LOS ANGELES CITY EMPLOYEES' RETIREMENT SYSTEM
(A DEPARTMENT OF THE CITY OF LOS ANGELES, CALIFORNIA)

ANNUAL FINANCIAL REPORT

JUNE 30, 2010

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INDEPENDENT AUDITOR'S REPORT

Board of Administration
Los Angeles City Employees' Retirement System
Los Angeles, California

We have audited the accompanying Retirement Plan and Postemployment Healthcare Plan Statement of Plan Net Assets of the Los Angeles City Employees' Retirement System (the System), a department of the City of Los Angeles, California, as of June 30, 2010, and the related Retirement Plan and Postemployment Healthcare Plan Statement of Changes in Plan Net Assets for the year then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year summarized comparative information has been derived from the System's 2009 financial statements and, in our report dated November 19, 2009 we expressed an unqualified opinion on those financial statements.

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

As discussed in Note 1 to the financial statements, the System adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments.*

In our opinion, the financial statements referred to above present fairly, in all material respects, the Net Assets of the Retirement Plan and Postemployment Healthcare Plan of the Los Angeles City Employees' Retirement System as of June 30, 2010, and the Changes in its Net Assets for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and required supplementary information, as listed in the table of contents, be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the GASB, who considers it to be an essential part of financial reporting for placing the financial statements in appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audits of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audits were conducted for the purpose of forming opinions on the financial statements taken as a whole. The schedules of administrative expenses and investment expenses, as shown in the financial section, and the introductory, investment, actuarial, and statistical sections are presented for purposes of additional analysis and are not a required part of the financial statements. The schedules of administrative expenses and investment expenses are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statement themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole. The introductory, investment, actuarial, and statistical sections have not been subjected to the auditing procedures applied in the audits of the financial statements and, accordingly, we do not express an opinion or provide any assurance on them.

BROWN ARMSTRONG
ACCOUNTANCY CORPORATION

Bakersfield, California
November 18, 2010

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's Discussion and Analysis

As management of the Los Angeles City Employees' Retirement System (LACERS), we are pleased to provide this overview and analysis of the financial activities of LACERS for the fiscal year ended June 30, 2010. We encourage readers to consider the information presented here in conjunction with additional information included in our letter of transmittal in the Introductory Section of LACERS Comprehensive Annual Financial Report.

Financial Highlights

- The amount of plan net assets of LACERS as of June 30, 2010 was $9,001,365,000.
- As the economy and financial market began to recover from the severe recession, the value of the plan net assets of LACERS as of June 30, 2010 increased by $858,377,000, or 10.5%, during the reporting period.
- The plan assets under the Retirement Plan and Postemployment Healthcare Plan are pooled for investment purposes. Investment income for the year was $1,066,833,000, as compared with an investment loss of $2,110,240,000 for the previous reporting period.
- Employer contributions made by the City of Los Angeles (the City) to both the Retirement Plan and the Postemployment Healthcare Plan were $362,751,000. This amount included annual contribution of $355,154,000, which was 19.43% of the City's estimated covered payroll of $1,827,864,000, Member contribution defrayal of $7,397,000, and City's matching contribution for Family Death Benefit Insurance Plan in the amount of $200,000.
- The employer contributions to the Retirement Plan represented 100% of the Annual Required Contribution as defined by GASB Statements No. 25 and No. 27. The employer contributions to the Postemployment Healthcare Plan represented 100% of the Annual Required Contribution as defined by GASB Statements No. 43 and No. 45.
- Deductions from net assets of LACERS included benefit payments, refunds of Member contributions, and administrative expenses. The total deductions from net assets were $698,168,000, a 12.4% increase from the prior fiscal year.
- Based on the most recent actuarial valuation as of June 30, 2010, the funded ratio for the Retirement Plan was 75.9% and the funded ratio for the Postemployment Healthcare Plan was 63.8%. The total funded ratio for LACERS was 74.0%. The funded ratio compares the actuarial value of assets to the actuarial accrued liabilities of a pension plan. The ratios change every valuation year, reflecting investment performance, demographic changes, actuarial assumption/ method changes, benefit structure changes, or a variety of other actuarial gains and losses.

Overview of the Financial Statements

The following discussion and analysis are intended to serve as an introduction to LACERS financial statements and the accompanying notes thereto. The required supplementary information and supplemental schedules provide additional financial data of LACERS operations.

Financial Statements

There are two financial statements presented by LACERS. The Statement of Plan Net Assets gives a snapshot of the account balances at year-end and shows the amount of the net assets, being the difference between the assets and liabilities, available to pay future benefits. Over time, increases or decreases in net assets may serve as a useful indicator of whether the net assets of LACERS are improving or deteriorating. The Statement of Changes in Plan Net Assets provides a view of current year additions to and deductions from the plan net assets. The two statements can be found on pages 11 and 12 of this report.

Notes to Financial Statements

The notes provide additional information that is essential for a full understanding of the data provided in the financial statements. The notes to the financial statements can be found on pages 13 – 27 of this report.

Required Supplementary Information

In addition to this Management's Discussion and Analysis, the other required supplementary information consists of a Schedule of Funding Progress, a Schedule of Employer Contributions, and the Notes to Required Supplementary Information for both the Retirement Plan and the Postemployment Healthcare Plan. These schedules and notes primarily present the actuarially-determined information in a multiyear format as required by the applicable financial reporting standards. This required supplementary information can be found on pages 28 – 31 of this report.

Supplemental Schedules

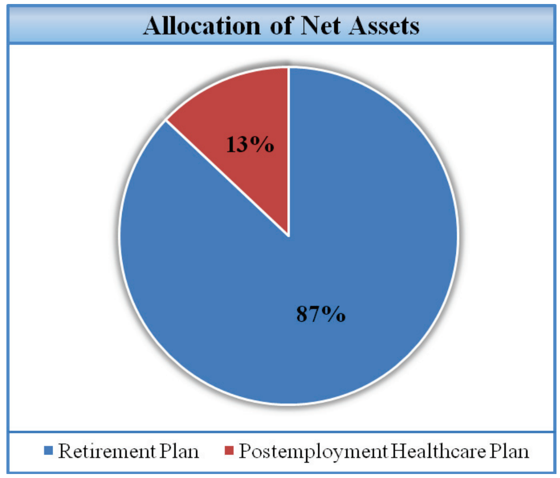
The supplemental schedules, including a Schedule of Administrative Expenses and a Schedule of Investment Expenses, are presented to provide additional financial information on LACERS operations for the current year. They can be found on pages 32 and 33 of this report.

Financial Analysis

Allocation of Net Assets

Net assets may serve as a useful indicator of a plan's financial position. The total plan net assets are allocated between the Retirement Plan and Postemployment Healthcare Plan, as required by the existing reporting standards. The following information provides a brief description of the asset allocation between the Retirement Plan and the Postemployment Healthcare Plan as of June 30, 2010 (dollars in thousands):

	Net Assets	Percent
Retirement Plan	$7,836,758	87.1%
Postemployment Healthcare Plan	1,164,607	12.9
Net Assets	$9,001,365	100.0%



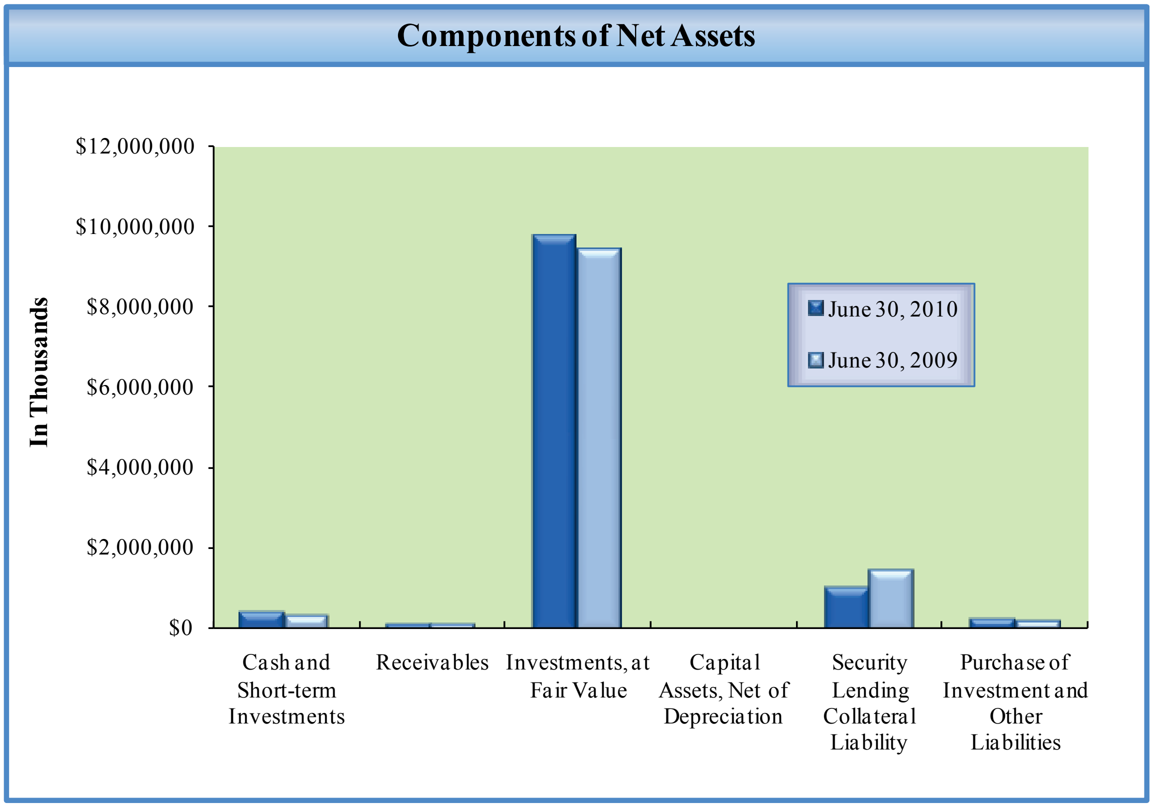
Net Assets

The following table and graph represent the detailed information regarding the components of the net assets of LACERS as of June 30, 2010 and 2009 (dollars in thousands):

	June 30, 2010	June 30, 2009	Change	
Cash and Short-term Investments	$ 372,183	$ 317,385	$ 54,798	17.3 %
Receivables	75,188	105,864	(30,676)	(29.0)
Investments, at Fair Value	9,740,098	9,354,516	385,582	4.1
Capital Assets, Net of Depreciation	380	349	31	8.9
Total Assets	10,187,849	9,778,114	409,735	4.2
Security Lending Collateral Liability	(987,637)	(1,447,412)	(459,775)	(31.8)
Purchase of Investment and Other Liabilities	(198,847)	(187,714)	11,133	5.9
Total Liabilities	(1,186,484)	(1,635,126)	(448,642)	(27.4)
Net Assets	$ 9,001,365	$ 8,142,988	$ 858,377	10.5 %

Financial Analysis (Continued)

Net Assets (Continued)



The majority of LACERS net assets are contained in its investment portfolio, which consists of cash and short-term investments, receivables, fixed income, equities, and other asset classes. Net assets increased by $858,377,000, or 10.5%, during this fiscal year. The increase is primarily attributable to the investment gain, including $859,186,000 of net appreciation in fair value of investments, as a result of market recovery immediately after the global financial and economic crisis of 2008-2009.

Change in Net Assets

The increase in net assets during the reporting period was the net effect of a combination of factors that either add to or deduct from the plan assets. The following table summarizes the change in net assets during the report year, as compared with the prior year (dollars in thousands):

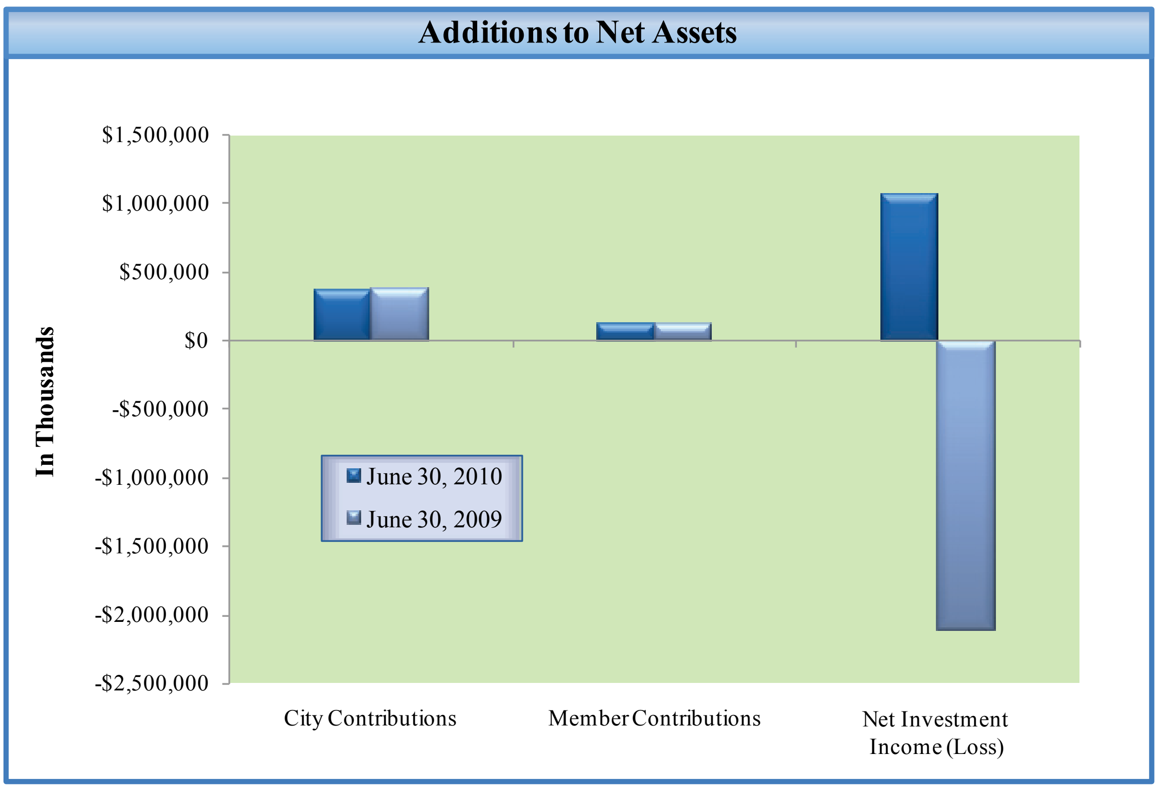
	June 30, 2010	June 30, 2009	Change	
Additions	$ 1,556,545	$ (1,608,010)	$ 3,164,555	(196.8) %
Deductions	(698,168)	(621,196)	(76,972)	12.4
Net Increase (Decrease)	858,377	(2,229,206)	3,087,583	(138.5)
Net Assets, Beginning of Year	8,142,988	10,372,194	(2,229,206)	(21.5)
Net Assets, End of Year	$ 9,001,365	$ 8,142,988	$ 858,377	10.5 %

Financial Analysis (Continued)

Change in Net Assets – Additions to Net Assets

The following table and graph represent the components that make up the additions to net assets for LACERS for the years ended June 30, 2010 and 2009 (dollars in thousands):

	June 30, 2010	June 30, 2009	Change
City Contributions	$ 362,751	$ 383,638	(5.4) %
Member Contributions	126,961	118,592	7.1
Net Investment Income (Loss)	1,066,833	(2,110,240)	(150.6)
Additions to Net Assets	$ 1,556,545	$ (1,608,010)	(196.8) %



Financial Analysis (Continued)

Change in Net Assets – Additions to Net Assets (Continued)

The "additions" to LACERS net assets include three main items that constitute the funding sources of LACERS benefits: City Contributions, Member Contributions, and Net Investment Income.

City Contributions to the Retirement Plan, the Postemployment Healthcare Plan and the Family Death Benefit Insurance Plan were $362,751,000 during the year, or $20,887,000 less than the prior fiscal year due to the decreased contribution rate recommended by the actuary in its June 30, 2008 actuarial valuation. The City contribution rate was 14.15% for Retirement Plan and 5.28% for the Postemployment Healthcare Plan, or 19.43% in total, of the City payroll for the fiscal year 2009-10, which was $1,827,864,000. The actual contribution to the Retirement Plan was equal to 100% of the Annual Required Contribution (ARC) of $258,643,000 as defined by GASB Statements No. 25 and No. 27. The actual contribution to the Postemployment Healthcare Plan was equal to 100% of the Annual Required Contribution (ARC) of $96,511,000 as defined by GASB Statements No. 43 and No. 45.

Factors that may affect the amount of Member Contributions include the change in number and composition of Members and the change in Member salaries. During the year, the number of active Members decreased by 12.7% primarily due to accelerated retirements stimulated by the City's Early Retirement Incentive Program (ERIP). However, Members' contribution was $126,961,000, which was $8,369,000 (7.1%) more than the prior year. The increase was mainly the result of ERIP participants' voluntary contributions to purchase additional service credit or additional annuity to supplement their retirement benefits. Also, increased member contributions were derived from the requirements of the ERIP Ordinance that all members contribute 6% of pay, including the age-rated members who previously contribute less than 6% of pay, net of the City defrayal (Refer to Note 2 – Retirement Plan Description).

The net investment income of $1,066,833,000 reflected the modest recovery of the financial and stock market from the heavy loss of the previous year. It is discussed in the next section with more detailed information.

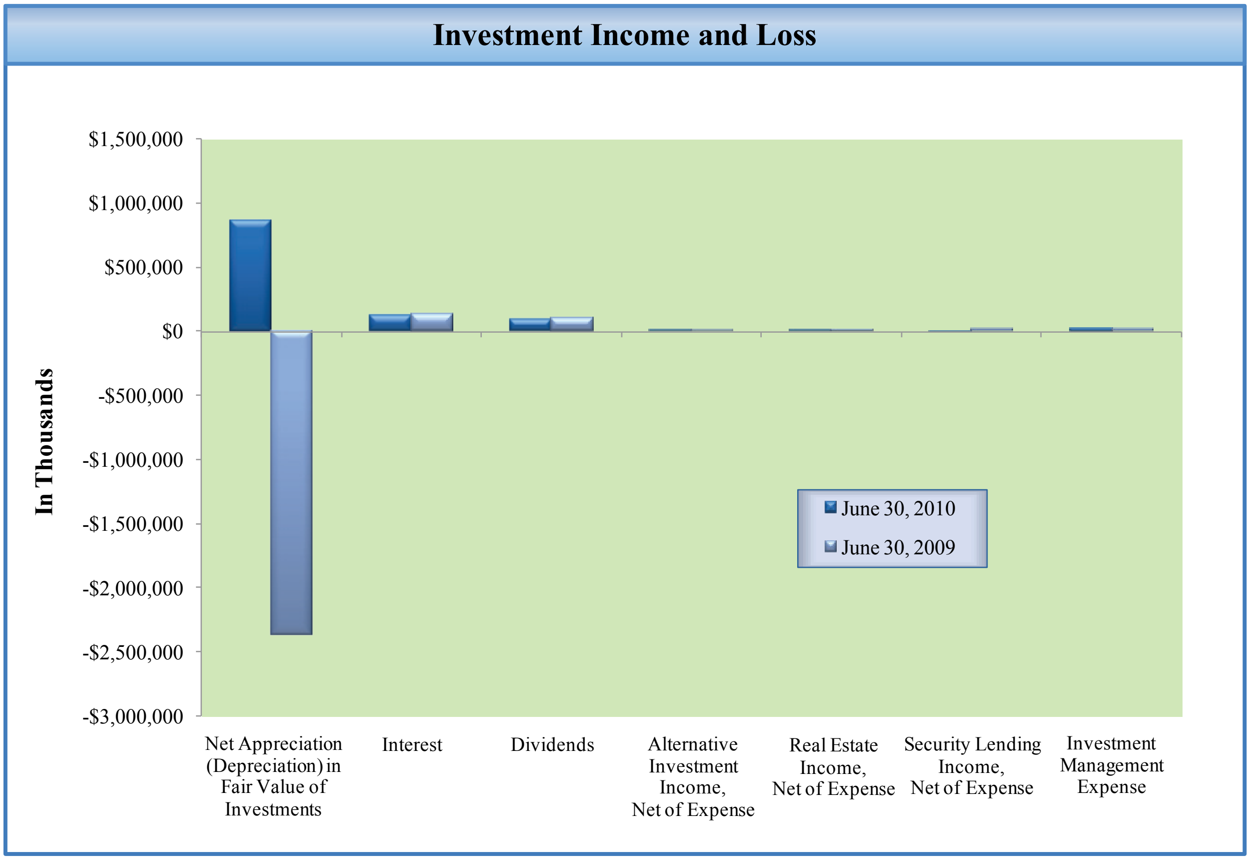
Investment Income and Loss

The following table and graph present the detail of investment income and loss, net of investment management expenses for the years ended June 30, 2010 and 2009 (dollars in thousands):

	June 30, 2010	June 30, 2009	Change
Net Appreciation (Depreciation)			
in Fair Value of Investments	$ 859,186	$ (2,362,887)	(136.4) %
Interest	122,720	131,394	(6.6)
Dividends	88,995	100,512	(11.5)
Alternative Investment Income, Net of Expense	9,023	8,421	7.1
Real Estate Income, Net of Expense	6,445	13,663	(52.8)
Security Lending Income, Net of Expense	3,822	15,660	(75.6)
Investment Management Expense	(23,358)	(17,003)	37.4
Total Investment Income (Loss)	$ 1,066,833	$ (2,110,240)	(150.6) %

Financial Analysis (Continued)

Investment Income and Loss (Continued)



The net investment income for the current fiscal year was $1,066,833,000, as compared with the loss of $2,110,240,000 for the previous fiscal year. This significant change was largely attributable to the net appreciation in market value of investments, in the amount of $859,186,000, as a result of the economy and financial markets showing signs of recovery immediately after the global financial and economic crisis of 2008-2009.

However, due to the slow pace of recovery and the depressed level of interest rates, other components of the investment income with the exception of the alternative investment, did not perform well. Investment income in interest, dividend, real estate, and security lending all decreased as compared with the previous year.

Interest income derived from bonds decreased by $8,674,000 (-6.6%), attributable to the Federal Reserve's policy to keep the federal funds rate to "near zero" which adversely affected the bond yields during the report year. Dividend income derived from stocks also decreased by $11,517,000 (-11.5%) due to lower distributions as most companies' profit and/or profit outlook suffered under the weak economy.

Real estate woes, which triggered the severe recession a year ago, continued through the end of the report period. LACERS real estate income decreased by $7,218,000 (-52.8%) as compared to the prior year. As a contrast, alternative investment income increased by $602,000 (7.1%) due to more venture and buyouts activities that came along with the improvement in financial markets.

LACERS earns additional investment income by lending securities to borrowers through its custodian bank. The borrowers provide cash or non-cash collateral to the System's custodial bank, which then invests the cash collateral in short and intermediate term fixed income securities. LACERS security lending income, net of expense, dropped significantly by 75.6%, or $11,838,000 less than what it received a year ago. Several factors contributed to the lower revenue: short and intermediate interest rates were very low; lending practices became more conservative at time of uncertainty; and the demand for security borrowing was not as strong as it was during the prior year.

Financial Analysis (Continued)

Investment Income and Loss (Continued)

Investment management expense for the current fiscal year increased by $6,355,000 (37.4%) from the previous year. The increase corresponds with the higher fair value of investment portfolio, as the investment management fees are based on the value of investment assets.

Change in Net Assets – Deductions from Net Assets

The following table and graphs provide information related to the deductions from net assets for the years ended June 30, 2010 and 2009 (dollars in thousands):

	June 30, 2010	June 30, 2009	Change
Benefit Payments	$ 653,134	$ 584,473	11.7 %
Refunds of Contributions	27,971	21,325	31.2
Administrative Expenses	17,063	15,398	10.8
Deductions from Net Assets	$ 698,168	$ 621,196	12.4 %

LACERS "deductions" from net assets in the reporting period can be summarized as Benefit Payments, Refunds of Contributions, and Administrative Expenses. These deductions represent the types of benefit delivery operations undertaken by LACERS and the costs associated with them. Total deductions increased by $76,972,000 or 12.4%.

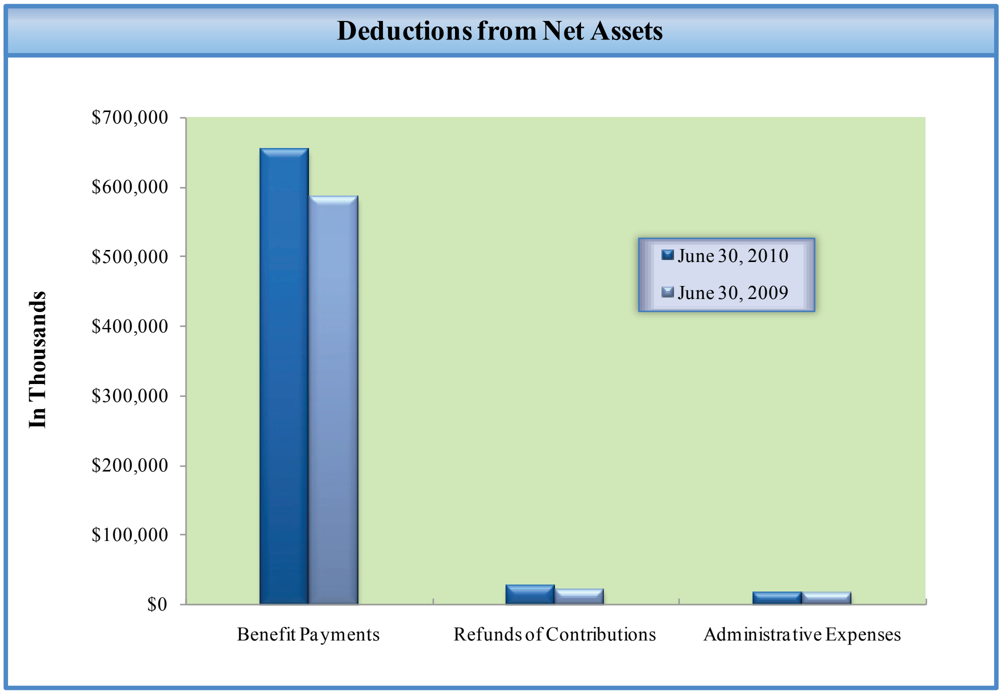
The benefit payments increased by $68,661,000, or 11.7%, compared to the prior year. This increase is predominately due to the City's Early Retirement Incentive Program (ERIP) which, by providing age credit and/or enhanced benefits, incentivized 2,400 members to retire during this fiscal year. The average monthly benefit amount increased by 8.0%, which included the average annual cost of living adjustment of approximately 2.9%. The large increase in number of retirees resulted not only increased retirement allowances, but also the Postemployment health plan costs. The Postemployment health plan cost increased by $9,357,000 or 12.7% compared to the prior fiscal year. The total benefit payments represent 93.5% of total deductions from System's net assets.

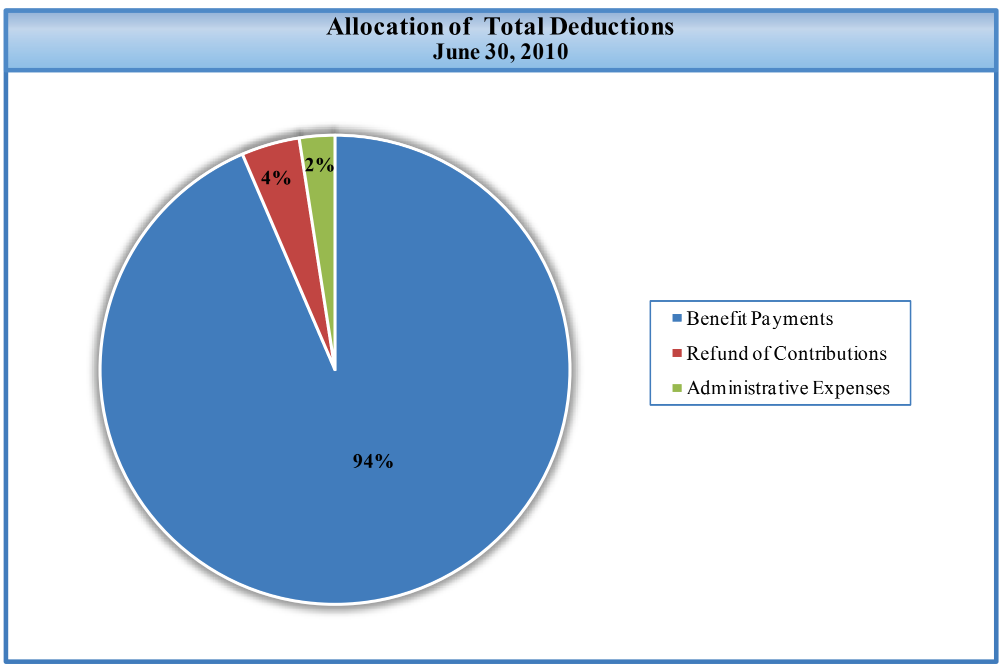
Refunds of contributions also increased by $6,646,000 or 31.2%. The increase was mainly the result of increased transfer of funds to the Department of Water and Power (DWP) Employees' Retirement Plan under the reciprocity program, as more City employees moved to DWP in the fiscal year when City struggled to close its significant budget deficit. Such transfers, in the amount of $18,029,000, represent 64.5% of total refunds paid during the current reporting year.

Administrative expense increased by $1,665,000 or 10.8% over the prior year. This increase was primarily attributable to the additional costs incurred to process the 2,400 ERIP cases. Such costs include salaries/wage and additional office lease for the employees on loan from other city departments and the Relief Retirement Workers hired temporarily, hardware and software expenses, overtime costs of LACERS employees, and additional actuarial fees.

Financial Analysis (Continued)

Change in Net Assets – Deductions from Net Assets (Continued)





Requests for Information

This financial report is designed to provide a general overview of LACERS finances for all those with an interest in LACERS finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to:

LACERS
Fiscal Management Section
360 E. Second Street, 2nd Floor
Los Angeles, CA 90012-4207

AUDITED FINANCIAL STATEMENTS

Statement of Plan Net Assets
Retirement Plan and Postemployment Healthcare Plan
As of June 30, 2010, with Comparative Totals
(In Thousands)

	Retirement Plan	Postemployment Healthcare Plan	2010 Total	2009 Total
Assets				
Cash and Short-Term Investments	$ 324,030	$ 48,153	$ 372,183	$ 317,385
Receivables				
Accrued Investment Income	29,046	4,316	33,362	37,221
Proceeds from Sales of Investments	32,815	4,877	37,692	59,511
Other	3,599	535	4,134	9,132
Total Receivables	65,460	9,728	75,188	105,864
Investments, at Fair Value				
U.S. Government Obligations	343,969	51,117	395,086	225,279
Municipal Bonds	1,189	176	1,365	3,931
Domestic Corporate Bonds	941,597	139,929	1,081,526	969,901
International Bonds	167,394	24,876	192,270	185,608
Opportunistic Debt	93,846	13,946	107,792	103,232
Domestic Stocks	2,846,819	423,061	3,269,880	3,045,441
International Stocks	1,469,942	218,446	1,688,388	1,473,068
Mortgages	479,228	71,217	550,445	556,873
Government Agencies	47,497	7,059	54,556	64,212
Real Estate	400,241	59,479	459,720	521,086
Venture Capital and Alternative Investments	828,336	123,097	951,433	758,473
Security Lending Collateral	859,855	127,782	987,637	1,447,412
Total Investments	8,479,913	1,260,185	9,740,098	9,354,516
Capital Assets				
Furniture, Fixtures and Equipment (Net of Depreciation)	331	49	380	349
Total Assets	8,869,734	1,318,115	10,187,849	9,778,114
Liabilities				
Accounts Payable and Accrued Expenses	(25,845)	(3,840)	(29,685)	(26,964)
Derivative Instruments	(22)	(3)	(25)	-
Purchases of Investments	(147,254)	(21,883)	(169,137)	(160,750)
Security Lending Collateral	(859,855)	(127,782)	(987,637)	(1,447,412)
Total Liabilities	(1,032,976)	(153,508)	(1,186,484)	(1,635,126)
Net Assets Held in Trust for Pension Benefits and Post-employment Healthcare Benefits	**$ 7,836,758**	**$ 1,164,607**	**$ 9,001,365**	**$ 8,142,988**

The accompanying notes are an integral part of these financial statements.

Statement of Changes in Plan Net Assets
Retirement Plan and Postemployment Healthcare Plan
For the Year Ended June 30, 2010, with Comparative Totals
(In Thousands)

	Retirement Plan	Postemployment Healthcare Plan	2010 Total	2009 Total
Additions				
Contributions				
City Contributions	$ 266,240	$ 96,511	$ 362,751	$ 383,638
Member Contributions	126,961	-	126,961	118,592
Total Contributions	393,201	96,511	489,712	502,230
Investment Income (Loss)				
Net Appreciation (Depreciation) in Fair Value of Investments Including Gain and Loss on Sales	729,621	129,565	859,186	(2,362,887)
Interest	106,614	16,106	122,720	131,394
Dividends	77,315	11,680	88,995	100,512
Alternative Investment Income, Net of Expense	8,232	791	9,023	8,421
Real Estate Income, Net of Expense	5,809	636	6,445	13,663
Security Lending Income	3,867	584	4,451	17,935
Less: Security Lending Expense	(534)	(95)	(629)	(2,275)
Sub-Total	930,924	159,267	1,090,191	(2,093,237)
Less: Investment Management Expense	(19,836)	(3,522)	(23,358)	(17,003)
Net Investment Income (Loss)	911,088	155,745	1,066,833	(2,110,240)
Total Additions	1,304,289	252,256	1,556,545	(1,608,010)
Deductions				
Benefits Payments	(569,938)	(83,196)	(653,134)	(584,473)
Refunds of Contributions	(27,971)	-	(27,971)	(21,325)
Administrative Expenses	(14,204)	(2,859)	(17,063)	(15,398)
Total Deductions	(612,113)	(86,055)	(698,168)	(621,196)
Net Increase (Decrease)	692,176	166,201	858,377	(2,229,206)
Net Assets Held in Trust for Pension Benefits and Postemployment Healthcare Benefits				
Beginning of Year	7,144,582	998,406	8,142,988	10,372,194
End of Year	**$ 7,836,758**	**$ 1,164,607**	**$ 9,001,365**	**$ 8,142,988**

The accompanying notes are an integral part of these financial statements.

Note 1 – Description of the System and Significant Accounting Policies

General Description

The Los Angeles City Employees' Retirement System (the System) is under the exclusive management and control of its Board of Administration (the Board), whose authority is granted by the Los Angeles City Charter (Article XI). The System is a department of the City of Los Angeles (the City). The System's financial statements are included in the City of Los Angeles' Annual Financial Report as a pension trust fund.

The System operates a single-employer defined benefit plan (the Retirement Plan) and a Postemployment Healthcare Plan. A description of each plan is located in Note 2 and Note 3. All Notes to the Financial Statements apply to both plans unless indicated otherwise.

Basis of Accounting

The financial statements are maintained on the accrual basis of accounting. Member contributions are recognized as revenues in the period in which compensation is paid to the Member by the employer. Because the employer has made a formal commitment to provide the contributions, employer contributions are recognized when due. Benefits and refunds are recognized when due and payable.

Basis of Presentation

The financial statements have been prepared in conformity with generally accepted accounting principles (GAAP) in the United States of America, as outlined by the Governmental Accounting Standards Board (GASB).

The accompanying financial statements include certain prior year summarized comparative information. Such information does not include sufficient detail to constitute a presentation in conformity with accounting principles generally accepted in the United States.

Implementation of New Accounting Pronouncements

For the fiscal year ended June 30, 2010, the System implemented the provisions of GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. This Statement addresses the recognition, measurement, and disclosure of information regarding derivative instruments entered into by state and local governments. The Statement requires governments to report most of their derivative instruments at fair value on the Statement of Plan Net Assets. GASB Statement No. 53 also established disclosure requirements, which include summary information of derivative instruments and their exposure to the financial risks. The Statement is effective for periods beginning after June 15, 2009. Certain requirements of GASB Statement No. 53 do not apply to the System as the System does not invest plan net assets for the purpose of hedging. The plan net assets were not materially affected by the implementation of GASB Statement No. 53.

Fair Value of Investments

Funds of the System are invested pursuant to the Los Angeles City Charter and the System's investment policy established by the Board under Article XI Section 1106(d) of the City Charter. The System's investment portfolios are composed of domestic and international equities, domestic and international bonds, derivative instruments, real estate and alternative investments, and short-term investments, which include obligations of the U.S. Treasury, agencies, commercial paper rated A-1, bankers' acceptances, repurchase agreements and the short-term investment fund managed in-house by staff.

Securities traded on national or international exchanges are valued at the last reported sales price at the current exchange rates. Short-term investments, bonds, stocks and alternative investments are reported at fair value. The fair values of real estate investment funds are provided by the individual real estate fund managers based on periodic appraisals, in the form of either annual in-house appraisals or longer-term appraisals by outside professionals, in accordance with the industry practice. The fair value determined as such is also reviewed and evaluated by the Board's real estate consultant. The fair value of alternative investment funds is provided by the individual General Partners at a liquidating event or other significant events during the reporting period. The fair values of derivative instruments are determined using available market information. Debt rewrites are valued based on yields currently available on comparable securities of issuers with similar credit ratings. Management's investment strategy, as it relates to the debt portfolio, is mainly to achieve market appreciation and not to hold bonds to their maturities.

Note 1 – Description of the System and Significant Accounting Policies (Continued)

Fair Value of Investments (Continued)

Investment transactions are accounted for on the date the securities are purchased or sold (trade date). Unsettled investment trades as of fiscal year-end are reported in the financial statements on an accrual basis. The corresponding proceeds due from sales are reported on the Statement of Plan Net Assets under Receivables and labeled as Proceeds from Sales of Investments, and amounts payable for purchases are reported under (current) Liabilities and labeled as Purchases of Investments. Dividend income is recorded on ex-dividend date, and interest income is accrued as earned.

For the equity index futures, an initial margin is required to open a position and maintain the collateral requirement until the position is closed. The System reports the collateral for the equity index futures in the short-term investments.

Capital Assets

Effective July 1, 2001, purchases of capital assets, consisting primarily of office furniture and computer equipment, are capitalized upon acquisition and depreciated over five years if the cost of purchase is $5,000 or more. Prior to July 1, 2001, these purchases were recorded and expensed in the year acquired. Depreciation is calculated using the straight-line method.

Administrative Expenses

All administrative expenses are funded from the System's plan net assets, which include the investment earnings and the contributions from the City and the Members.

Reserves

As provided in the Los Angeles City Charter, the System is maintained on a reserve basis, determined in accordance with accepted actuarial methods. The Los Angeles City Charter establishes reserves for the following:

Member Contributions – Active Member contributions to the Retirement Plan and interest credited to Members' accounts, less refunds of Member contributions and transfers to the annuity reserve.

Employer Contributions – Consists of the following components:

Basic Pensions – City contributions and investment earnings (losses), accumulated to provide for the City's guaranteed portion of retirement benefits, less payments to retired Members.

Annuity – Member contributions transferred to the City and used to provide for the Members' share of retirement benefits and investment earnings (losses) excluding net appreciation (depreciation) in fair value of investments, less payments to retired Members.

Larger Annuity – Member's larger annuity account balances at retirement including IRS Section 457 deferred compensation and other rollovers, investment earnings (losses) including net appreciation (depreciation) in fair value of investments, less payments to retired participating Members.

Family Death Benefits – Member contributions, matching City contributions, and investment earnings (losses) excluding net appreciation (depreciation) in fair value of investments reserved to pay benefits under the family death benefits insurance plan established by the System, less payments to beneficiaries.

Postemployment Health Benefits – City contributions and investment earnings (losses) accumulated to provide healthcare benefits for retirees, less payments to insurance providers and/or reimbursements to retired Members.

Reserve balances as of June 30, 2010, were as follows (in thousands):

Member Contributions	$ 1,414,912
Basic Pensions	5,795,880
Annuity	593,430
Larger Annuity	20,092
Family Death Benefits	12,444
Postemployment Health Benefits	1,164,607
Total Reserves	$ 9,001,365

Use of Estimates in Preparation of the Financial Statements

The preparation of the financial statements in conformity with GAAP in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting years. Actual results could differ from those estimates.

Note 2 – Retirement Plan Description

Plan Description

The Retirement Plan covers all full-time personnel and department-certified part-time employees of the City of Los Angeles, except for sworn employees of the Fire and Police departments, Department of Water and Power employees, elected officials who elected to participate in an alternative Defined Contribution Plan, and certain Port Police officers of the Harbor Department including those who elected to opt out of LACERS Plan.

The Retirement Plan provides for service and disability retirement benefits, as well as death benefits. Changes to the benefits require approval by the City Council.

At June 30, 2010, the components of the System's membership were as follows:

Active:	
Vested	18,822
Nonvested	7,423
	26,245
Inactive:	
Nonvested	3,804
Terminated Entitled to Benefits, Not Yet Receiving Benefits	1,540
Retired	17,264
Total	48,853

Funding Policies and Funded Status and Progress

The Plan's funding policy under Article XI Sections 1158 and 1160 of the Los Angeles City Charter provides for periodic employer contributions at actuarially-determined rates that, expressed as percentages of annual covered payroll together with certain fixed amounts, are sufficient to accumulate the required assets to pay benefits when due. For the year ended June 30, 2010, the annual required contribution to the Retirement Plan by the City was determined at 14.15% of covered payroll, determined by the June 30, 2008 actuarial valuation. The actual contribution made by the City for fiscal year 2009-10 was equal to the recommended rate as adopted by the Board of Administration, which is the recommended contribution rate set equal to the greater of the current funding policy or the minimum Annual Required Contribution (ARC) as determined under GASB Statements 25 and 27.

Prior to the ERIP, there were two different types of contributions from Members; Members who entered the System prior to February 1983 (Defrayal Group) contributed from 8.22% to 13.33% of their salaries based upon their ages when they entered the System; however, these contributions were subsidized by the City under a collective bargaining agreement (see Note 6 – Defrayal Portion of Member Contributions-Retirement Plan). Members entering the System subsequent to January 1983 contribute a flat rate of 6%. Starting November 8, 2009, all Members of the System contribute a flat rate of 6% of pay regardless of their entry date. Further, ERIP Ordinance stipulates the member contribution rate for all employees shall increase to 7% on July 1, 2011 for a period of 15 years, or until the ERIP Cost Obligation is fully paid, whichever comes first.

Members of the System have a vested right to their own contributions and accumulated interest posted to their accounts. Generally after five years of employment, Members are eligible for future retirement benefits, which increase with length of service. If a Member is at least age 70 or with five or more years of service terminates employment, the Member has the option of receiving retirement benefits when eligible or withdrawing from the System, and having his or her contributions and accumulated interest refunded. Benefits are based upon age, length of service, and compensation.

As of June 30, 2010, the most recent actuarial valuation date, the Plan was 75.9% funded. The actuarial accrued liability for benefits was $12,595,025,000 and the actuarial value of assets was $9,554,027,000, resulting in an unfunded actuarial accrued liability (UAAL) of $3,040,998,000. The covered payroll as of June 30, 2010 valuation was $1,817,662,000. The ratio of UAAL to the covered payroll was 167.3%.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, inflation, and investment returns. The funded status of the plan and the annual required contributions of the employer, determined by the annual actuarial valuations, are subject to continual revisions as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information on page 28 following the notes to financial statements, provides multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Note 2 – Retirement Plan Description (Continued)

Funding Policies and Funded Status and Progress (Continued)

In November 2009, the Board adopted a preliminary actuarial valuation for the fiscal year ending June 30, 2009 prepared by LACERS consulting actuary. This preliminary valuation did not include the effect of the City's ERIP due to the lack of sufficient data at the time. As the complete ERIP election information became available, the revised valuation for the fiscal year ending June 30, 2009 was performed in April 2010 to reflect the liability associated with the City's ERIP election. The Schedules of Funding Progress presented in the Required Supplementary Information have been updated accordingly for the actuarial valuation year of June 30, 2009.

Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan Members) and include the types of benefits provided at the time of each valuation and historical pattern of sharing of benefit costs between the employer and plan Members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in the actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations. The actuarial methods and significant assumptions used in the valuation year of June 30, 2010 are summarized in this note to conform to the disclosure requirements for GASB Statement No. 50.

Note 2 – Retirement Plan Description (Continued)

Funding Policies and Funded Status and Progress (Continued)

Valuation Date	June 30, 2010
Actuarial-Cost Method	Projected Unit Credit Cost Method – assuming a closed group.
Amortization Method	Level Percent of Payroll – assuming a 4.25% increase in total covered payroll.
Remaining Amortization Period	Multiple layers. Actuarial gains/losses are amortized over 15 years. Assumption or method changes are amortized over 30 years. The existing layers on June 30, 2005, except those arising from the phase-in of contribution rates for the May 30, 2002 experience study, were combined and amortized over 30 years. Plan changes, including the liability change due to 2009 ERIP, are amortized over 15 years. Future ERIPs will be amortized over 5 years. Actuarial surplus is amortized over 30 years. The amortization period may be adjusted to comply with GASB requirements on maximum amortization period for all layers combined.
Asset Valuation Method	Market value of assets less unrecognized returns in each of the last 7 years. Unrecognized return is equal to the difference between the actual market return and the expected return on the market value, and is recognized over a seven-year period. The result of such smoothing process shall fall between 60% - 140% of Market Value.
Actuarial Assumptions:	
Investment Rate of Return	8.00%
Includes Inflation at	3.75%
Real Across-the-Board Salary Increase	0.50%
Projected Salary Increases	Ranges from 12.25% to 6.75% for Members with less than 5 years of service. Ranges from 6.50% to 4.75% for Members with 5 or more years of service.
Cost of Living Adjustments	3.00%
Mortality Table for Retirees and Beneficiaries	RP-2000 Combined Healthy Mortality Table, set back 1 year
Mortality Table for Disabled Retirees	RP-2000 Combined Healthy Mortality Table, set forward 7 years
Percent Married / Domestic Partner	76% of male participants; 50% of female participants are assumed to be married.
Spouse Age Difference	Male retirees are assumed to be 4 years older than their female spouses. Female retirees are assumed to be 2 years younger than their male spouses.

Note 3 – Postemployment Healthcare Plan Description

Plan Description

The System provides Postemployment Healthcare benefits to eligible retirees of the Retirement Plan and their spouses/domestic partners. Generally the benefits of this single employer Postemployment Healthcare Plan are available to all employees who 1) participate in the Retirement Plan; 2) have at least 10 years of service with the System; and 3) enrolled in a System-sponsored medical or dental plan or are a participant in the Medical Premium Reimbursement Program (MPRP). The retiree or surviving spouse/domestic partner can choose from the health plans that are available, which include medical, vision, caregiver, and dental benefits, or participate in the MPRP if he/she resides in an area not covered by the available medical plans. The retiree or surviving spouse/domestic partner receives medical or dental subsidies based on years of service. The maximum subsidies are set annually by the Board.

Funding Policies and Funded Status and Progress

The Plan's funding policy under Article XI Sections 1158 and 1160 of the Los Angeles City Charter provides for periodic employer contributions at actuarially-determined rates that, expressed as percentages of annual covered payroll together with certain fixed amounts, are sufficient to accumulate the required assets to pay benefits when due. The required contribution rate for the Postemployment Healthcare Plan for the fiscal year ended June 30, 2010, was 5.28% of covered payroll, determined by the June 30, 2008 actuarial valuation. As of June 30, 2010, the most recent actuarial valuation date, the Plan was 63.8% funded. The actuarial accrued liability for benefits was $2,233,874,000 and the actuarial value of assets was $1,425,726,000, resulting in an unfunded actuarial accrued liability (UAAL) of $808,148,000. The covered payroll as of June 30, 2010 valuation was $1,817,662,000. The ratio of UAAL to the covered payroll was 44.5%.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, investment returns, and the healthcare cost trends. The funded status of the plan and the annual required contributions of the employer, determined by the annual actuarial valuations, are subject to continual revisions as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information on page 30 following the notes to financial statements, provides multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

In November 2009, the Board adopted a preliminary actuarial valuation for the fiscal year ending June 30, 2009 prepared by LACERS consulting actuary. This preliminary valuation did not include the effect of the City's ERIP due to the lack of sufficient data at the time. As the complete ERIP election information became available, the revised valuation for the fiscal year ending June 30, 2009 was performed in April 2010 to reflect the liability associated with the City's ERIP election. The Schedules of Funding Progress presented in the Required Supplementary Information have been updated accordingly for the actuarial valuation year of June 30, 2009.

Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan Members) and include the types of benefits provided at the time each valuation and historical pattern of sharing of benefit costs between the employer and plan Members to that point. The actuarial methods and assumptions used include techniques such as 7-year smoothing of assets and amortization of UAAL over 15 or 30 years, that are designed to reduce the effects of short-term volatility in funding, consistent with the long-term perspective of the calculations.

Note 3 – Postemployment Healthcare Plan Description (Continued)

Actuarial Methods and Assumptions (Continued)

Valuation Date	June 30, 2010
Actuarial-Cost Method	Projected Unit Credit Cost Method – assuming a closed group.
Amortization Method	Level Percent of Payroll – assuming a 4.25% increase in total covered payroll.
Remaining Amortization Period	Multiple layers. Actuarial gains/losses are amortized over 15 years. Assumption or method changes from experience study are amortized over 30 years, except that health cost trend and premium assumption changes are amortized over 15 years. The unfunded layers on June 30, 2005 were combined and amortized over 30 years. Plan changes, including the liability change due to 2009 ERIP, are amortized over 15 years. Future ERIPs will be amortized over 5 years. Actuarial surplus is amortized over 30 years. The amortization period may be adjusted to comply with GASB requirements on maximum amortization period for all layers combined.
Asset Valuation Method	Market value of assets less unrecognized returns in each of the last 7 years. Unrecognized return is equal to the difference between the actual market return and the expected return on the market value, and is recognized over a seven-year period. The result of such smoothing process shall fall between 60% - 140% of Market Value.
Actuarial Assumptions:	
Investment Rate of Return	8.00%
Mortality Table for Retirees and Beneficiaries	RP-2000 Combined Healthy Mortality Table, set back 1 year
Mortality Table for Disabled Retirees	RP-2000 Combined Healthy Mortality Table, set forward 7 years
Marital Status	60% of male and 30% of female retirees who receive a subsidy are assumed to be married or have a qualified domestic partner and elect dependent coverage.
Spouse Age Difference	Male retirees are assumed to be 4 years older than their female spouses. Female retirees are assumed to be 2 years younger than their male spouses.
Surviving Spouse Coverage	With regard to Members who are currently alive, 100% of eligible spouses or domestic partners are assumed to elect continued health coverage after the Member's death.
Participation	50% of inactive Members are assumed to receive a subsidy for a City approved health carrier. 100% of retirees becoming eligible for Medicare is assumed to be covered by both Parts A and B.

Note 3 – Postemployment Healthcare Plan Description (Continued)

Actuarial Methods and Assumptions (Continued)

Health Care Cost Trend Rates

Trend Rates to be applied in the following fiscal years, to all health plans. Trend Rate is to be applied to premium for shown fiscal year to calculate next fiscal year's projected premium.

Medical Premium Trend Rates to be applied to Fiscal Year 2010-2011 and later years are:

First Fiscal Year (July 1, 2010 through June 30, 2011)		
Carrier	Under Age 65	Age 65 & Over
Kaiser HMO	7.84%	4.39%
Blue Cross HMO	10.03%	N/A
Blue Cross PPO	8.44%	8.52%
Secure Horizons	N/A	8.55%

Fiscal Year 2011 - 2012 and later	
Fiscal Year	Trend (Approx)
2011 - 2012	9.75%
2012 - 2013	9.25%
2013 - 2014	8.75%
2014 - 2015	8.25%
2015 - 2016	7.75%
2016 - 2017	7.25%
2017 - 2018	6.75%
2018 - 2019	6.25%
2019 - 2020	5.75%
2020 - 2021	5.25%
2021 and later	5.00%

Dental Premium Trend to be applied is 5.00% for all years.

Medicare Part B Premium Trend for the 2010-2011 fiscal year will be calculated based on actual increase from 2010 to 2011 when it becomes available. 5.00% assumed for the calendar years following 2011 calendar year.

Note 4 – Contributions Required and Contributions Made

The System currently uses the projected unit credit cost method to determine the required annual contribution amount for the Retirement Plan and the Postemployment Healthcare Plan. The required annual contribution amount is composed of two components, (1) normal cost, which is the cost of the portion of the benefit that is allocated to a given year, and (2) the payment to amortize the unfunded actuarial accrued liability (UAAL) which is the difference between LACERS actuarial liabilities and actuarial assets.

For the valuation as of June 30, 2010, the components of the UAAL are amortized as a level percent of pay. Based on the System's amortization policy, increases or decreases in the UAAL due to plan or assumption changes are amortized over 30 years, except that health cost trend and premium assumption changes are amortized over 15 years. Experience gains and losses are amortized over 15 years, subject to adjustments to comply with GASB requirements on maximum amortization period for all layers combined. The amortization periods are "closed" as the amounts calculated annually are amortized over either a 15- or 30-year period.

The contributions to the System for the year ended June 30, 2010, in the amount of $489,712,000 ($393,201,000 for the Retirement Plan and $96,511,000 for the Postemployment Healthcare Plan), were made in accordance with actuarially-determined requirements computed by the actuarial valuation dated June 30, 2008.

Contributions to the System consisted of the following for the year ended June 30, 2010 (in thousands):

	Retirement Plan	Postemployment Healthcare Plan
City Contributions:		
Required Contribution	$ 258,643	$ 96,511
Defrayal Portion of Member Contributions	7,397	-
Family Death Benefit Insurance Plan	200	-
Total City Contributions	266,240	96,511
Member Contributions	126,961	-
Total Contributions	$ 393,201	$ 96,511

The amount of the City contributions made for the Retirement Plan under the Required Contribution category ($258,643,000) were equal to 100% of the Annual Required Contributions (ARC) of the employer as defined by GASB Statements No. 25 and No. 27. The City contributions made for the Postemployment Healthcare Plan, in the amount of $96,511,000, represents 100% of the ARC as defined by GASB No. 43 and No. 45. Member contributions ($126,961,000) were made toward the Retirement Plan and voluntary Family Death Benefit Insurance Plan.

Note 5 – Historical Trend Information

Historical trend information designed to provide information about the System's progress made in accumulating sufficient assets to pay benefits when due is presented on pages 28 through 29 for the Retirement Plan and pages 30 through 31 for the Postemployment Healthcare Plan.

Note 6 – Defrayal Portion of Member Contributions-Retirement Plan

For Members who entered the System prior to February 1983 (Defrayal Group), the City subsidized a portion of Member contributions. Payments made by the City based on the subsidy are not refundable to Members upon their withdrawal from the System prior to retirement.

As all Members of the System, including the Defrayal Group, contribute 6% starting November 8, 2009 and a large number of members in the Defrayal Group retired during ERIP election, the subsidized amount to the Defrayal Group by the City for the current fiscal year decreased to $7,397,000, which is approximately 2.8% of total City contributions paid to the Retirement Plan for the year ended June 30, 2010. The City's subsidy will be completely phased out after June 30, 2011.

Note 7 – Cash and Short-Term Investments and Investments

The Board has the responsibility for the investment of the System's funds, and should discharge its duties with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims, as prescribed by Article XI Section 1106(c) of the City Charter.

Note 7 – Cash and Short-Term Investments and Investments (Continued)

The System considers investments with maturity of 12 months or less to be short-term investments. The carrying value of cash and short-term investments at June 30, 2010, on the Retirement Plan and Postemployment Healthcare Plan, included approximately $2,237,000 held in the System's general operating accounts with the City Treasurer and short-term investments funds (STIF) of $369,946,000 for a total of $372,183,000. The amounts held by the City Treasurer are pooled with the monies of other City agencies and invested by the City Treasurer's office. These assets are not individually identifiable. At June 30, 2010, short-term investments included collective STIF of $96,462,000, international STIF of $273,417,000 and future initial margin of $67,000.

The fair value of derivative instruments, including equity index future contracts, currency forward contracts, and rights and warrants, are recorded in the Statement of Plan Net Assets with a net negative value of $25,000 and reported as a (current) Liability. The changes in fair value of the derivative instruments during the fiscal year are recorded in the Statement of Changes in Plan Net Assets as Investment Income (Loss). The System enters into derivative contracts for investment purposes and to manage risks associated with its investment portfolio. For financial reporting purposes, all the System's derivatives for the current and previous fiscal years are classified as investment derivatives. The previous year's financial statements were not restated due to the restating adjustment not having a material impact on the financial statements. Therefore, the changes in fair value of the derivative instruments for the fiscal year ended, as presented below, are the same as its fair value at June 30, 2010.

The notional amount and the fair value of derivative instruments as of June 30, 2010 are as follows (dollars in thousands):

Derivative Type	Notional Amount	Fair Value	Change in Fair Value
Future Contracts - Equity Index	$ 13,287	$ (92)	$ 92
Currency Forward Contracts	171,740	(26)	26
Right / Warrants	N/A	93	(93)
Net		$ (25)	$ 25

Credit Risk - Investments

Credit Risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The System seeks to maintain a diversified portfolio of fixed income instruments in order to obtain the highest total return for the fund at an acceptable level of risk within this asset class. The credit quality ratings of investments in fixed income securities by a nationally recognized statistical rating organization as of June 30, 2010 are as follows (dollars in thousands):

S & P Ratings	Fair Value	Percentage
AAA	$ 553,883	27.74 %
AA	61,243	3.07
A	400,599	20.06
BBB	512,893	25.68
BB	160,665	8.04
B	106,542	5.34
CCC	27,287	1.37
CC	16,770	0.84
C	837	0.04
Not Rated	156,155	7.82
	1,996,874	100.00 %
U.S. Government Guaranteed Securities *	386,166	
Total Fixed Income Securities	$ 2,383,040	

* Consists of U.S. Government Bonds and GNMA Mortgage-Backed Securities which had the AAA rating.

Credit Risk - Derivatives

Derivatives are subject to credit risk that the counterparty to a contract will default. The System is exposed to credit risk on reported assets of the investment derivatives that are traded over the counter. The credit risk of exchange traded derivatives for future contracts is considered minimal because the exchange clearing house is the counterparty and guarantees the performance.

The System permits investment managers, under the terms of individual guidelines, to use derivatives instruments as set forth in each manager's investment guidelines to control portfolio risk. It is the responsibility of these investment managers to actively monitor counterparties on their financial safety and ensure compliance with the investment restrictions. The System has no general investment

Note 7 – Cash and Short-Term Investments and Investments (Continued)

Credit Risk – Derivatives (Continued)

policy with respect to netting arrangements or collateral requirements. However, these individual investment managers have set up the arrangements with the counterparties to net off the positive and negative contracts with the same counterparty in case of the counterparty's default.

As of June 30, 2010, without respect to netting arrangements, the System's maximum loss on derivative instruments subject to credit risk, namely currency forward contracts, is as follows (dollars in thousands):

S & P Ratings	Amount
AA	$ 587
AA-	181
A	1,388
Total Credit Risk	$ 2,156

Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of a financial institution's failure of depository financial institution, the System would not be able to recover its deposits or would not be able to recover collateral securities that are in the possession of an outside party. Deposits are exposed to custodial credit risk if they are not insured or not collateralized. As of June 30, 2010, the System has exposure to such risk in the amount of $34,480,000, or 1.68% of the fair value of total international investments. The amount represents non-invested cash denominated in foreign currencies, managed by 11 different investment managers, and held outside of the System's custodial bank. The System's policy requires each individual publicly traded equities investment managers to hold no more than 10% of their portfolios in the form of cash. The plan is in compliance with the policy.

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the System would not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. Investment securities are exposed to custodial credit risk if the securities are not insured, or are not registered in the System's name, and held by the counterparty. The System's investments are not exposed to custodial credit risk if they are insured or registered in the System's name. The System's investments were not exposed to custodial credit risk because all securities were held by the System's custodial bank in the System's name.

Concentration of Credit Risk

The investment portfolio as of June 30, 2010 contained no concentration of investments in any one entity that represented 5 percent or more of the total investment portfolio.

Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. One of the ways the System manages its exposure to interest rate risk is by requiring the fixed income investment managers to maintain their portfolio effective duration within a specified range of the BC U.S. Universal Bond Index, the BC Intermediate Government Credit Index, or the BC Aggregate Bond Index, depending on the Board's mandates. The effective duration is a measure, in years, of interest-rate sensitivity in debt investments. The longer the effective duration, the greater the sensitivity to interest rate changes. Information about the sensitivity of the fair values of the System's investments to market interest rate fluctuations is provided by the following table that shows the weighted average effective duration of the System's fixed income securities by investment type (dollars in thousands):

Investment Type	Amount	Weighted Average Duration (in Years)
Asset Backed Securities	$ 41,214	1.58
Commercial Mortgage-Backed Securities	109,228	5.75
Corporate Bonds	1,153,893	6.63
Government Agencies	57,353	4.26
Government Bonds	353,937	4.84
Government Mortgage-Backed Securities	441,217	2.42
Index Linked Government Bonds	71,932	3.77
Municipal/Provincial Bonds	1,365	1.39
Non-Government Backed C.M.O.s	45,109	1.95
Opportunistic Debt	107,792	2.87
Total Fixed Income Securities	$ 2,383,040	

Note 7 – Cash and Short-Term Investments and Investments (Continued)

Highly Sensitive Investments

Highly Sensitive Investments are certain debt investments whose terms may cause their fair value to be highly sensitive to market interest rate changes. Terms include such information as embedded options, coupon multipliers, benchmark indexes, and reset dates. The System's asset-backed investments have embedded prepayment options that will typically cause prepayments by the obligees of the underlying investments when interest rates fall. Prepayments eliminate the stream of future interest payments and, therefore, diminish the fair value of the asset-backed investment. The following table shows the fair value of the System's asset-backed investments by investment type (in thousands):

Investment Type	Amount
Asset Backed Securities	$ 41,214
Commercial Mortgage-Backed Securities	109,228
Government Agencies	57,353
Government Mortgage-Backed Securities	441,217
Non-Government Backed C.M.O.s	45,109
Total Asset-Backed Investments	$ 694,121

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or deposit. The System's Asset Allocation policy sets a target of 20% of the total portfolio for non-U.S. investments in equities. In addition, fixed income, real estate, and alternative investment managers may hold non-U.S. investments depending on their individual mandates. Forward currency contracts are permitted primarily to reduce the foreign currency risk.

Note 7 – Cash and Short-Term Investments and Investments (Continued)

Foreign Currency Risk (Continued)

The System's non-U.S. currency investment holdings as of June 30, 2010, which represents 17.2% of fair value of total investments, are as follows (in thousands):

Foreign Currency Type	Cash and Adjustments to Cash	Equity	Fixed Income	Derivatives Instruments	Other Investments	Total Fair Value in USD
Argentine peso	$ 68	$ -	$ -	$ -	$ -	$ 68
Australian dollar	6,498	87,399	-	(49)	-	93,848
Brazilian real	301	18,816	2	-	-	19,119
British pound sterling	(7,098)	212,993	-	(151)	22,688	228,432
Canadian dollar	8,250	47,413	8,278	16	-	63,957
Columbian peso	-	1,351	-	-	-	1,351
Czech koruna	9	-	-	-	-	9
Danish krone	316	11,211	-	-	-	11,527
Egyptian pound	-	3,348	-	-	-	3,348
Euro	3,789	338,285	-	876	75,954	418,904
Hong Kong dollar	1,331	138,873	-	52	-	140,256
Hungarian forint	13	985	-	-	-	998
Indian rupee	908	25,482	-	-	-	26,390
Indonesian rupiah	382	13,914	-	-	-	14,296
Japanese yen	(13,325)	268,252	-	(953)	32,687	286,661
Malaysian ringgit	99	7,587	-	-	-	7,686
Mexican peso	24	6,810	11,149	-	-	17,983
New Israeli shekel	1,219	3,257	-	-	-	4,476
New Taiwan dollar	1,957	43,188	-	-	-	45,145
New Zealand dollar	118	536	-	-	-	654
Norwegian krone	(872)	9,813	-	8	-	8,949
Philippine peso	117	16,170	-	-	-	16,287
Polish zloty	(61)	3,760	-	-	-	3,699
Singapore dollar	504	35,851	-	-	-	36,355
South African rand	(9)	26,037	-	-	-	26,028
South Korean won	1,072	72,210	-	-	-	73,282
Swedish krona	3,092	17,178	-	-	-	20,270
Swiss franc	3,753	71,464	-	(197)	-	75,020
Thai baht	146	26,141	-	-	-	26,287
Turkish lira	(56)	6,489	-	-	-	6,433
Total Investments Held in Foreign Currency	$ 12,545	$ 1,514,813	$ 19,429	$ (398)	$ 131,329	$ 1,677,718

Note 8 – Securities Lending Agreement

The System has entered into various short-term arrangements with its custodian under Article XXXIV Section 504 of the City Charter, whereby securities are lent to various brokers. The custodian determines which lenders' accounts to lend securities from by using an impartial sequential system that matches loan requests with various lenders' accounts. All lenders are deemed to have relatively equal opportunity to profit from the lending of securities. Therefore, should a collateral deficiency occur beyond the custodian's responsibilities, the deficiency is allocated pro rata among all lenders.

Minimum collateralization is 102% of fair value of the borrowed U.S. securities and 105% for international securities. Collateral consists of cash, government securities, and irrevocable bank letters of credit. Cash collateral may be invested separately or pooled in a separate fund for investing in money market or cash equivalent investments.

The borrower has all incidents of ownership with respect to borrowed securities and collateral, including the right to vote and transfer or loan borrowed securities to others. The System is entitled to receive all distributions, which are made by the issuer of the borrowed securities, directly from the borrower. Under the agreement, the custodian will indemnify the System as a result of the custodian's failure to: 1) make a reasoned determination of the creditworthiness of a potential borrower before lending and, during the term of the loan or loans, the borrower files a petition of bankruptcy or similar action; 2) demand adequate collateral; or 3) otherwise maintain the securities lending program in compliance with the Federal Financial Institutions Examination Council Supervisory Policy on Securities Lending.

These agreements provide for the return of the securities and revenue determined by the type of collateral received. The cash collateral values of securities on loan to brokers are shown at their fair value on the statement of plan net assets.

As of June 30, 2010, the System had no credit risk exposure to borrowers because the amounts the System owed the borrowers exceed the amounts the borrowers owed the System. The System had no losses on securities lending transactions resulting from default of a borrower or lending agent. Due to the nature of the securities lending program and Northern Trust's collateralization of loans at 102% and 105% plus accrued interest for fixed income securities, it was previously believed that there were no material credit risks to the System as defined in GASB Statement No. 28 and GASB Statement No. 40 by our participation in the securities lending program. However, with the short-term illiquid and volatile environment for fixed income markets, we believe that there is more risk in the credit quality of the collateral pool than previously anticipated. Reduced demand in securities lending given recent brokerage firm failures is an indication of the overall increasing risks associated with securities lending.

All securities loans can be terminated on demand by either the System or the borrower. Cash collateral is invested in a collateral account consisting of short and intermediate term investments. The System cannot pledge or sell non-cash collateral unless the borrower defaults.

The following tables represent the balances of collateral received and loaned securities as of June 30, 2010 (in thousands):

Fair value of collateral received for loaned securities as of June 30, 2010:

Securities Lent	Cash	Non-Cash	Total Collateral Value
U.S. Government and Agency Securities	$ 258,909	$ -	$ 258,909
Domestic Corporate Fixed Income Securities	102,574	-	102,574
International Fixed Income Securities	6,548	140,879	147,427
Domestic Stocks	509,117	2,800	511,917
International Stocks	110,489	128,107	238,596
	$ 987,637	$ 271,786	$ 1,259,423

Fair value of loaned securities as of June 30, 2010:

Securities Lent	Cash	Non-Cash	Total Fair Value of Underlying Securities
U.S. Government and Agency Securities	$ 252,880	$ -	$ 252,880
Domestic Corporate Fixed Income Securities	99,856	-	99,856
International Fixed Income Securities	6,171	132,803	138,974
Domestic Stocks	494,171	2,720	496,891
International Stocks	103,288	117,501	220,789
	$ 956,366	$ 253,024	$ 1,209,390

Note 8 – Securities Lending Agreement (Continued)

As of June 30, 2010, the fair value of the lent securities was $1,209,390,000. The fair value of associated collateral was $1,259,423,000. Of this amount, $987,637,000 represents the fair value of cash collateral and $271,786,000 represents the fair value of the non-cash collateral. Non-cash collateral, which the System does not have the ability to sell unless the borrower defaults, is not reported in the statement of plan net assets. The System's income and expenses related to securities lending were $4,451,000 and $629,000, respectively, for the year ended June 30, 2010.

Note 9 – Futures and Forward Contracts

The System uses derivative financial instruments, primarily to manage portfolio risk. Futures and forward contracts are marked to market and are recorded in the Statement of Plan Net Assets at fair value. Futures contracts have little credit risk, as organized exchanges are the guarantors. Forward agreements are subject to the creditworthiness of the counterparties, which are principally large financial institutions (Refer to Note 7 – Credit Risk-Derivatives).

At June 30, 2010, the System had outstanding equity index futures with an aggregate notional amount of $13,287,000. In addition, at June 30, 2010, the System had outstanding forward purchase commitments with a notional amount of $171,740,000 and offsetting forward sales commitments with notional amounts of $171,740,000, which expire through September 2010. The System maintains margin collateral on the positions with brokers, consisting of cash and U.S. Treasury Bills. The total collateral margin was $14,287,000 as of June 30, 2010.

Note 10 – Commitments and Contingencies

At June 30, 2010, the System was committed to future purchases of real estate and alternative investments at an aggregate cost of approximately $707,183,000.

REQUIRED SUPPLEMENTARY INFORMATION

(Dollars in Thousands)

Schedule of Funding Progress

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Underfunded or (Overfunded) AAL (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	Underfunded or (Overfunded) AAL as a Percentage of Covered Payroll ((b-a)/c)
June 30, 2005	$ 7,193,142	$ 9,321,525	$ 2,128,383	77.2 %	$ 1,589,305	133.9 %
June 30, 2006	7,674,999	9,870,662	2,195,663	77.8	1,733,340	126.7
June 30, 2007	8,599,700	10,526,874	1,927,174	81.7	1,896,609	101.6
June 30, 2008	9,438,318	11,186,404	1,748,086	84.4	1,977,645	88.4
June 30, 2009*	9,577,747	12,041,984	2,464,237	79.5	1,816,171	135.7
June 30, 2010	9,554,027	12,595,025	3,040,998	75.9	1,817,662	167.3

* Based on revised June 30, 2009 actuarial valuation.

Schedule of Employer Contributions

	Employer Contributions Total	
Year Ended June 30	Annual Required Contribution	Percentage Contributed
2005	$ 183,241	86 %
2006	227,741	100
2007	277,517	100
2008	288,119	100
2009	274,555	100
2010	258,643	100

Note 1 – Description

The historical trend information about the System is presented as required supplementary information. The information is intended to help users assess the funding status of the Plan on a going-concern basis and to assess progress made in accumulating assets by paying benefits when due.

Note 2 – Significant Factors Affecting Trend in Actuarial Information and Employer Contributions

In consideration of the more volatile investment markets and the plan sponsor's financial conditions, the Board adopted a revised asset smoothing policy to lengthen the asset smoothing period from five years to seven years and modify the market value corridor from 50% - 150% to 60% - 140%. According to the actuary's projection, the City contribution rates will be lower in the next five years than they would have been under the prior policy.

Due to asset smoothing, the large investment losses from the previous two years have not been fully recognized in the actuarial valuation. As of June 30, 2010, there is a combined unrecognized investment loss in the amount of $2,018,219,000. The deferred loss will be recognized in the determination of the actuarial value of assets for funding purposes in the next few years. This implies that earning the assumed rate of investment return of 8% per year (net of expenses) on a market value basis will result in investment losses on the actuarial value of assets in the next few years. Therefore, the contribution requirements would increase in the next few years even if the actual market return is equal to the assumed 8% rate and all other actuarial assumptions are met.

(Dollars in Thousands)

Schedule of Funding Progress

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Underfunded or (Overfunded) AAL (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	Underfunded or (Overfunded) AAL as a Percentage of Covered Payroll ((b-a)/c)
June 30, 2005	$ 893,378	$ 1,718,899	$ 825,521	52.0%	$ 1,589,305	51.9%
June 30, 2006	990,270	1,730,799	740,529	57.2	1,733,340	42.7
June 30, 2007	1,185,544	1,730,400	544,856	68.5	1,896,609	28.7
June 30, 2008	1,342,920	1,928,043	585,123	69.7	1,977,645	29.6
June 30, 2009*	1,342,497	2,058,177	715,680	65.2	1,816,171	39.4
June 30, 2010	1,425,726	2,233,874	808,148	63.8	1,817,662	44.5

* Based on revised June 30, 2009 actuarial valuation.

Schedule of Employer Contributions

	Employer Contributions Total	
Year Ended June 30	Annual Required Contribution	Percentage Contributed
2005	$ 53,190	100 %
2006	76,116	100
2007	115,233	100
2008	108,848	100
2009	95,122	100
2010	96,511	100

Note 1 – Description

The historical trend information about the System is presented as required supplementary information. The information is intended to help users assess the funding status of the Plan on a going-concern basis and to assess progress made in accumulating assets by paying benefits when due. As the Board decided to comply with the requirements in GASB No. 43 and No. 45 for the actuarial valuation of the Postemployment Healthcare Plan as of June 30, 2005, the funded ratios for years prior to June 30, 2005 were not calculated using the parameters required by GASB No. 43 and No. 45 because the plan's funding policy excluded active employees with less than 10 years of service. Similarly, the annual required contribution (ARC) for fiscal year ended June 30, 2006 was determined in the June 30, 2004 valuation and it was not calculated using the parameters required by GASB No. 43 and No. 45.

Note 2 – Significant Factors Affecting Trend in Actuarial Information and Employer Contributions

In consideration of the more volatile investment markets and the plan sponsor's financial conditions, the Board adopted a revised asset smoothing policy to lengthen the asset smoothing period from five years to seven years and modify the market value corridor from 50% - 150% to 60% - 140%. According to the actuary's projection, the City contribution rates will be lower in the next five years than they would have been under the prior policy.

Due to asset smoothing, the large investment losses from the previous two years have not been fully recognized in the actuarial valuation. As of June 30, 2010, there is a combined unrecognized investment loss in the amount of $2,018,219,000. The deferred loss will be recognized in the determination of the actuarial value of assets for funding purposes in the next few years. This implies that earning the assumed rate of investment return of 8% per year (net of expenses) on a market value basis will result in investment losses on the actuarial value of assets in the next few years. Therefore, the contribution requirements would increase in the next few years even if the actual market return is equal to the assumed 8% rate and all other actuarial assumptions are met.

SUPPLEMENTAL SCHEDULES

Schedule of Administrative Expenses
For the Year Ended June 30, 2010
(In Thousands)

	Retirement Plan	Postemployment Healthcare Plan	Total
Personnel Services:			
Staff Salaries	$ 9,279	$ 1,648	$ 10,927
Staff Benefits	1,169	208	1,377
Total Personnel Services	10,448	1,856	12,304
Professional Services:			
Actuarial	303	54	357
Data Processing	762	135	897
Audit	90	16	106
Retirees' Health Consulting	-	337	337
Legal Counsel	476	85	561
Medical for Temporary Disability	120	21	141
Total Professional Services	1,751	648	2,399
Communication:			
Printing	95	17	112
Telephone	14	2	16
Postage	99	18	117
Member Outreach Program	2	-	2
Travel	58	10	68
Total Communication	268	47	315
Rentals:			
Office Space	1,126	199	1,325
Equipment Leasing	32	6	38
Total Rentals	1,158	205	1,363
Miscellaneous:			
Office	461	82	543
Depreciation	118	21	139
Total Miscellaneous	579	103	682
Total Administrative Expenses	$ 14,204	$ 2,859	$ 17,063

Schedule of Investment Expenses
For the Year Ended June 30, 2010
(In Thousands)

	Assets Under Management	Fees
Retirement Plan		
Investment Management Expense:		
Fixed Income Managers	$ 2,074,720	$ 5,386
Equity Managers	4,316,761	13,039
Subtotal Investment Management Expense	6,391,481	18,425
Other Investment Expense:		
Alternative Investments Consulting Fee	-	939
Real Estate and Other Consulting Fee	-	472
Subtotal Other Investment Expense	-	1,411
Postemployment Healthcare Plan		
Investment Management Expense:		
Fixed Income Managers	308,320	956
Equity Managers	641,507	2,315
Subtotal Investment Management Expense	949,827	3,271
Other Investment Expense:		
Alternative Investments Consulting Fee	-	167
Real Estate and Other Consulting Fee	-	84
Subtotal Other Investment Expense	-	251
Total Investment Management Expense and Other Investment Expense, Excluding Alternative Investments, Real Estate and Securities Lending	$ 7,341,308	$ 23,358
Alternative Investments Managers' Fees:		
Retirement Plan	$ 828,336	$ 17,067
Postemployment Healthcare Plan	123,097	3,031
Total Alternative Investments Managers' Fees	$ 951,433	$ 20,098
Real Estate Managers' Fees:		
Retirement Plan	$ 400,241	$ 9,129
Postemployment Healthcare Plan	59,479	1,621
Total Real Estate Managers' Fees	$ 459,720	$ 10,750
Security Lending Fees:		
Retirement Plan	$ 859,855	$ 534
Postemployment Healthcare Plan	127,782	95
Total Security Lending Fees	$ 987,637	$ 629