

Missouri State Employees' Retirement System
A Component Unit of the State of Missouri

A Little Change Today Can Make a Big Difference Tomorrow



Comprehensive Annual Financial Report

Fiscal Year Ended June 30, 2003



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A Component Unit of the State of Missouri



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Fiscal Year Ended June 30, 2003

Gary Findlay
Executive Director

Gary Irwin
Chief Finance Officer



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* Missouri State Employees' Plan

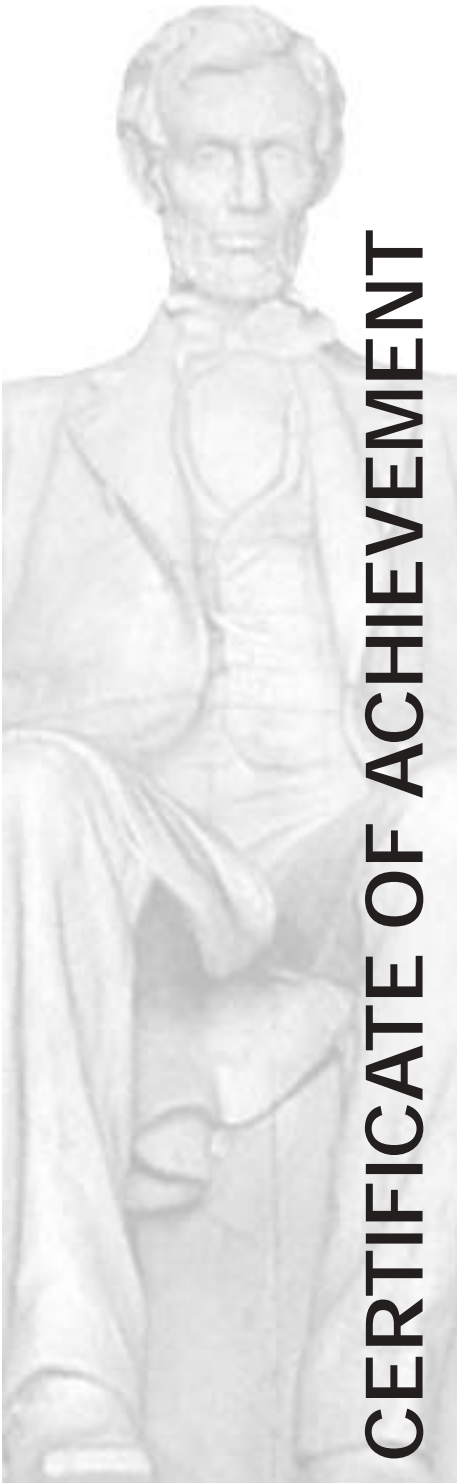
**Administrative Law Judges and Legal Advisors' Plan

The penny is part of our nation's history and culture. It was the first coin authorized to be minted by the government, with Benjamin Franklin suggesting its original design. Over the centuries, the penny's design has symbolized the spirit of the nation, from Liberty to Lincoln. The penny has been an integral part of the American experience. Whose childhood would be complete without penny candy and other small purchases?



A penny for your thoughts





Letter of Transmittal



October 1, 2003

The Board of Trustees
Missouri State Employees' Retirement System
907 Wildwood Drive
Jefferson City, MO 65109

Dear Board Members:

It is with great pleasure that I submit the annual report of the Missouri State Employees' Retirement System (MOSERS).

Report Contents and Structure

MOSERS is considered a component unit of the state of Missouri for financial reporting purposes and, as such, the financial statements contained in this report are also included in the *State of Missouri's Comprehensive Annual Financial Report*. The financial information presented in this report is the responsibility of the management of MOSERS, and sufficient internal accounting controls exist to provide reasonable assurance regarding the safekeeping of assets and fair presentation of the financial statements, supporting schedules, and statistical tables. The report is also designed to comply with the reporting requirements of Sections 104.480, 104.1006, and 105.661 of the Revised Statutes of Missouri (RSMo) as amended. The report is divided into the following five sections:

- The Introductory Section, which contains general information regarding the operations of MOSERS;
- The Financial Section, which contains a management discussion and analysis report, the independent auditors' opinion, the financial statements and notes thereto, and required

supplementary information regarding the funds administered by MOSERS;

- The Investment Section, which contains information pertaining to the management of the investments of the pension trust funds, including reports from the system's chief investment officer and investment consultant;
- The Actuarial Section, which contains information regarding the financial condition and financial position of the retirement plans administered by the system, including the retained actuary's opinion and the opinion of an independent reviewing actuary; and,
- The Statistical Section, which contains general statistical information regarding system participants and finances.

Fiscal Year 2003 Highlights

Deferred Retirement Option Provision

This was the first full year following implementation of the Deferred Retirement Option Provision (BackDROP), which became available to general state employees on January 1, 2002. For the year ended June 30, 2003, 610 retiring members elected the BackDROP option and received \$40.5 million in BackDROP payments. This may be compared to the six-month period ending June 30, 2002 during which 308 members elected the BackDROP option and received \$19.2 million in BackDROP payments.

Legislation Enacted During the 2003 Legislative Session

Senate Bill 248, enacted this year, created a health care retirement incentive plan for general state employees eligible to retire on or after February 1, 2003 through January 1, 2004 and who actually retired no later than September 1, 2003. Under this legislation, an eligible member who retired during the window period could elect to continue their state-sponsored health care coverage for him/herself and any eligible dependents at the same cost as if such retiree were an active employee. The retiree is eligible for the active employee rate for a maximum period

of five years or until becoming eligible for Medicare, whichever occurs first, at which time the rate reverts to the applicable rate for retiree coverage. The legislation also limits the number of employees departments may hire to replace those employees who retired under the incentive to no more than 25% of the positions vacated. Exceptions to the 25% restriction may be made for critical, seasonal and positions that are 100% federally funded. In addition, the colleges and universities have been excluded from the 25% restriction. The legislation further requires MOSERS, the Missouri Consolidated Health Care Plan, and the State's Office of Administration to provide written reports by April 1, 2004 to the Governor and General Assembly regarding the various financial impacts of this retirement incentive.

The prompt delivery of accurate information to eligible members was particularly critical at this time in order to allow members sufficient time to make decisions about participating in the incentive program. That is because participation required members to submit retirement applications by July 31, 2003 in order to be eligible to retire by the September 1, 2003 deadline.

Update on Service Purchases Rollover Activity

The volume of service purchases remained at somewhat elevated levels during the fiscal year primarily due to the federal legislation that went into effect January 1, 2002 which allowed members to rollover their 457 deferred compensation funds to purchase service, combined with the retirement incentive legislation enacted during the year. During the fiscal year ended June 30, 2003, approximately \$3.7 million was received for the purchase of service credit whereas \$3.9 million was received during the fiscal year ended June 30, 2002. During both years, rollovers represented approximately 63% of the service purchase funds received.

Technology Improvements

We have continued to capitalize on technology to keep pace with and improve on our delivery of quality customer service. While we continue to use our newsletters, brochures, phone counseling, and group meetings to ensure that all prospective retirees have sufficient information to make informed decisions, a primary focus this year was improving member access to information via the system's web site. Upon request, members are issued a personal

identification number (PIN) that can be used to gain access to the data we maintain. Members are now able to view their personal information in our database and produce their own benefit estimates without the intervention of a benefits specialist. The volume of estimates being produced in this manner suggests that this is very popular. We anticipate that this will become an increasingly attractive customer service feature.

In addition to our web site improvements, this year we equipped each benefits specialist with two flat screen monitors, thus providing them with the ability to view database information and imaged records at the same time they are counseling a member in person or over the phone, which speeds up the process considerably. The benefit specialists can also use the second screen to show detailed information to members during one-on-one counseling sessions.

The speed with which new information is added to the files and the accuracy of that information is vital to our success. By adding faster scanners, we have now reached the point where all information received is scanned and routed within 24 hours of receipt. In addition, we have improved the accuracy of the keying and document routing process through an audit function established within the records management section.

Focus Groups and Surveys

To assure that we are on target with our newsletters, brochures, and seminars, we have continued the use of focus groups in developing and delivering our final products. During the fiscal year, we conducted focus group meetings on our BackDROP benefit estimates and our *Summary Annual Report*. We believe the focus group process has given us a much better understanding of how to effectively serve our members, and we will continue to use them in the future.

Using telephone log information, we randomly select about 60 members each month who called with an inquiry. Those individuals are sent a customer service survey covering a range of subjects. Survey forms that are returned are reviewed by the manager of benefits and the benefits supervisor and are assessed to determine whether or not there are any adjustments that need to be made in our

Introductory Section

service delivery activity. We have also begun using targeted surveys to assess the quality of our customer service and determine how we can make improvements. This year, surveys were conducted on general customer service, the retirement process, the LTD process, and the board election process. In addition, we have added a question of the month to our web site and provided a suggestion box on the site to facilitate member input regarding any aspect of our services. Managers analyze the survey data, discuss member concerns and suggestions with their staff, and implement changes as warranted.

MOSERS has participated in the Benefits Administration Benchmarking survey administered by Cost Effectiveness Measurement, Inc. (CEM) over the last several years.

Through our participation, we obtain peer group comparisons on our benefits administration operation, which is used to help identify those areas where we have excelled and those areas where we could improve.

According to the most recent survey, because of the accuracy and speed of our systems, MOSERS is able to provide a formal written pension estimate to members in less than one day, while the average for our peer group is nine days. In fact, we received the highest ranking for customer service among our peers.

Member Information Security

One area of concern expressed by our members in the past was the use of social security numbers on benefit statements and other documents. System generated member numbers are now used in place of social security numbers on all outgoing correspondence where the social security number is not essential. Also, since many of our discarded documents contain personally identifiable information, we entered into a contract with a new on-site paper shredding service, which allows us to physically monitor the destruction of those documents.

Staff Team Building

This year we did two things that I believe helped staff have a better understanding of how personalities and preferences will impact employees differently and how an appreciation for those differences can make for a more collegial work environment. Last Columbus Day the staff participated in Myers-Briggs Personality Inventory training for half a day and then spent the balance of the day engaged in team

building exercises. Later in the year, we followed up with “True Colors” training targeted at helping employees understand how they can more effectively relate to their co-workers.

Investment Activity

The MOSERS’ investment program has undergone major restructuring over the past year. As a result of an asset/liability study conducted in the spring of 2002, the Board approved a new asset allocation model that added several new asset classes including marketable alternatives, distressed debt, timber, and private equity. In addition, authority was granted to staff to make strategic sub-asset class allocation decisions at the margins within predetermined ranges. These changes contributed significantly to the fund’s performance over the past year. MOSERS’ investment portfolio produced a total return, net of expenses, of 7.0% for the year ended June 30, 2003. Relative to the policy benchmark return of 5.9%, this indicates MOSERS’ practices resulted in 1.1% of value added versus the market for the year. In addition, when compared to other public funds, our returns for fiscal year 2003 rank in the top 9% of statewide funds with over \$1 billion in assets. The fund has achieved its goal of adding value over its policy benchmark and over the longer term has continued to exceed the actuarial real rate of return target of 5%. Additional information regarding the investment results for the year is included in the Investment Section of this report.

Summary of Financial Information

The following schedule is a summary of the pension trust funds’ additions and deductions for the years ended June 30, 2003, and June 30, 2002.

	Pension Trust Funds	
	Year Ended June 30, 2003	Year Ended June 30, 2002
Additions	\$518,210,724	\$(113,571,787)
Deductions	(345,647,243)	(291,085,249)
Net Change	\$172,563,481	\$(404,657,036)

The following schedule is a summary of the revenues and expenses of the Internal Service Fund (insurance activity) for the years ended June 30, 2003, and June 30, 2002.

Internal Service Fund

	Year Ended June 30, 2003	Year Ended June 30, 2002
Operating revenues	\$ 25,659,537	\$ 25,190,197
Operating expenses	(25,644,550)	(25,192,940)
Nonoperating revenues	31,179	47,767
Net Change	\$ 46,166	\$ 45,024

Additional financial information can be found in the management discussion and analysis report, financial statements, and schedules included in the financial section of this report.

Plan Financial Condition

The funding objective of MOSERS' pension trust funds is to meet long-term benefit promises through contributions which remain approximately level as a percent of member payroll over decades of time. Historical information relating to progress in meeting this objective is presented on pages 37-40. During the year ended June 30, 2003, the funded ratio of the Missouri State Employees' Plan, which covers 93,404 participants, decreased from 95.9% to 90.9%, primarily as the result of plan investment experience in previous years. The funded ratio of the Administrative Law Judges' and Legal Advisors' Plan, which covers 109 participants, decreased from 83.5% to 78.3%, primarily as the result of plan investment experience in previous years. Funding of the Judicial Plan, which covers 859 participants, began on July 1, 1998. During the year ended June 30, 2003, the funded ratio of the Judicial Plan increased from 11.6% to 12.9%, primarily as the result of favorable plan experience during the year. Additional information regarding the financial condition of the pension trust funds can be found in the actuarial section of this report.

Certificate of Achievement for Excellence in Financial Reporting

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to MOSERS for its comprehensive annual financial report (CAFR) for the fiscal year ended June 30, 2002. The Certificate of Achievement is a prestigious national award, recognizing conformance with the highest standards for preparation of state and local government financial reports.

In order to be awarded a Certificate of Achievement, a governmental unit must publish an easily readable and efficiently organized CAFR conforming to program standards. The CAFR must satisfy both generally accepted accounting principles and applicable legal requirements. A Certificate of Achievement is valid for a period of one year only. MOSERS has received a Certificate of Achievement for the last fourteen consecutive years (fiscal years ended 1989-2002). We believe our current report continues to conform to the Certificate of Achievement program requirements, and we are submitting it to GFOA for evaluation.

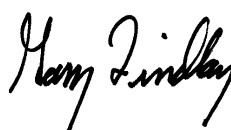
Conclusion

This report is a product of the combined efforts of the MOSERS' staff and advisors functioning under your leadership. It is intended to provide complete and reliable information that will facilitate the management decision making process; serve as a means for determining compliance with legal requirements; and allow for the evaluation of responsible stewardship of the funds of the system. As in the past, MOSERS received an unqualified opinion from our independent auditors on the financial statements included in this report. The opinion of the independent auditor can be found on page 18.

Copies of this report are provided to the Governor, State Auditor, Joint Committee on Public Employee Retirement of the general assembly, and all state agencies. These agencies form the link between MOSERS and its members, and their cooperation contributes significantly to the success of MOSERS. We hope all recipients of this report find it informative and useful.

I would like to take this opportunity to express my gratitude to you, the staff, the advisors, and other people who have worked so diligently to assure the continued successful operation of the system.

Respectfully submitted,



Gary Findlay
Executive Director

Letter from the Board Chair



October 1, 2003

Dear Members:

On behalf of the board of trustees, I am pleased to present the *MOSERS' Comprehensive Annual Financial Report* for the fiscal year ended June 30, 2003. In keeping with this year's annual report theme, fiscal year 2003 will certainly be remembered as a year filled with "change" for the system. This report highlights these changes and provides information on the financial status of your retirement system.

Fiscal year 2003 began with the board's approval of a new asset allocation based upon an asset/liability study which was conducted in the spring of 2002. The majority of the past year has been spent implementing this new asset allocation mix. As a result of many of the changes that were implemented, I am pleased to report that the system generated a return of 7% net of expenses for the fiscal year. This return compares quite favorably to the public pension fund universe of funds greater than \$1 billion, placing MOSERS' investment returns in the top 9% of funds within this category. On an even brighter note, despite a difficult investment market over the past few years, the system has been able to ensure that your retirement system remains well funded and your promised benefits are secure.

On the legislative front, Senate Bill 248 was passed and took effect July 1, 2003. This bill established a health care retirement incentive for eligible active or retired members who were eligible on or after February 1, 2003 through January 1, 2004, and actually retired no later than September 1, 2003. Those eligible members who retired during this

period may continue medical coverage for themselves and any eligible dependents at the active employee rate for five years or until becoming eligible for Medicare. The legislation was designed to reduce state payroll as a means of helping balance the state budget. While the financial impact to the retirement system has not yet been determined, the system has witnessed a significant increase in the number of members applying for retirement. Despite record numbers of retirements during this period, MOSERS' staff mobilized to meet the counseling needs of the members and processed all paperwork in a timely manner.

The board experienced significant turnover throughout the fiscal year. We bid farewell to several long time members who have contributed a great deal to the system. I would like to express the board's collective thanks to elected trustees Tom Hodges and Bryan Ornburn and appointed trustees Representative Richard Franklin and Representative Bill Skaggs for their dedication and service to the system and our members. Several new additions were made to the board throughout the year. On behalf of the board, I am pleased to welcome Wayne Bill, Marsha Buckner, and Don Martin who were all elected by the membership. In addition, we welcome two newly appointed trustees, Representative Bill Deeken and Representative Todd Smith. We look forward to working with them.

In closing, if you have any questions regarding this report, please contact us at MOSERS, PO Box 209, Jefferson City, MO 65102, or by calling 1-800-827-1063. We look forward to our continued service to you, as we strive to make "little changes today for a big difference tomorrow."

Sincerely,

A handwritten signature in cursive script that reads "Carol Gilstrap".

Carol Gilstrap, Board Chair
Board of Trustees

Board of Trustees

left to right

Lori Strong-Goeke
Governor Appointed Member

Wayne Bill
Elected Active Member

State Treasurer Nancy Farmer
Ex-Officio Member

Carol Gilstrap
Board Chair
Governor Appointed Member

Senator John Russell
Member of the Senate

Representative Bill Deeken
Member of the House
of Representatives

Representative Todd Smith
Member of the House
of Representatives

Commissioner Jacquelyn White
Ex-Officio Member

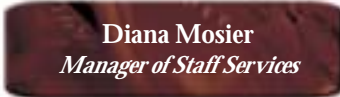
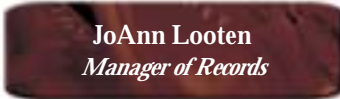
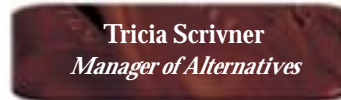
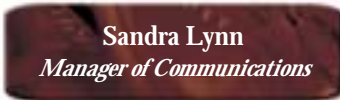
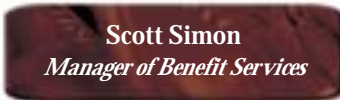
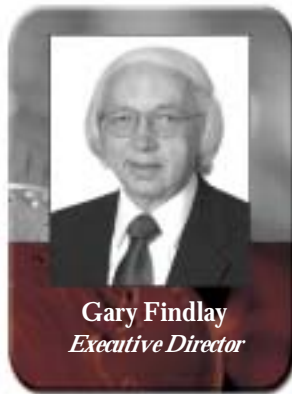
Senator Ed Quick
Member of the Senate

Marsha Buckner
Active Elected Member

Don Martin
Elected Retired Member



Administrative Organization



About MOSERS

MOSERS was established September 1, 1957, and is governed by laws of the state of Missouri.

Purpose

MOSERS provides retirement, survivor, and disability benefits, and life insurance to its members.

MOSERS administers retirement benefits for most state employees, including members of the Missouri General Assembly, elected state officials, administrative law judges and legal advisors, and judges. MOSERS is responsible for administering the law in accordance with the expressed intent of the Missouri General Assembly and bears a fiduciary obligation to the state employees who are its members and beneficiaries.

MOSERS Mission

To play an integral role in the future financial security of plan participants by promptly and courteously delivering quality benefits and information which members value and trust through professional plan administration and prudent management of system assets.

Administration

State law provides that responsibility for the administration of MOSERS is vested in an eleven member board of trustees. The board is comprised of:

- Two members of the Senate appointed by the President Pro Tem of the Senate.
- Two members of the House of Representatives appointed by the Speaker of the House.
- Two members appointed by the Governor.
- The State Treasurer.
- The Commissioner of Administration.
- Three other members of the system: two active members elected by the active and terminated-vested members, and one retiree elected by the retired members.

The day-to-day management of MOSERS is delegated to the executive director who is appointed by the board and serves at its pleasure. The executive director acts as advisor to the board on all matters pertaining to the system, contracts for professional services, and employs the remaining staff needed to operate the system.

Organization

The executive director, deputy executive director - chief operations officer, and the deputy executive director - chief investment officer are responsible for planning, organizing, and administering the operations of the system under the broad policy guidance and direction of the board.

MOSERS' office is divided into eight administrative sections that perform specific functions for the system.

Executive Services

The executive services team provides administrative support by assisting the executive director and chief operations officer in the major legal, operational, and oversight functions of the retirement, benefit, and communication programs.

Accounting

This section is responsible for all financial records of the programs administered by MOSERS, including the preparation of financial and statistical reports. Accounting performs the purchasing functions for MOSERS and interfaces with the investment custodian, Office of Administration accounting, various payroll/personnel departments, life insurance companies, actuaries, banks, and the IRS.

Benefit Services

Benefit services is responsible for all contact with the membership regarding the benefit programs administered by MOSERS, which include retirement, life insurance, and long-term disability.

Communications

Communications is responsible for providing clearly written and attractively designed publications and educational seminars needed to inform all members about benefit programs administered by MOSERS.

Communications and the information technology section are jointly responsible for MOSERS' web site.

Information Technology

Utilizing an IBM AS400 minicomputer and high-end work stations, information technology provides all computer and technical design support for MOSERS' data processing activities. This group is responsible for establishing and updating computer programs to implement plan changes and also maintains members' folder information on FileNet - an optical disk image system that allows information to be stored and processed using computer displayed images of original documents. Information technology is also responsible for administration of the personal computer network and the telephone system. Information technology and the communications section are jointly responsible for MOSERS' web site.

Investments

The primary functions of the investment staff are to provide internal investment management and consulting services to the board and the executive director. Other functions include a key role in hiring and terminating external investment managers, analyzing and rebalancing the overall asset allocation and portfolio, serving as a liaison to the investment community, and informing and advising the board and executive director on financial, economic, political and other developments which may affect the system. The investment staff also works with the asset consultant and the executive director in selecting and monitoring external money managers. Information regarding the investment professionals who provide services to MOSERS can be found in the investment section of this report.

Records Management

Records Management is responsible for establishing and maintaining all membership records - including maintenance of the data on the electronic imaging system, balancing payroll deductions for insurance, and entering the payroll, service, and leave data into the system's computerized database.

Staff Services

Staff services provides clerical support, mail services, and general building maintenance for MOSERS' personnel. Human resources is also represented in this section.

Outside Professional Services

Actuary

Gabriel, Roeder, Smith & Co.

Actuaries and Consultants
Norman L. Jones, Brad Armstrong
Southfield, Michigan

Auditors

KPMG LLP

Certified Public Accountants
Andrew J. Blossom, Melissa Benton
Kansas City, Missouri

Legal Counsel

Thompson Coburn

Attorneys at Law
General Counsel
Allen Allred, Tom Litz
St. Louis, Missouri

Perkins Coie

Attorneys at Law
Timberland Counsel
Jim Johnston
Seattle, Washington

Master Custodian

Mellon Financial Corp.

Primary Custodian
Irene Speridakos, Judy Hanlon
Boston, Massachusetts

Investment

Management Consultants

Summit Strategies, Inc.

General Asset Consultant
Steve Holmes, Tom Pollihan
St. Louis, Missouri

TimberLink LLC

Timber Consultant
Kate Robie
Atlanta, Georgia

Risk Management Consultants

Charlesworth & Associates, LLC

Art Charlesworth, Bob Charlesworth
Overland Park, Kansas

Third-Party Administrators

The Standard Insurance Company

Tom Trussell
Overland Park, Kansas

TIAA-CREF

Robert Kissel, Lisa Dunkel
Chicago, Illinois

Securities Lending Advisors

Credit Suisse First Boston Corporation

Dwight Skerritt
New York, New York

Lehman Brothers

Johnine Kilgallon
New York, New York

Investment Advisors

AmeriCap Advisers, LLC

Michael Gayed, Nadia Albert,
Steve Shobin
New York, New York

BlackRock Financial Management

Rob Capaldi, Andy Phillips,
Dennis Schaney
New York, New York

The Blackstone Group

Blackstone Alternative Asset
Management, LP
Hal Lindquist, Tom Hill,
Rupal Doshi
New York, New York

Blackstone Real Estate Advisors, LP

Gary Summers, Maryfrances Metrick
New York, New York

Blackstone Bridge Advisors, LP

Steve Saslow, Stephen Morton
New York, New York

Capital Guardian Trust Company

Andy Barth, Mike Nyeholt
Los Angeles, California

CFSC Wayland Advisers, Inc.

Steve Adams, Patrick Halloran
Minnetonka, Minnesota

DDJ Capital Management, LLC

Mike Forrester, David Breazzano,
Judy Mencher
Wellesley, Massachusetts

Dimensional Fund Advisors, Inc.

Rex Sinquefeld, Carol Wardlaw
Santa Monica, California

Hoisington Investment

Management Co.

Van Hoisington, Lacy Hunt
Austin, Texas

Legg Mason Capital Management, Inc

Chuck Knudsen, Kyle Prechtel Legg
Baltimore, Maryland

Mastholm Asset Management, LLC

Thomas Garr, Theodore Tyson
Bellevue, Washington

Merrill Lynch Asset

Management Group

Rick Vella, Lisa Torrington
New York, New York

MHR Fund Management, LLC

Hal Goldstein, Mark Rachesky
New York, New York

NISA Investment Advisers, LLC

Robert Krebs, Bill Marshall
St. Louis, Missouri

Oak Associates, Ltd.

Sandra Noll, Jim Oelschlager
Akron, Ohio

OakBrook Investments

Michael Lorenzen
Janna Sampson
Lisle, Illinois

Oaktree Capital Management, LLC

Howard Marks, Russell Bernard,
John Moon, Tim Jensen,
Greg Brandner
Los Angeles, California
New York, New York

Silchester International Investors

Christopher Cowie, Stephen Butt
London, England

The Lincoln Penny was the first U.S. coin to feature a historic figure. The original Lincoln Head Penny was designed in 1909 to celebrate the 100th anniversary of his birth. The Lincoln Memorial was added to the back of the one-cent coin by Mint engraver Frank Gasparro in 1959 to mark Lincoln's 150th birthday, making it the first and only coin to have the same person engraved on both sides.

