cannot be precisely determined prospectively because the commencement and duration of benefits for active employees and the duration of future benefit payments for retirees are uncertain. Therefore, pension cost determinations are based on actuarial assumptions and actuarial cost methods, which are used to establish total cost and assign that cost to periods of time. For example, the amortization period of actuarial gains and losses is established by statute. Actuarial assumptions, gains and losses vary over time and have a significant impact on the determination of an appropriate rate.

To provide a basis for predicting future costs, SERS' actuary reviews economic and demographic experience over five-year periods. That experience is used to develop actuarial assumptions about future salary growth, investment returns, and demographic factors such as rates of retirement and death.

On an annual basis, the actuary conducts a valuation of the Retirement Fund. Based upon the latest member demographic data, the actuary determines the value of expected future obligations and compares it to the value of the Retirement Fund's assets. Based on this valuation, the actuary recommends employer contribution rates to the State Employees' Retirement Board (Board). The Retirement Code vests the Board with the authority to establish the employer contribution rates, and the Board uses the annual actuarial valuation to do so.

Interrelationship of Funding Sources

The framers of the Retirement Code designed SERS as a system that, to remain financially sound, would require regular funding each year from each of the three sources shown at right: employees, employers and investment earnings. Currently, most employees contribute 6.25% of salary, a rate set by statute. The currently assumed annual rate of return on investments is 8.5% (an assumption adopted by the SERS Board based on advice from the staff, investment consultant and actuary). The “normal” employer contribution rate - the amount employers would pay if the assumed rate of return and all other actuarial assumptions proved to be precisely correct - is approximately 8.3% of payroll.

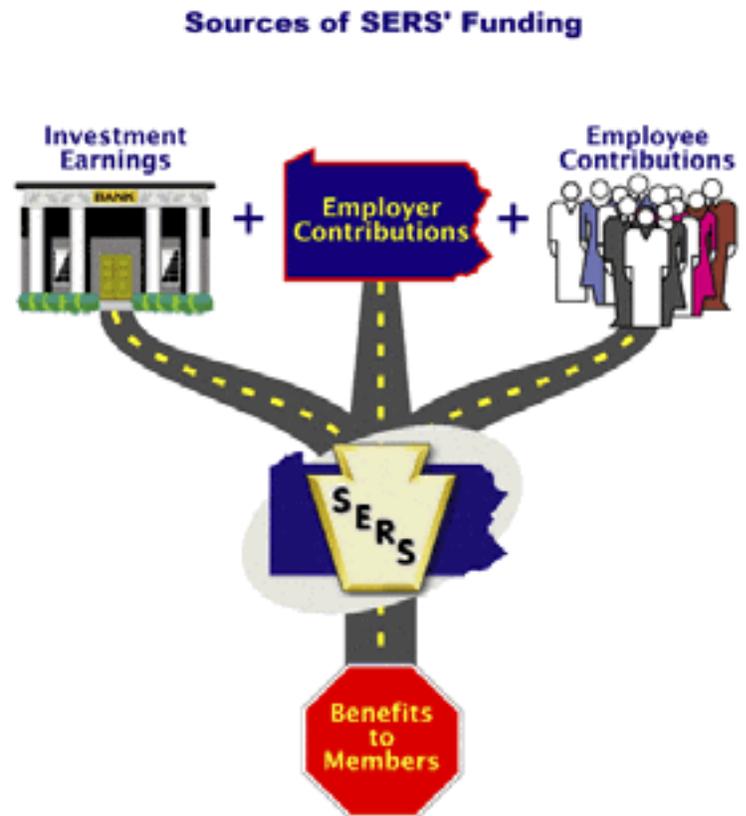
Obviously, however, it is beyond the power of the Board to know in advance how much investments will earn in any given year. Actual returns can vary widely; in fact, it is highly unlikely that the investment returns will precisely match the assumed return in any given year. The Retirement Code recognizes this reality and deals with it by creating a linkage between investment earnings and employer contributions. It does so by requiring the SERS Board to adjust the employer contribution rate each year based on actual investment returns and actuarial experience: When investment earnings exceed the 8.5% actuarially assumed return, the Board may be able to reduce the employer contribution rate. Conversely, when investment earnings fall short of assumptions, the Board may find it necessary to increase the employer contribution rate. Since the employee rate is fixed by statute, it does not change from year to year, regardless of investment gains or losses. The employer share, however, can and does vary widely. As discussed below, the employer share has recently been as low as zero but is projected to approach 25% after 2012. See *illustration History of SERS' Employer Contribution Rates on page 33*.

Funding Source 1: Investment Earnings

From 1995 through 1999, the Retirement Fund experienced investment rates of return ranging from a low of 15.4% to a high of 25.2%, and earned its best ever five-year annualized return of close to 19%. SERS also posted strong returns over the past three years, with earnings of 24.3%, 15.1% and 14.9% for 2003, 2004 and 2005 respectively. See *illustration SERS Investment Performance on page 31*. Those returns significantly exceeded the actuarially assumed returns.

In order to smooth out fluctuations in the market value of assets, which could otherwise result in volatile year-to-year changes in employer contribution requirements, SERS and its actuary rely upon the actuarial value of assets (not the market value) for funding calculations. Over a 5-year period, the Actuarial Value of Assets gradually recognizes the differences between total investment return and the assumed annual rate of return. During the past 10 years, the Retirement Fund earned a compounded rate of return of 10.2%, exceeding the actuarially assumed rate of return, which has been 8.5% per year since 1995.

By allocating the investment rate of return over a 5-year period, SERS recognizes only 20% of the asset gain/loss (the difference between the actual return and the actuarial assumption at 8.5%), which occurred during the year immediately preceding the actuarial valuation date, with the remainder to be recognized (at an additional 20%

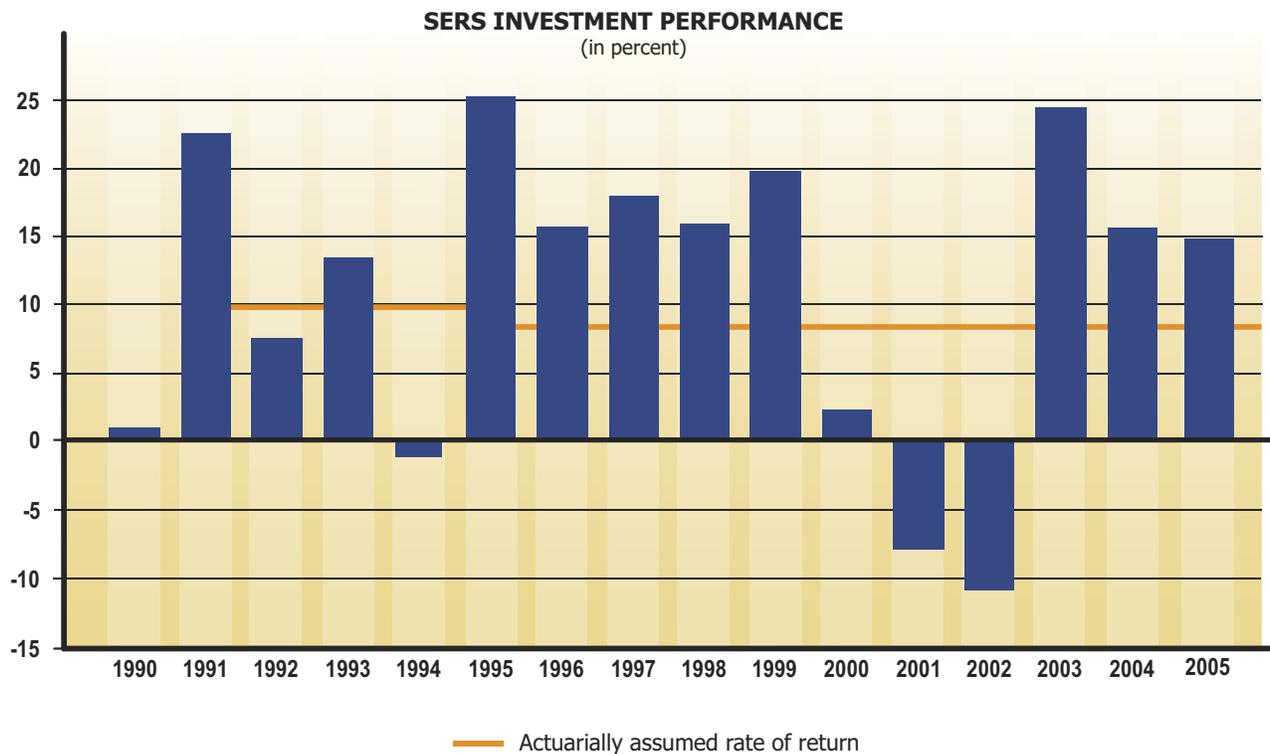


per year) over the following four years. As a result, when investment earnings trends change, there is a delayed effect on employer contribution rates.

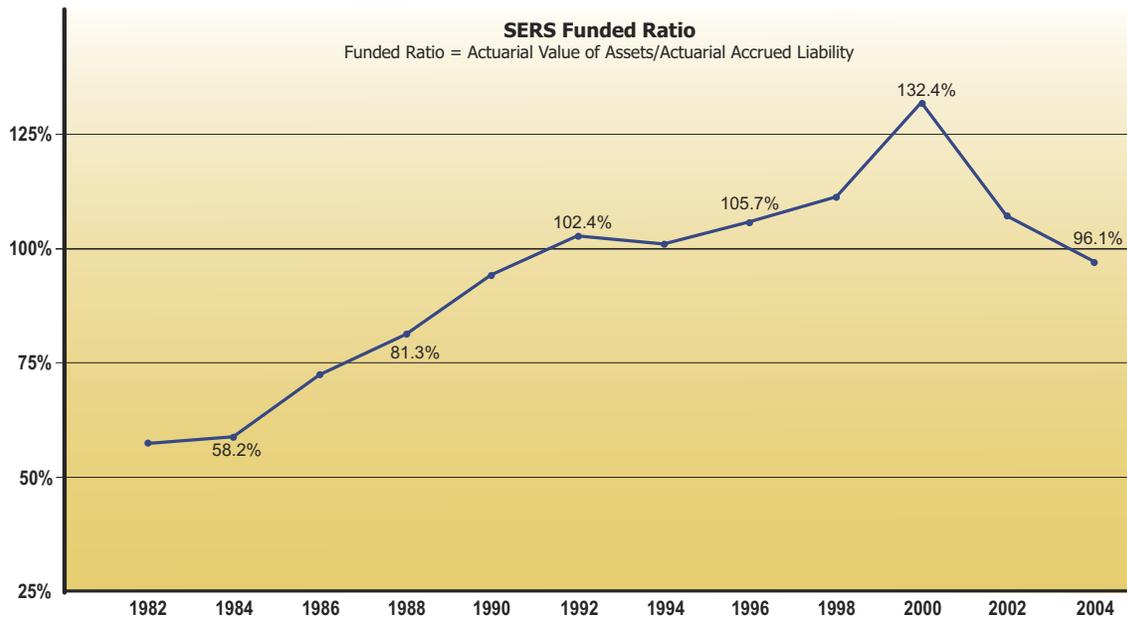
Funded Position

The funded position of the Retirement Fund is measured by its Funded Ratio -- the Actuarial Value of Assets, divided by the Actuarial Accrued Liability. The most recent actuarial valuation of December 31, 2004, reflects that the Retirement Fund was 96.1% funded. That makes SERS one of the best-funded state pension plans in the nation. By way of comparison, the Wilshire Associates "2005 Wilshire Report on State Retirement Systems" a compilation of 2004 data on 64 state retirement plans, found that the average funding level of the 64 plans was just 83%.

The 96.1% funded ratio for 2004 marks the first time since 1992 that SERS has been less than fully funded. The decline to less than fully funded status was expected and resulted from a combination of less favorable investment earnings in 2000, 2001, and 2002, and Act 2001-9, which significantly increased the Retirement Fund's actuarial accrued liabilities. See illustration *SERS Funded Ratio* on page 32.



- The System has used an actuarially assumed rate of return of 8.5% since 1995.
- During the past 10 years, the Retirement Fund earned a compounded rate of return of 10.2%, significantly higher than the actuarially assumed rate of return, which has been 8.5% per year since 1995.
- As losses from the 2000-2002 period amortize into the rate calculation, employer contribution rates are expected to increase.
- SERS employs a five-year averaging method to recognize investment gains and losses.
- SERS has exceeded the actuarially assumed rate of return for 13 of the past 20 years.



Funding Source 2: Employer Contributions

The Board establishes the employer contribution rate annually, based upon the actuary's recommendation. The employer contribution rate is expressed as a percentage of payroll. Different service classifications of SERS members require different contribution rates.

The total Employer Contributions are made up of two parts - the Normal Cost and a contribution for the Unfunded Actuarial Liability (UAL), if any. The Normal Cost is the cost of SERS benefits to be earned in the coming year. Currently, the Normal Cost is 8.25%. The Unfunded Actuarial Liability (UAL) is the amount of the Actuarial Accrued Liability in excess of the Actuarial Value of Assets. In theory, if the UAL were zero, and all of the actuarial assumptions turned out to be correct, and there were no amendments to the Retirement Code, the Normal Cost contributions would be sufficient to fund the liabilities for all participants. However, the Normal Cost alone usually will not fund the Retirement Fund's total liabilities. The total liabilities that will not be funded by future Normal Cost is the Actuarial Accrued Liability.

The UAL is amortized, that is, funded in installments. The Retirement Code was modified in 2003 and now requires amortization payments to be in equal dollar annual installments over a period of 30 years. Act 2003-40 changed the funding period for most, but not all, of SERS' actuarial liabilities from 10 years to 30 years, effectively spreading out the payment of SERS' costs and liabilities. In essence, Act 2003-40 refinanced the pension mortgage from a 10-year term to a 30-year term. The Act also set a series of floor contribution rates. Employers are paying the floor rate of 3% this fiscal year. The floor rate for 2006-07 is 4%.

Act 2003-40 changed the amortization schedule in a way that was intended to reduce employer contributions over a 10-year period by approximately \$5 billion, while maintaining the employer rate in single digits through 2011. That was achieved at the cost of what are expected to be sharp increases in the employer rate in later years, beginning with what amounts to a "balloon payment" in 2012. The increase is necessitated by financing costs and the opportunity loss in not having the contribution monies available to invest and compound in the immediate period.

Since 1992 the UAL amortization part of the employer contribution has been a credit. This credit has served to offset a portion of the Employer Normal Cost contribution otherwise required, resulting in Total Employer Contributions below the level of Employer Normal Costs. With even more favorable investment experience after 1992, this UAL amortization credit gradually increased, ultimately reaching a level in the year 2000 where it exceeded the Employer Normal Cost. Thus, for fiscal 2001-2002 the employer contribution rate for Class A Members was, for the first time ever, zero. The rate remained at zero for the 2002-03 fiscal year.

SERS employers save money in every year in which the employer rate is below the Employer Normal Cost. Over the past decade, SERS employers, and Pennsylvania taxpayers, have saved more than \$2 billion as a result of SERS' actual

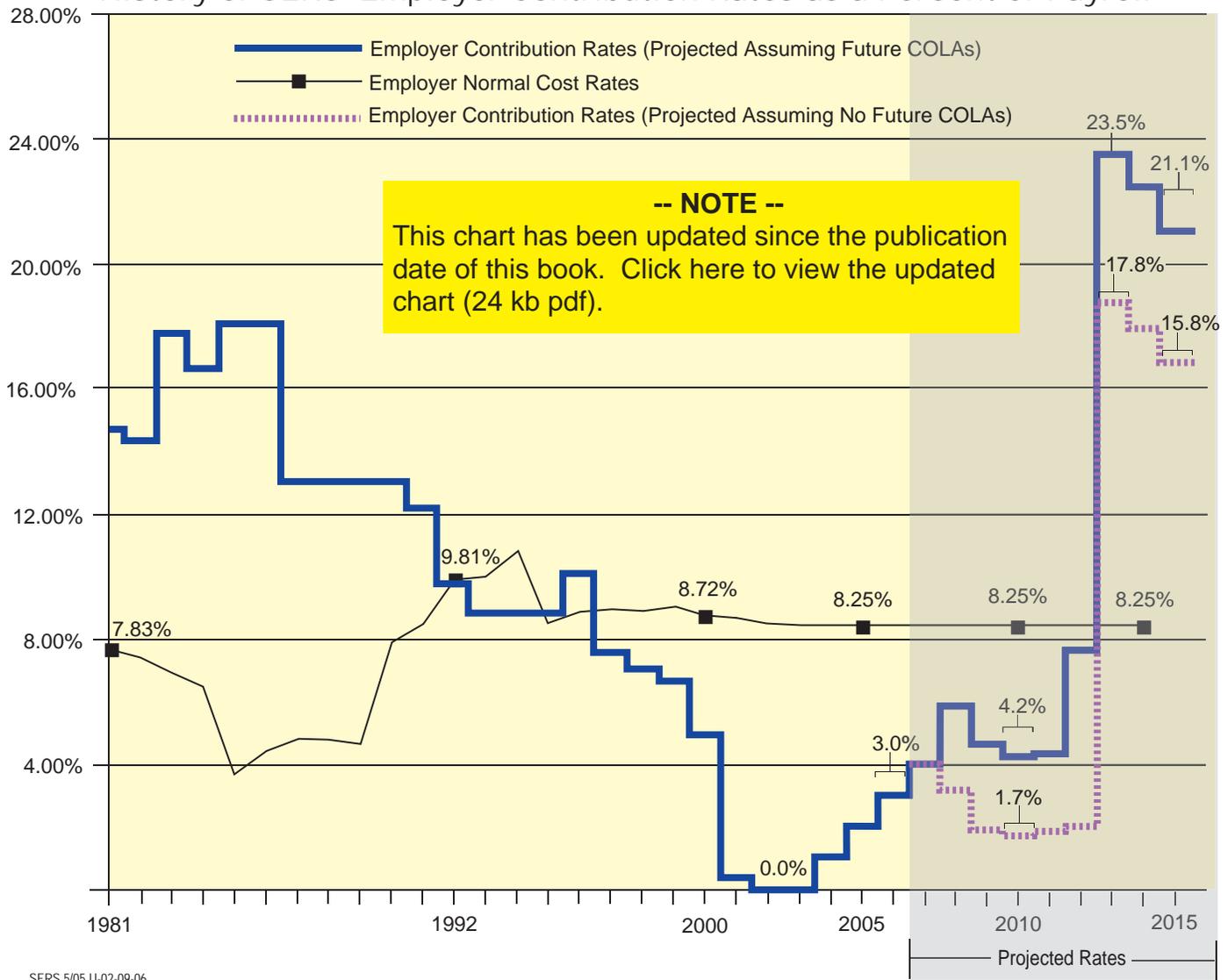
employer contribution rates being consistently below the Employer Normal Cost. See illustration *History of SERS' Employer Contribution Rates* below.

See Appendix on page 36, which demonstrates the components of the employer contribution rate and associated increases and decreases.

Employer Contribution Provisions

- Employer contributions to SERS represent the Normal Cost to fund the Retirement Fund and payments to fund the Unfunded Actuarial Liability.
- As a result of strong investment performance, the employer contribution rate was reduced to 0.0% in the 2000 and 2001 Actuarial Reports.
- The Commonwealth has saved more than \$2 billion over the past decade because the actual employer rate has been held below the Employer Normal Cost, even dropping to zero for two years.
- The employer rate is expected to rise and may escalate above 20% in 2012 and remain above 10% until 2034.

History of SERS' Employer Contribution Rates as a Percent of Payroll



Per Act 2003-40, the floor contribution rates require a minimum employer contribution of 3% for fiscal year 2005-06 and 4% for fiscal year 2006-07.

Among the many SERS benefit costs that the actuary values each year is the cost of the Retirement Code's Option 4. Under Option 4, a retiring SERS member may elect to receive a refund of all or part of that member's accumulated deductions (employee contributions plus 4% statutory interest) and also receive a reduced annuity based on the remaining value of the member's retirement account. Election of Option 4 increases the cost to the Retirement Fund because the refund is calculated at 4% interest whereas it is assumed that, if the accumulated deductions were left in the Retirement Fund, they would earn 8.5% interest. Approximately 80% of retirees choose the Option 4 refund.

Funding Source 3: Employee Contributions

The simplest component of the funding scheme is employee contributions. Pursuant to the Retirement Code, SERS members pay a statutorily determined contribution rate. Most SERS members contribute to the Retirement Fund at the rate of 6.25% of their gross compensation. Commonwealth employees made approximately \$310 million in contributions in 2005.

- SERS active members pay a fixed percentage of compensation.
- By law, Class AA members contribute 6.25% of pay.
- Member contributions are, by statute, credited with 4% annual interest and are recorded for each individual member and reported on the member's annual Statement of Account.

Explanation of SERS Supplemental Annuities ("Cost of Living Adjustments" or "COLAs")

The Retirement Code contains procedures, definitions, and actuarial requirements for calculating benefits. The Retirement Code does not provide for an automatic annual inflation-based COLA as Social Security does. Instead, the Legislature has from time to time voted to grant increases in benefits for retirees. While commonly referred to as "COLAs," these supplemental annuities (as they are properly known) are not dictated by any inflation-based formula. The amount and structure of each supplemental annuity is entirely within the discretion of the Legislature, and each requires new legislation. Also, because the Retirement Code does not provide for advanced funding or actuarial reserves for COLAs, COLAs historically have been funded after they have been granted. COLAs are paid from future employer contributions.

Over the past 30 years, the Pennsylvania General Assembly has legislated eight general COLAs effective in 1968, 1974, 1979, 1984, 1989, 1994, 1998, and 2002/2003. Generally, the amount of the COLA has been determined by a formula that accounts for years of service, years in retirement, and inflation since the previous COLA.

COLAs generally have been given to retirees who have reached either their normal retirement ("superannuation") age, (60 for most classes but 50 for some) or the age at which the member would have been credited with 35 eligibility points (or 30 eligibility points for "30 and Out" retirees), and all disabled retirees. COLAs are payable to early retirees once they reach superannuation age. The Pennsylvania Constitution prohibits paying COLAs to beneficiaries of deceased members or survivor annuitants.

COLAs increase the Retirement Fund's liabilities (as a result of the increases in benefits paid to members). However, the usual SERS funding mechanism does not provide a source from which to pay for the increased benefits. Therefore, when the actuary determines the cost of a COLA, the liability for the COLA is established in SERS' Supplemental Annuity Account. Under current law, the COLA liability must be amortized over 10 years, with the amortization payments being included in the employer contribution rate. Thus, the money to pay for COLAs ultimately comes from increased future employer contributions.

Benefits to Members

- At retirement, SERS calculates the actuarial value of the annuity to be paid over the remaining life of the member and transfers the balance of the member's accumulated deductions and reserves from the State Accumulation Account into the Annuity Reserve Account to pay the lifetime benefit.
- The Annuity Reserve Account contains funds for all current retirees and beneficiaries based on the amount of the original benefit at retirement.
- No funds are in the Annuity Reserve Account to pay for future COLAs.

Payment Methods

Members may elect to take a lump sum withdrawal of accumulated deductions (Option 4) and receive a reduced retirement annuity.

Funding of Supplemental Annuities

- Because the Retirement Code does not provide for automatic COLAs or the necessary funding, each new supplemental annuity must be legislated individually.
- Every supplemental annuity or COLA enacted since 1968 required an amendment to the Retirement Code and added a new liability to the Retirement Fund.

Funding Process & Actuarial Status - Appendix

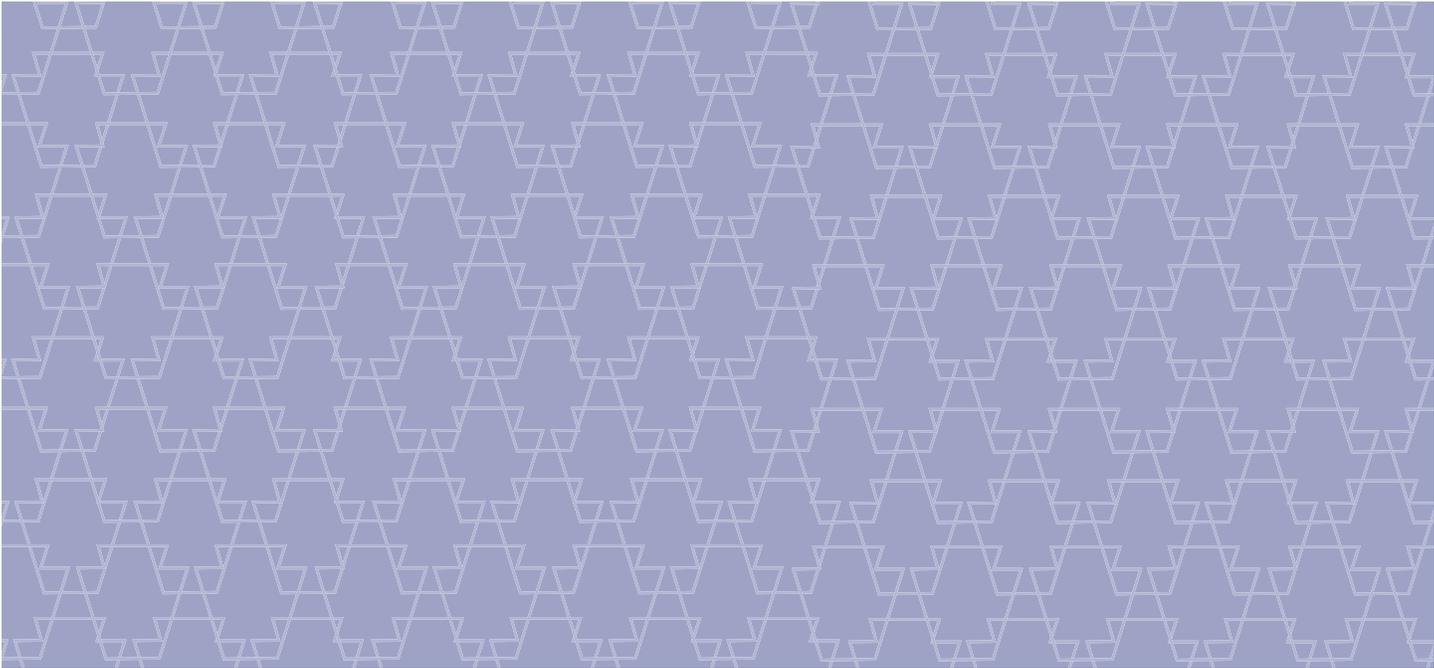
Analysis of the Change in Employer Contribution Rate from 1992 to 2004

Valuation Year (ending December 31)	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Employer Rate % (Beginning)	8.92	8.92	8.92	10.27	7.69	7.28	6.70	5.00	1.39	0.00**	0.00**	1.04	2.00***
Change in Employer Rate Due to:													
Investment Returns %	-1.04	-0.90	0.11	-0.75	-0.69	-1.40	-1.80	-3.18	-1.98	-0.27	3.60	3.18	2.51
• COLA %	-	-	0.67	-	-	0.82*	-	-	-	-	0.77	1.21	-
• Code Amendments %	0.53	-	-	0.72	-	-	-	-	-0.65	0.27	-	-2.00	-2.76
• Other Actuarial Experience %	0.51	0.90	0.57	-2.55	0.28	-	0.10	-0.43	-0.40	-1.75	0.06	-1.43	1.25
Employer Rate % (Ending)	8.92	8.92	10.27	7.69	7.28	6.70	5.00	1.39	0.00**	0.00**	1.04	2.00***	3.00***

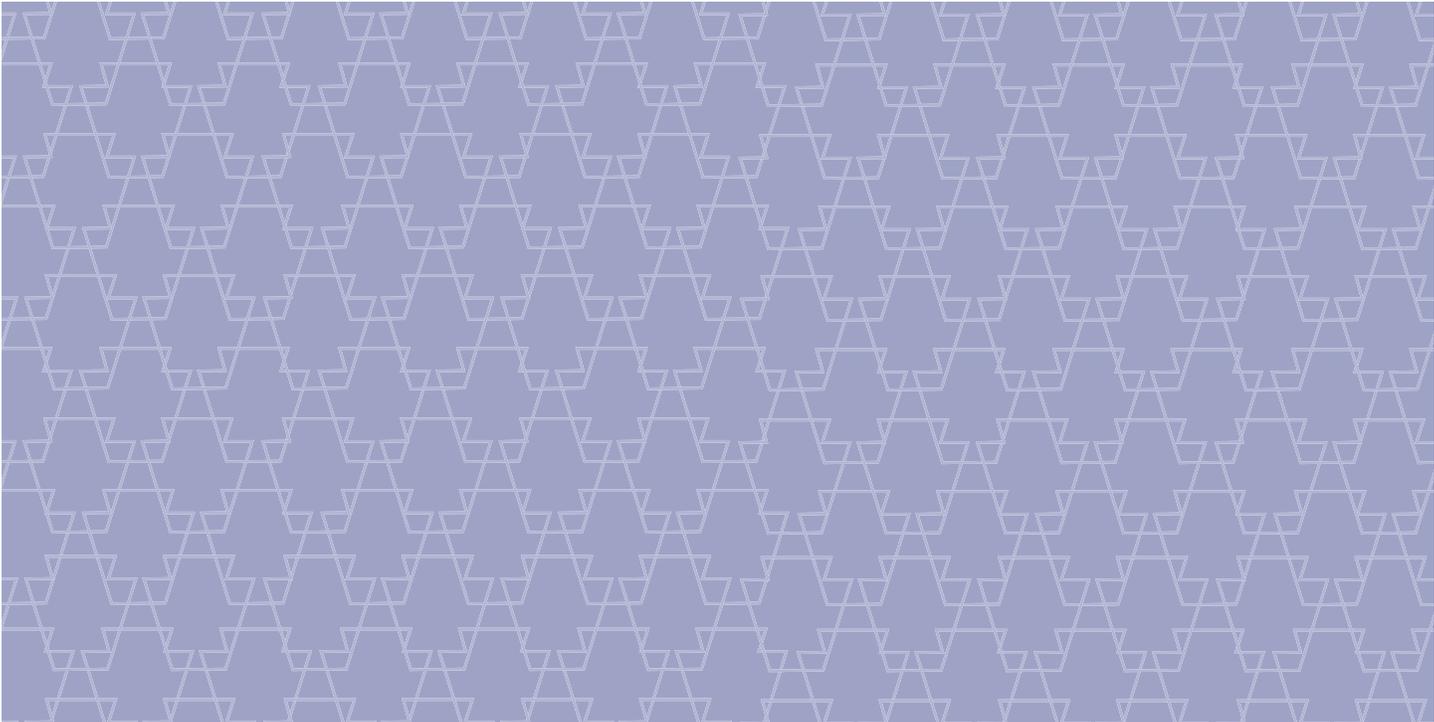
*COLA was passed in 1997 and effective in 1998

**The calculation produces a negative rate, with the actual rate implemented at 0.0%.

***Floor employer rate established by the Code



Investment Policy, Objectives and Performance



Investment Policy

The State Employees' Retirement Board adopted a formal Statement of Investment Policy in 1979. It has been revised periodically, principally to reflect and incorporate legislative changes governing investments. The purpose of the statement is to formalize the Board's investment objectives, policies, and procedures: to establish guidelines for the investment of Fund assets, and to define the duties and responsibilities of the various entities involved in the investment process. The major elements of the statement are:

- As fiduciaries, the Board will exercise that degree of judgment, skill and care under the circumstances then prevailing which persons of prudence, discretion and intelligence, who are familiar with such matters, exercise in the management of their own affairs in investment matters;
- The Fund's overall investment objective is to provide a total rate of return, over full economic cycles, which exceeds the return of a fully diversified market portfolio within each asset class. The Board seeks to meet this objective within acceptable risk parameters through adherence to a policy of diversification of investments by type, industry, quality and geographic location;
- The Board employs an investment staff and also contracts with investment advisors and consultants to provide expert, professional judgment in all investment decisions;
- An annual Investment Plan is prepared to control the allocation of funds during the year among investment advisors and categories of assets;
- Guidelines are established for each category of assets used by the Fund's investment advisors to provide a framework for monitoring quality, diversification and liquidity; and
- Where investment characteristics, including yield, risk and liquidity, are equivalent, the Board's policy favors investments which have a positive impact on the economy of Pennsylvania.

Investment Objectives

To assure an adequate accumulation of reserves in the Fund at the least cost to the citizens of the Commonwealth and to provide some protection against the erosion of principal by inflation, the long-term investment objectives of the Fund, are:

- Achieve a net total return equivalent to the actuarial rate of return assumption, or preferably in excess of this rate in order to improve the funded ratio of the Fund through investment earnings.
- Achieve in Domestic Stocks a total return that exceeds the total return of the Russell 3000 Index;
- Achieve in International Stocks a total return that exceeds the total return of the SERS Custom International Stock Index;
- Achieve in the Fixed Income asset class a total return that exceeds the total return of the SERS Fixed Income Custom Index;
- Achieve in the Equity Real Estate asset class a total return that exceeds the total return of the Townsend Stylized Benchmark;
- Achieve in the Cash asset class a total return that exceeds the total return on U.S. Treasury Bills (90 days);
- Achieve in the Venture Capital asset class a total return that exceeds the Cambridge Venture Capital Benchmark;
- Achieve in the Private Equity asset class a total return that exceeds the Cambridge Private Equity Benchmark.

Total return includes income and both realized and unrealized gains and losses and is computed on market value. The Board seeks to meet these objectives within acceptable risk parameters through adherence to a policy of diversification of investments by type, industry, investment manager style and geographic location.

Asset Allocation Trends

Prudent Person Investment Standards

The SERS Board investment authority is governed by the “prudent person” standard as set forth in Title 71, Pennsylvania Consolidated Statutes, Section 5931(a). Enactment of the “prudent person” standard in Act 1994-29 and the 2003 asset/liability study completed by Rocatton Investment Advisors and the SERS Investment Staff are the foundation of SERS’ “2006 Annual Five-Year Investment Plan.” With prudent person investment authority, SERS is able to pursue a broader array of investment opportunities that enhance the ability to achieve competitive rates of return while maintaining risk at acceptable levels. The asset/liability study demonstrated that the prudent application of this expanded authority should result in a more efficient portfolio that better serves the needs of SERS.

Total Fund Asset Allocation Trend: 2006 through 2010

SERS will implement the “Investment Plan” over a period of five years. Thus, the Fund’s asset allocation strategy will evolve over this timeframe until the long-term targets for each asset category are achieved by the end of the year 2010. The evolution of the asset allocation strategy is reflected in the table below.

2005		2006	2007	2008	2009	2010
55.1%	Stocks	56.5%	55.5%	52.5%	50.0%	47.0%
16.0%	Fixed Income	16.5%	16.5%	19.0%	21.5%	24.0%
6.8%	Real Estate	8.0%	8.0%	8.0%	8.0%	8.0%
12.6%	Alternative Investments	12.0%	13.0%	13.5%	13.5%	14.0%
7.4%	Inflation Protection	7.0%	7.0%	7.0%	7.0%	7.0%
2.1%	Cash	0.0%	0.0%	0.0%	0.0%	0.0%
100.0%		100.0%	100.0%	100.0%	100.0%	100.0%

Estimated Investment Performance*

Calendar Year Basis

through December 31, 2005 (net of fees)

Asset Class	1 Year Return	3 Year Return	5 Year Return	10 Year Return
Domestic Stocks	8.1%	18.6%	3.7%	10.0%
Russell 3000 Index ^{1/}	6.1%	15.9%	1.6%	9.0%
International Stocks	19.3%	26.5%	7.6%	9.7%
SERS Custom International Stock Benchmark (26% Hedged) ^{2/}	20.3%	27.7%	8.0%	7.2%
Fixed Income	4.9%	8.4%	7.4%	7.0%
SERS Custom Fixed Income Benchmark	4.0%	6.5%	6.8%	6.2%
Cash	2.9%	2.0%	2.3%	4.0%
90 day U.S. T-bills	3.1%	1.8%	2.3%	3.9%
Real Estate ^{3/}	30.9%	18.4%	13.3%	13.1%
Townsend Stylized Benchmark	20.6%	15.4%	12.1%	12.0%
Private Equity ^{3/}	36.5%	24.3%	8.4%	17.9%
Cambridge Private Equity Index	35.1%	22.0%	6.3%	15.2%
Venture Capital ^{3/}	8.3%	-3.5%	-16.0%	8.7%
Cambridge Venture Capital Index	11.5%	2.7%	-16.7%	20.4%
Inflation Protection ^{4/}	24.7%	21.9%	N/A	N/A
Inflation Protection Custom Index	24.5%	20.8%	9.6%	9.5%
Total Fund	14.9%	18.0%	6.2%	10.2%
Total Fund Benchmark	13.7%	16.7%	5.2%	9.0%

* Returns for periods longer than one year are annualized.

^{1/}The Domestic Stocks Benchmark is the Wilshire 5000 Index through 12/31/98, and the Russell 3000 thereafter.

^{2/}The International Stocks Composite and the Custom International Index were unhedged prior to 5/1/96.

^{3/}Results for the Real Estate, Private Equity, Venture Capital and Indices are lagged one quarter.

^{4/}Inflation Protection was initially funded in November, 2001.

Estimated Investment Performance*

Commonwealth Fiscal Year Basis

through June 30, 2005 (net of fees)

Asset Class	1 Year Return	3 Year Return	5 Year Return	10 Year Return
Domestic Stocks	9.4%	11.1%	0.5%	10.6%
Russell 3000 Index ^{1/}	8.1%	9.5%	-1.4%	9.9%
International Stocks	18.1%	13.2%	2.3%	8.5%
SERS Custom International Stock Benchmark (26% Hedged) ^{2/}	18.6%	14.6%	1.9%	6.0%
Fixed Income	10.0%	10.0%	7.9%	7.6%
SERS Custom Fixed Income Benchmark	8.4%	8.5%	7.2%	6.7%
Cash	1.8%	1.7%	2.6%	4.1%
90 day U.S. T-bills	2.2%	1.6%	2.6%	4.0%
Real Estate ^{3/}	14.8%	12.3%	10.9%	11.6%
Townsend Stylized Benchmark	14.6%	12.0%	11.4%	11.3%
Private Equity ^{3/}	24.2%	15.4%	4.1%	16.6%
Cambridge Private Equity Index	22.1%	12.9%	2.4%	14.4%
Venture Capital ^{3/}	1.8%	-11.2%	-16.2%	8.9%
Cambridge Venture Capital Index	11.6%	-6.2%	-15.1%	22.0%
Inflation Protection ^{4/}	22.0%	23.9%	N/A	N/A
Inflation Protection Custom Index	18.4%	22.9%	10.3%	10.5%
Total Fund	13.5%	11.4%	3.3%	10.1%
Total Fund Benchmark	13.4%	10.9%	2.4%	9.1%

* Returns for periods longer than one year are annualized.

^{1/}The Domestic Stock Benchmark was the Wilshire 5000 through 12/31/98, and the Russell 3000 thereafter.

^{2/}The SERS Custom International Stock Benchmark (26% Hedged) was unhedged prior to May 1, 1996.

^{3/}Results for the Real Estate, Private Equity, Venture Capital and Indices are lagged one quarter.

^{4/}Inflation Protection was initially funded in November of 2001.

Investment-Related Statistics

1980 - 2005

Year End	SERS Fund Market Value (\$ millions) ^{1/}	# of Investment Advisors	# of Portfolios	# of Consultants	Annual Fund Rate of Return
1980	\$2,689	3	3	3	5.3%
1981	2,817	5	6	3	0.9%
1982	3,730	6	7	4	27.8%
1983	4,396	14	17	4	13.0%
1984	4,922	22	24	4	9.4%
1985	6,157	23	26	3	23.1%
1986	7,120	30	34	3	15.2%
1987	7,367	37	42	3	3.3%
1988	8,312	41	49	3	12.8%
1989	9,785	47	59	4	17.8%
1990	9,886	53	65	4	1.0%
1991	11,940	56	68	4	22.6%
1992	12,453	66	79	4	7.4%
1993	13,701	61	80	4	13.2%
1994	13,330	78	100	4	- 1.1%
1995	16,343	81	103	4	25.2%
1996	18,492	96	126	4	15.9%
1997	21,312	112	154	4	18.0%
1998	24,123	99 ^{2/}	163	3	16.3%
1999	28,093	116	204	3	19.9%
2000	27,881	132	245	3	2.2%
2001	24,706	143	277	3	-7.9%
2002	20,880	149	289	3	-10.9%
2003	24,535	153	295	4	24.3%
2004	26,641	163	324	4	15.1%
2005	28,805	167	364	3	14.9%

*Audited except for the most recent year.

^{1/}Market values for Real Estate and Alternative Investments are lagged by one quarter adjusted for allocations and distributions. Market values also include non-investment receivables and payables.

^{2/}Restated in 1998 and thereafter to eliminate double counting of managers managing assets across asset classes.

Plan & Investment Class Rankings

as of September 30, 2005

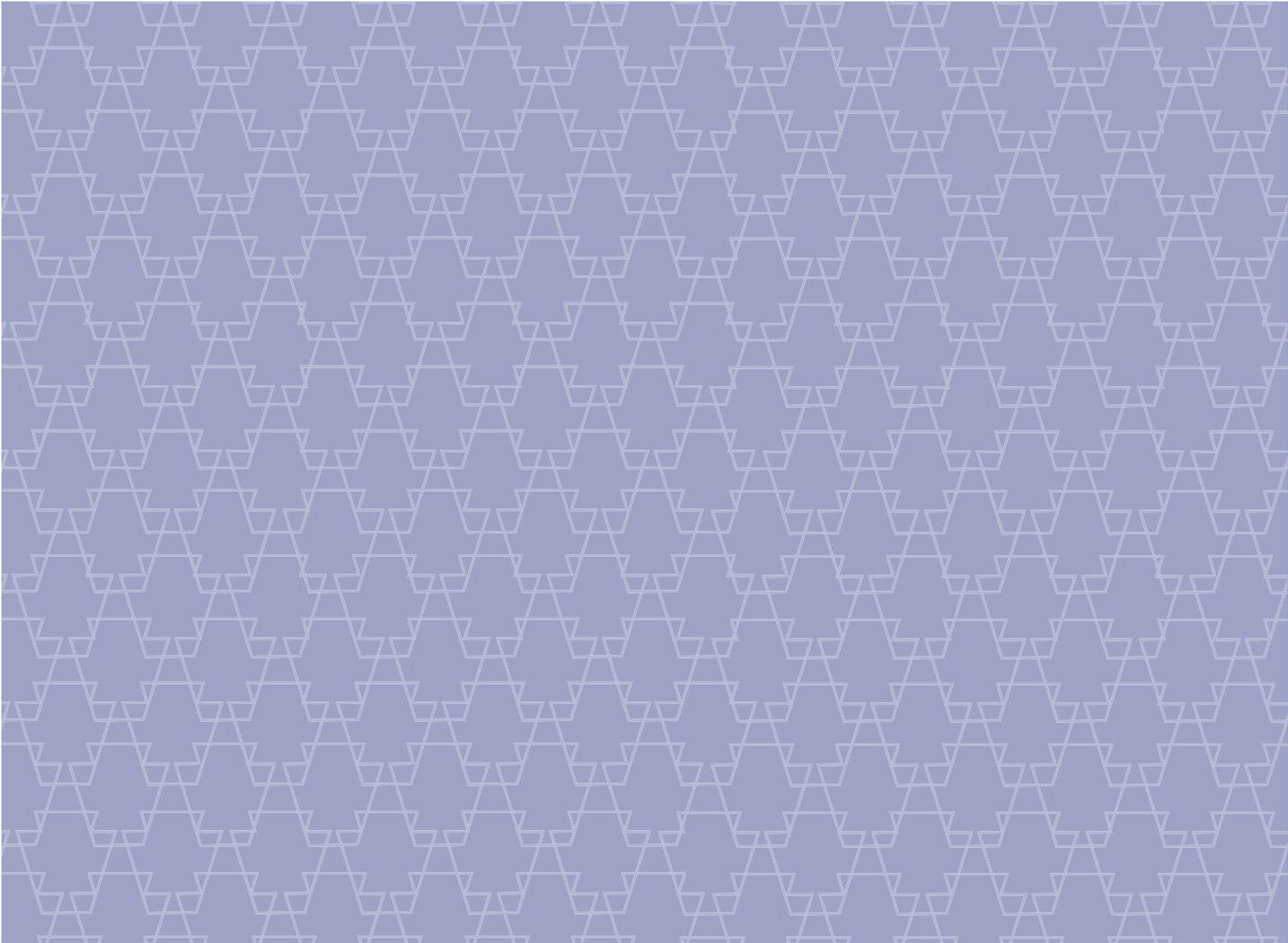
The January 23, 2006, edition of Pensions & Investments listed a ranking of U.S. pension plan sponsors according to total assets and amounts invested in various asset classes as of September 30, 2005. The survey results for the total SERS Fund (defined benefit plan plus the defined contribution plan), as well as for various asset classes are listed below.

Category	Amount (\$ mil)	Total Fund Rank	Public Fund Rank
SERS ^{1/}	\$29,818	38 th	25 th
Venture Capital ^{2/}	908	8 th	5 th
Private Equity ^{3/}	2,246	12 th	9 th
Real Estate (equity)	1,481	24 th	19 th

^{1/}The Pensions & Investments survey ranked plan sponsors according to the combined assets of their defined benefit and defined contribution plans.

^{2/}The Venture Capital data reflects only the market value of actual funded investments as of June 30, 2005. SERS also has outstanding unfunded commitments for the Venture Capital area that have been approved by our Board of Trustees. In total, SERS has made \$2,990.2 million in actual Venture Capital commitments through December 31, 2005.

^{3/}The Private Equity data reflects only the market value of actual funded investments as of June 30, 2005. SERS also has outstanding unfunded commitments for the Private Equity area that have been approved by our Board of Trustees. In total, SERS has made \$6,106.2 million in actual Private Equity commitments through December 31, 2005.



Investment Program Summary

as of Dec. 31, 2005



Investment Program Summary

as of December 31, 2005

SERS' assets are administered by the SERS Board. The Board has adopted an Investment Policy (Policy) that incorporates the provisions of the Retirement Code which govern the investment of SERS' assets. The Policy provides investment objectives and guidelines. An Investment Plan is reviewed and updated annually for strategic asset allocation purposes, as well as for diversification needs within each asset class.

Market Value as of December 31, 2005: SERS' assets had an unaudited market value of approximately \$28,805.2 million.

SERS Asset Allocation

Asset Class	Market Value (Unaudited)		2005 Target Allocation	Long-Term Target Allocation
	\$ (mil)	%		
Domestic Stocks	\$9,786.1	34.0%	35.0%	30.0%
International Stocks	6,028.1	20.9%	20.0%	17.0%
Currency Overlay	56.7 ^{1/}	0.2%	0.0%	0.0%
Fixed Income	4,619.8	16.0%	18.0%	24.0%
Cash	598.5	2.1%	0.0%	0.0%
Real Estate	1,968.8	6.8%	8.0%	8.0%
Alternative Investments	3,623.3	12.6%	12.0%	14.0%
Inflation Protection	2,123.9	7.4%	7.0%	7.0%
Total	\$28,805.2	100.0%	100.0%	100.0%

^{1/} The market value of the currency overlay represents amounts receivable (payable) due to changes in the underlying exchange rates of forward currency contracts. The contracts are used to hedge the effect of currency fluctuations in international stock holdings.

Number of Investment Advisors: SERS had 167 external investment advisory firms managing portfolios. There are 45 advisors in the public markets domain and 145 covered alternative investments and real estate. Sixteen of these advisors manage 39 portfolios across asset classes.

- 13 U.S. Stock advisors
- 13 International Stock advisors
- 2 Currency Overlay advisors
- 14 Fixed Income advisors
- 1 Cash advisor
- 2 Inflation Protection advisors
- 24 Real Estate advisors
- 53 Venture Capital general partners managing limited partnerships
- 68 Private Equity general partners managing limited partnerships

In addition, Board appointments included one U.S. stock advisor and one private equity general partnership.

Number of Investment Portfolios: SERS had 364 investment portfolios/accounts. Fifty-five of these accounts are public market investments, while 309 covered private markets.

- 17 U.S. Stock portfolios
- 18 International Stock portfolios
- 2 Currency Overlay portfolios
- 15 Fixed Income portfolios
- 1 Cash portfolio
- 2 Inflation Protection portfolios
- 49 Real Estate portfolios
- 108 Venture Capital limited partnership interests
- 152 Private Equity limited partnership interests

In addition, Board appointments included one U.S. stock portfolio, two real estate portfolios, one private equity limited partnership, and two venture capital limited partnerships.

Eighty-six investment advisors manage 283 portfolios within and across asset classes for SERS.

U.S. Stock Investments Summary

as of December 31, 2005

U.S. Stocks is one of eight major asset classes which SERS uses to diversify the investments of the Fund. SERS' investment plan diversifies stock investments while maintaining a reasonable risk posture relative to the benchmark. SERS contracts with external investment advisors to manage portfolios.

Policy: Stock investments are employed by the Fund primarily because their expected large return premiums versus inflation will, if realized, help preserve and enhance the real value of the Fund over long periods of time. The U.S. stock asset class is managed on a total return basis.

SERS' long term investment objective in the U.S. Stock asset class is to achieve a total return, net of fees, that exceeds the total return of the Russell 3000 Index.

Stock investments shall emphasize, but not be limited to, publicly traded securities which provide SERS with an equity interest in private sector concerns (e.g., common stock, preferred stock, convertible preferred stock, convertible bonds and derivative instruments providing stock like returns).

SERS' 2006 Investment Plan targets a long-term allocation of 30.0% of assets to U.S. Stocks. The U.S. stocks structure reflects the broad U.S. market in terms of capitalization (large, medium, small). SERS U.S. stock portfolio, in aggregate, will strive to reflect the risk characteristics of the Russell 3000 Index, which is a good proxy for the broad, investable U.S. market.

The large cap segment of the portfolio is benchmarked to the S&P 500 Index utilizing indexed, enhanced indexed and transportable alpha strategies including market neutral and funds-of-hedge funds. The remainder of the portfolio represents the medium and small capitalization segments of the domestic stock market. Exposure to the medium and small capitalization segment of the market is achieved with actively managed traditional long-only advisors and global macro transportable alpha strategies benchmarked to the Russell 2500 Index.

Market Value as of December 31, 2005: U.S. Stocks had a \$9,786.1 million market value, 34.0% of the total fund's \$28,805.2 million market value on December 31, 2005.

Number of Investment Advisors: SERS had contracts with 13 external investment advisors to manage U.S. Stock portfolios.

Number of Investment Portfolios: SERS had 17 U.S. Stock portfolios managed by the 13 investment advisors.

Type of Investment Portfolios: As of December 31, 2005, 81.2% of SERS U.S. Stock allocation was in large capitalization stock strategies, including the equitized fund-of-funds absolute return strategies, and 18.8% was in medium/small capitalization stock strategies. The alpha transport strategies, used in both the large capitalization and medium/small capitalization segments, replicate a broad market return benchmark through derivatives and then add alpha through uncorrelated return streams. SERS has one equitization manager to replicate the benchmarks for the alpha transport strategies.

U.S. Stock Investments Summary *(continued)*

	U.S. Stock Investment Advisor	Investment Style	*Market Value As of 12/31/05 (\$ Millions)
1.	Barclays Global Investors	S&P 500 Index	\$1,611.2
		Enhanced indexing	327.9
		Russell 2500 Index (Transition)	394.1
2.	AXA Rosenberg Investment Management	Russell 2500, risk controlled	331.7
3.	Blackstone Alternative Asset Management (BAAM)	Absolute return Fund-of-funds	1,686.3
4.	Bridgewater	Global Macro	392.4
5.	Emerald	PA stocks	206.3
6.	First Quadrant	Equitized long/short U.S. market neutral	70.7
7.	Iridian Asset Management	Mid-cap private business value	308.9
8.	Martingale Asset Management	Equitized long/short U.S. market neutral	87.2
9.	Mellon Equity Associates	PA stocks	207.5
	The Boston Company	Equitized long/short U.S. market neutral	87.6
10.	Mesirow Financial	Absolute return Fund-of-funds	1,290.1
11.	Morgan Stanley Alternative Investment Partners	Absolute return strategy equitization	125.3
		Absolute return Fund-of-funds	1,086.6
12.	PAAMCO Absolute Return	Absolute return Fund-of-funds	1,496.7
13.	Twin Market Neutral	Equitized long/short U.S. market neutral	75.6
	Total		\$9,786.1

**Includes stocks and cash which the manager had available for investment. Numbers may not add due to rounding.*

International Stock Investments Summary

as of December 31, 2005

International stocks is one of eight major asset classes that SERS uses to diversify the investments of the Fund. SERS' investment plan diversifies stock investments while maintaining a reasonable risk posture relative to the benchmarks. SERS contracts with external investment advisors to manage portfolios.

Policy: Stock investments are employed by the Fund primarily because their expected large return premiums versus inflation will, if realized, help preserve and enhance the real value of the Fund over long periods of time. The International Stock asset class is managed on a total return basis.

SERS' long term investment objective for the international stock component of the stock asset class is to achieve a total return, net of fees, that exceeds the total return of the S&P/Citigroup World Equity Broad Market Index Europe and Pacific, a proxy for large cap and small cap stocks in non-U.S. developed markets, and the MSCI Emerging Markets Index, a proxy for stocks in emerging markets.

SERS' 2006 Investment Plan targets an allocation of 10.4% of total Fund assets to stocks in non-U.S. developed markets, 2.6% of total Fund assets to strategies dedicated to small-cap stocks in non-U.S. markets, and 4% of total Fund assets to strategies dedicated to stocks in emerging markets, by the end of 2010.

Market Value as of December 31, 2005: International Stocks had a \$6,028.1 million market value or 20.9% of the total Fund's \$28,805.2 million market value on December 31, 2005. In addition, the fair value of forward exchange contracts in the currency overlay program amounted to \$56.7 million.

Number of Investment Advisors: SERS had contracts with 13 external investment advisors to manage international stock portfolios. In addition, SERS had contracts with two external advisors to manage the currency overlay program.

Number of Investment Portfolios: SERS had 18 stock portfolios managed by the 13 investment advisors and two accounts for the currency overlay program.

Type of Investment Portfolios: As of December 31, 2005, SERS had 18 actively managed international portfolios. 13.0% of total Fund assets was allocated to stocks in non-U.S. developed markets, 3.6% of total Fund assets was allocated to strategies dedicated to small-cap stocks in non-U.S. markets, and 4.3% was allocated to strategies dedicated to stocks in emerging markets.

International Stock Investments Summary *(continued)*

	International Stock Investment Advisor	Investment Style	*Market Value as of 12/31/05 (\$ millions)
Integrated developed and emerging markets			
Broad Mandates			
1.	Artisan Partners Limited Partnership	Growth stocks	\$559.9
2.	Morgan Stanley Investment Management Limited (London) EAFE value equity team	Free cash flow value	740.6
3.	Templeton Investment Counsel, LLC	5-year stock value	763.9
Regional Mandates			
4.	Marathon Asset Management LLP	Europe - relative value sectors	615.1
5.	Walter Scott & Partners Limited	Europe - growth	353.1
6.	J.P. Morgan Investment Management Inc. (New York) Japan equity team	Japan - benchmark risk control	413.8
7.	GAM International Management Ltd GAM Institutional Group Trust	Pacific basin ex Japan - value	151.2
	Morgan Stanley Investment Management Inc. (New York) Asia equity team	Pacific basin ex Japan - growth	147.2
Dedicated Small Cap			
8.	Harris Associates L.P.	Small cap - intrinsic value	349.9
9.	Merrill Lynch Investment Managers International Limited Specialist equities teams	Small cap - growth	342.5
10.	Pictet International Management Limited International small cap equity team	Small cap - value with growth	357.0
Dedicated Emerging Markets			
11.	Bernstein Investment Research and Management Pictet International Management Limited Emerging markets equity team	Global emerging markets - value	129.0
		Global emerging markets - value	370.2
12.	Rexiter Capital Management Limited Templeton Asset Management Ltd. Global emerging markets team TIFI Emerging Markets Series	Global emerging markets - core	126.1
		Global emerging markets - value	340.2
	Templeton Asset Management Ltd. Templeton Strategic Emerging Markets Fund team Templeton Strategic Emerging Markets Fund, L.P.	Global emerging markets private placements with public companies	101.1
	Templeton Strategic Emerging Markets Fund II, L.P.	Global emerging markets private placements with public companies	32.2
13.	Oaktree Capital Management, LLC OCM Emerging Markets Feeder Fund, L.P.	Pacific basin emerging and developed - long/short	135.1
Total International Stocks			\$6,028.1

International Stock Investments Summary *(continued)*

	<i>Currency Overlay</i> Investment Advisor	Investment Style	*Market Value as of 12/31/05 (\$ millions)
1.	Pareto Partners	currency overlay	\$23.7
2.	Record Treasury	currency overlay	33.0
	Total Currency Overlay		\$56.7
	Total International and Currency Overlay		\$6,084.8

**Includes stocks and cash which the manager had available for investment. Numbers may not add due to rounding*

Fixed Income Investments Summary

as of December 31, 2005

Fixed Income is one of eight major asset classes that SERS uses to diversify the investments of the Fund. The SERS' Investment Plan diversifies Fixed Income investments and strategies. SERS contracts with external investment advisors to manage portfolios.

Policy: The Fixed Income asset class is employed by the Fund because of its ability to generate current income from interest payments, increase the value of the Fund through the reinvestment of those interest payments, serve as a Benefit Payment Reserve during periods of financial stress, serve as a hedge against disinflation and/or deflation and to help diversify the overall Fund. The Fixed Income asset class is managed on a total return basis.

In the Fixed Income asset class, SERS' long-term investment objective is to achieve a total return, net of fees, that exceeds the total return of the SERS Custom Fixed Income Index which is comprised of the Lehman Intermediate, Lehman Aggregate, the Citigroup High Yield Market and J.P. Morgan Emerging Market Bond indexes.

SERS' 2006 Investment Plan targets a long-term allocation of 24.0% of assets of the total Fund to the Fixed Income asset class. Of this amount, 63% is targeted to the core strategies and 37% to specialty strategies (High-yield and emerging market debt).

Market Value as of December 31, 2005: Fixed Income had a \$4,619.8 million market value, 16.0% of the total Fund's \$28,805.2 million market value on December 31, 2005.

Number of Investment Advisors: SERS had contracts with 14 external investment advisors to manage portfolios within the Fixed Income asset class as of December 31, 2005.

Number of Investment Portfolios: SERS had a total of 15 portfolios within the Fixed Income asset class.

Type of Investment Portfolios: The Fixed Income asset class is divided into core and specialty segments.

Core: Core portfolios invest in relatively liquid, high quality, fixed income securities with intermediate term durations that meet return, disinflation/deflation, benefit reserve payments and diversification needs of the Fund. SERS had five actively managed core bond portfolios; two Lehman Intermediate actively managed portfolios three Lehman Aggregate actively managed portfolios with a market value of \$1,775.4 million and one passively managed core bond portfolio with a market value of \$256.4 million. The combination of core portfolios represented 44% of the asset class.

Specialty: The specialty strategy portfolios (high-yield, emerging market debt, and subordinated debt) focus on debt instruments offering higher return premiums and different risk characteristics than core fixed income securities. SERS had corporate high yield portfolios with a market value of \$1,075.4 million, emerging market debt portfolios with a market value of \$1,162.9 million, one high yield commercial mortgage-backed securities portfolio with a market value of \$278.8 million, one whole-loan mortgage portfolio with a market value of \$32.2 million, one subordinated debt portfolio with a market value of \$11.9 million that invests in Pennsylvania companies, and one mezzanine debt portfolio with a market value of \$26.8 million. The specialty portfolios represent 56% of the asset class.

Fixed Income Investments Summary *(continued)*

	Fixed Income Investment Advisor	Investment Style	*Market Value As of 12/31/05 (\$ Millions)
Core			
1.	Goldman Sachs Asset Management	Active domestic intermediate duration	\$373.4
2.	MDL Capital Management	Active domestic intermediate duration	92.4
3.	Standish (Mellon)	Domestic - index	256.4
4.	Morgan Stanley	Active domestic	833.8
5.	NISA Investment Advisors	Active domestic intermediate duration	375.4
6.	Taplin, Canida & Habacht	Active domestic	100.4
Specialty			
7.	Legg Mason	Whole-loan mortgages	32.2
	Salomon Brothers Asset Management	Global High yield	1,143.2
8.	Berwind (Eureka) Financial Group	PA Capital Fund	11.9
9.	Fidelity Management Trust Company	Commercial mortgage backed securities	278.8
10.	Oaktree Capital Management	Mezzanine Fund	26.8
11.	W. R. Huff Asset Management	High yield bonds	449.4
12.	Gramercy Advisors	Emerging market debt -absolute return	92.1
13.	Greylock Capital Management	Emerging market debt -absolute return	100.5
14.	PIMCO	Emerging market debt	453.1
Total			\$4,619.8

**Includes securities and cash that the manager had available for investment. Numbers may not add due to rounding.*

Cash Investments Summary

as of December 31, 2005

Cash is one of eight major asset classes that SERS uses for investments of the Fund. The SERS' Investment Plan calls for minimizing cash balances while meeting cash flow requirements.

Policy: Cash investments are employed by the Fund to provide for SERS' liquidity needs and to accumulate funds for future permanent investment. The Cash asset class is to be managed on a total return basis, with the exception that temporary investments such as overnight repurchase agreements ("repo"), commercial paper, and banker's acceptance may alternatively be evaluated on a yield-to-maturity basis given their extremely short maturities.

In the Cash asset class, SERS' long term investment objectives are to achieve a total return, net of fees, that exceeds the total return on 90 day U.S. Treasury Bills. SERS' current Investment Plan targets an allocation of 0% of assets to the Cash asset class.

Market Value as of December 31, 2005: Cash had a \$598.5 million market value, 2.1% of the total Fund's \$28,805.2 million market value on December 31, 2005.

Number of Investment Advisors: In accordance with SERS' 2006 Investment Plan, SERS utilizes the Pennsylvania State Treasury Department to manage its cash accounts. The Pennsylvania State Treasury Department, as sole custodian of the Fund, is responsible for selecting the cash managers that the Fund utilizes.

Number of Investment Portfolios: SERS' cash portfolio is managed primarily by the Treasurer. In addition, Valley Forge and Swarthmore manage a short-term duration segment of the portfolio to provide additional yield on assets not deemed necessary for immediate liquidity.

Type of Investment Portfolios: SERS Cash asset class currently employs a money market short-term investment strategy. The portfolio also contains the uninvested cash balances held by other SERS investment advisors in other asset classes.

In the aggregate, the State Treasury managed approximately \$876 million on behalf of SERS and SERS' external investment advisors as of December 31, 2005.

Inflation Protection Investments Summary

as of December 31, 2005

Inflation Protection is one of eight major asset classes that SERS uses for investments of the Fund. The objective of this asset class is to reduce the deleterious affects of inflation by investing in strategies that specifically respond to expected and unexpected inflation.

Policy: Inflation Protection investments are employed by the Fund to provide diversification within the total portfolio and to act as a hedge against inflation.

SERS' long term investment objective in the inflation protection asset class is to achieve a total return, net of fees, that exceeds the total return of the Customized Inflation Protection Benchmark.

The strategy is a combination of indexed commodities, TIPS and a diversified inflation hedges portfolio. The strategy provides diversification and low correlations to other asset classes in the portfolio. The commodities are based on the Goldman Sachs Commodity Index (GSCI) which is a "basket" of 26 commodities that are traded on U.S. exchanges. Exposure to the GSCI is achieved through swap contracts. The underlying cash for the GSCI swaps is intermediate-duration Treasury Inflation Protection Securities (TIPS). These fixed-income securities adjust for actual changes in inflation, and therefore retain their real value. The prices of these investments are expected to generally move independently of the broad market movements that affect other financial assets such as stocks and bonds. Commodities historically have the highest correlation with inflation, considerably outperforming stocks and bonds during rising inflation periods, but underperforming when inflation was stable or falling. They provide an inflation hedge because their prices are linked to global supply and demand conditions for the world's basic commodities. This is the general underlying driver of inflation.

SERS' 2006 Investment Plan targeted a long-term allocation of 7.0% of assets to Inflation Protection. The commodity allocation is a passively managed exposure to the commodity markets. Exposure is gained by entering into swap agreements that provide the GSCI return that would be achieved by passively holding the underlying commodity futures contracts. The TIPS generate higher incremental return above typical cash instruments. On December 31, 2005, the passive commodity portfolio represented 5.3% of the total Fund. The active strategy over/under weights inflation-sensitive instruments including commodities, inflation-sensitive stocks, and bonds. The active diversified inflation hedge portfolio amounted to 2.0% of the total Fund.

Market Value as of December 31, 2005: Inflation protection strategies had a \$2,123.9 million market value, 7.4% of the total Fund's \$28,805.2 million market value on December 31, 2005.

Number of Investment Advisors: SERS had contracts with two external investment advisors to manage the Inflation Protection portfolios.

Number of Investment Portfolios: SERS had Inflation Protection portfolios managed by the two investment advisors.

Types of Investment Portfolios: The commodity portfolio achieves the commodity index return by employing a swap agreement whereby SERS "swaps" the return earned on a short-term cash portfolio for the return of the Goldman Sachs Commodity Index. The advisor manages both the underlying TIPS portfolio and the commodity swaps.

The diversified inflation hedge portfolio seeks to add value from both bottom-up selection of global equity, fixed income, and commodities instruments, as well as active top-down asset class and sector allocation.

	Inflation Protection Investment Advisor	Investment Style	*Market Value As of 12/31/05 (\$ Millions)
1.	NISA Investment Advisors	Indexed commodities and TIPS	\$1,539.7
2.	Wellington	Diversified inflation hedge portfolio	584.2
	Total		\$2,123.9

Real Estate Investments Summary

as of December 31, 2005

Equity Real Estate is one of eight major asset classes that SERS uses to diversify the investments of the Fund. SERS' investment plan diversifies Real Estate investments and balances real estate management styles. In accordance with the plan, SERS contracts with external investment advisors to manage portfolios.

Policy: Equity Real Estate investments are generally long-term, illiquid investments that due to their high correlation with inflation provide an inflation hedge and, due to their low correlation with stocks and bonds, provide diversification within the total portfolio. It is expected that the long-term total return (income and appreciation) for real estate will fall between that of stocks and bonds. The Equity Real Estate asset class is managed on a total return basis.

In the Equity Real Estate asset class, SERS' long-term investment objective is to achieve a total net return that exceeds the total return of the NCREIF Index for rolling five year periods. SERS' 2006 Investment Plan targets a long-term allocation of 8% of assets to the Equity Real Estate asset class.

Investments are made through commingled fund investments, limited partnerships, REITs and separate account portfolios where SERS contracts with external investment advisors to own properties directly or with other co-investors. SERS' Equity Real Estate portfolio provides for diversification by:

- Transaction structure;
- Property type;
- Geographic location; and
- Development phase.

Market Value as of December 31, 2005: Real Estate had an estimated \$1,968.8 million market value, approximately 6.8% of the total Fund's December 31, 2005 market value. This market value represents September 30, 2005 actual numbers adjusted for cash flows, which occurred in the fourth quarter 2005. Real estate market values and detailed property data is lagged by one quarter due to the timing of the receipt of the private market valuations and information.

Number of Investment Advisors: SERS had contracts with 24 external investment advisors to manage real estate portfolios as of December 31, 2005.

Number of Investment Portfolios: SERS had investments in 49 real estate portfolios managed by the 24 investment advisors.

Type of Investment Portfolios: As of September 30, 2005, the composition of the real estate portfolio was:

- 37% pooled funds, 63% separate accounts;
- 28% office, 7% industrial, 10% retail, 19% residential, 13% hotel/motel, 7% timber, 16% other;
- 15% Pennsylvania, 25% East excluding PA, 30% West, 20% South, 8% Midwest, 2% International; and,
- 42% of the market value of the separate accounts was invested in fifteen investments located in Pennsylvania.

Real Estate Investments Summary *(continued)*

	Real Estate Investment Advisor	SERS Initial Funding	Property Type	Transaction Structure	**Market Value as of 9/30/05 (\$ millions)
1.	Apollo-AREF III	06/26/98	Opportunistic	equity and debt	\$33.3
2.	Berwind - BPG Fund IV	04/20/98	Opportunistic	equity and debt	12.1
	BPG Fund V	11/29/99	Opportunistic	equity and debt	22.4
	BPG Fund VI	09/09/02	Opportunistic	equity and debt	23.5
	BPG Fund VII	2005	Opportunistic	equity and debt	0.7
3.	Blackstone - BREP II	02/26/97	Opportunistic	equity and debt	3.7
	BREP III	10/22/99	Opportunistic	equity and debt	13.2
	BREP IV	12/08/03	Opportunistic	equity and debt	21.6
	BREP V		Opportunistic	equity and debt	-
4.	Campbell Group		Timber	equity ownership	-
5.	Cliffwood Select Equity Fund	08/04/00	Long/Short REITs	public securities	34.8
6.	CRA Securities	01/31/96	REITs	public securities	377.7
7.	Filmore Capital Partners		Debt	equity and debt	-
8.	Forest Investment Assoc.	10/30/92	Timber	equity ownership	164.2
9.	Heitman Capital Mgmt	12/28/87	Diversified	equity ownership	28.1
	JMB Group Trust III	12/31/84	Office, retail	equity ownership	0.1
10.	LaSalle Investment Mgmt.	10/01/93	Diversified	equity ownership	126.8
11.	Legg Mason Real Estate Adv.	10/01/93	PA diversified	equity ownership	188.1
	Eastern Retail Holdings	01/07/99	Retail	equity and debt	44.0
12.	Lowe Enterprises	10/01/93	Diversified	equity ownership	376.5
13.	Lubert-Adler Fund II	10/30/98	Opportunistic	equity and debt	16.7
	Lubert-Adler Fund III	11/10/00	Opportunistic	equity and debt	17.7
	Lubert-Adler Fund IV	3/31/04	Opportunistic	equity and debt	20.4
14.	Miller Global Fund III	01/19/99	Diversified	equity and debt	1.1
15.	Oaktree Capital Management:				
	TCW Fund VI	04/20/94	Opportunistic	equity and debt	2.5
	OCM Opportunity Fund A	05/09/96	Opportunistic	equity and debt	25.8
	OCM Opportunity Fund II	12/15/98	Opportunistic	equity and debt	7.0
	OCM Opportunity Fund III	03/05/03	Opportunistic	equity and debt	26.8
16.	Oxford Development	01/09/97	Industrial	equity ownership	12.5
17.	Prudential Senior Housing I	12/22/98	Senior housing	equity and debt	5.1
	Prudential Senior Housing II	06/12/01	Senior housing	equity and debt	24.5
18.	Rockpoint Fund I	09/28/04	Opportunistic	equity and debt	16.6
	Rockpoint Fund II	09/27/05	Opportunistic	equity and debt	0.1
19.	Sentinel Corp.	07/31/84	Diversified	equity ownership	71.2
20.	Starwood: SOF IV	03/24/97	Opportunistic	equity and debt	11.7
	SOF V	05/14/99	Opportunistic	equity and debt	14.9
	SOF VI	03/27/03	Opportunistic	equity and debt	64.8
	SOF VII		Opportunistic	equity and debt	-0.5
21.	UBS-Brinson: PMSA	09/30/83	Diversified	equity mortgages	63.2
	RESA	06/3/84	Diversified	equity ownership	74.2
	Multifamily Trust	08/02/99	Residential	equity ownership	7.5
22.	Urdang Investment Mgmt.	05/15/02	REITs	public securities	50.9
23.	Westbrook Partners: WREF II	06/16/97	Opportunistic	equity and debt	5.6
	WREF III	09/01/98	Opportunistic	equity and debt	16.0
	WREF IV	05/01/01	Opportunistic	equity and debt	17.8
	WREF V	02/16/05	Opportunistic	equity and debt	21.8
24.	Goldman Sachs:				
	Whitehall V & VI	04/20/94	Opportunistic	equity and debt	4.5
	Whitehall V-S & VI-S	12/11/95	Opportunistic	equity and debt	1.1
	Whitehall VII & VIII	05/28/96	Opportunistic	equity and debt	6.0
September 30, 2005 Total					\$2,077.8
4 th Quarter 2005 Net Cash Flow Adjustments					-109.0
December 31, 2005 Total					\$1,968.8

*Numbers may not add due to rounding.

**Market values are lagged by one quarter due to the timing of the receipt of private market valuations and information.

Alternative Investments Summary

as of December 31, 2005

Alternative Investments is comprised of Venture Capital and Private Equity investments, both of which take the form of limited partnerships, and is one of eight major asset classes that SERS uses to diversify the investments of the fund.

Venture Capital and Private Equity Defined

Venture Capital is the financing of young, rapidly growing companies, typically at three stages of development. (1) Seed and Early Stage: Seed is the form of venture capital that supports companies in their conceptual phase, i.e., a product and market are identified, and a corporation may have been formed. Early Stage financing supports companies pursuing a business plan but not yet generating meaningful revenues. The product has been developed and may have been shipped to customers for testing. Management positions have been filled and an operating team is in place. (2) Late Stage financing supports companies that have proven revenues, and are in the process of rolling out operations and building sales to achieve profitability. (3) Growth or Expansion Financing supports profitable or nearly profitable businesses that, lacking access to significant debt financing, need capital for growth and expansion. Companies at either the later stage or growth or expansion stage may be nearing a strategic sale to another company or an initial public offering.

Private Equity primarily refers to investments in the equity and subordinated debt of established companies. Private equity approaches undertaken by SERS' limited partnerships include: (1) Leveraged buyouts ("LBO") in which companies are acquired through the use of borrowed funds, or a combination of borrowed funds and contributed equity capital. The acquired company's assets serve as collateral for the borrowed funds, which are repaid from the company's cash flows. (2) Distressed debt investing involves: (a) de-leveraging of debt-laden, but successful, companies by infusing capital to permit debt reduction in exchange for an equity stake in the company, or (b) acquiring debt of a troubled, sometimes bankrupt company, at steep discounts to face value, followed by assistance to return the company to profitability to permit selling of the debt securities at levels above the discounted purchase price. (3) Secondary interests in established private equity funds - these interests are purchased from other investors who seek liquidity or desire to realign or rebalance their investment portfolios, often for non-financial reasons. Such partnerships interests are often purchased at significant discounts to net asset value and often occur when the acquired partnerships begin to realize profits.

Investment Objective: SERS' long term investment objective for Alternative Investments is to achieve a risk-adjusted total return, net of fees, in excess of the return generated by the S&P 500 Index. SERS' 2006 Investment Plan anticipates a long-term allocation range with a midpoint of 14%.

Market Value as of December 31, 2005: The asset class total market value stood at \$3,623.3 million after adjusting the September valuation for subsequent cash flows in the 4th quarter. Alternative investment market values lag one quarter due to timing of the receipt of private market valuations, reports and other information. These values do not include 4th quarter unrealized appreciation/depreciation. Alternative investments represent 12.6% of the Fund. Sub-asset class market values and fund percentages were as follows:

	Total Active Commitments (\$ mil)	Market Value (\$ mil)	Percent Allocation to Total Fund
Venture Capital	\$2,990.2	\$942.0	3.3%
Private Equity	6,106.2	2,681.3	9.3%
Total Alternative Investments	\$9,096.4	\$3,623.3	12.6%

Alternative Investments Summary *(continued)*

Number of Limited Partnerships: As of December 31, 2005, SERS had made commitments to 260 active Alternative Investments limited partnerships; 108 commitments were made to Venture Capital partnerships and 152 to Private Equity partnerships. (This does not include 14 partnerships – 11 Venture Capital and three Private Equity – that are now “inactive,” or in the liquidation phase, and investments pending contract approval.)

SERS Venture Capital Portfolio

SERS Venture Capital program includes commitments to 108 venture capital limited partnerships, comprising a fund portfolio that is well-diversified by stage of investment, industry focus, and geography. This fund portfolio holds investment interests in approximately 2,000 growing companies, the majority of them working to commercialize novel solutions to current and future challenges in information technology, communications and medicine.

The program’s scope has expanded over the years to include top investment funds nationally and internationally. Many of these managers have investments that are either located in Pennsylvania or employ Pennsylvania citizens. This significant Pennsylvania component recognizes the program’s initial statutory mandate, as well as its ongoing effort to invest in Pennsylvania venture capital funds whose expected returns are at least equal to those of investment opportunities elsewhere.

The Venture Capital program also includes investments in six fund-of-funds, which are limited partnerships that, in turn, invest in venture capital funds. Four of these fund-of-funds commitments have the strategic goal of enabling SERS to gain indirect exposure to many top-tier venture capital funds that SERS would otherwise have difficulty accessing directly. The other two of these commitments are to funds investing in minority-focused venture capital funds.

SERS Private Equity Portfolio

The Private Equity program has commitments to 152 buyout-oriented partnerships, which are well-diversified by size of investment and geographic focus. This fund portfolio holds investment interests in over 2,000 companies. Hostile acquisitions are avoided; most transactions are privately negotiated rather than auctioned, and are usually completed with present management in place.

Of these buyout fund investments, 21 are in distressed debt funds. These funds each conduct their distressed investment strategies in a differentiated manner; i.e., they employ control or non-control approaches, and accordingly, have differing degrees of active influence over the companies in which they invest.

SERS’ 28 non-U.S. private equity fund investments include 22 funds investing in companies based in the U.K. and Europe (including two Scandinavian fund) and four funds investing in Asian companies. The U.K./Europe funds are attempting to capitalize on recent trends favoring the restructuring of large companies, generational succession in businesses established after World War II, and the cross-border business opportunities within the region since the formation of the European Economic Union and currency harmonization. The Asian partnership investments focus on the expanded opportunities in the region created by attractive valuations, favorable demographic trends, economic growth, and changing attitudes in many Asian countries regarding foreign investment.

The Private Equity program also includes investments in four international fund-of-funds, whose objective is to capture superior returns from select funds globally. These fund-of-funds’ holdings are well-diversified with a geographic emphasis on developed countries.

The program also includes eight partnerships that specialize in secondary purchases of interests in established buyout and venture capital partnerships.

Lastly, SERS utilizes one manager to oversee the stock distributions that are received from SERS’ private equity investments.

Venture Capital Committed, Drawn and Distributed

as of September 30, 2005

The Capital Committed column represents total dollars allocated from SERS to each limited partnership. Capital Drawn is the portion of SERS capital commitments drawn by the General Partner to be invested with underlying portfolio companies. The Distributions column shows the value of original capital and profits returned to SERS.

Active Funds Venture Capital Limited Partnership	Financing Stage Focus	SERS Initial Funding	Capital Committed	Capital Drawn	Distributions
APA Fostin	Early Stage	9/30/1987	\$20,000,000	\$20,000,000	\$76,979,572
APAX Excelsior VI	Later Stage	7/3/2000	35,000,000	29,016,638	17,489,746
APEX Investment Fund IV	Early Stage	8/31/1999	25,000,000	25,000,000	257,565
APEX Investment Fund V	Early Stage	7/25/2001	20,000,000	14,000,000	0
Abingworth Bioventures IV, L.P.	Seed/Early Stage	7/16/2003	20,000,000	6,540,000	0
Adams Capital Management II	Early Stage	9/30/1999	30,000,000	30,000,000	0
Adams Capital Management III	Early Stage	10/25/2000	30,000,000	20,700,000	0
Advanced Technology Ventures VI	Early Stage	3/9/2000	10,000,000	9,500,000	240,896
Advanced Technology Ventures VII LP	Early Stage	12/6/2000	25,000,000	12,959,700	2,452,474
Alloy Annex I, L.P.	Seed/Early Stage	7/16/2003	5,000,000	3,000,000	0
Alloy Ventures 2000 L.P.	Early Stage	4/26/2000	20,000,000	18,000,000	2,074,620
Alloy Ventures 2002 LP	Early Stage	3/20/2002	25,000,000	11,250,000	2,602,018
Alloy Ventures 2005, L.P.	Seed/Early Stage	7/13/2005	25,000,000	1,000,000	0
Atlas Venture Fund IV	Early Stage	3/23/1999	26,000,000	22,430,303	4,211,947
Atlas Venture Fund V L.P.	Early Stage	1/28/2000	37,200,000	34,066,720	3,808,897
Atlas Venture Fund VI	Early Stage	1/24/2001	24,800,000	16,499,513	1,455,629
Austin Ventures VIII	Early Stage	1/29/2001	20,932,140	13,347,742	1,454,071
Austin Ventures IX	Early Stage	1/9/2005	20,000,000	0	0
Bachow Investments III	Later Stage	11/9/1994	25,000,000	25,073,149	25,024,149
Birchmere Ventures III	Early Stage	3/18/2004	10,000,000	1,870,524	0
Care Capital III	Later Stage	*	25,000,000	0	0
Charles River Partnership XI LP	Early Stage	1/31/2001	11,032,259	8,163,872	694,663
Clearstone Venture Partners III-A, L.P.	Early/Late Stage	4/21/2004	25,000,000	4,500,000	0
Cross Atlantic Technology Fund	Early Stage	2/14/2000	20,000,000	19,449,041	198,860
Cross Atlantic Technology Fund II	Early Stage	12/28/2001	32,900,000	21,385,000	1,499,189
Draper Fischer Jurvetson VI	Early Stage	8/13/1999	8,000,000	7,240,000	50,908
Draper Fisher Jurvetson Fund VII LP	Early Stage	7/26/2000	20,000,000	14,171,716	511,102
Draper Triangle Ventures	Early Stage	8/31/1999	20,000,000	19,703,807	1,927,730
Draper Triangle Ventures II, L.P.	Early Stage	9/10/2003	12,000,000	1,154,467	0
Edison Venture Fund III	Later Stage	3/1/1994	25,000,000	25,000,000	45,769,783
Fairview Capital	Fund of Funds	9/28/1994	10,000,000	10,000,000	4,273,128
Fairview II	Fund of Funds	3/1/1998	10,000,000	9,300,000	1,565,318
Fostin Capital II	Early Stage	10/5/1989	8,000,000	7,500,000	11,415,869
Frazier Healthcare III	Early Stage	2/4/1999	30,000,000	27,375,000	1,428,575
Frazier Healthcare IV	Early Stage	3/14/2001	30,000,000	17,892,010	3,064,868
Frazier Healthcare V	Early/Late Stage	12/8/2004	30,000,000	1,542,000	0
Grotech PA III	Later Stage	6/29/1990	3,000,000	3,014,865	2,910,452
Grotech Partners IV	Later Stage	11/1/1993	25,000,000	25,157,827	42,558,884
Grotech Partners V	Later Stage	9/18/1998	25,000,000	25,125,000	22,378,391

Active Funds Venture Capital Limited Partnership	Financing Stage Focus	SERS Initial Funding	Capital Committed	Capital Drawn	Distributions
Halpern Denny Fund II	Later Stage	4/23/1998	25,000,000	25,116,871	2,591,403
Halpern Denny Fund III	Later Stage	4/26/2000	25,000,000	21,931,740	11,372,443
HarbourVest Partners VI	Fund of Funds	5/7/1999	200,000,000	148,586,055	29,460,974
HarbourVest Partners VII	Fund of Funds	4/24/2002	75,000,000	12,375,000	0
Healthcare Ventures III	Early Stage	7/9/1992	15,000,000	15,000,000	29,573,725
Healthcare Ventures V	Early Stage	10/17/1997	25,000,000	24,312,500	45,306,314
Healthcare Ventures VI	Early Stage	6/19/2000	35,000,000	34,125,000	3,462,611
Healthcare Ventures VII	Early Stage	7/24/2002	35,000,000	18,900,000	0
Healthcare Ventures VIII, L.P.	Early Stage	7/13/2005	35,000,000	900,000	0
Highland Capital Partners VI	Early Stage	10/25/2000	25,000,000	15,937,500	3,582,296
Highland Capital Partners VII	Early Stage	*	50,000,000	0	0
InterWest Partners VIII	Early Stage	8/25/2000	25,000,000	20,000,000	3,102,481
InterWest Partners IX	Early Stage	*	20,000,000	0	0
I. P. II L.P.	Early Stage	12/17/2001	8,600,000	4,886,074	864,148
I. P. III L.P.	Seed/Early Stage	10/27/2004	8,000,000	496,000	0
J.H. Whitney Equity Fund III LP	Later Stage	3/12/1998	20,000,000	20,171,316	34,843,171
J.H. Whitney IV LP	Later Stage	2/1/2000	20,000,000	16,712,208	1,596,861
J.P. Morgan Venture Capital Investors	Fund of Funds	7/8/1999	100,000,000	87,421,220	6,595,784
JMI Equity Fund V, L.P.	Early/Late Stage	4/27/2005	24,000,000	3,240,000	0
JP Morgan Venture Capital Investors II	Fund of Funds	8/23/2000	100,000,000	42,102,360	4,102,137
Keystone V	Later Stage	12/26/1997	25,000,000	25,117,132	2,062,796
Keystone Venture IV	Later Stage	7/13/1993	15,000,000	15,045,275	9,687,679
Kline Hawkes Pacific LP	Early Stage	8/30/2000	15,000,000	14,280,716	3,509,564
Knightbridge Venture Capital VI, L.P.	Early Stage	4/21/2004	20,000,000	800,000	0
Lightspeed Venture Partners VII	Early Stage	*	25,000,000	0	0
Meridian Venture Partners II, L.P.	Buyouts	1/26/2005	10,000,000	7,500,000	0
Meritech Capital Partners II	Later Stage	10/25/2000	25,000,000	16,288,426	3,188,691
Meritech Capital Partners III	Later Stage	*	35,000,000	0	0
Mid-Atlantic III	Early Stage	4/1/1997	20,008,308	20,111,247	2,717,446
Mid-Atlantic Venture Fund IV L.P.	Early Stage	5/4/2000	30,000,000	26,400,000	217,297
Morgenthaler Partners VII L.P.	Early Stage	7/26/2001	35,000,000	22,750,000	859,848
Morgenthaler Partners VIII L.P.	Diversified	*	35,000,000	0	0
NEPA Venture-II	Early Stage	7/24/1992	7,500,000	7,526,234	34,000,329
New Enterprise Associates 11	Early Stage	10/29/2003	25,000,000	10,625,000	0
New Enterprise Associates IX	Early Stage	10/28/1999	20,000,000	19,600,000	1,086,474
New Enterprise Associates VI	Early Stage	3/2/1994	25,000,000	25,000,000	196,734,032
New Enterprise Associates X LP	Early Stage	9/13/2000	35,000,000	28,028,000	8,772,295
New Enterprises Associates VII	Early Stage	4/1/1997	30,000,000	30,000,000	96,797,241
Novo Vita	Early Stage	10/25/2000	11,616,498	10,950,420	0
Oak Investment Partners XI	Later Stage	6/9/2004	35,000,000	11,889,706	0
P/A Fund I	Later Stage	6/2/1993	30,000,000	29,999,999	64,201,030
P/A Fund III	Later Stage	4/1/1997	100,000,000	100,000,000	128,281,098
PA Early Stage Partners III L.P.	Early Stage	6/6/2001	10,000,000	2,700,000	0
Pitango Venture Capital Fund IV, LP	Diversified	4/21/2004	25,000,000	4,201,534	0
Polaris Venture Partners	Early Stage	6/4/1996	15,000,000	14,595,000	45,978,188
Polaris Venture Partners II	Early Stage	9/8/1998	25,000,000	24,250,000	24,859,455

Active Funds Venture Capital Limited Partnership	Financing Stage Focus	SERS Initial Funding	Capital Committed	Capital Drawn	Distributions
Polaris Venture Partners III L.P.	Early Stage	1/6/2000	50,000,000	44,000,000	7,718,368
Polaris Venture Partners IV L.P.	Early Stage	7/31/2001	50,000,000	21,500,000	0
Quaker Bio Ventures	Early Stage	2/25/2003	20,000,000	6,122,957	77,043
Sprout VII	Early Stage	2/24/1995	18,000,000	18,000,000	34,163,082
Summit Accelerator Fund L.P.	Early Stage	11/15/1999	8,000,000	6,560,000	2,680,786
Summit Venture Capital Fund II	Diversified	*	15,000,000	0	0
Summit IV	Later Stage	6/27/1995	25,000,000	24,000,000	181,792,498
Summit V	Later Stage	3/1/1998	37,500,000	35,437,500	30,286,301
T.Rowe Price Stock Distribution Account	Stock Distribution	1/3/2005	0	89,384,785	49,418,474
TA/Advent VII	Later Stage	7/30/1993	25,000,000	25,112,500	88,471,851
TA/Advent VIII	Later Stage	2/3/1997	30,000,000	29,541,093	45,720,261
TL Ventures III LP	Early Stage	1/3/1997	15,000,000	15,062,614	18,583,704
TL Ventures IV	Early Stage	5/13/1999	35,000,000	35,000,000	7,974,759
TL Ventures V	Early Stage	7/13/2000	40,000,000	27,648,219	573,525
Three Arch Capital LP	Early Stage	12/20/2000	20,000,000	13,800,000	2,090,011
Three Arch Partners IV, L.P.	Early/Late Stage	9/10/2003	25,000,000	2,800,000	0
U S Venture Partners VII LP	Early Stage	1/24/2000	13,750,000	13,087,500	216,840
US Venture Partners VIII LP	Early Stage	12/6/2000	26,250,000	19,100,625	930,734
Weston Presidio II	Later Stage	11/27/1995	20,000,000	17,000,000	41,383,117
Weston Presidio III	Later Stage	3/31/1999	35,000,000	30,187,086	16,369,259
Weston Presidio IV	Later Stage	6/21/2000	35,000,000	28,232,752	7,371,801
Weston Presidio V	Buyouts	*	50,000,000	0	0
Worldview Technology Partners IV	Early Stage	1/31/2001	18,130,023	13,307,040	1,907,983
TOTAL Active VC Commitments			<u>\$2,990,219,228</u>	<u>\$2,056,686,098</u>	<u>\$1,615,437,432</u>

*Not Funded as of 9/30/05.
Commitments as of 12/31/05
Cash flows as of 9/30/05

Inactive Venture Capital

	Capital Committed	Capital Drawn	Distributions
TOTAL Inactive Venture Capital	<u>\$61,700,000</u>	<u>\$54,664,429</u>	<u>\$90,157,497</u>

Private Equity Investments Committed, Drawn and Distributed

as of September 30, 2005

The Capital Committed column represents total dollars allocated from SERS to each limited partnership. Capital Drawn is the portion of SERS capital commitments drawn by the General Partner to be invested with underlying portfolio companies. The Distributions column shows the value of original capital and profits returned to SERS.

Active Funds Private Equity Limited Partnership	Financing Stage Focus	SERS Initial Funding	Capital Committed	Capital Drawn	Distributions
ABACUS Fund Partners L.P.	Hedge Fund	4/24/2000	\$15,000,000	\$15,149,220	\$8,131,989
ABRY Broadcast Partners III	Buyouts	4/1/1997	25,000,000	26,891,281	18,588,857
ABRY Broadcast Partners IV LP	Buyouts	7/26/2000	35,000,000	27,478,479	23,398,667
ABRY Mezzanine Partners	Mezzanine	12/5/2001	30,000,000	24,047,291	9,537,812
ABRY Partners V, L.P.	Buyouts	10/27/2004	45,000,000	6,446,781	0
ABS Capital Partners III L.P.	Buyouts	1/26/1999	35,000,000	29,705,650	15,029,605
ABS Capital Partners IV L.P.	Buyouts	10/13/2000	35,000,000	29,360,662	10,449,996
ABS Capital Partners V L.P.	Buyouts	*	20,000,000	0	0
AG Capital Recovery Partners II LP	Distressed Debt	10/1/2001	17,600,000	17,695,470	25,583,161
AG Capital Recovery Partners III LP	Distressed Debt	3/20/2002	20,000,000	16,000,000	24,208,501
AG Capital Recovery Partners IV LP	Distressed Debt	1/23/2003	50,000,000	30,415,216	14,185,728
APAX Capital Risque III (France)	Buyouts	11/29/1990	5,000,000	5,103,877	9,775,420
APAX Europe IV L.P.	Buyouts	3/31/1999	35,000,000	28,725,143	17,551,903
APAX Europe V LP	Buyouts	12/6/2000	60,000,000	60,409,166	34,506,150
APAX Europe VI LP	Buyouts	5/19/2005	60,000,000	13,122,224	0
APAX Germany	Buyouts	1/30/1991	5,200,000	5,246,602	12,101,312
APAX Germany II	Buyouts	7/15/1997	8,737,262	8,455,477	15,885,342
APAX UK Ventures VI	Buyouts	12/9/1997	9,000,000	6,861,111	12,302,931
AXA Secondary Fund III	Secondaries	11/19/2004	26,000,000	5,192,537	2,582,148
AXA Secondary Fund III-2	Secondaries	11/29/2004	14,000,000	2,562,005	1,323,201
Accel Europe L.P.	Early Stage	7/2/2001	10,000,000	5,450,000	0
Alpha Private Equity Fund 4 L.P.	Mid Market Buyouts	1/23/2002	26,580,000	25,568,130	6,864,312
Apollo Investment Fund IV	Buyouts	8/3/1998	75,000,000	71,903,010	56,236,055
Apollo Investment Fund V	Buyouts	4/18/2001	50,000,000	36,513,948	37,976,154
Apollo Investment Fund VI	Buyouts	*	40,000,000	0	0
Asia Pacific Growth Fund III	Global Situations	3/8/1999	15,000,000	15,089,765	2,253,053
Audax Private Equity Fund II, L.P.	Mid Market Buyouts	4/27/2005	25,000,000	2,442,396	0
Audax Private Equity Fund L.P.	Mid Market Buyouts	5/25/2000	35,000,000	34,311,995	7,606,561
Avenue Special Situations Fund III, L.P.	Distressed Debt	7/16/2003	50,000,000	42,428,808	0
Avenue Special Situations Fund IV, L.P.	Distressed Debt	*	50,000,000	0	0
B III Capital Partners	Distressed Debt	8/1/1997	35,000,000	34,503,390	35,052,537
BC European Capital VII LP	Buyouts	7/27/2000	35,000,000	30,922,263	17,990,144
BC European Capital VII Top Up	Buyouts	3/14/2001	10,000,000	9,339,558	4,989,020
BC European Capital VIII	Buyouts	*	97,635,000	0	0
Bain Capital Fund VII	Buyouts	7/6/2000	25,000,000	24,062,500	12,248,965
Bain Capital Fund VIII-E, L.P.	Buyouts	9/15/2004	13,405,000	2,214,055	0
Berkshire Fund VI LP	Mid Market Buyouts	9/28/2001	20,000,000	5,637,123	4,795,236
Blackstone Capital II	Buyouts	8/26/1994	40,000,000	42,820,894	90,404,013
Blackstone Capital III	Buyouts	11/3/1997	75,000,000	74,047,752	79,134,210

Active Funds Private Equity Limited Partnership	Financing Stage Focus	SERS Initial Funding	Capital Committed	Capital Drawn	Distributions
Blackstone Capital IV	Buyouts	10/31/2001	75,000,000	47,338,608	27,692,914
Blackstone Capital V	Buyouts	*	150,000,000	0	0
Blackstone Communications Partners I LP	Buyouts	8/29/2000	25,000,000	16,372,344	9,758,000
Brynwood Partners V, L.P.	Mid Market Buyouts	7/31/2005	10,000,000	2,969,395	0
Cerberus Institutional Partners L.P.	Distressed Debt	3/5/1999	35,000,000	35,000,000	34,354,564
Cerberus Institutional Partners Series Three	Distressed Debt	9/10/2003	35,000,000	19,950,000	0
Cerberus Institutional Partners Series Two	Distressed Debt	10/9/2001	35,000,000	30,100,793	6,595,586
Charterhouse Capital Partners VII	Buyouts	12/4/2002	50,000,000	34,687,761	7,096,460
Charterhouse Equity Partners II	Buyouts	3/30/1994	40,000,000	43,849,172	96,810,448
Charterhouse Equity Partners III	Buyouts	11/19/1997	50,000,000	55,395,586	18,625,374
Chrysalis Capital Partners	Distressed Debt	*	20,000,000	0	0
Clayton Dubilier & Rice V	Buyouts	5/3/1995	50,000,000	49,491,168	49,826,483
Clayton Dubilier & Rice VI	Buyouts	1/4/1999	50,000,000	37,625,542	17,741,863
Code Hennessy & Simmons	Buyouts	9/28/1989	10,000,000	9,650,000	27,208,717
Code Hennessy & Simmons II	Buyouts	7/12/1994	20,000,000	20,000,000	41,955,373
Code Hennessy & Simmons III	Buyouts	8/1/1997	40,000,000	38,724,000	36,579,699
Code Hennessy & Simmons IV	Mid Market Buyouts	8/31/1999	100,000,000	91,670,000	36,093,723
Code Hennessy & Simmons V	Middle/Later Stage	*	50,000,000	0	0
DLJ Merchant Banking Fund II	Buyouts	5/22/1997	75,000,000	81,814,100	76,747,353
DLJ Merchant Banking Fund III	Buyouts	6/6/2001	85,000,000	87,384,516	63,161,321
Electra European Fund II	Buyouts	*	52,072,000	0	0
Elevation Partners, L.P.	Private Equity	10/27/2004	35,000,000	376,769	0
Energy Spectrum Partners IV, L.P.	Mid Market Buyouts	11/15/2004	50,000,000	6,794,667	0
Eureka II, L.P.	Mid Market Buyouts	*	20,000,000	0	0
First Reserve Fund X, L.P.	Buyouts	1/15/2004	30,000,000	8,706,550	4,311,418
Francisco Partners LP	Buyouts	5/8/2000	50,000,000	41,234,586	15,138,090
Frontenac VII	Buyouts	8/1/1997	40,000,000	40,000,000	50,597,767
GTC&R V	Buyouts	4/25/1997	11,400,000	11,400,000	16,085,108
GTC&R VI	Buyouts	6/25/1998	50,000,000	50,375,000	39,141,912
GTC&R VII	Buyouts	3/15/2000	55,000,000	46,705,921	46,161,124
GTCR VIII	Buyouts	5/12/2003	75,000,000	30,375,000	9,076,126
Great Hill Equity Partners	Buyouts	4/12/1999	30,000,000	29,775,000	18,584,553
Great Hill Equity Partners II LP	Buyouts	7/26/2000	35,000,000	29,137,500	18,736,585
Gryphon Partners II LP	Buyouts	8/6/1999	35,000,000	33,466,384	16,300,795
Gryphon Partners III, LP	Buyouts	6/9/2004	30,000,000	13,007,757	496,495
Hancock IPEP II (Harbourvest II)	Fund of Funds	4/1/1997	25,000,000	24,357,775	25,931,274
HarbourVest Inter III	Fund of Funds	6/22/1998	40,000,000	33,600,000	13,788,683
Harbourvest Intl' Private Equity Partners IV	Fund of Funds	12/6/2000	40,000,000	19,600,000	4,220,776
Hellman & Friedman II	Global Situations	1/7/1992	21,130,323	23,218,222	39,736,483
Hellman Friedman III	Global Situations	6/14/1995	50,000,000	40,308,123	82,535,584
Hellman Friedman IV	Global Situations	8/3/1999	75,000,000	64,513,521	23,190,382
Hellman Friedman V	Diversified	8/1/2004	80,000,000	13,518,001	0
Invemed Catalyst Fund L.P.	Mid Market Buyouts	9/30/1999	25,000,000	13,048,955	1,264,803
J.H. Whitney V LP	Later Stage	9/13/2000	20,000,000	17,663,701	9,053,222
J.H. Whitney VI LP	Buyouts	1/5/2006	50,000,000	0	0
J.W. Childs Equity Partners III L.P.	Middle/Later Stage	1/23/2002	40,000,000	25,350,181	2,561,572
JP Morgan US Corp Finance Investors II	Fund of Funds	7/24/2002	50,000,000	17,040,057	2,846,511

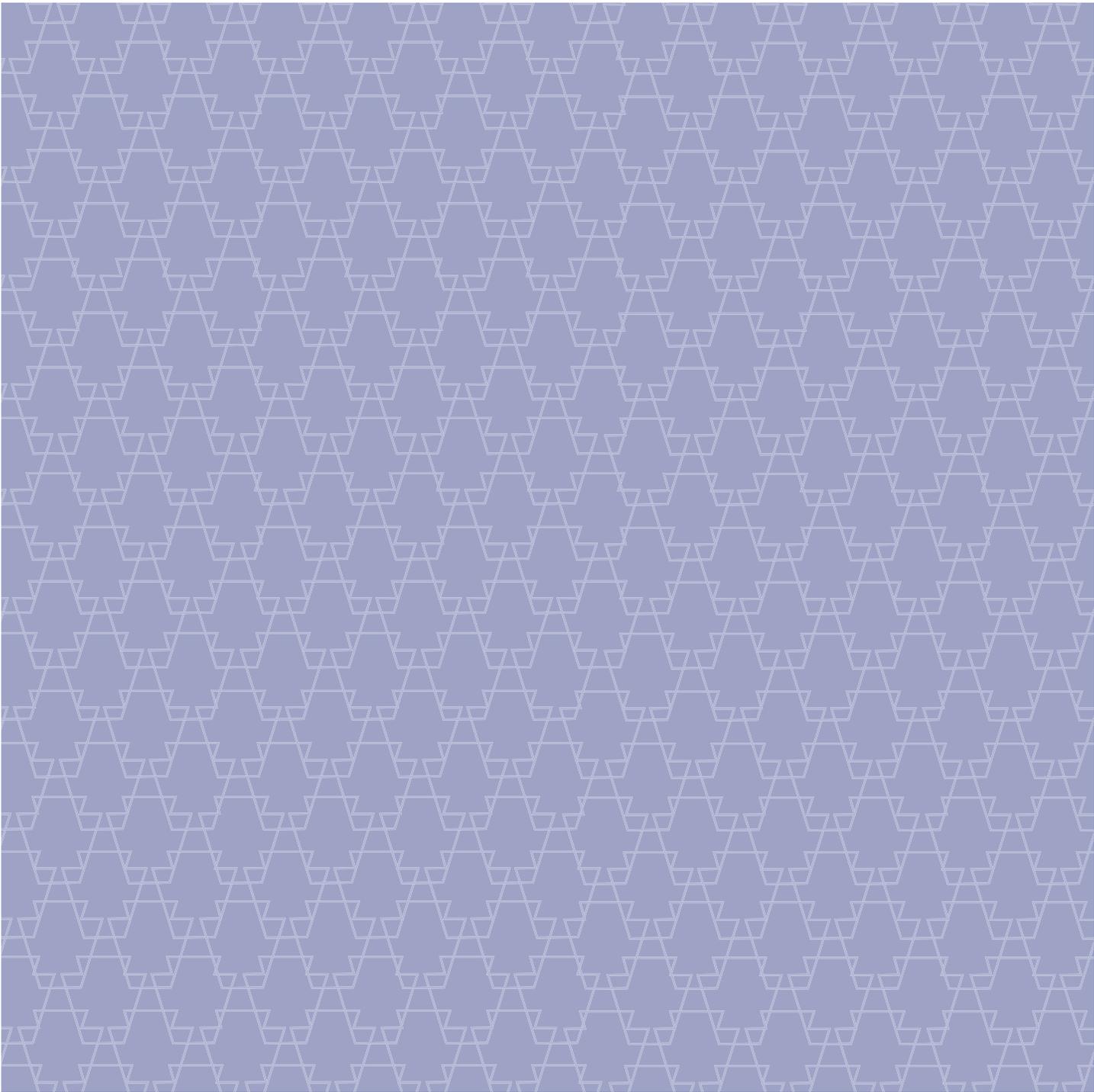
Active Funds Private Equity Limited Partnership	Financing Stage Focus	SERS Initial Funding	Capital Committed	Capital Drawn	Distributions
Kelso Investment Associates V	Buyouts	1/26/1994	40,000,000	54,411,479	102,741,751
Kelso VI	Buyouts	7/7/1998	75,000,000	69,057,922	67,765,022
Kelso VII	Buyouts	2/11/2004	40,000,000	11,997,882	1,224,018
LLR Equity Partners II, L.P.	Buyouts	1/29/2004	25,000,000	4,237,377	0
LLR Equity Partners LP	Mid Market Buyouts	1/24/2000	25,000,000	24,559,977	21,634,615
Landmark Equity IV	Secondaries	2/28/1995	14,900,000	12,880,353	16,755,902
Landmark Equity Partners V	Secondaries	1/27/1996	19,624,113	19,434,947	22,733,583
Leeds Weld Equity Partners IV, L.P.	Mid Market Buyouts	7/30/2004	20,000,000	5,289,713	0
Lexington Capital Partners II	Secondaries	4/1/1998	40,000,000	39,286,000	32,367,214
Lexington Capital Partners III L.P.	Secondaries	1/26/1999	35,000,000	33,476,950	28,652,912
Lexington Capital Partners V	Secondaries	7/25/2001	75,000,000	54,828,916	24,996,707
Lexington Capital Partners VI	Secondaries	1/12/2006	50,000,000	0	0
Lime Rock Partners III, L.P.	Diversified	10/27/2004	15,000,000	2,347,503	0
Lime Rock Resources, L.P.	Diversified	*	20,000,000	0	0
Madison Dearborn Capital Partners	Buyouts	2/23/1993	15,000,000	14,529,060	39,639,246
Madison Dearborn Capital Partners IV	Buyouts	10/27/2000	90,000,000	60,077,376	22,986,959
Madison Dearborn Capital Ptners II	Buyouts	1/3/1997	40,000,000	40,080,476	63,890,142
Madison Dearborn III	Buyouts	4/6/1999	75,000,000	76,193,028	43,190,827
Matlin Patterson Global Opportunities Partners II,	Distressed Debt	12/3/2003	30,000,000	12,990,978	2,093,051
MatlinPatterson Global Opportunities Partners LP	Distressed Debt	5/4/2001	35,000,000	33,613,973	31,172,241
Media/Communication III	Buyouts	6/2/1997	25,000,000	24,131,061	19,963,053
Media/Communications IV	Buyouts	2/5/1999	25,000,000	23,125,000	0
Media/Communications Ventures Fund V LP	Buyouts	7/26/2000	35,000,000	28,540,101	2,749,010
Newbridge Asia II L.P.	Global Situations	9/3/1999	15,000,000	15,199,629	13,250,716
Newbridge Asia III LP	Early Stage	7/6/2000	15,000,000	14,955,632	4,072,448
Newbridge Asia IV LP	Buyouts	6/1/2005	40,000,000	5,852,140	0
Nordic Capital V L.P.	Buyouts	12/4/2002	40,000,000	34,620,207	3,374,148
Nordic Capital VI L.P.	Buyouts	*	60,000,000	0	0
OCM Opportunities Fund	Distressed Debt	1/12/1996	24,000,000	24,534,457	34,577,066
OCM Opportunities Fund II	Distressed Debt	2/5/1998	40,000,000	40,099,999	48,581,140
OCM Opportunities Fund III	Distressed Debt	1/20/2000	60,000,000	60,007,890	77,538,597
OCM Opportunities Fund IV	Distressed Debt	12/31/2001	70,000,000	68,250,000	105,475,290
OCM Opportunities Fund V	Distressed Debt	7/14/2004	40,000,000	40,003,507	43,836
OCM Opportunities Fund VI, L.P.	Distressed Debt	9/14/2005	40,000,000	14,000,000	0
OCM Principal Opportunities	Distressed Debt	11/12/1996	25,000,000	25,057,879	21,624,589
OCM Principal Opportunities II	Distressed Debt	3/14/2001	25,000,000	25,000,000	19,028,645
OCM/GFI Power Opportunities Fund II, L.P.	Buyouts	4/27/2005	25,000,000	4,208,548	29,205
Oakhill Capital Partners	Buyouts	5/17/1999	50,000,000	52,034,224	34,856,494
Oaktree Capital Management LLC	Diversified	5/28/2004	20,000,000	20,577,053	1,976,914
Palamon European Equity L.P.	Buyouts	7/23/1999	30,000,000	29,025,951	19,557,817
Palamon European Equity II L.P.	Diversified	*	40,114,200	0	0
Parthenon Investors II	Mid Market Buyouts	9/25/2001	20,000,000	13,671,372	7,623,606
Permira European Fund	Buyouts	7/1/1997	36,000,000	32,159,947	66,356,857
Permira European Fund II	Buyouts	6/7/2000	50,000,000	37,408,893	34,412,322
Permira European Fund III, L.P.	Buyouts	10/3/2003	112,640,170	41,214,370	10,777,500

Active Funds Private Equity Limited Partnership	Financing Stage Focus	SERS Initial Funding	Capital Committed	Capital Drawn	Distributions
Permira UK Venture Fund III	Buyouts	8/29/1989	9,063,438	8,946,988	26,106,191
Permira UK Venture Fund IV	Buyouts	4/2/1996	15,000,000	15,993,572	19,584,370
Providence Equity Partners IV LP	Middle/Later Stage	10/25/2000	25,000,000	23,986,647	13,950,837
Providence Equity Partners V LP	Mid Market Buyouts	7/14/2004	50,000,000	6,939,916	0
RRZ Private Equity	Buyouts	11/7/1996	20,000,000	20,024,505	10,848,280
SCP Private Equity Partners II L.P.	Buyouts	6/15/2000	25,000,000	20,377,446	1,706,851
ShoreView Capital Partners	Buyouts	4/23/2003	38,000,000	22,724,896	5,935,510
Sterling Capital Partners II	Buyouts	3/16/2005	30,000,000	3,470,043	0
Sterling Capital Partners LP	Buyouts	10/15/2002	15,000,000	9,282,757	2,754,216
Summit Ventures VI LP	Later Stage	1/11/2001	62,000,000	47,752,929	10,197,052
Summit Partners Private Equity Fund VII L.P.	Private Equity	*	97,134,500	0	0
TA/ Advent IX	Later Stage	9/20/2000	45,000,000	38,700,000	15,739,096
TPG Partners II	Buyouts	5/2/1997	75,000,000	76,320,468	58,051,392
TPG Partners III	Buyouts	12/15/1999	75,000,000	68,365,858	58,942,842
TPG Partners IV	Buyouts	12/3/2003	30,000,000	16,316,107	3,655,090
Thomas H Lee Equity Fund V LP	Buyouts	7/1/2000	100,000,000	84,949,184	47,501,451
Thomas H. Lee Equity Fund IV LP	Buyouts	4/24/1998	70,000,000	63,384,100	33,551,411
UMS Partners Fund I, L.P.	Distressed Debt	7/14/2004	10,000,000	3,500,000	0
Vestar Capital Partners III	Buyouts	5/7/1997	25,000,000	22,944,027	18,098,980
Vestar Capital Partners IV L.P.	Mid Market Buyouts	11/22/1999	100,000,000	76,548,917	39,170,109
Vestar Capital Partners V	Mid Market Buyouts	*	50,000,000	0	0
TOTAL Active Private Equity			<u>\$6,106,236,006</u>	<u>\$4,024,220,564</u>	<u>\$3,014,207,245</u>

*Not funded as of 9/30/05.
Commitments as of 12/31/05
Cash flows as of 9/30/05

Inactive Private Equity

	Capital Committed	Capital Drawn	Distributions
TOTAL Inactive Private Equity	<u>\$57,500,000</u>	<u>\$57,882,394</u>	<u>\$101,649,373</u>



Pennsylvania Investments Summary

as of Dec. 31, 2005

Pennsylvania Investments Summary

as of December 31, 2005

The SERS Board, employees of SERS and agents of the Board stand in a fiduciary relationship to the members and beneficiaries of the System regarding the investments and disbursements of the Fund. Subject to "prudent person" investment responsibilities contained in the Retirement Code and the Fiscal Code, the Board has exclusive control and management of the Fund and full power to invest the assets of the Fund. The Board adopted a formal Statement of Investment Policy in 1979, which was last revised effective October 27, 2004 to reflect and incorporate subsequent legislative and policy changes governing investments. Where investment characteristics including yield, risk and liquidity are equivalent, the Board's policy favors investments that have a positive impact on the economy of Pennsylvania.

The most significant impact the Fund can have on the State's economy is to manage an overall program that achieves a fully funded status and lowers the employer contributions to the Fund below the normal cost. The Fund has been successful in these endeavors, maintaining a well funded status since 1992 and reducing the employer contributions from over 18% in 1981 to the current rate of 3.02%. These reduced employer contributions below the actuarial normal cost projections saved the taxpayers in excess of \$2 billion. The reduction of such contributions may then be used by the legislature for purposes it deems most important to Pennsylvania citizens and taxpayers, such as tax reduction, economic development or other priorities. Nevertheless, the Fund also seeks to invest in State-based companies and other State entities when investment characteristics are equivalent.

Market Value of Pennsylvania Investments as of December 31, 2005: SERS' assets had an unaudited market value in Pennsylvania investments of approximately \$1,353.6 million on December 31, 2005 (4.7% of SERS total fund).

SERS Pennsylvania Investments By Asset Class (In \$ millions)

Asset Class	Total PA Market Value
U.S. Stocks	\$422.6
Fixed Income	86.4
Real Estate	303.8
Venture Capital	99.8
Private Equity	441.0
Total	\$1,353.6

SERS investment portfolios have historically had substantial investments in Pennsylvania firms, as some large national firms are headquartered in the Pittsburgh, Philadelphia and Harrisburg areas, including Hershey Foods, Cigna Corp., Rohm & Haas Co., and H. J. Heinz Co. In addition, SERS has invested in portfolios that are designed to give emphasis to investments in Pennsylvania while meeting the fiduciary standards mentioned previously.

Stocks: SERS has two Pennsylvania stock portfolios that increase exposure to "in-state" corporations. SERS' Pennsylvania stock universe is comprised of 333 publicly-traded corporations which: 1) name their headquarters as Pennsylvania and have Pennsylvania employees or operations; or 2) have Pennsylvania-based employment exceeding 25% of total corporate employment. Emerald Advisers, Inc. of Lancaster and Mellon Equity Associates of Pittsburgh actively manage portfolios principally derived from SERS' Pennsylvania stock universe. The market value of SERS' two Pennsylvania stock funds was \$413.8 million as of December 31, 2005. The following were some of the top-performing Pennsylvania stocks for the year-to-date ending December 31, 2005:

Pennsylvania Investments Summary *(continued)*

Company	Location	December 2005
<p>ViroPharma</p> <p>ViroPharma is a company committed to the commercialization, development, and discovery of new antiviral medicines. The Company is focusing on a number of ribonucleic acid virus diseases, including viral meningitis and viral respiratory infection.</p>	Exton	470.8%
<p>JLG Industries</p> <p>JLG Industries manufactures, distributes, and markets aerial work platforms, variable-reach material handlers, and hydraulic excavators. The Company sells its products to independent distributors who rent and sell the Company's products to a broad range of customers.</p>	M'Connellsburg	132.8%
<p>Sunoco</p> <p>Sunoco refines and markets petroleum, as well as transports crude oil and refined products. The Company's petroleum products include fuels, lubricants, and petrochemicals. Sunoco's operations are conducted principally in the eastern half of the United States.</p>	Philadelphia	94.2%
<p>Ansoft Corporation</p> <p>Ansoft Corporation develops, markets, and supports electronic design automation software based on electromagnetic principles. The Company's software is used by engineers in the design of high performance electronic devices and systems, such as cellular phones and computer circuit boards.</p>	Pittsburgh	68.6%
<p>Atlas America</p> <p>Atlas America is an independent energy company that develops, produces, and transports natural gas and oil in the Appalachian Basin of the United States. The Company's principal operations include well drilling, as well as oil and gas production.</p>	Moon Township	68.5%
<p>Allegheny Technologies</p> <p>This Company produces specialty materials. The Company's products include stainless steel, nickel and cobalt-based alloys, and other specialty materials. Allegheny Technologies also produces precision forging and iron castings.</p>	Pittsburgh	68.2%
<p>Allegheny Energy</p> <p>Allegheny Energy is an electric utility holding company. The Company, through various subsidiaries, serves customers in parts of Maryland, Ohio, Pennsylvania, Virginia, and West Virginia.</p>	Greensburg	60.6%
<p>CONSOL Energy</p> <p>CONSOL Energy produces high-BTU bituminous coal, and also coal bed methane gas. The Company markets coal primarily to the electric power generation industry, and secondarily to other consumers of coal. The majority of CONSOL's mines employ longwall mining systems, which are capital-intensive operations with a low variable cost structure.</p>	Pittsburgh	60.4%

Pennsylvania Investments Summary *(continued)*

In addition to the two Pennsylvania stock portfolios, SERS also had an additional \$63.4 million invested in the stock of Pennsylvania companies as of December 31, 2005. These stocks were held in SERS' S&P 500 Index fund and in SERS actively managed portfolios providing a total of \$422.6 million invested in Pennsylvania companies.

Fixed Income: In 1998, the SERS Board approved the funding for the Pennsylvania Capital Fund with a \$50 million allocation committed to the program. The program commenced in March 1999 and is being managed by Berwind Financial Group (Berwind) and PNC Equity Management (PNC). Each advisor was awarded commitments of \$25 million to be invested over four years. Both entities provide a match to SERS' investment. The program provides debt financing to support the expansion and growth of Pennsylvania small business. The Fund seeks to lend to established, profitable, companies in good financial condition with annual revenues between \$10 and \$100 million. The majority of the Fund's investments had a maturity of between five and ten years. Loan amounts usually ranged from \$2 million to \$15 million. As of December 31, 2005, SERS portion of Berwind investments totaled \$11.9 million while PNC investments had matured and all capital was returned to SERS during the fourth quarter of 2005. Some of Berwind's investments have also matured and the capital was distributed back to SERS. Examples of some of SERS' investments through The Pennsylvania Capital Fund as of December 31, 2005 are:

- Berwind invested \$3.8 million in senior subordinated debt from Synogy, Inc. of Conshohocken. Synogy is a leading provider of Enterprise Incentive Management software and services.
- Berwind invested \$2.0 million in redeemable preferred stock from Elite Health Solutions, Inc of Mechanicsburg. Elite Health Solutions provides portable X-ray and related mobile diagnostics services primarily at nursing homes and correctional facilities.

As of December 31, 2005, SERS had \$5.7 million invested in Pennsylvania mortgages through Legg Mason. The commercial mortgages are for a community shopping center located in Lewistown, Pa. (Mifflin County Commons). It is estimated that as of December 31st, 2005, the various commercial projects financed within the Commonwealth by SERS under the commercial mortgage program have directly employed thousands of Pennsylvania workers during the lifetime of the program. This figure does not take into account those who are employed in the property management and maintenance areas of these projects, nor does it consider the favorable "ripple effect" that such jobs may have on the local economy.

Additionally, SERS had approximately \$68.8 million invested as of December 31, 2005, in corporate securities issued by Pennsylvania-based companies. These securities are held in SERS' various externally managed bond portfolios.

Cash: SERS is one of the largest investors in the Pennsylvania State Treasury Department's Short Term Investment Pool.

Pennsylvania Investments Summary *(continued)*

Real Estate: In 1987 SERS began investing directly in the Pennsylvania commercial real estate market and subsequently established two separate account real estate portfolios. The portfolios, managed by Heitman Capital Management and Legg Mason Real Estate Services (LMRES), formerly RAI Advisors, Inc., have a Pennsylvania focus. The Heitman separate account had a requirement to invest on a best efforts basis 50% of its initial allocation within the Commonwealth while the LMRES account is focused primarily on investing within the state.

As of September 30, 2005, the SERS real estate portfolio contained 71 Pennsylvania properties totaling 16 million square feet ("s.f.") of office, retail and warehouse space, and 4,113 apartment, hotel and senior housing units. The gross market value of the Pennsylvania real estate portfolio investments totaled \$1,702 million, of which SERS' ownership share was \$303.8 million. The portfolio contains numerous notable Pennsylvania real estate investments:

- **30 N. Third Street** - SERS owns a 100% interest in this major downtown Harrisburg office building, which contains 200,000 s.f. of office space. The building serves as both an investment for SERS and as SERS' headquarters, in addition to providing office space for other businesses with operations in the city.
- **79 North Industrial and Research Park** - This investment, located in Allegheny County, consists of eight industrial buildings with a total of 473,578 s.f. and 83 acres of undeveloped land.
- **Koppers Building** - SERS acquired this 356,439 s.f. 34-story landmark office building located in downtown Pittsburgh in May 1997.
- **Park Ridge One and Two** - These two five-story suburban Pittsburgh office buildings, which total 206,279 s.f., were transferred from SERS mortgage portfolio in the first quarter 1999.
- **General Residential Holdings** - Under the oversight of Legg Mason, SERS has invested with a local developer in eight separate land holdings in the Philadelphia area. To date, five of the parcels have been sold.
- **Lehigh Valley Industrial** - In August 1998 SERS began investing in the purchase of prime industrial parcels located in the Lehigh Valley area, with the guidance of Legg Mason and a local operator.
- **Kinzua Management Unit** - In July 1998 SERS invested in 18,602 acres of hardwood timberland located in seven Pennsylvania counties and one New York county, all within the Allegheny region. Subsequently, in the first quarter of 1999 an additional 2,197 acres of Pennsylvania timberland was purchased. The existing SERS timberland manager, Forest Investment Associates, manages these holdings.

Pennsylvania Investments Summary *(continued)*

Real Estate Separate Account Pennsylvania Properties as of September 30, 2005*

	Property	Location	Description	Market Value of SERS (\$ millions)	Manager
1.	30 North Third St.	Harrisburg	10-story office building containing 193,000 s.f.	\$21.1	Heitman Capital Management
2.	William Penn Plaza	Monroeville	9-story office, 138,000 s.f. building plus hotel land lease	13.3	Legg Mason Real Estate Services
3.	I-79 North Industrial Park	Allegheny County	8 industrial buildings containing 473,000s.f. in a self-contained park	19.1	Legg Mason Real Estate Services
4.	Koppers Building	Pittsburgh	356,439 s.f. office	18.9	Legg Mason Real Estate Services
5.	General Residential Holdings	Chester County	residential land development	10.5	Legg Mason Real Estate Services
6.	Lehigh Valley Industrial	Lehigh Valley	Industrial land development	5.1	Legg Mason Real Estate Services
7.	Park Ridge One & Two	Pittsburgh	two office bldgs, total s.f. 206,479	12.1	Legg Mason Real Estate Services
8.	Toll Brothers Realty Trust	Huntington Valley	Private REIT	44.4	Legg Mason Real Estate Services
9.	Toll Brothers Realty Trust II	Huntington Valley	Private REIT	17.5	Legg Mason Real Estate Services
10.	1180 Church Road	Lansdale	455,000 s.f. office/warehouse	27.1	Legg Mason Real Estate Services
11.	Alcoa Bus. Center	Pittsburgh	229,000 s.f. office bldg	15.6	Legg Mason Real Estate Services
12.	Dewey Homes Gty	Philadelphia	Gty to Bank for land	11.1	Legg Mason Real Estate Services
13.	Station Square	Lansdale	348 multifamily units	14.9	Legg Mason Real Estate Services
14.	Courtyard by Marriott	Collegeville	130 room hotel	2.2	Legg Mason Real Estate Services
15.	Kinzua Mgmt Unit	Various PA counties	timber	74.1	Forest Investment Associates
	Total			\$307.0^{1/}	

* Real estate market values and detailed property data lags by one quarter due to the timing of the receipt of private market valuations and information. "Separate Account" denotes assets that are owned by entities controlled by SERS.

^{1/}Net Market Value exclusive of property leverage. Legg Mason also uses portfolio debt which equaled \$24 million at 9/30/05.

Pennsylvania Investments Summary *(continued)*

Alternative Investments

The Alternative Investments program is comprised of investments in venture capital and private equity. Both sub-asset classes seek investment in limited partnerships that offer attractive risk-adjusted net returns materially exceeding those likely to be produced by SERS' public stock investments. Although the Board's fiduciary duty is to SERS' members and beneficiaries, investments in Pennsylvania provide an ancillary and subordinate benefit to the state's economy. The investment policy acknowledges that such benefit, e.g., derived from investments in Pennsylvania-based companies, or firms employing Pennsylvanians, should be considered after other primary fiduciary investment characteristics are satisfied.

The market value as of December 31, 2005, of the Alternative Investments asset class stood at \$3,623.3 million, and represented 12.6% of the Fund. SERS had 260 commitments to active limited partnerships: 108 to venture capital partnerships and 152 to private equity partnerships. Of the 260 active commitments, 11.5% are to funds sponsored by Pennsylvania-based investment managers. As of September 30, 2005, Pennsylvania-based investment managers generated a net IRR of 6.2%.

The Alternative Investments program also seeks to attract funds with a national focus to invest in Pennsylvania businesses. Many of SERS' fund sponsors function as lead investors and, in turn, provide Pennsylvania with capital from numerous out-of-state investors. As of December 31, 2005, SERS' Venture Capital and Private Equity partnerships invested in 130 Pennsylvania companies employing approximately 20,500 employees with payrolls of \$1.0 billion. The market value of these investments is \$4.7 billion. In addition, partnerships in which SERS participates invested in 105 companies not domiciled in Pennsylvania but who employ 13,800 Pennsylvania citizens with payrolls of \$406 million. The business activities of both groups combined are considerable; these companies employ approximately 34,300 Pennsylvanians and have an estimated annual payroll of approximately \$1.4 billion. These large nationally-oriented fund sponsors bring sophisticated managerial and operational expertise to Pennsylvania companies, further leveraging SERS' invested capital. Based on a 3.07% income tax rate this generated 2005 state income tax revenue of approximately \$43 million.

Venture Capital

A 2004 study completed by the National Venture Capital Association ranked the top five states by employment at venture capital backed firms headquartered in state as of 2003. Pennsylvania ranked 4th with 604,000 employees at venture backed firms. California ranked 1st, Texas 2nd, and Massachusetts 3rd.

Venture Capital: SERS has a long history of funding venture capital programs focused on Pennsylvania. The program commenced operations in 1985 when SERS made commitments to four managers.

Throughout the 1990's SERS maintained a steady pace of investing with Pennsylvania managers. Between 1993 and 1998 SERS committed \$255 million with six different managers overseeing eight funds. During this time period, SERS also committed \$50 million with Grotech Capital Partners, a manager headquartered outside of Pennsylvania that specifically sought Pennsylvania-based opportunities. During 1999, SERS made commitments to several new Pennsylvania venture capital managers. These included Draper Triangle Advisors, Adams Capital Management, and Cross Atlantic Technology. SERS' commitments to 1999 vintage year funds totaled \$70 million.

The steady pace of Pennsylvania investing continued in 2000, 2001 and 2002. Sixteen percent of SERS' 2000 venture capital commitments were made to four Pennsylvania-based venture capital managers, 17% of 2001 venture commitments were made to three Pennsylvania managers and in 2002, 19% of committed capital was allocated to two Pennsylvania-based managers. In 2003, the SERS Board allocated 12.6% of its venture commitments to a Pennsylvania based manager, Draper Triangle Capital Corp. As of December 31, 2005, 19.9%

Pennsylvania Investments Summary *(continued)*

of active venture capital commitments are allocated to Pennsylvania-based venture capital managers.

The following companies are examples of Pennsylvania venture capital investments funded by SERS' venture capital partnerships:

- **Brandywine Senior Care, Inc.** (Grotech IV, V) Brandywine Senior Care was formed in 1996 and is striving to become the least costly highest-quality provider of the non-acute continuum of care. They own and manage skilled nursing rehabilitation centers as well as assisted living residences. 790 Pennsylvania residents are employed by Brandywine with an annual payroll of \$17.5 million.
- **St. George Crystal** (APEX V) St. George Crystal designs, manufactures and markets fine lead crystal for all market levels from mass merchandisers to private labels and specialty retailers. The company is located in Jeannette, Pennsylvania. St. George employs 265 Pennsylvania residents with an annual PA payroll of \$7.5 million.
- **TargetRx** (Quaker BioVentures, NEA 9) TargetRx offers member physicians an online forum to share their attitudes and beliefs with pharmaceutical companies through surveys and other market research activities. Physicians gauge the effectiveness of existing therapies and identify the need for new treatments. TargetRx is based in Horsham. The company currently employs 99 PA residents. The total annual PA payroll approximates \$8 million.
- **Traffic.com** (TL Ventures III, IV and PA Early Stage III) Traffic.com provides real-time traffic information to consumers. The company employs 196 PA residents and is headquartered in Wayne.

Private Equity

SERS' initial Pennsylvania-focused private equity investment was made in 1988, when SERS invested \$10 million with RR&Z Pennsylvania Fund #1. In 1996, SERS committed \$20 million to the RR&Z Private Equity Fund, which was a continuation of the strategy developed in Pennsylvania Fund #1. Over the course of two years, 1999 and 2000, SERS committed \$75 million with three Pennsylvania based private equity managers; Gladwyne Partners LLC, LLR Management, and SCP Private Equity Partners. During 2003 and 2004, the SERS Board approved a \$25 million commitment to LLR Equity Partners II and a \$10 million commitment to UMS Partners Fund I. In 2005 SERS continued to invest with Pennsylvania based private equity managers. The Board committed to invest up to \$20 million to Eureka II, L.P.

As with venture capital, SERS' search for private equity fund managers includes those with a history of investing in Pennsylvania-based companies although the investment firm itself may not be headquartered in Pennsylvania. These managers include, but are not limited to, ABS Capital Partners, Blackstone Capital, Code Hennessy & Simmons, Golder Thoma Cressey & Rauner, Media Communications and Oaktree Capital Management.

The following companies are examples of Pennsylvania investments funded by SERS' private equity partnerships:

- **Graham Packaging** (Blackstone Capital Partners III) A worldwide leader in the design, manufacture, and sale of customized blow molded plastic containers for the branded food and beverage, household and personal care, and automotive lubricants markets with 56 plants throughout North America, Europe, and Latin America.
- **Nexstar Broadcasting Group, Inc.** (ABRY III) Nexstar is a television broadcasting company that focuses on

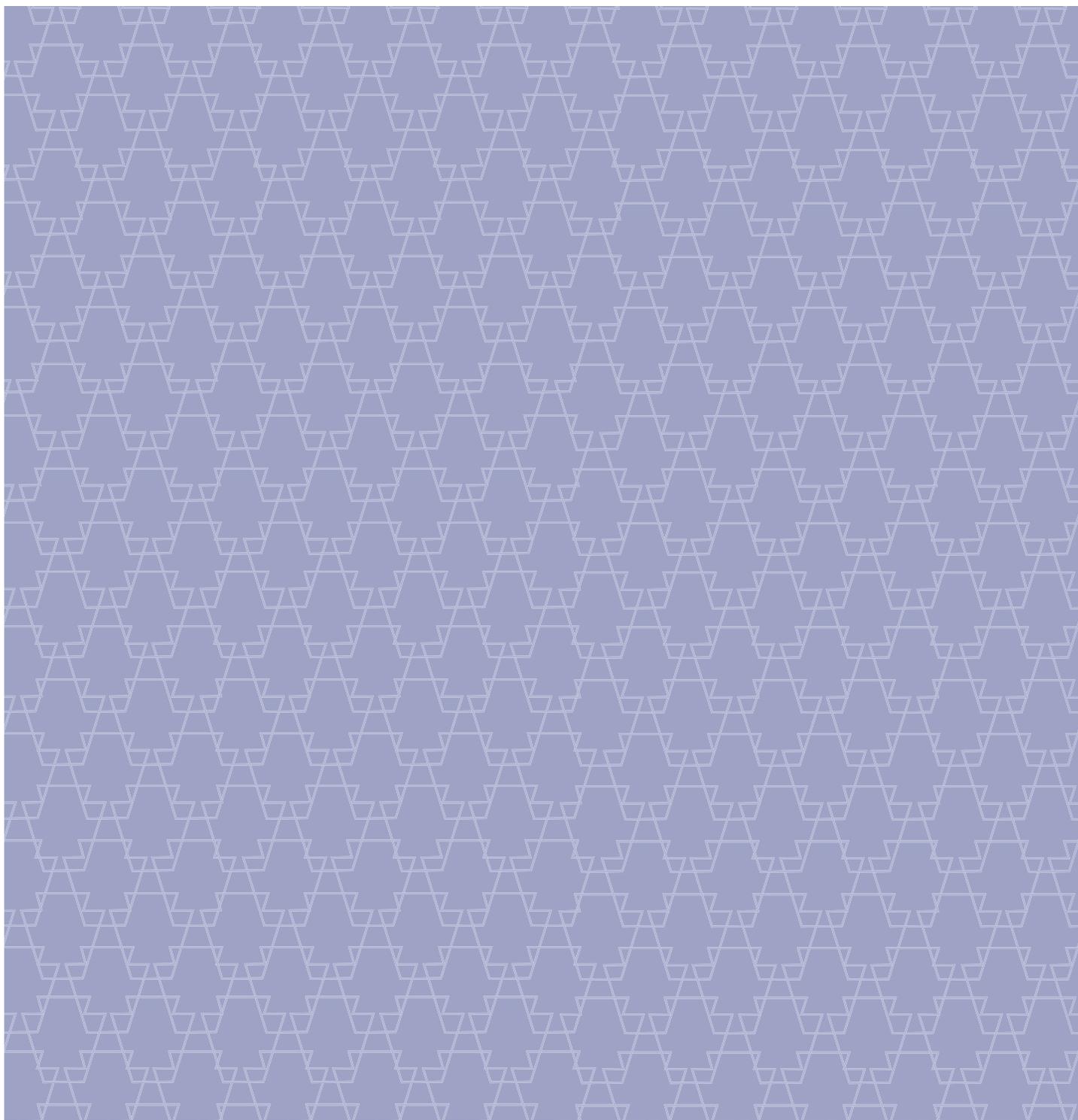
Pennsylvania Investments Summary *(continued)*

the acquisition, development, and operation of television stations in medium-sized U.S. markets. Nexstar employs 229 Pennsylvania residents at an annual payroll of \$8.1 million.

- **Sungard Data Systems** (Providence Equity V, Blackstone Capital Partners IV, Blackstone Communications I, TPG Partners III and TPG Partners IV) Sungard's main corporate office is located in Wayne, Pennsylvania. SunGard provides software and processing solutions for financial services, higher education and the public sector. The company also helps information-dependent enterprises of all types to ensure the continuity of their business. On a global basis, SunGard serves more than 25,000 customers in more than 50 countries. Sungard employs 1,850 Pennsylvania residents earning total annual salaries of \$137 million.
- **TMG Health, Inc.** (SCP Private Equity Partners II) TMG offers business process outsourcing services to the Medicare, Medicaid, and retiree health plan markets. TMG provides operational outsourcing solutions and information systems for health plans, providers and insurers. The company is headquartered in King of Prussia with its national operation center located in Scranton. TMG currently employs approximately 700 PA citizens.

Women/Minority Advisors and Brokers

as of Dec. 31, 2005



Women/Minority Investment Advisor and Broker Report

December 31, 2005

Investment Advisors

The following five women or minority-owned firms were under contract with SERS to provide investment advisory services as of December 31, 2005.

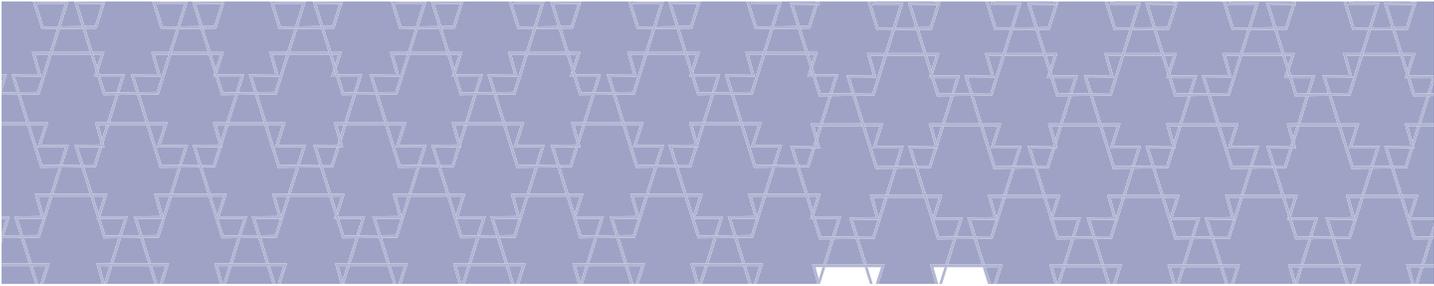
Firm	Status	SERS Assets Under Management
Fairview Capital I & II	Minority Woman-Owned	\$20.0 million commitment (19.3 million actually funded)
MDL Capital Management	Minority-Owned	92.4 million (market value)
Pacific Alternative Asset Management Co.	Woman-Owned	1,496.7 million (market value)
Taplin, Canida	Minority Woman-Owned	100.4 million (market value)

Brokers and Brokerage Commissions

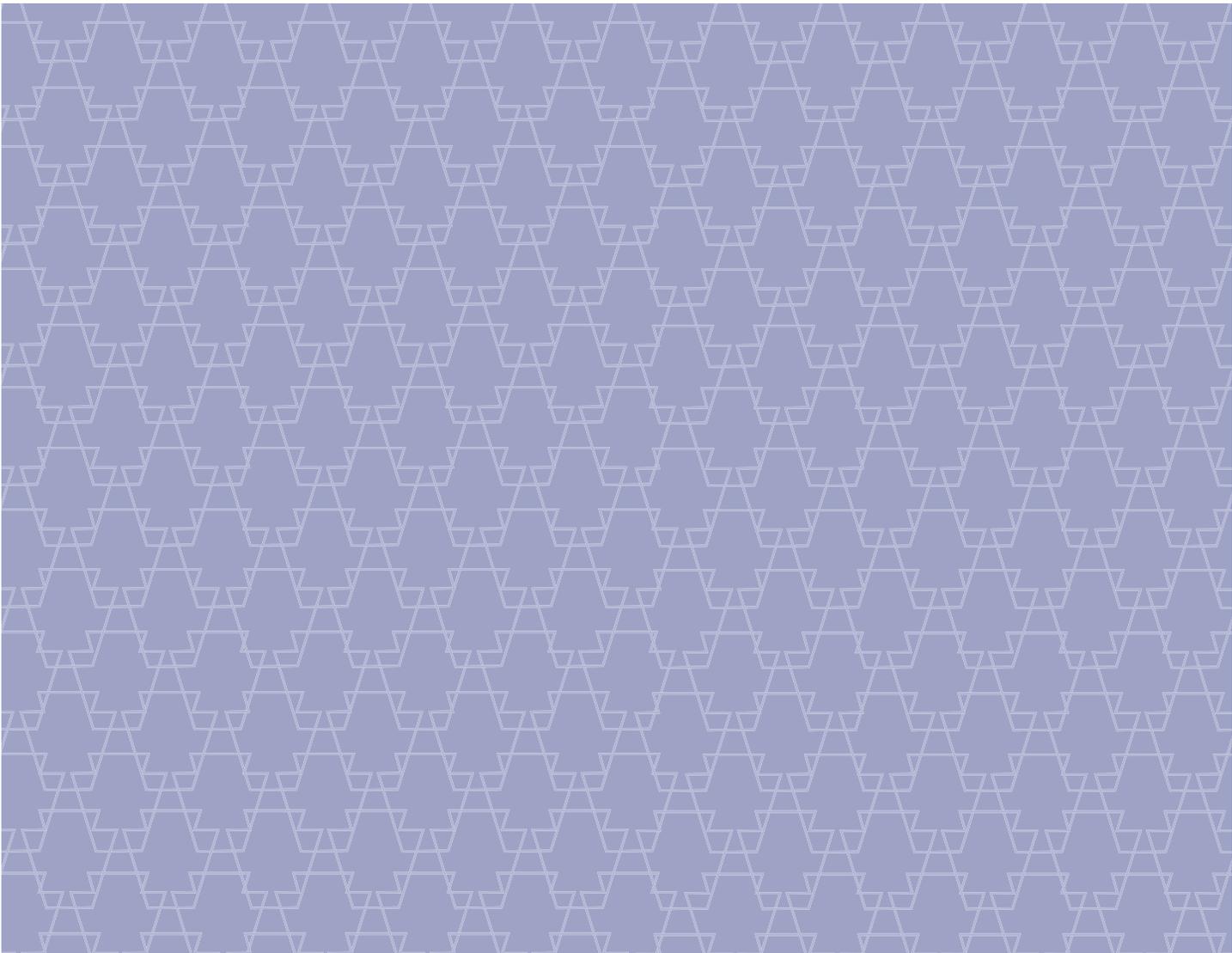
SERS's external investment advisors utilized the following minority-owned brokerage firms during calendar year 2005.

Firm	SERS Commissions	Firm	SERS Commissions
BOE Securities	\$12,120	Magna Capital	\$46,636
Berean Capital	7,766	Mogavero Lee & Co	11,004
Blaylock Partners	28,523	Montrose Securities	8,478
Cabrera Capital Markets	13,613	Mischler Financial Group	39,756
East West Securities	81,816	PCS Securities	15,806
Guzman & Company	366	Pacific American	100,108
Institutional Capital	33,035	Saratoga	59,299
Ivy Securities	59,214	Seslia Securities	57,850
Jackson Partners	2,754	UBS Warburg	2,424
Loop Capital	9,444	Williams Capital Group	46,205
		YSC Global	16,827
Total Minority Commissions \$757,125			

Minority commissions totaled \$757,125 for the year. Of this amount, international stock managers had \$161,509 of commissions credited to minority brokers. The SERS Board has a policy of targeting 5%-10% of domestic stock commissions to be done with minority brokers. This year SERS did 11.0% with the domestic stock managers. In addition, although not included in the Board mandate, other SERS advisors are encouraged to trade through minority brokers. Last year fixed income managers traded \$98.4 million of securities through minority brokers.



Deferred Compensation Program



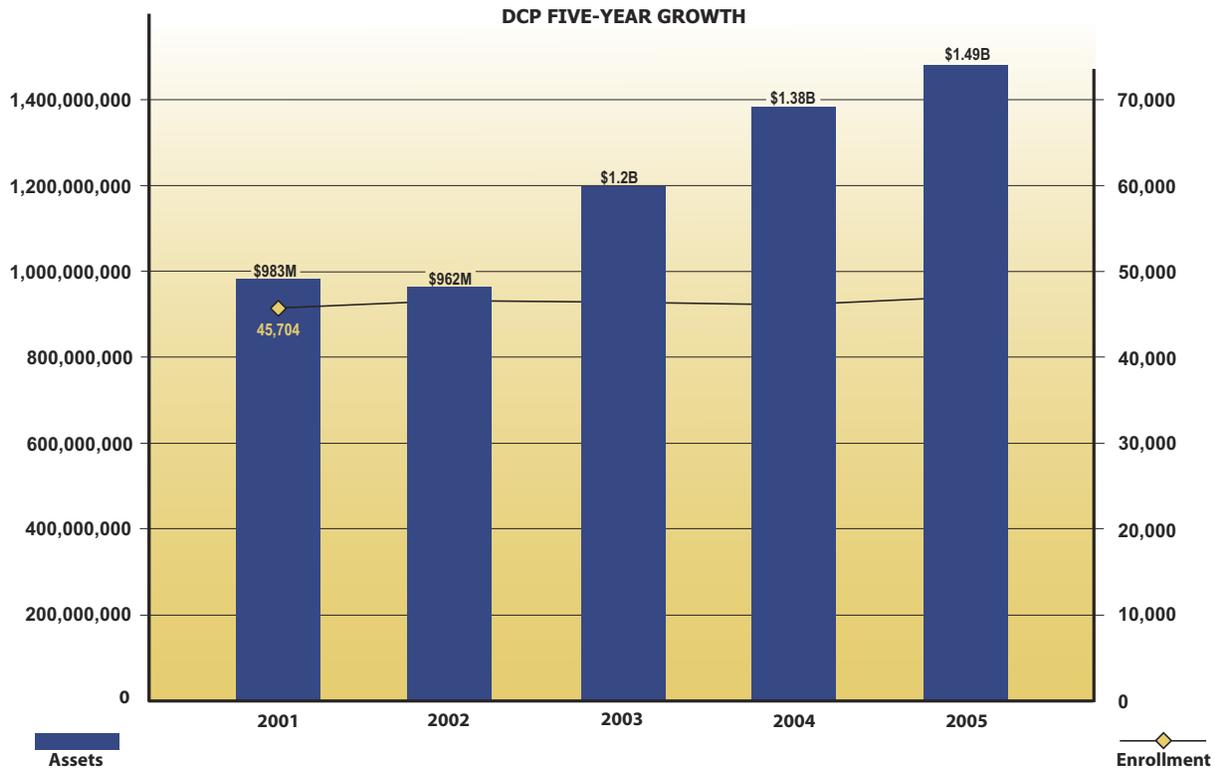
Deferred Compensation Program

Program History

Act 1987-81 assigned to the SERS Board (SERB) the responsibility to establish and monitor a Deferred Compensation Program for Commonwealth officers and employees, through which participants may voluntarily build retirement savings by deferring a portion of salary to selected investment options. The Program is established as a trust, and is administered in accordance with Internal Revenue Code Section 457(b). Through the Request for Proposal process, the SERB selected Great-West Retirement Services as Third Party Administrator (TPA) of the Deferred Compensation Program. The duties of the TPA are to maintain individual participant records, market the program to participants, and counsel the members about the Program's benefits. The core investment options are selected by the SERB, and are independent of the TPA's functions.

Growth of the Program

Over the past five years, the Program's assets have significantly increased in value from \$983 million to approximately \$1.5 billion. As of December 31, 2005, there were 46,917 active and inactive participants in the Program. Almost 46% of all eligible employees participate in the Program. The amount of annual participant deferrals over the past five years increased from \$112 million in 2001, to over \$134 million in 2005. Benefit payments to participants likewise increased over that same time span, from \$28 million in 2001, to \$39 million in 2005. The chart below depicts the Program's asset and participation growth over the past five years.



Deferred Compensation Program *(continued)*

Program Highlights

The Program provides participant assistance via individual and/or group counseling sessions with the eligible employee, at the employees' work site. The TPA has established a local walk-in office in the Harrisburg downtown area. A toll free telephone service with counselors is also available to offer personal assistance. A telephone Voice Response Unit can be accessed at anytime to allow the participant to check on their account balances, or transfer funds among different investment options. The participants may also access the Program's Web site to view their most recent investment position, to make future allocation changes and to transfer among investment options. Over the past year the Program has enhanced the Web site security for the participant by eliminating the use of social security numbers during the sign-in process.

