

**SAN FRANCISCO CITY AND COUNTY
EMPLOYEES' RETIREMENT SYSTEM**

Financial Statements and
Required Supplementary Information
(With Independent Auditor's Report Thereon)

Years Ended June 30, 2013 and 2012



Certified Public Accountants.

**SAN FRANCISCO CITY AND COUNTY
EMPLOYEES' RETIREMENT SYSTEM
Years Ended June 30, 2013 and 2012**

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INDEPENDENT AUDITOR'S REPORT

Retirement Board of San Francisco
City and County Employees' Retirement System
San Francisco, California

Report on the Financial Statements

We have audited the accompanying financial statements of the San Francisco City and County Employees' Retirement System ("Retirement System"), a pension trust fund of the City and County of San Francisco, California, as of and for the years ended June 30, 2013 and 2012, and the related notes to the financial statements, which collectively comprise the Retirement System's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Retirement System as of June 30, 2013 and 2012, and the changes in its financial position for the years then ended in accordance with accounting principles generally accepted in the United States of America.


Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that management's discussion and analysis and the schedules of funding progress and employer contributions, as listed in the table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an 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 basic financial statements, and other knowledge we obtained during our audits of the basic 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.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated December 16, 2013 on our consideration of the Retirement System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Retirement System's internal control over financial reporting and compliance.

Macias Gini & Cunnell LLP

Walnut Creek, California
December 16, 2013

SAN FRANCISCO CITY AND COUNTY EMPLOYEES' RETIREMENT SYSTEM
Management's Discussion and Analysis – Unaudited
Years Ended June 30, 2013 and 2012
(Dollar amounts in thousands)

The management of the City and County of San Francisco Employees' Retirement System (Retirement System) is pleased to provide this overview and analysis of the financial activities of its cost-sharing multiple-employer defined benefit pension plan (the Plan) for the years ended June 30, 2012 and 2011. We encourage readers to consider the information presented here in conjunction with the *Financial Statements and Required Supplementary Information*, which follow this discussion. All amounts, unless otherwise indicated, are expressed in thousands of dollars.

Financial Highlights

Fiscal Year 2013

- The assets of the Retirement System exceeded its liabilities at the close of the year ended June 30, 2013. The Plan held \$17,011,545 of net position restricted for pension benefits. All of the net position is available to meet the Retirement System's ongoing obligations to plan participants and their beneficiaries.
- The Retirement System's funding objective is to meet long-term benefit obligations through contributions and investment income. As of July 1, 2012, the date of the last actuarial valuation, the funded ratio for the Retirement System was 82.6%. In general, this indicates that for every dollar of benefits promised, the Retirement System has approximately \$0.83 of assets available for payment based on the actuarial value of assets as of the date of the actuarial valuation.
- For the year ended June 30, 2013, the Retirement System's net investment income of \$2,064,550 represents a 13.50% increase in plan net position. (This return is based on plan net position as of the beginning of the fiscal year.) Net appreciation in fair value of investments increased by \$1,976,746 primarily as a result of the strong returns in the equity markets.
- Total net position held in trust for pension benefits increased by \$1,717,821, or 11.2%, primarily as a result of strong investment returns which were slightly reduced by the net difference between contributions received by the Plan and increased benefit payments made from the Plan.
- Members' contributions to the Plan totaled \$258,726, an increase of \$60,566 or 30.6% from the prior year, primarily as a result of the voter-approved Proposition C (November 2011) employee cost-sharing provisions which became effective as of July 1, 2012. For example, based on the required employer contribution rate of 20.71% set by the Retirement Board for FY 2012-2013, many Plan members were required to pay an additional 2.5% or 3.0% in employee contributions.
- In order to maintain the fiscal soundness of the Plan, required employer contributions to the Plan totaled \$442,870, an increase of \$32,073 or 7.8% from the prior year.
- Total deductions from the Plan were \$1,048,325, an increase of 5.4% from the prior year due to the increase in benefits paid during the current fiscal year.

Fiscal Year 2012

- The assets of the Retirement System exceeded its liabilities at the close of the year ended June 30, 2012. The Plan held \$15,293,724 of net position restricted for pension benefits. All of the net position is available to meet the Retirement System's ongoing obligations to plan participants and their beneficiaries.
- The Retirement System's funding objective is to meet long-term benefit obligations through contributions and investment income. As of July 1, 2011, the funded ratio for the Retirement System was 87.7%. In general, this indicates that for every dollar of benefits promised, the Retirement System had approximately \$0.88 of assets available for payment based on the actuarial value of assets as of the date of the actuarial valuation.

SAN FRANCISCO CITY AND COUNTY EMPLOYEES' RETIREMENT SYSTEM

Management's Discussion and Analysis – Unaudited

Years Ended June 30, 2013 and 2012

(Dollar amounts in thousands)

- For the year ended June 30, 2012, the Retirement System's net investment income of \$80,402 represents a 0.52% increase in plan net position. (This return is based on plan net position as of the beginning of the fiscal year.) However, net appreciation in fair value of investments decreased by \$2,804,915 primarily as a result of the decline in the equity markets.
- Total net position held in trust for pension benefits decreased by \$305,115, or 2.0%, primarily as a result of market conditions and the net difference between contributions received by the Plan and increased benefit payments made from the Plan.
- Members' contributions to the Plan totaled \$198,160, an increase of \$16,405 or 9.0% from the prior year.
- In order to maintain the fiscal soundness of the Plan, required employer contributions to the Plan totaled \$410,797, an increase of \$101,974 or 33.0% from the prior year.
- Total deductions from the Plan were \$994,474, an increase of 8.6% from the prior year due to the increase in benefits paid during the current fiscal year.

Overview of Financial Statements

The following discussion and analysis are intended to serve as an introduction to the Retirement System's financial statements, which are comprised of the following components:

1. **Statements of Plan Net Position** are snapshots of account balances as of the close of the year – June 30, 2013 and 2012. They indicate the total assets as of June 30, 2013 and 2012, total liabilities at those dates and the net position restricted for future payment of retirement benefits and operating expenses.
2. **Statements of Changes in Plan Net Position** provide a view of additions to and deductions from the Plan during the years ended June 30, 2013 and 2012.
3. **Notes to Financial Statements** provide additional information that is essential to a full understanding of the data provided in the financial statements.

The statements of plan net position and the statements of changes in plan net position report information about the Retirement System's financial activities, prepared using the accrual basis of accounting. Contributions to the Plan are recognized when due and benefits and refunds are recognized and payable in accordance with the terms of the Plan.

Investments are reported at fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Securities that do not have an established market are reported at estimated fair value derived from third party pricing services. Purchases and sales of investments are recorded on a trade date basis. Alternative investments represent the Retirement System's interest in limited partnerships. The fair values of the Retirement System's partnership interests and real estate investments are based on net asset values provided by the general partners and investment managers.

Investments in forward currency contract investments are commitments to purchase and sell stated amounts of foreign currency. Changes in fair value of open contracts are immediately recognized as gains or losses. The fair value of forward currency contracts are determined by quoted currency prices from national exchanges.

Additional information on the Retirement System's investments can be found in Note 4 of this report.

SAN FRANCISCO CITY AND COUNTY EMPLOYEES' RETIREMENT SYSTEM
Management's Discussion and Analysis – Unaudited
Years Ended June 30, 2013 and 2012
(Dollar amounts in thousands)

Results of Actuarial Valuations

Fiscal Year 2013

The Retirement System's July 1, 2012 (the date of the most recent actuarial valuation) funding ratio is 82.6%, which means the Retirement System has approximately \$0.83 available for each \$1.00 of benefit obligations based on the actuarial value of assets as of the date of the actuarial valuation.

Fiscal Year 2012

The Retirement System's July 1, 2011 funding ratio is 87.7 %, which means the Retirement System has approximately \$0.88 available for each \$1.00 of benefit obligations based on the actuarial value of assets as of the date of the actuarial valuation.

Financial Analysis

The Plan's net position may serve over time as a useful indication of the Plan's financial position. The assets of the Plan exceeded its liabilities at June 30, 2013 and 2012. All of the Plan's net position is restricted to meet the Retirement System's ongoing obligation to Plan participants and their beneficiaries.

The Plan's net position as of June 30, 2013, 2012, and 2011 are represented in the table below:

Net Position Summary – June 30, 2013, 2012, and 2011

| | 2013 | 2012 | 2011 |
|---------------------------|----------------------|----------------------|----------------------|
| Other assets | \$ 450,504 | \$ 413,955 | \$ 163,603 |
| Investments at fair value | 18,049,488 | 16,303,220 | 16,488,300 |
| Total assets | 18,499,992 | 16,717,175 | 16,651,903 |
| Total liabilities | 1,488,447 | 1,423,451 | 1,053,064 |
| Net position | <u>\$ 17,011,545</u> | <u>\$ 15,293,724</u> | <u>\$ 15,598,839</u> |

As of June 30, 2013, the Plan's combined net position held in trust for pension benefits increased by \$1,717,821 or 11.2% for the year, primarily due to strong investment returns as a result of the improvement in financial market conditions. Payables to brokers decreased by \$17,939 and payables to borrowers of securities increased by \$87,791 due to the timing of investment trades and lending activities.

As of June 30, 2012, the Plan's combined net position held in trust for pension benefits decreased by \$305,115 or 2.0% for the year, primarily due to investment returns that did not offset the net difference between contributions received by the Plan and benefit payments made from the Plan. Payables to brokers increased by \$336,483 and payables to borrowers of securities increased by \$23,913 due to the timing of investment trades and lending activities.

The Retirement Board and the consulting actuary concur that the Plan remains in a strong financial position to meet its obligations to the Plan members and beneficiaries. Fiscal 2012/2013 saw a continuation of the economic recovery within the United States as the Federal Reserve's accommodative fiscal policy remained in place. Corporate earnings rose during the fiscal year as did consumer spending while consumer confidence reached its highest level since early 2008. The unemployment rate also improved (falling to 7.6%). However, many workers have ceased looking for full time work – creating an artificially low labor force and resulting lower unemployment rate. Outside the United States, economic growth remains low in the developed economies. In Western Europe supportive fiscal measures from the European Central Bank led to improving results. The export driven emerging economies, however, continue to struggle as GDP growth rates, although strongly positive, remain near recent lows.

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(Dollar amounts in thousands)

As fiduciaries to the Plan members and beneficiaries, the Retirement Board, Retirement System staff, and our investment consultants continuously monitor the Plan's investment strategies, which comply with a "prudent expert" standard, to secure and maintain the sustainability of the Plan.

Highlights of Changes in Net Position – Years ended June 30, 2013, 2012, and 2011
(Dollars in thousands)

| | <u>2013</u> | <u>2012</u> | <u>2011</u> |
|---|----------------------|----------------------|----------------------|
| Additions: | | | |
| Member contributions | \$ 258,726 | \$ 198,160 | \$ 181,755 |
| Employer contributions | 442,870 | 410,797 | 308,823 |
| Interest | 182,160 | 195,517 | 208,400 |
| Dividends | 188,644 | 170,759 | 159,671 |
| Net appreciation/(depreciation) in fair value of investments | 1,729,781 | (246,965) | 2,557,950 |
| Securities lending income | 5,096 | 4,718 | 5,697 |
| Investment expenses | (41,654) | (44,540) | (44,579) |
| Securities lending borrower rebates and expenses | 523 | 913 | 436 |
| Total additions | <u>2,766,146</u> | <u>689,359</u> | <u>3,378,153</u> |
| Deductions: | | | |
| Benefits | 1,023,354 | 968,528 | 889,744 |
| Refunds of contributions | 9,453 | 11,030 | 11,548 |
| Administrative expenses | 14,169 | 13,661 | 13,544 |
| Other administrative expenses - OPEB | 1,349 | 1,255 | 1,264 |
| Total deductions | <u>1,048,325</u> | <u>994,474</u> | <u>916,100</u> |
| Change in net position | 1,717,821 | (305,115) | 2,462,053 |
| Net position - beginning of the year | <u>15,293,724</u> | <u>15,598,839</u> | <u>13,136,786</u> |
| Net position - end of the year | <u>\$ 17,011,545</u> | <u>\$ 15,293,724</u> | <u>\$ 15,598,839</u> |

Fiscal Year 2013

- Member contributions for the year ended June 30, 2013 increased by \$60,566 or 30.6% from the prior year. This is primarily the result of the voter-approved Proposition C (November 2011) employee cost-sharing provisions which became effective as of July 1, 2012. For example, based on the required employer contribution rate of 20.71% set by the Retirement Board for FY 2012-2013, many Plan members were required to pay an additional 2.5% or 3.0% in employee contributions.

SAN FRANCISCO CITY AND COUNTY EMPLOYEES' RETIREMENT SYSTEM

Management's Discussion and Analysis – Unaudited

Years Ended June 30, 2013 and 2012

(Dollar amounts in thousands)

- In order to maintain the fiscal soundness of the Plan, \$442,870 in required employer contributions were made during the year ended June 30, 2013. The increase of \$32,072 in required employer contributions reflect an increase in the employer contribution rate from 18.09% in fiscal year 2012 to 20.71% in fiscal year 2013, due to the continued recognition of investment losses from the year ended June 30, 2009.
- Net investment income increased by \$1,984,148 from the prior year. The majority of the increase is attributed to the \$1,976,746 increase in net appreciation in fair value of investments primarily due to strong investment returns as a result of the improvement in financial market conditions. Interest income decreased by \$13,357, due mainly to uncertainty in the domestic fixed income market.
- Benefit payments to Plan participants increased by \$54,826 or 5.7%, which is primarily due to a \$53.7 million increase in service retirement benefits as a result of increased average benefit payments.
- COLA payments decreased \$2.4 million or 4.2% because no Supplemental COLA was paid on July 1, 2012.
- Refunds of contributions decreased by \$1,577 or 14.3%, which continued the trend from the fiscal year ended June 30, 2012.

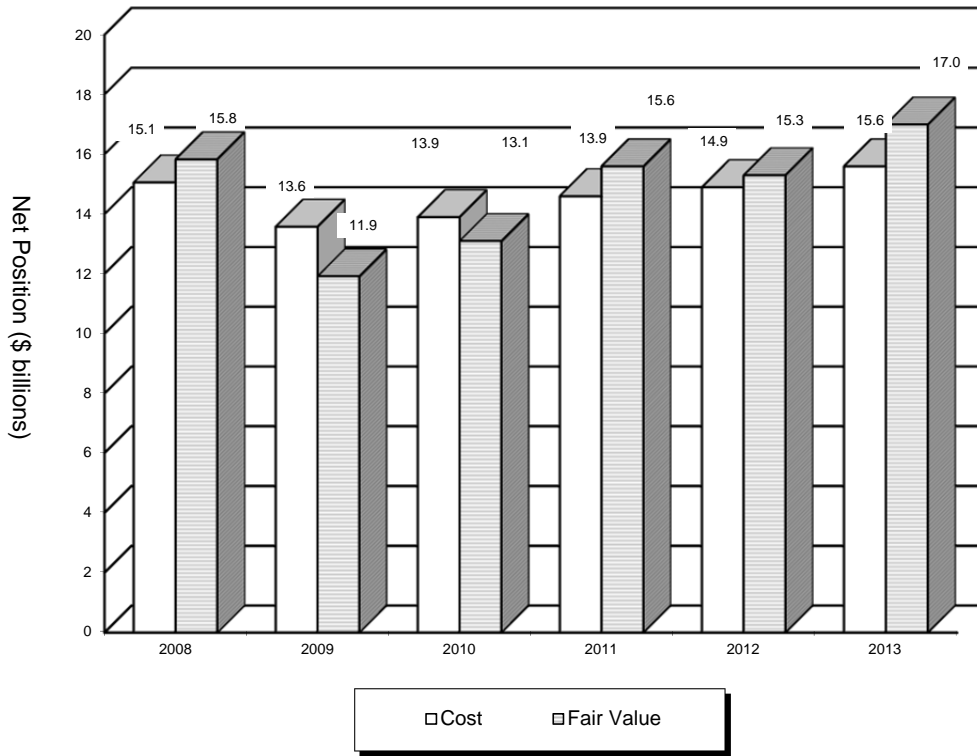
Fiscal Year 2012

- Member contributions for the year ended June 30, 2012 increased by \$16,405 or 9.0% from the prior year. This is primarily due to an increase in the member contribution rates for all safety members during the year. For example, with the passage of Proposition D in 2010, the member contribution rate for all new safety members hired on or after July 1, 2010 increased from 7.5% to 9.0% of covered compensation. In addition, pursuant to collective bargaining agreements with the safety labor organizations, the member contribution rate for all safety members who were hired on or before June 30, 2012 was also increased from 7.5% to 9.0% of covered pay.
- In order to maintain the fiscal soundness of the Plan, \$410,797 in required employer contributions were made during the year ended June 30, 2012. The increase of \$101,974 in required employer contributions reflect an increase in the employer contribution rate from 13.56% in fiscal year 2011 to 18.09% in fiscal year 2012, due to the continued recognition of investment losses from the year ended June 30, 2009.
- Net investment income decreased by \$2,807,173 from the prior year. The majority of the decrease is attributed to the \$2,804,915 decrease in net appreciation in fair value of investments primarily as a result of the decline in the international equity markets. Interest income also decreased by \$12,883, due mainly to uncertainty in the domestic fixed income market.
- Benefit payments to Plan participants increased by \$78,784 or 8.9% consistent with the \$54.5 million increase in retirement allowances initiated and paid during the year as well as \$8.7 million in additional basic COLA and Supplemental COLA paid to most retired members effective July 1, 2011.
- Refunds of contributions decreased by \$518 or 4.5%, primarily as a result of fewer permanent workforce reductions implemented by the City and County during the year ended June 30, 2012.

SAN FRANCISCO CITY AND COUNTY EMPLOYEES' RETIREMENT SYSTEM
Management's Discussion and Analysis – Unaudited
Years Ended June 30, 2013 and 2012
(Dollar amounts in thousands)

Plan net position as of June 30, 2008 through 2013 expressed at cost and fair value are represented in the chart below:

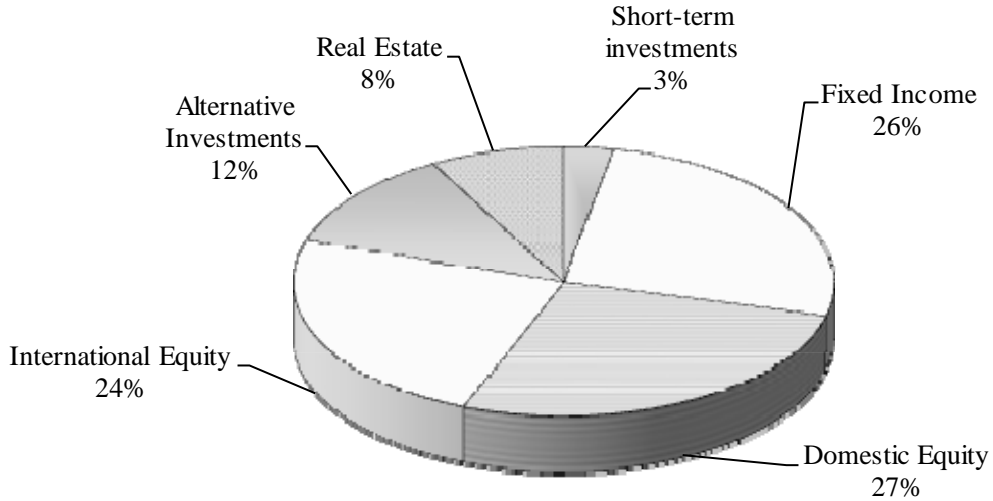
Plan Net Position as of June 30 (\$billions)



SAN FRANCISCO CITY AND COUNTY EMPLOYEES' RETIREMENT SYSTEM
Management's Discussion and Analysis – Unaudited
Years Ended June 30, 2013 and 2012
(Dollar amounts in thousands)

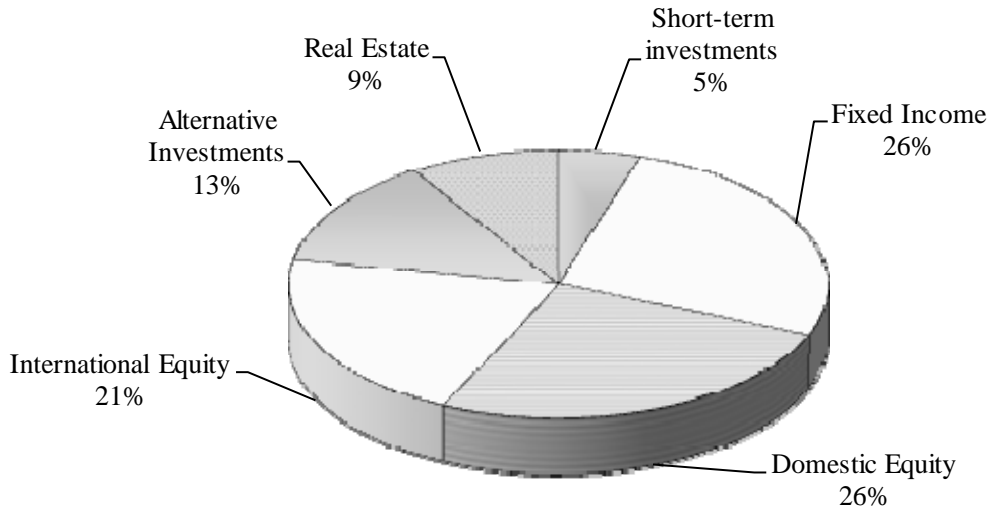
The asset allocation at fair value based on holdings (excluding securities lending collateral and foreign currency contracts) as of June 30, 2013 is represented in the chart below:

Asset Allocation as of June 30, 2013 - Fair Value



The asset allocation at fair value based on holdings (excluding securities lending collateral and foreign currency contracts) as of June 30, 2012 is represented in the chart below:

Asset Allocation as of June 30, 2012 - Fair Value



SAN FRANCISCO CITY AND COUNTY EMPLOYEES' RETIREMENT SYSTEM
Management's Discussion and Analysis – Unaudited
Years Ended June 30, 2013 and 2012
(Dollar amounts in thousands)

Currently Known Facts and Events

The Retirement System's funding objective is to meet long-term benefit obligations through contributions and investment income. As of July 1, 2012, the date of the Retirement System's most recent actuarial valuation, the funded status of the Retirement System on an actuarial value of assets basis was 82.6%, a decrease from the 87.7% funded status as of July 1, 2011. This decrease was primarily due to a loss on the actuarial value of assets reflecting the continued impact of the five-year smoothing of FY 2008-2009 investment losses and FY 2011-2012 actuarial investment losses (the investment return for FY 2011-2012 was 0.52% which was lower than the assumed rate of investment return of 7.66% for that fiscal year). In addition, economic assumption changes approved by the Retirement Board increased actuarial liabilities.

At its January 2013 meeting, after review of the analysis and recommendation prepared by the consulting actuarial firm, the Retirement Board voted to continue to phase in reductions to the Retirement System's long-term investment earnings assumption, long-term wage/inflation assumption and long-term consumer price index assumption over a three-year period as previously approved in December 2011. The three-year reductions are as follows: long-term investment earnings assumption from 7.75% to 7.50% (7.66% for the 2011 valuation; 7.58% for the 2012 valuation; and 7.50% for the 2013 valuation); long-term wage inflation assumption from 4.00% to 3.75% (3.91% for the 2011 valuation; 3.83% for the 2012 valuation; and 3.75% for the 2013 valuation); and long-term consumer price index assumption from 3.50% to 3.25% (3.41% for the 2011 valuation; 3.33% for the 2012 valuation; and 3.25% for the 2013 valuation). These economic assumptions together with demographic assumptions based on periodic demographic studies are utilized to prepare the actuarial valuation of the Retirement System each year.

The Retirement Board believes that the Retirement System remains in a strong financial position to meet its obligations to Plan participants and beneficiaries.

Requests for information

This financial report is designed to provide a general overview of the Retirement System's finances for the years ended June 30, 2013 and 2012. Questions regarding any of the information provided in this report or requests for additional financial information should be addressed to:

Jay Huish, Executive Director
San Francisco City and County Employees' Retirement System
30 Van Ness Avenue, Suite 3000
San Francisco, CA 94102

SAN FRANCISCO CITY AND COUNTY EMPLOYEES' RETIREMENT SYSTEM
Statements of Plan Net Position
June 30, 2013 and 2012
(In thousands)

| | <u>2013</u> | <u>2012</u> |
|---|----------------------|----------------------|
| Assets: | | |
| Deposits | \$ 60,874 | \$ 28,516 |
| Contributions receivable - members | 14,317 | 10,854 |
| Contributions receivable - City and County | 25,276 | 23,234 |
| Investment income receivable: | | |
| Interest | 22,618 | 23,080 |
| Dividends | 11,744 | 9,816 |
| Securities lending | 599 | 571 |
| Receivable from brokers, general partners, and others | 315,076 | 317,884 |
| Investments at fair value: | | |
| Short-term investments | 572,556 | 706,721 |
| City investment pool | 7,769 | 4,780 |
| Debt securities: | | |
| U.S. government and agency securities | 966,411 | 1,036,859 |
| Other debt securities | 3,324,166 | 3,010,690 |
| Equity securities: | | |
| Domestic | 4,576,833 | 4,025,320 |
| International | 4,044,601 | 3,195,651 |
| Real estate | 1,430,711 | 1,403,412 |
| Alternative investments | 2,129,578 | 2,021,472 |
| Foreign currency contracts, net | (7,403) | (15,790) |
| Invested securities lending collateral | 1,004,266 | 914,105 |
| Total investments | <u>18,049,488</u> | <u>16,303,220</u> |
| Total assets | <u>18,499,992</u> | <u>16,717,175</u> |
| Liabilities: | | |
| Payable to brokers | 445,447 | 463,386 |
| Deferred retirement option program | 20,502 | 27,257 |
| Other | 17,337 | 15,438 |
| Payable to borrowers of securities | 1,005,161 | 917,370 |
| Total liabilities | <u>1,488,447</u> | <u>1,423,451</u> |
| Plan net position – restricted for pension benefits | <u>\$ 17,011,545</u> | <u>\$ 15,293,724</u> |

See accompanying notes to financial statements.

SAN FRANCISCO CITY AND COUNTY EMPLOYEES' RETIREMENT SYSTEM
Statements of Changes in Plan Net Position
Years Ended June 30, 2013 and 2012
(In thousands)

| | 2013 | 2012 |
|---|---------------|---------------|
| Additions: | | |
| Member contributions | | |
| Miscellaneous | \$ 211,545 | \$ 152,090 |
| Police | 27,633 | 27,528 |
| Fire | 19,548 | 18,542 |
| Total member contributions | 258,726 | 198,160 |
| Employer contributions | | |
| Miscellaneous | 364,503 | 344,942 |
| Police | 46,314 | 39,389 |
| Fire | 32,053 | 26,466 |
| Total employer contributions | 442,870 | 410,797 |
| Investment income (expenses) | | |
| Interest | 182,160 | 195,517 |
| Dividends | 188,644 | 170,759 |
| Net appreciation/(depreciation) in fair value of investments | 1,729,781 | (246,965) |
| Securities lending income | 5,096 | 4,718 |
| Investment expenses | (41,654) | (44,540) |
| Securities lending borrower rebates and expenses | 523 | 913 |
| Net investment income | 2,064,550 | 80,402 |
| Total additions | 2,766,146 | 689,359 |
| Deductions: | | |
| Benefits | 1,023,354 | 968,528 |
| Refunds of contributions | 9,453 | 11,030 |
| Administrative expenses | 14,169 | 13,661 |
| Other administrative expenses - other postemployment benefits | 1,349 | 1,255 |
| Total deductions | 1,048,325 | 994,474 |
| Net increase/(decrease) | 1,717,821 | (305,115) |
| Plan net position – restricted for pension benefits | | |
| Beginning of year | 15,293,724 | 15,598,839 |
| End of year | \$ 17,011,545 | \$ 15,293,724 |

See accompanying notes to financial statements.

SAN FRANCISCO CITY AND COUNTY EMPLOYEES' RETIREMENT SYSTEM

Notes to Financial Statements Years Ended June 30, 2013 and 2012 (Dollar amounts in thousands)

(1) Plan Description

(a) General

The San Francisco City and County Employees' Retirement System (the Retirement System) administers a cost-sharing multiple-employer defined benefit pension plan (the Plan) established to provide pension benefits for substantially all employees of the City and County of San Francisco (the City and County), certain classified and certificated employees of the Community College and Unified School Districts, and San Francisco Trial Court employees other than judges. The Retirement System provides service retirement, disability, and death benefits based on specified percentages of defined final average monthly salary and annual cost-of-living adjustments after retirement. While the Plan is not subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA), it is a tax-qualified plan under Internal Revenue Code provisions. The City and County Charter (the Charter) and the Administrative Code are the authorities that establish and amend the benefit provisions of and employer and member obligations to the Plan.

The Retirement System is considered to be a part of the City and County's financial reporting entity and is included in the City and County's basic financial statements as a pension trust fund. The financial statements of the Retirement System are intended to present only the plan net position and changes in plan net position of the Retirement System. They do not purport to, and do not, present fairly the financial position of the City and County as of June 30, 2013 and 2012, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Retirement System is administered by the Executive Director, an employee of the City and County, in accordance with the provisions of the Charter and Administrative Code, and the policies and regulations of the Retirement Board. The City and County's basic financial statements can be obtained from City Hall, Room 316, 1 Dr. Carlton B. Goodlett Place, San Francisco, CA 94102.

The Retirement System pays benefits according to the category of employment and the type of benefit coverage provided by the City and County. The three main categories of Plan membership are:

- **Miscellaneous Members** – staff, operational, supervisory, and all other eligible employees who are not in special membership categories.
- **Firefighter Members** – firefighters and other employees whose principal duties are in fire prevention and suppression work or who occupy positions designated by law as firefighter member positions.
- **Police Members** – police officers and other employees whose principal duties are in active law enforcement or who occupy positions designated by law as police member positions.

(b) Service Retirement

Miscellaneous Members who became members prior to July 1, 2010 qualify for a service retirement benefit if they are at least 50 years old and have at least 20 years of credited service or if they are at least 60 years old and have at least 10 years of credited service. The service retirement benefit is calculated using the member's final compensation (highest one-year average monthly compensation) multiplied by the member's years of credited service times the member's age factor up to a maximum of 75% of the member's final compensation.

SAN FRANCISCO CITY AND COUNTY EMPLOYEES' RETIREMENT SYSTEM

Notes to Financial Statements
Years Ended June 30, 2013 and 2012
(Dollar amounts in thousands)

Miscellaneous Members who became members on or after July 1, 2010 and prior to January 7, 2012 qualify for a service retirement benefit if they are at least 50 years old and have at least 20 years of credited service or if they are at least 60 years old and have at least 10 years of credited service. The service retirement benefit is calculated using the member's final compensation (highest two-year average monthly compensation) multiplied by the member's years of credited service times the member's age factor up to a maximum of 75% of the member's final compensation.

Miscellaneous Members who became members on or after January 7, 2012 qualify for a service retirement benefit if they are at least 53 years old and have at least 20 years of credited service or if they are at least 60 years old and have at least 10 years of credited service. The service retirement benefit is calculated using the member's final compensation (highest three-year average monthly compensation) multiplied by the member's years of credited service times the member's age factor up to a maximum of 75% of the member's final compensation.

Firefighter Members and Police Members who became members of the Plan before November 2, 1976 qualify for a service retirement benefit if they are at least 50 years old and have at least 25 years of credited service. The service retirement benefit is calculated using the member's final compensation (monthly salary earnable at the rank or position the member held for at least one year immediately prior to retiring) multiplied by the member's years of credited service times the member's age factor up to a maximum of 90% of the member's final compensation.

Firefighter Members and Police Members who became members of the Plan on or after November 2, 1976 and prior to July 1, 2010 qualify for a service retirement benefit if they are at least 50 years old and have at least 5 years of credited service. The service retirement benefit is calculated using the member's final compensation (highest one-year average monthly compensation) multiplied by the member's years of credited service times the member's age factor up to a maximum of 90% of the member's final compensation.

Firefighter Members and Police Members who became members of the Plan on or after July 1, 2010 and prior to January 7, 2012 qualify for a service retirement benefit if they are at least 50 years old and have at least 5 years of credited service. The service retirement benefit is calculated using the member's final compensation (highest two-year average monthly compensation) multiplied by the member's years of credited service times the member's age factor up to a maximum of 90% of the member's final compensation.

Firefighter Members and Police Members who became members of the Plan on or after January 7, 2012 qualify for a service retirement benefit if they are at least 50 years old and have at least 5 years of credited service. The service retirement benefit is calculated using the member's final compensation (highest three-year average monthly compensation) multiplied by the member's years of credited service times the member's age factor up to a maximum of 90% of the member's final compensation.

(c) Disability Retirement

Miscellaneous Members are eligible to apply for a disability retirement benefit, regardless of age, when they have 10 or more years of credited service and they sustain an injury or illness that prevents them from performing their duties. The disability retirement benefit is calculated using the member's final compensation (highest one-year average monthly compensation) multiplied by

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Notes to Financial Statements Years Ended June 30, 2013 and 2012 (Dollar amounts in thousands)

the member's years of credited service times the disability factor (1.8) up to a maximum of 75% of average final compensation.

Firefighter Members and Police Members are eligible to apply for an industrial disability retirement benefit from their first day on the job in firefighter or police service if their disability is caused by an illness or injury that they receive while performing their duties. The industrial disability retirement benefit is based on the member's final compensation (monthly salary earnable at the rank or position the member held at the beginning of the absence) multiplied by the permanent disability rating (from 50% to 90%) or the member's service retirement benefit if the member is eligible for a service retirement.

Firefighter Members and Police Members are eligible to apply for an ordinary disability retirement benefit, regardless of age, when they have 10 or more years of credited service and they sustain an injury or illness that is not caused by their work, but that prevents them from performing their duties.

(d) Separation and Death Benefits

Separation from Employment

Upon separation from City employment, **Miscellaneous Members** may either elect to withdraw their accumulated contributions from the Plan or, if they have 5 or more years of credited service, elect to leave their accumulated contributions in the Plan and receive a vesting benefit that is first payable at or after age 50 for members hired prior to January 7, 2012 or at or after age 53 for members hired on or after January 7, 2012. Miscellaneous members hired before November 2, 1976 need 10 years of credited service to elect the vesting option.

Upon separation from City employment, **Firefighter Members and Police Members** may either elect to withdraw their accumulated contributions from the Plan or, if they have 5 or more years of credited service, elect to leave their accumulated contributions in the Plan and receive a deferred benefit that is first payable at or after age 50.

Death Benefits Prior to Retirement

Generally, upon the death of an active employee who is eligible for a service retirement, the Retirement System provides continuation benefits to a qualified surviving spouse or qualified domestic partner equal to 50% to 100% of the member's retirement allowance that the member would have received had he or she retired on the date of death.

For qualified surviving spouses and qualified domestic partners of **Firefighter Members and Police Members** who die prior to becoming eligible for service retirement and whose death is due to an injury received in or illness caused by the performance of duty, salary continuation is provided to the qualified survivor until such time as the member would have qualified for service retirement had he or she lived at which time a continuation benefit equal to 100% of the member's service retirement allowance is provided to the qualified survivor.

A lump sum death payment equal to 6 months' earnable salary plus the member's accumulated contributions is provided upon the death of an active employee not yet eligible for a service retirement to the member's named beneficiary or estate.

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Death Benefits after Retirement

Generally, upon the death of a retired member, the Retirement System provides continuation benefits to a qualified surviving spouse or qualified domestic partner equal to 50% to 100% of the member's retirement allowance as of the date of death.

(e) Cost of Living Adjustments (COLA)

Basic COLA

Miscellaneous Members receive a benefit adjustment each July 1 equal to the percentage increase or decrease in the Consumer Price Index (CPI) rounded to the nearest 1%, to a maximum of 2% of the member's previous June 30 retirement benefit. If the CPI decreases in a particular year, however, the negative adjustment cannot reduce a member's monthly retirement benefit below the initial pension amount.

Firefighter Members and Police Members who became members of the Plan before November 2, 1976 receive a benefit adjustment each July 1 equal to 50% of the actual dollar increase or decrease in the salary of the rank or position on which the member's retirement benefit is based. Although decreases are possible in a given year, a negative adjustment cannot reduce a member's monthly benefit below the initial pension amount.

Firefighter Members and Police Members who became members of the Plan on or after November 2, 1976 receive a benefit adjustment each July 1 equal to the percentage increase or decrease in the CPI rounded to the nearest 1%, to a maximum of 2% of the member's previous June 30 retirement benefit. If the CPI decreases in a particular year; however, the negative adjustment cannot reduce a member's monthly retirement benefit below the initial pension amount.

Supplemental COLA

Effective July 1, 2012, the Plan provides for a Supplemental COLA in years when there are sufficient "excess" investment earnings in the Plan and the Plan is fully funded on a market value of assets basis. The Supplemental COLA, payable on July 1 in those years when paid, increases the total monthly benefit adjustment (including the Basic COLA) up to a maximum of 3.5% of the member's previous June 30 monthly retirement benefit. The Supplemental COLA can be paid in increments of 0.5% in years where the excess earnings available to fund the Supplemental COLA are not sufficient to fund up to the 3.5% maximum. For members hired prior to January 7, 2012, all Supplemental COLAs paid to retired members will continue into the future in the event an additional Supplemental COLA is not payable in any given year. For members hired on or after January 7, 2012, Supplemental COLAs will not be permanent adjustments to retirement benefits. In any year when a Supplemental COLA is not paid, all previously paid Supplemental COLAs will expire.

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Notes to Financial Statements
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(f) Deferred Retirement Option Program

In February 2008, the voters of the City and County approved a Charter amendment to provide a Deferred Retirement Option Program (DROP) for certain Police members of the Plan to be effective July 1, 2008. An eligible police officer could elect to participate in DROP for a specified period of time up to a maximum of three years depending on the rank of the police officer. While participating in DROP, the police officer continues to work and receive pay as a police officer and accrues monthly DROP distributions posted to a nominal account maintained by the Retirement System. The monthly DROP distribution is equal to the participant's monthly service retirement allowance calculated as of the participant's entry into DROP. Interest at an annual effective rate of 4% and applicable COLAs are posted to the participant's DROP account during participation in DROP. Upon exiting from DROP, the participant receives a lump sum distribution from his or her DROP account and begins to receive a monthly service retirement allowance calculated using age, covered compensation, and service frozen as of the date of his or her entry into DROP. DROP was closed to new applicants on June 30, 2011.

Changes in DROP liabilities during the years ended June 30, 2013 and 2012 are as follows:

| | <u>2013</u> | <u>2012</u> |
|-----------------------------------|------------------|------------------|
| DROP liability, beginning of year | \$ 27,257 | \$ 17,641 |
| Additions | 21,265 | 24,570 |
| Distributions | <u>(28,020)</u> | <u>(14,954)</u> |
| DROP liability, end of year | <u>\$ 20,502</u> | <u>\$ 27,257</u> |

(g) Membership

Membership of the Retirement System consisted of the following as of June 30, 2013:

| | <u>Police</u> | <u>Fire</u> | <u>Miscellaneous</u> | <u>Total</u> |
|------------------------------|---------------|--------------|----------------------|---------------|
| Retirees and beneficiaries | | | | |
| currently receiving benefits | 2,550 | 2,083 | 21,529 | 26,162 |
| Active members | 1,967 | 1,358 | 25,392 | 28,717 |
| Terminated members | | | | |
| entitled to but not yet | | | | |
| receiving benefits | 120 | 64 | 5,640 | 5,824 |
| Total | <u>4,637</u> | <u>3,505</u> | <u>52,561</u> | <u>60,703</u> |

Membership of the Retirement System consisted of the following as of June 30, 2012:

| | <u>Police</u> | <u>Fire</u> | <u>Miscellaneous</u> | <u>Total</u> |
|------------------------------|---------------|--------------|----------------------|---------------|
| Retirees and beneficiaries | | | | |
| currently receiving benefits | 2,355 | 2,080 | 20,755 | 25,190 |
| Active members | 1,879 | 1,336 | 24,882 | 28,097 |
| Terminated members | | | | |
| entitled to but not yet | | | | |
| receiving benefits | 120 | 60 | 5,369 | 5,549 |
| Total | <u>4,354</u> | <u>3,476</u> | <u>51,006</u> | <u>58,836</u> |

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Notes to Financial Statements Years Ended June 30, 2013 and 2012 (Dollar amounts in thousands)

(2) Summary of Significant Accounting Policies

(a) Basis of Presentation

The accompanying financial statements are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America as promulgated by the Governmental Accounting Standards Board (GASB).

Member contributions are recognized in the period in which the contributions are due. Employer contributions and member contributions made by the employer to the Plan are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the Plan.

(b) Investments

Investments are reported at fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Securities that do not have an established market are reported at estimated fair value derived from third party pricing services. Purchases and sales of investments are recorded on a trade date basis.

The fair values of the Retirement System's real estate investments are based on net asset values provided by the investment managers. Partnership financial statements are audited annually as of December 31 and net asset values are adjusted monthly or quarterly for cash flows to/from the Retirement System, investment earnings and expenses, and changes in fair value. The Retirement System has established leverage limits for each investment style based on the risk/return profile of the underlying investments. The leverage limits for core and value-added real estate investments are 40% and 65%, respectively. The leverage limits for high return real estate investments depend on each specific offering. Outstanding mortgages for the Retirement System's real estate investments were \$1,513,865, including \$70,415 in recourse debt as of June 30, 2013, and \$1,771,908, including \$103,415 in recourse debt as of June 30, 2012. The underlying real estate holdings are valued periodically based on appraisals performed by independent appraisers in accordance with Uniform Standards of Professional Appraisal Practice (USPAP). Such fair value estimates involve subjective judgments of unrealized gains and losses, and the actual market price of the real estate can only be determined by negotiation between independent third parties in a purchase and sale transaction.

Alternative investments represent the Retirement System's interest in limited partnerships. The fair values of alternative investments are based on net asset values provided by the general partners. Partnership financial statements are audited annually as of December 31 and net asset values are adjusted monthly or quarterly for cash flows to/from the Retirement System, investment earnings and changes in fair value. Such fair value estimates involve subjective judgments of unrealized gains and losses, and the actual market price of the investments can only be determined by negotiation between independent third parties in a purchase and sale transaction.

The Charter and Retirement Board policies permit the Retirement System to use investments of the Plan to enter into securities lending transactions – loans of securities to broker-dealers and other entities for collateral with a simultaneous agreement to return the collateral for the same securities in the future. The collateral may consist of cash or non-cash; non-cash collateral is generally U.S. Treasuries or other U.S. government obligations. The Retirement System's

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Notes to Financial Statements Years Ended June 30, 2013 and 2012 (Dollar amounts in thousands)

securities custodian is the agent in lending the Plan's domestic securities for collateral of 102% and international securities for collateral of 105%. Contracts with the lending agent require them to indemnify the Retirement System if the borrowers fail to return the securities (and if the collateral were inadequate to replace the securities lent) or fail to pay the Retirement System for income distributions by the securities' issuers while the securities are on loan. Non-cash collateral cannot be pledged or sold unless the borrower defaults, and therefore, is not reported in the Retirement System's financial statements.

All securities loans can be terminated on demand by either the Retirement System or the borrower, although the average term of the loans as of June 30, 2013 and 2012 was 70 days and 75 days, respectively. All cash collateral received was invested in a separately managed account by the lending agent using investment guidelines developed and approved by the Retirement System. As of June 30, 2013 and 2012, the weighted average maturity of the reinvested cash collateral account was 26 days and 17 days, respectively. The term to maturity of the loaned securities is generally not matched with the term to maturity of the investment of the said collateral. Cash collateral may also be invested separately in term loans, in which case the maturity of the loaned securities matches the term of the loan.

Cash collateral invested in the separate account managed by the lending agent is reported at fair value. Payable to borrowers of securities in the statements of plan net position represents the cash collateral received from borrowers. Additionally, the income and costs of securities lending transactions, such as borrower rebates and fees, are recorded respectively as revenues and expenses in the statements of changes in plan net position.

(c) Administrative Expenses

All costs to administer the Retirement System are borne by the Retirement System.

(d) Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted 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 additions and deductions during the reporting period. Actual results could differ from those estimates.

(e) Implementation of GASB Statements

GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, incorporates into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins of the AICPA Committee on Accounting Procedures which does not conflict with or contradict other GASB pronouncements. The provisions of this statement are effective for financial statement periods beginning after December 15, 2011.

GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources and renames the resulting measure of net

SAN FRANCISCO CITY AND COUNTY EMPLOYEES' RETIREMENT SYSTEM

Notes to Financial Statements Years Ended June 30, 2013 and 2012 (Dollar amounts in thousands)

assets as net position. The provisions of this statement are effective for financial statement periods beginning after December 15, 2011.

As of July 1, 2011, the Retirement System adopted the above GASB standards, which did not have a significant impact on its financial statements.

(f) New GASB Statements

In June 2012, the GASB issued Statements No. 67, *Financial Reporting for Pension Plans—an amendment of GASB Statement No. 25* and No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27* to improve accounting and financial reporting by governmental pension plans.

Key changes include:

- Separating how the accounting and financial reporting is determined from how pensions are funded.
- Employers with defined benefit pension plans will recognize a net pension liability, as defined by the standard, in their government-wide, proprietary and fiduciary fund financial statements.
- Incorporating ad hoc cost-of-living adjustments and other ad hoc postemployment benefit changes into projections of benefit payments, if an employer's past practice and future expectations of granting them indicate they are essentially automatic.
- Using a discount rate that applies (a) the expected long-term rate of return on pension plan investments for which plan assets are expected to be available to make projected benefit payments, and (b) the interest rate on a tax-exempt 20-year AA/Aa or higher rated municipal bond index to projected benefit payments for which plan assets are not expected to be available for long-term investment in a qualified trust.
- Adopting a single actuarial cost allocation method – entry age normal – rather than the current choice among six actuarial cost methods.
- Requiring more extensive note disclosures and required supplementary information.

The statements relate to accounting and financial reporting and do not apply to how governments approach the funding of their pension plans. At present, there generally is a close connection between the ways many governments fund pensions and how they account for and report information about them in audited financial reports. The statements would separate how the accounting and financial reporting is determined from how pensions are funded.

Application of Statement 67 is effective for financial statements for the Retirement System in the fiscal year ending June 30, 2014. The Retirement System has not completed the process of evaluating the impact that will result from adopting this statement, and is therefore unable to disclose the impact that adopting these statements will have on its financial position and the results of operations when the statements are adopted.

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Notes to Financial Statements Years Ended June 30, 2013 and 2012 (Dollar amounts in thousands)

(3) Deposits

Deposits are carried at cost, which approximates fair value. Deposits in bank accounts were \$60,874 and \$28,516 as of June 30, 2013, and 2012, respectively.

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government may not be able to recover its deposits or may not be able to recover collateral securities that are in the possession of an outside party. The Retirement System does not have a specific policy addressing custodial credit risk for deposits. As of June 30, 2013 and 2012, the Retirement System's deposits in bank accounts were not exposed to custodial credit risk.

(4) Investments

The Retirement System's investments are invested pursuant to investment policy guidelines as established by the Retirement Board. The objective of the policy is to maximize the expected return of the fund at an acceptable level of risk. The Retirement Board has established percentage guidelines for types of investments to ensure the portfolio is diversified.

Investment managers are required to diversify by issue, maturity, sector, coupon, and geography. Investment managers retained by the Retirement System follow specific investment guidelines and are evaluated against specific market benchmarks that represent their investment style. Any exemption from general guidelines requires approval from the Retirement Board. The Retirement System invests in securities with contractual cash flows, such as asset backed securities, commercial mortgage backed securities, and collateralized mortgage obligations. The value, liquidity, and related income of these securities are sensitive to changes in economic conditions, including real estate values, delinquencies or defaults, or both, and may be affected by shifts in the market's perception of the issuers and changes in interest rates.

The investment policy permits investments in domestic and international debt and equity securities; real estate; securities lending; foreign currency contracts, derivative instruments, and alternative investments, which include investments in a variety of commingled partnership vehicles.

The Retirement System is not directly involved in repurchase or reverse repurchase agreements. However, external investment managers retained by the Retirement System may employ repurchase arrangements if the securities purchased or sold comply with the manager's investment guidelines. The Retirement System monitors the investment activity of its investment managers to ensure compliance with guidelines. In addition, the Retirement System's securities lending cash collateral separately managed account is authorized to use repurchase arrangements. As of June 30, 2013 and 2012, \$326 million (or 32.5% of cash collateral) and \$195 million (or 21.3% of cash collateral), respectively, consisted of such agreements.

The Retirement System maintains its operating fund cash in the City's investment pool. The City's pool is invested pursuant to investment policy guidelines established by the City Treasurer, subject to review by the Treasury Oversight Committee. The Treasury Oversight Committee, established under California Government Code Sections 27130 to 27137, is composed of various City officials and representatives of agencies with large cash. The policy addresses soundness of financial institutions in which the City will deposit funds, types of investment instruments as permitted by the California Government Code, and the percentage of the portfolio which may be invested in certain instruments with longer terms to maturity. The provisions of the City's investment policy also address interest rate risk, credit risk, and concentration of credit risk and provides for additional restrictions related to

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Notes to Financial Statements
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investments. The notes to the basic financial statements of the City provide more detailed information concerning deposit and investment risks associated with the City's pool of cash and investments at June 30, 2013 and 2012.

(a) Interest Rate Risk

Interest rate risk is the risk that changes in interest rates may adversely affect the fair value of an investment. The Retirement System does not have a specific policy to manage interest rate risk.

Below are tables depicting the segmented time distribution for fixed income investments based upon the expected maturity (in years) as of June 30, 2013 and 2012.

Investments at Fair value of June 30, 2013

| Investment Type | Fair Value | Maturities | | | |
|---|---------------------|-----------------------------|-------------------|-------------------|---------------------|
| | | Less than 1 year | 1-5 years | 6-10 years | 10+ years |
| Asset Backed Securities | \$ 194,581 | \$ 305 | \$ 97,482 | \$ 9,221 | \$ 87,573 |
| Bank Loans | 22,143 | 6,320 | 15,311 | 512 | - |
| City investment pool | 7,769 | - | 7,769 | - | - |
| Collateralized Bonds | 17,250 | - | 379 | - | 16,871 |
| Commercial Mortgage-Backed | 594,746 | 2,271 | 81,163 | 23,140 | 488,172 |
| Commercial Paper | 3,765 | 3,765 | - | - | - |
| Commingled and Other | | | | | |
| Fixed Income Funds | 349,207 | 363,520 | 17 | - | (14,330) |
| Corporate Bonds | 1,587,605 | 577,150 | 357,728 | 475,067 | 177,660 |
| Corporate Convertible Bonds | 266,207 | 29,451 | 135,058 | 23,711 | 77,987 |
| Foreign Currencies and Cash Equivalents | 248,745 | 248,745 | - | - | - |
| Government Agencies | 301,281 | 276,122 | 17,776 | 6,682 | 701 |
| Government Bonds | 400,662 | 33,432 | 250,480 | 45,513 | 71,237 |
| Government Mortgage | | | | | |
| Backed Securities | 352,028 | 103,855 | 3,982 | 8,797 | 235,394 |
| Index Linked Government Bonds | 3,071 | - | - | - | 3,071 |
| Mortgages | 49 | - | 49 | - | - |
| Municipal/Provincial Bonds | 56,315 | 4,772 | 8,559 | 5,654 | 37,330 |
| Non-Government Backed | | | | | |
| Collateralized Mortgage Obligations | 146,051 | - | 7,459 | 2,239 | 136,353 |
| Options | (261) | (261) | - | - | - |
| Short-Term Investment Funds | 320,046 | 320,046 | - | - | - |
| Swaps | (358) | - | 161 | - | (519) |
| Total | \$ 4,870,902 | \$ 1,969,493 | \$ 983,373 | \$ 600,536 | \$ 1,317,500 |

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Investments at Fair value of June 30, 2012

| <u>Investment Type</u> | <u>Fair Value</u> | <u>Maturities</u> | | | |
|---|---------------------|-----------------------------------|---------------------|-------------------|---------------------|
| | | <u>Less than</u> <u>1 year</u> | <u>1-5 years</u> | <u>6-10 years</u> | <u>10+ years</u> |
| Asset Backed Securities | \$ 143,976 | \$ - | \$ 52,966 | \$ 3,933 | \$ 87,077 |
| Bank Loans | 16,260 | 4,798 | 11,148 | 314 | - |
| City investment pool | 4,780 | - | 4,780 | - | - |
| Collateralized Bonds | 12,497 | - | - | 609 | 11,888 |
| Commercial Mortgage-Backed | 552,518 | - | 35,594 | 52,758 | 464,166 |
| Commingled and Other | | | | | |
| Fixed Income Funds | 233,922 | 233,712 | 19 | - | 191 |
| Corporate Bonds | 1,400,196 | 386,810 | 404,647 | 404,438 | 204,301 |
| Corporate Convertible Bonds | 211,337 | 22,680 | 116,187 | 16,675 | 55,795 |
| Government Agencies | 172,928 | 154,279 | 8,291 | 10,358 | - |
| Government Bonds | 544,099 | 2,069 | 403,077 | 62,083 | 76,870 |
| Government Mortgage | | | | | |
| Backed Securities | 547,152 | 193,215 | 2,276 | 19,190 | 332,471 |
| Index Linked Government Bonds | 10,745 | - | 10,745 | - | - |
| Foreign Currencies and Cash Equivalents | 393,657 | 393,657 | - | - | - |
| Mortgages | 72 | - | 72 | - | - |
| Municipal/Provincial Bonds | 42,367 | - | 12,814 | 2,093 | 27,460 |
| Non-Government Backed | | | | | |
| Collateralized Mortgage Obligations | 157,941 | - | 2,865 | 2,330 | 152,746 |
| Options | 991 | 947 | 44 | - | - |
| Short-Term Bills and Notes | 576 | 576 | - | - | - |
| Short-Term Investment Funds | 312,489 | 312,489 | - | - | - |
| Swaps | 547 | - | 2,047 | (1,158) | (342) |
| Total | \$ 4,759,050 | \$ 1,705,232 | \$ 1,067,572 | \$ 573,623 | \$ 1,412,623 |

(b) Credit Risk – Investments

Credit risk is the risk that an issuer or other counterparty to an investment may not fulfill its obligations. Fixed income investment managers retained by the Retirement System follow specific investment guidelines and are evaluated against specific market benchmarks that represent their investment style. Fixed income managers typically are limited within their portfolios to no more than 5% exposure in any single security, with the exception of United States Treasury and government agency securities. The Retirement System's credit risk policy is embedded in the individual investment manager agreements as prescribed and approved by the Retirement Board.

Investments are classified and rated using the lower of (1) Standard & Poor's (S&P) rating or (2) Moody's Investors Service (Moody's) rating corresponding to the equivalent S&P rating. If only a Moody's rating is available, the rating equivalent to S&P is used for the purpose of this disclosure.

The credit rating of the United States remains a point of concern for investors. In 2011, S&P lowered the credit rating for U.S. long-term debt to AA+ from AAA and continue to maintain that posture. Moody's and Fitch, the other two large credit rating agencies continue to maintain a AAA rating for U.S. long-term debt, although Fitch has recently placed the U.S. on negative watch – indicating the potential for a credit downgrade. The ongoing concern by the credit rating

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agencies over the credit worthiness of U.S. government debt has an impact on the credit risk and value of the Retirement System's investments in U.S. government agency securities, U.S. government bonds, and U.S. government mortgage-backed securities.

The following table illustrates the Retirement System's exposure to credit risk as of June 30, 2013. Investments issued or explicitly guaranteed by the U.S. government of \$926,112 as of June 30, 2013 are not considered to have credit risk and are excluded from the tables below.

Credit Ratings of Fixed Income Investments as of June 30, 2013

| Credit Rating | Fair Value | Fair Value as a Percentage of Total |
|---------------|--------------|--|
| AAA | \$ 283,141 | 7.2% |
| AA | 173,085 | 4.4% |
| A | 298,781 | 7.6% |
| BBB | 579,060 | 14.7% |
| BB | 215,932 | 5.5% |
| B | 312,311 | 7.9% |
| CCC | 156,362 | 4.0% |
| CC | 6,605 | 0.2% |
| C | 5,064 | 0.1% |
| D | 85 | 0.0% |
| Not Rated | 1,914,364 | 48.4% |
| Total | \$ 3,944,790 | 100.0% |

The following table illustrates the Retirement System's exposure to credit risk as of June 30, 2012. Investments issued or explicitly guaranteed by the U.S. government of \$854,540 as of June 30, 2012 are not considered to have credit risk and are excluded from the tables below.

Credit Ratings of Fixed Income Investments as of June 30, 2012

| Credit Rating | Fair Value | Fair Value as a Percentage of Total |
|---------------|--------------|--|
| AAA | \$ 233,579 | 6.0% |
| AA | 109,844 | 2.8% |
| A | 302,566 | 7.7% |
| BBB | 641,007 | 16.4% |
| BB | 190,713 | 4.9% |
| B | 300,298 | 7.7% |
| CCC | 111,816 | 2.9% |
| CC | 10,775 | 0.3% |
| D | 16,276 | 0.4% |
| Not Rated | 1,987,636 | 50.9% |
| Total | \$ 3,904,510 | 100.0% |

The securities listed as "Not Rated" include short-term investment funds, government mortgage backed securities, and investments that invest primarily in rated securities, such as commingled funds and money market funds, but do not themselves have a specific credit rating. Excluding these investments, the "not rated" component of credit would be approximately 13.0% for 2013 and 11.5% for 2012.

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(c) Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of the Retirement System's investment in a single issuer. Guidelines for investment managers typically restrict a position to become no more than 5% (at fair value) of the investment manager's portfolio. Securities issued or guaranteed by the U.S. government or its agencies are exempt from this limit.

As of June 30, 2013 and 2012, the Retirement System had no investments of a single issuer that equaled or exceeded 5% of total Retirement System's investments or net position.

(d) Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government may not be able to recover the value of investment or collateral securities that are in the possession of an outside party. The Retirement System does not have a specific policy addressing custodial credit risk for investments, but investments are generally insured, registered, or held by the Retirement System or its agent in the Retirement System's name. As of June 30, 2013 and 2012, \$76,726 and \$73,535, respectively, of the Retirement System's investments were exposed to custodial credit risk because they were not insured or registered in the name of the Retirement System, and were held by the counterparty's trust department or agent but not in the Retirement System's name.

For fiscal years 2013 and 2012, cash received as securities lending collateral is invested in a separate account managed by the lending agent using investment guidelines approved by the Retirement System and held by the custodial bank. Securities in this separately managed account are not exposed to custodial credit risk.

(e) Foreign Currency Risk

The Retirement System's exposure to foreign currency risk derives from its positions in foreign currency denominated cash, equity, fixed income, alternative investments, real estate, and swap investments. The Retirement System's investment policy allows international managers to enter into foreign exchange contracts, which are limited to hedging currency exposure existing in the portfolio.

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The Retirement System's net exposures to foreign currency risk as of June 30, 2013 are as follows:

Foreign Currency Risk Analysis as of June 30, 2013

| Currency | Cash | Equities | Fixed Income | Alternative Investments | Real Estate | Foreign Currency Contracts | Total |
|------------------------|------------------|---------------------|-------------------------|------------------------------------|------------------------|---|---------------------|
| Australian dollar | \$ 1,244 | \$ 100,546 | \$ 31,709 | \$ 14,818 | \$ - | \$ (45,951) | \$ 102,366 |
| Brazilian real | 43 | 28,104 | 31,852 | - | - | 12,853 | 72,852 |
| British pound sterling | 180 | 540,682 | 7,525 | - | - | (36,085) | 512,302 |
| Canadian dollar | 50 | 47,750 | 8,794 | - | - | (54,989) | 1,605 |
| Chilean peso | - | - | - | - | - | 12,170 | 12,170 |
| Chinese yuan renminbi | - | - | - | - | - | 27,628 | 27,628 |
| Colombian peso | - | - | - | - | - | 2,614 | 2,614 |
| Czech koruna | - | 1,121 | - | - | - | (18,854) | (17,733) |
| Danish krone | 1 | 22,772 | - | - | - | (1,265) | 21,508 |
| Euro | 41,831 | 692,954 | 34,375 | 255,304 | - | 3,790 | 1,028,254 |
| Hong Kong dollar | 668 | 199,136 | - | - | - | 974 | 200,778 |
| Hungarian forint | - | 742 | - | - | - | (509) | 233 |
| Indian rupee | - | - | - | - | - | 12,374 | 12,374 |
| Indonesian rupiah | 35 | 24,623 | - | - | - | 8,788 | 33,446 |
| Japanese yen | 2,859 | 542,967 | - | - | 51,523 | (59,515) | 537,834 |
| Malaysian ringgit | - | 4,756 | - | - | - | (13,055) | (8,299) |
| Mexican peso | 24 | 16,164 | 31,347 | - | - | 20,576 | 68,111 |
| New Israeli shekel | 33 | 6,187 | - | - | - | 6,649 | 12,869 |
| New Romanian Leu | - | - | - | - | - | 8,829 | 8,829 |
| New Russian ruble | - | - | - | - | - | 3,194 | 3,194 |
| New Taiwan dollar | 360 | 23,669 | - | - | - | (49,985) | (25,956) |
| New Zealand dollar | (32) | - | - | - | - | (36,930) | (36,962) |
| Nigerian naira | - | - | - | - | - | - | - |
| Norwegian krone | 221 | 22,987 | - | - | - | 12,895 | 36,103 |
| Peruvian nuevo sol | - | - | - | - | - | (14,342) | (14,342) |
| Philippine peso | - | 816 | - | - | - | (27,181) | (26,365) |
| Polish zloty | - | 181 | - | - | - | 3,075 | 3,256 |
| Singapore dollar | 197 | 50,585 | - | - | - | (63,942) | (13,160) |
| South African rand | - | 12,973 | - | - | - | (240) | 12,733 |
| South Korean won | 1,235 | 82,837 | - | - | - | (14,449) | 69,623 |
| Swedish krona | 638 | 58,933 | - | - | - | 222 | 59,793 |
| Swiss franc | 69 | 213,106 | - | - | - | (15,707) | 197,468 |
| Thai baht | - | 25,429 | - | - | - | (18,238) | 7,191 |
| Turkish lira | - | 18,414 | - | - | - | 13,987 | 32,401 |
| Total | \$ 49,656 | \$ 2,738,434 | \$ 145,602 | \$ 270,122 | \$ 51,523 | \$ (320,619) | \$ 2,934,718 |

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The Retirement System's net exposures to foreign currency risk as of June 30, 2012 are as follows:

Foreign Currency Risk Analysis as of June 30, 2012

| Currency | Cash | Equities | Fixed Income | Alternative Investments | Real Estate | Foreign Currency Contracts | Total |
|------------------------|------------------|---------------------|-------------------------|------------------------------------|------------------------|---|---------------------|
| Australian dollar | \$ 651 | \$ 98,421 | \$ 22,639 | \$ 6,812 | \$ - | \$ (145,518) | \$ (16,995) |
| Brazilian real | - | 25,994 | 26,532 | - | - | 37,223 | 89,749 |
| British pound sterling | 114 | 397,375 | - | - | - | (30,081) | 367,408 |
| Canadian dollar | 84 | 55,879 | 40,315 | - | - | (6,854) | 89,424 |
| Chilean peso | - | - | - | - | - | 11,606 | 11,606 |
| Chinese yuan renminbi | - | - | - | - | - | 42,782 | 42,782 |
| Colombian peso | - | - | - | - | - | 35,097 | 35,097 |
| Czech koruna | - | 884 | - | - | - | (23,991) | (23,107) |
| Danish krone | 213 | 20,697 | - | - | - | (2,330) | 18,580 |
| Euro | 22,369 | 536,231 | 1,397 | 239,888 | - | (386,953) | 412,932 |
| Hong Kong dollar | 1,035 | 165,492 | - | - | - | 1,487 | 168,014 |
| Hungarian forint | - | 818 | - | - | - | 24,903 | 25,721 |
| Indian rupee | - | - | - | - | - | 32,429 | 32,429 |
| Indonesian rupiah | 137 | 13,697 | - | - | - | 12,501 | 26,335 |
| Japanese yen | 3,038 | 382,914 | - | - | 63,121 | (170,036) | 279,037 |
| Malaysian ringgit | - | 3,297 | - | - | - | (11,180) | (7,883) |
| Mexican peso | 1,135 | 7,744 | 24,641 | - | - | 31,709 | 65,229 |
| New Israeli shekel | 13 | 4,759 | - | - | - | (35,643) | (30,871) |
| New Romanian Leu | - | - | - | - | - | 6,553 | 6,553 |
| New Russian ruble | - | - | - | - | - | 27,767 | 27,767 |
| New Taiwan dollar | 100 | 24,569 | - | - | - | (42,376) | (17,707) |
| New Zealand dollar | 218 | - | - | - | - | (2,706) | (2,488) |
| Nigerian naira | 576 | - | - | - | - | - | 576 |
| Norwegian krone | 36 | 15,261 | - | - | - | 196,559 | 211,856 |
| Peruvian nuevo sol | - | - | - | - | - | 10,638 | 10,638 |
| Philippine peso | - | 698 | - | - | - | 19,545 | 20,243 |
| Polish zloty | - | 1,351 | - | - | - | 32,081 | 33,432 |
| Singapore dollar | 147 | 45,707 | - | - | - | (34,614) | 11,240 |
| South African rand | 52 | 13,607 | - | - | - | 23,596 | 37,255 |
| South Korean won | 755 | 87,949 | - | - | - | 9,137 | 97,841 |
| Swedish krona | 51 | 47,538 | - | - | - | 141,599 | 189,188 |
| Swiss franc | 111 | 151,403 | - | - | - | (159,824) | (8,310) |
| Thai baht | - | 19,241 | - | - | - | 7,950 | 27,191 |
| Turkish lira | - | 10,124 | 2,069 | - | - | 59,439 | 71,632 |
| Total | \$ 30,835 | \$ 2,131,650 | \$ 117,593 | \$ 246,700 | \$ 63,121 | \$ (287,505) | \$ 2,302,394 |

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(f) Derivative Instruments

In June 2008, the Governmental Accounting Standards Board (GASB) issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, which became effective for financial statements for periods beginning after June 15, 2009. Pursuant to the requirements of this statement, the Retirement System has provided a summary of derivative instrument activities during the reporting periods presented and the related risks.

As of June 30, 2013 and 2012, the derivative instruments held by the Retirement System are considered investments and not hedges for accounting purposes. The gains and losses arising from this activity are recognized as incurred in the statement of changes in plan net position. All investment derivatives discussed below are included within the investment risk schedules, which precede this subsection. Investment derivative instruments are disclosed separately to provide a comprehensive and distinct view of this activity and its impact on the overall investment portfolio.

Valuation methods used by the Retirement System are described in more detail in Note 2(b). The fair value of the exchange traded derivative instruments, such as futures, options, rights, and warrants are based on quoted market prices. The fair values of forward foreign currency contracts are determined using a pricing service, which uses published foreign exchange rates as the primary source. The fair values of swaps are determined by the Retirement System's investment managers based on quoted market prices of the underlying investment instruments.

The tables below present the notional amounts, the fair values, and the related net appreciation (depreciation) in the fair value of derivative instruments that were outstanding at June 30, 2013 and 2012:

| As of and for the Year Ended June 30, 2013 | | | |
|---|------------------------|-------------------|--|
| Derivative Type / Contracts | Notional Amount | Fair Value | Net Appreciation (Depreciation) in Fair Value |
| Forwards | | | |
| Foreign Exchange Contracts | (a) | \$ (7,411) | \$ (7,411) |
| Other Contracts | (a) | 101 | 101 |
| Options | | | |
| Foreign Exchange Contracts | 2,837 | (261) | (649) |
| Swaps | | | |
| Credit Contracts | 81,450 | (357) | 521 |
| Rights/Warrants | | | |
| Equity Contracts | 890 shares | 1,051 | (30) |
| Total | | <u>\$ (6,877)</u> | <u>\$ (7,468)</u> |

^(a) SFERS' investment managers enter into a wide variety of forward foreign exchange and other contracts, which frequently do not involve the US dollar. As a result, a US dollar-based notional value is not included.

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As of and for the Year Ended June 30, 2012

| Derivative Type / Contracts | Notional Amount | Fair Value | Net Appreciation (Depreciation) in Fair Value |
|------------------------------------|------------------------|-------------------|--|
| Forwards | | | |
| Foreign Exchange Contracts | (a) | \$ (15,791) | \$ (15,791) |
| Other Contracts | (a) | 109 | 109 |
| Futures | | | |
| Equity Contracts | \$ 1 | - | - |
| Interest Rate Contracts | (1) | - | - |
| Options | | | |
| Foreign Exchange Contracts | (29,717) | 991 | (22) |
| Swaps | | | |
| Credit Contracts | 111,153 | 1,035 | (613) |
| Interest Rate Contracts | 3,100 | (488) | (488) |
| Rights/Warrants | | | |
| Equity Contracts | 338 shares | 28 | (252) |
| Total | | \$ (14,116) | \$ (17,057) |

(a) SFERS' investment managers enter into a wide variety of forward foreign exchange and other contracts, which frequently do not involve the US dollar. As a result, a US dollar-based notional value is not included.

All investment derivatives are reported as investments at fair value in the statement of plan net position. Rights and warrants are reported in equity securities. Foreign exchange contracts are reported in foreign currency contracts, which also include spot contracts that are not derivatives. All other derivative contracts are reported in other debt securities. All changes in fair value are reported as net appreciation (depreciation) in fair value of investments in the statements of changes in plan net position.

Counterparty Credit Risk

The Retirement System is exposed to credit risk on derivative instruments that are in asset positions. As of June 30, 2013, the fair value of forward currency contracts (including foreign exchange contract options) to purchase and sell international currencies were \$5,606 and \$13,278, respectively. The Retirement System's counterparties to these contracts held credit ratings of A or better on 97.5% of the positions as assigned by one or more of the major credit rating organizations (S&P, Moody's and/or Fitch), while 2.5% were unrated. As of June 30, 2012, the fair value of forward currency contracts (including foreign exchange contract options) to purchase and sell international currencies were \$11,904 and \$26,704, respectively. The Retirement System's counterparties to these contract held credit ratings of A or better as assigned by one or more of the major credit rating organizations (S&P, Moody's and/or Fitch).

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Custodial Credit Risk

The custodial credit risk disclosure for exchange traded derivative instruments is made in accordance with the custodial credit risk disclosure requirements of GASB Statement No. 40. At June 30, 2013 and 2012, all of the Retirement System's investments in derivative instruments are held in the Retirement System's name and are not exposed to custodial credit risk.

Interest Rate Risk

The tables below describe the maturity periods of the derivative instruments exposed to interest rate risk at June 30, 2013 and 2012.

Derivative Interest Rate Risk as of June 30, 2013

| <u>Derivative Type / Contracts</u> | <u>Fair Value</u> | <u>Maturities</u> | | | |
|------------------------------------|-------------------|--------------------|------------------|-------------------|------------------|
| | | <u>Less than 1</u> | | | |
| | | <u>year</u> | <u>1-5 years</u> | <u>6-10 years</u> | <u>10+ years</u> |
| Swaps | | | | | |
| Credit Contracts | \$ (357) | \$ - | \$ 161 | \$ - | \$ (518) |
| Forwards | | | | | |
| Other Contracts | 101 | 101 | - | - | - |
| Total | <u>\$ (256)</u> | <u>\$ 101</u> | <u>\$ 161</u> | <u>\$ -</u> | <u>\$ (518)</u> |

Derivative Interest Rate Risk as of June 30, 2012

| <u>Derivative Type / Contracts</u> | <u>Fair Value</u> | <u>Maturities</u> | | | |
|------------------------------------|-------------------|--------------------|------------------|-------------------|------------------|
| | | <u>Less than 1</u> | | | |
| | | <u>year</u> | <u>1-5 years</u> | <u>6-10 years</u> | <u>10+ years</u> |
| Swaps | | | | | |
| Credit Contracts | \$ 1,035 | \$ - | \$ 2,047 | \$ (670) | \$ (342) |
| Interests Rate Contracts | (488) | - | - | (488) | - |
| Forwards | | | | | |
| Other Contracts | 109 | 109 | - | - | - |
| Total | <u>\$ 656</u> | <u>\$ 109</u> | <u>\$ 2,047</u> | <u>\$ (1,158)</u> | <u>\$ (342)</u> |

The Retirement System did not hold any derivative instruments that are highly sensitive to changes in interest rates as of June 30, 2013. The following tables detail the reference rate, notional amount, and fair value of interest rate swaps that are highly sensitive to changes in interest rates as of June 30, 2012:

Derivative Instruments Highly Sensitive to Interest Rate Changes as of June 30, 2012

| <u>Investment Type</u> | <u>Reference Rate</u> | <u>Notional Value</u> | <u>Fair Value</u> |
|------------------------|---|-----------------------|-------------------|
| Interest Rate Swaps | Receiving variable 3 month LIBOR, paying fixed (3.6%) | \$ 3,100 | \$ (488) |

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Foreign Currency Risk

At June 30, 2013, the Retirement System is exposed to foreign currency risk on its investments in forwards, options, rights and warrants denominated in foreign currencies.

Derivative Instruments Foreign Currency Risk Analysis as of June 30, 2013

| <u>Currency</u> | <u>Forwards</u> | <u>Options</u> | <u>Rights/ Warrants</u> | <u>Total</u> |
|------------------------|-------------------|-----------------|-----------------------------|-------------------|
| Australian dollar | \$ 1,139 | \$ (270) | \$ 2 | \$ 871 |
| Brazilian real | (1,120) | - | 151 | (969) |
| British pound sterling | 188 | - | - | 188 |
| Canadian dollar | 424 | - | - | 424 |
| Chilean peso | (775) | - | - | (775) |
| Chinese yuan renminbi | 200 | - | - | 200 |
| Colombian peso | (28) | - | - | (28) |
| Czech koruna | 36 | - | - | 36 |
| Danish krone | 15 | - | - | 15 |
| Euro | (506) | - | - | (506) |
| Hong Kong dollar | 1 | - | - | 1 |
| Hungarian forint | (12) | - | - | (12) |
| Indian rupee | (920) | - | - | (920) |
| Indonesian rupiah | (264) | - | - | (264) |
| Japanese yen | 848 | - | - | 848 |
| Malaysian ringgit | (301) | - | - | (301) |
| Mexican peso | (294) | - | - | (294) |
| New Israeli shekel | (45) | - | - | (45) |
| New Romanian leu | (96) | - | - | (96) |
| New Russian ruble | (203) | - | - | (203) |
| New Taiwan dollar | (59) | - | - | (59) |
| New Zealand dollar | (235) | (32) | - | (267) |
| Norwegian krone | (876) | - | - | (876) |
| Peruvian nuevo sol | 310 | - | - | 310 |
| Philippine peso | (78) | - | - | (78) |
| Polish zloty | (230) | - | - | (230) |
| Singapore dollar | 625 | - | - | 625 |
| South African rand | (469) | - | - | (469) |
| South Korean won | (107) | - | - | (107) |
| Swedish krona | (398) | - | - | (398) |
| Swiss franc | (195) | - | - | (195) |
| Thai baht | 213 | - | - | 213 |
| Turkish lira | (490) | - | - | (490) |
| Total | \$ (3,702) | \$ (302) | \$ 153 | \$ (3,851) |

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At June 30, 2012, the Retirement System is exposed to foreign currency risk on its investments in forwards, options, rights and warrants denominated in foreign currencies.

Derivative Instruments Foreign Currency Risk Analysis as of June 30, 2012

| <u>Currency</u> | <u>Forwards</u> | <u>Options</u> | <u>Rights/ Warrants</u> | <u>Total</u> |
|------------------------|--------------------|----------------|-----------------------------|--------------------|
| Australian dollar | \$ (14,197) | \$ 13 | \$ 17 | \$ (14,167) |
| Brazilian real | 2,355 | - | - | 2,355 |
| British pound sterling | (1,562) | 52 | - | (1,510) |
| Canadian dollar | (1,282) | 5 | - | (1,277) |
| Chilean peso | 394 | - | - | 394 |
| Chinese yuan renminbi | 56 | - | - | 56 |
| Colombian peso | (265) | - | - | (265) |
| Czech koruna | 518 | - | - | 518 |
| Danish krone | (20) | - | - | (20) |
| Euro | (149) | 226 | 11 | 88 |
| Hungarian forint | (310) | - | - | (310) |
| Indian rupee | 989 | - | - | 989 |
| Indonesian rupiah | (234) | - | - | (234) |
| Japanese yen | (1,110) | - | - | (1,110) |
| Malaysian ringgit | 971 | - | - | 971 |
| Mexican peso | (3,214) | - | - | (3,214) |
| New Israeli shekel | 1,351 | - | - | 1,351 |
| New Romanian leu | 133 | - | - | 133 |
| New Russian ruble | 643 | - | - | 643 |
| New Taiwan dollar | 831 | - | - | 831 |
| New Zealand dollar | (7,351) | 218 | - | (7,133) |
| Norwegian krone | (636) | - | - | (636) |
| Peruvian nuevo sol | 2 | - | - | 2 |
| Philippine peso | (766) | - | - | (766) |
| Polish zloty | 183 | - | - | 183 |
| Singapore dollar | (51) | - | - | (51) |
| South African rand | (39) | - | - | (39) |
| South Korean won | (603) | - | - | (603) |
| Swedish krona | (1,838) | - | - | (1,838) |
| Swiss franc | 1,130 | 90 | - | 1,220 |
| Thai baht | 39 | - | - | 39 |
| Turkish lira | (851) | - | - | (851) |
| Total | <u>\$ (24,883)</u> | <u>\$ 604</u> | <u>\$ 28</u> | <u>\$ (24,251)</u> |

Contingent Features

At June 30, 2013 and 2012, the Retirement System held no positions in derivatives containing contingent features.

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(5) Currency Management Program

As of June 30, 2013, the Retirement System's currency management program is managed by two investment managers. The objective of the currency management program is to produce a risk-adjusted return of approximately 100 basis points.

The Retirement System's international equity managers do not actively manage the underlying currency risk. Currency risk can be reduced through an active currency management program.

Each currency manager manages currency risk through foreign exchange spot and forward contracts and currency options. Only international equities are subject to the currency management program. The Retirement System's international fixed income currency exposure is actively managed by four developed market bond managers and two emerging market bond managers. All four developed bond managers have discretion to invest in U.S. or international developed markets.

As of June 30, 2013, the Retirement System's allocation to international equities (including cash and other assets) was primarily denominated in foreign currencies and totaled \$4,254,513, which represented 25.2% of plan net position. For the year ended June 30, 2013, the currency management program lost \$11,207 in value or 0.26% of the international equity portfolio (including cash and other assets) and 0.07% of the Retirement System's average total portfolio value.

As of June 30, 2012, the Retirement System's allocation to international equities (including cash and other assets) was primarily denominated in foreign currencies and totaled \$3,394,510, which represented 22.3% of plan net position. For the year ended June 30, 2012, the currency management program lost \$20,969 in value or 0.58% of the international equity portfolio (including cash and other assets) and 0.14% of the Retirement System's average total portfolio value.

(6) Securities Lending

The Retirement System lends U.S. government obligations, domestic and international bonds, and equities to various brokers with a simultaneous agreement to return collateral for the same securities plus a fee in the future. The securities lending agent manages the securities lending program and receives securities and cash as collateral. Cash and non-cash collateral is pledged at 102% and 105% of the fair value of domestic securities and international securities lent, respectively. There are no restrictions on the number of securities that can be lent at one time. However, starting in the year ended June 30, 2009, the Retirement System engaged in a systematic reduction of the value of securities on loan with a target of no more than ten percent (10%) of total fund assets on loan at any time. The term to maturity of the loaned securities is generally not matched with the term to maturity of the investment of the corresponding collateral.

The Retirement System does not have the ability to pledge or sell collateral securities unless a borrower defaults. The securities collateral is not reported on the statements of net position. As of June 30, 2013 and 2012, the Retirement System has no credit risk exposure to borrowers because the amounts the Retirement System owes them exceed the amounts they owe the Retirement System. As with other extensions of credit, the Retirement System may bear the risk of delay in recovery or of rights in the collateral should the borrower of securities fail financially. However, the lending agent indemnifies the Retirement System against all borrower defaults.

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As of June 30, 2013, the Retirement System has lent \$1,298,556 in securities and received collateral of \$1,005,161 and \$338,432 in cash and securities, respectively, from borrowers. The cash collateral is invested in a separate account managed by the lending agent using investment guidelines approved by the Retirement Board. Due to the decline in the fair value of assets held in the separately managed account, the Retirement System's invested cash collateral was valued at \$1,004,266. The net unrealized loss of \$895 is presented as part of the net appreciation (depreciation) in fair value of investments in the statement of changes in plan net position in the year in which the unrealized gains and losses occur. The Retirement System is exposed to investment risk including the possible loss of principal value in the separately managed securities lending account due to the fluctuation in the fair value of the assets held in the account.

The Retirement System's securities lending transactions as of June 30, 2013 are summarized in the following table.

| Securities Lending as of June 30, 2013 | | | |
|---|--|----------------------------|--|
| Security Type | Fair Value of Loaned Securities | Cash Collateral | Fair Value of Securities Collateral |
| Securities Loaned for Cash Collateral | | | |
| International Corporate Fixed Income | \$ 8,400 | \$ 8,873 | \$ - |
| International Equities | 77,863 | 82,809 | - |
| International Government Fixed Income | 3,846 | 3,970 | - |
| U.S. Corporate Fixed Income | 160,374 | 164,134 | - |
| U.S. Equities | 437,396 | 448,319 | - |
| U.S. Government Fixed Income | 291,450 | 297,056 | - |
| Securities Loaned with Non-Cash Collateral | | | |
| International Corporate Fixed Income | 2,367 | - | 2,464 |
| International Equities | 295,696 | - | 314,030 |
| International Government Fixed Income | 10,047 | - | 10,534 |
| U.S. Corporate Fixed Income | 12 | - | 12 |
| U.S. Equities | 9,980 | - | 10,246 |
| U.S. Government Fixed Income | 1,125 | - | 1,146 |
| Total | \$ 1,298,556 | \$ 1,005,161 | \$ 338,432 |

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Years Ended June 30, 2013 and 2012

(Dollar amounts in thousands)

The following table presents the segmented time distribution for the reinvested cash collateral account based upon the expected maturity (in years) as of June 30, 2013.

Fair Value of Cash Collateral Account as of June 30, 2013

| <u>Investment Type</u> | <u>Fair Value</u> | <u>Maturity</u> <u>Less than 1 year</u> |
|-------------------------------------|---------------------|--|
| Commercial Paper | \$ 43,968 | \$ 43,968 |
| Government Agencies | 35,013 | 35,013 |
| Negotiable Certificates of Deposits | 204,013 | 204,013 |
| Repurchase Agreements | 326,400 | 326,400 |
| Short Term Investment Funds | 394,872 | 394,872 |
| Total | <u>\$ 1,004,266</u> | <u>\$ 1,004,266</u> |

The Retirement System's exposure to credit risk in its reinvested cash collateral account as of June 30, 2013 is as follows:

Credit Rating of Cash Collateral Account as of June 30, 2013

| <u>Credit Rating</u> | <u>Fair Value</u> | <u>Fair Value as a</u> <u>Percentage of Total</u> |
|----------------------|---------------------|--|
| AAA | \$ 35,013 | 3.5% |
| AA | 485,749 | 48.4% |
| A | 483,421 | 48.1% |
| Not Rated | 83 | 0.0% |
| Total | <u>\$ 1,004,266</u> | <u>100.0%</u> |

As of June 30, 2012, the Retirement System has lent \$1,202,568 in securities and received collateral of \$917,370 and \$308,162 in cash and securities, respectively, from borrowers. The cash collateral is invested in a separate account managed by the lending agent using investment guidelines approved by the Retirement System. Due to the decline in the fair value of assets held in the separately managed account, the Retirement System's invested cash collateral was valued at \$914,105. The net unrealized loss of \$3,265 is presented as part of the net appreciation (depreciation) in fair value of investments in the statement of changes in plan net position in the year in which the unrealized gains and losses occur. The Retirement System is exposed to investment risk including the possible loss of principal value in the separately managed securities lending account due to the fluctuation in the fair value of the assets held in the account.

SAN FRANCISCO CITY AND COUNTY EMPLOYEES' RETIREMENT SYSTEM

Notes to Financial Statements
Years Ended June 30, 2013 and 2012

(Dollar amounts in thousands)

The Retirement System's securities lending transactions as of June 30, 2012 are summarized in the following table.

| Securities Lending as of June 30, 2012 | | | |
|---|--|----------------------------|--|
| Security Type | Fair Value of Loaned Securities | Cash Collateral | Fair Value of Securities Collateral |
| Securities Loaned for Cash Collateral | | | |
| International Corporate Fixed Income | \$ 2,921 | \$ 3,011 | \$ - |
| International Equities | 87,075 | 89,637 | - |
| U.S. Corporate Fixed Income | 175,000 | 177,029 | - |
| U.S. Equities | 431,068 | 433,707 | - |
| U.S. Government Fixed Income | 210,324 | 213,986 | - |
| Securities Loaned with Non-Cash Collateral | | | |
| International Corporate Fixed Income | 475 | - | 487 |
| International Equities | 262,284 | - | 272,205 |
| International Government Fixed Income | 30,389 | - | 32,418 |
| U.S. Corporate Fixed Income | 234 | - | 236 |
| U.S. Equities | 2,798 | - | 2,816 |
| Total | \$ 1,202,568 | \$ 917,370 | \$ 308,162 |

The following table presents the segmented time distribution for the reinvested cash collateral account based upon the expected maturity (in years) as of June 30, 2012.

| Investment Type | Fair Value | Maturities | |
|-------------------------------------|-------------------|-------------------------|------------------|
| | | Less than 1 year | 1-5 years |
| Asset Backed Securities | \$ 16,143 | \$ 11,412 | \$ 4,731 |
| Commercial Paper | 24,995 | 24,995 | - |
| Government Agencies | 52,899 | 17,862 | 35,037 |
| Negotiable Certificates of Deposits | 80,012 | 80,012 | - |
| Repurchase Agreements | 195,000 | 195,000 | - |
| Short Term Investment Funds | 545,056 | 545,056 | - |
| Total | \$ 914,105 | \$ 874,337 | \$ 39,768 |

SAN FRANCISCO CITY AND COUNTY EMPLOYEES' RETIREMENT SYSTEM

Notes to Financial Statements
Years Ended June 30, 2013 and 2012

(Dollar amounts in thousands)

The Retirement System's exposure to credit risk in its reinvested cash collateral account as of June 30, 2012 is as follows:

Credit Rating of Cash Collateral Account as of June 30, 2012

| <u>Credit Rating</u> | <u>Fair Value</u> | <u>Fair Value as a Percentage of Total</u> |
|----------------------|-------------------|--|
| AAA | \$ 26,266 | 2.9% |
| AA | 90,390 | 9.9% |
| A | 249,101 | 27.2% |
| BB | 179 | 0.0% |
| B | 1,551 | 0.2% |
| CCC | 1,562 | 0.2% |
| Not Rated | 545,056 | 59.6% |
| Total | <u>\$ 914,105</u> | <u>100.0%</u> |

(7) Investments in Real Estate Holdings

Real estate investments represent the Retirement System's interests in real estate limited partnerships. The changes in these investments during the years ended June 30, 2013 and 2012 are summarized as follows:

| | <u>2013</u> | <u>2012</u> |
|--------------------------------|---------------------|---------------------|
| Investments: | | |
| Beginning of the year | \$ 1,403,412 | \$ 1,266,863 |
| Capital investments | 145,023 | 79,482 |
| Equity in net earnings | 80,643 | 69,757 |
| Net appreciation in fair value | 62,011 | 106,617 |
| Capital distributions | (260,378) | (119,307) |
| End of the year | <u>\$ 1,430,711</u> | <u>\$ 1,403,412</u> |

(8) Benefits

Allowances and benefits incurred during the year are summarized as follows:

| | <u>2013</u> | <u>2012</u> |
|----------------------------------|---------------------|-------------------|
| Service retirement benefits | \$ 770,521 | \$ 716,744 |
| Disability retirement benefits | 168,365 | 161,782 |
| Death benefits | 8,387 | 8,198 |
| COLA benefit adjustments | 54,816 | 57,234 |
| DROP accrued retirement benefits | 21,265 | 24,570 |
| Total | <u>\$ 1,023,354</u> | <u>\$ 968,528</u> |

SAN FRANCISCO CITY AND COUNTY EMPLOYEES' RETIREMENT SYSTEM

Notes to Financial Statements
Years Ended June 30, 2013 and 2012
(Dollar amounts in thousands)

(9) Funding Policy

(a) Contributions

Contributions are made to the Plan by both the employers and the participating employees. Employee contributions are mandatory as required by the Charter. Employee contribution rates for fiscal years 2013 and 2012 as a percentage of gross covered salary were as follows:

| | |
|--|------|
| Participants entering the Retirement System prior to November 2, 1976 | |
| Police and fire | 7.0% |
| Miscellaneous | 8.0% |
| Participants entering the Retirement System after November 2, 1976 and prior to July 1, 2010 | 7.5% |
| Participants entering the Retirement System on or after July 1, 2010 | |
| Police and fire | 9.0% |
| Miscellaneous | 7.5% |

Beginning in the year ended June 30, 2006, most employee groups agreed through collective bargaining for employees to contribute all or a portion of the employee contributions, per memorandums of understanding (MOU's), on a pretax basis. As of July 1, 2011, substantially all employee groups have agreed through collective bargaining for employees to contribute all employee contributions on a pre-tax basis.

Prior to the early 1950s, all Retirement System members were covered by the Federal Old-Age and Survivors Disability Insurance provisions of the Federal Social Security Act. In the early 1950s, the City and County agreed to exclude uniformed police officers and firefighters from Social Security coverage. Prior to 1990, miscellaneous members covered by Social Security were able to elect to reduce the above stated rate of employee contributions in consideration of their anticipated Social Security benefit payments. All participants who elected such reduction must repay the amount of unpaid employee contributions with interest or there will be an appropriate actuarial reduction in benefits.

Participants terminating service with the employers may withdraw employee contributions plus interest. The interest rate applied to accumulated employee contributions is determined by the Retirement System's consulting actuary and recommended to the Retirement Board. The Retirement Board reviews and sets the crediting interest rate for the Plan on an annual basis. Interest for the years ended June 30, 2013 and 2012 accumulated at 4.00%.

The basic employer contributions are the amounts deemed necessary on an actuarial basis using the entry age normal cost method to provide the Retirement System with assets sufficient to pay the basic benefits that are not provided for by employees' contributions. Contribution rates used in fiscal years 2013 and 2012 are based on a schedule of rates determined from actuarial studies by the consulting actuary as of July 1, 2011 and 2010, respectively.

SAN FRANCISCO CITY AND COUNTY EMPLOYEES' RETIREMENT SYSTEM

Notes to Financial Statements
Years Ended June 30, 2013 and 2012

(Dollar amounts in thousands)

The actuarial methods and significant assumptions used to compute the actuarially determined annual required contribution for both actuarial studies are the same, unless otherwise noted.

| | |
|---------------------------------------|--|
| Valuation dates | July 1, 2011 and July 1, 2010 |
| Actuarial cost method | Entry age normal |
| Amortization method | Level percentage of payroll |
| Amortization period | Actuarial gains and losses, assumption changes, and supplemental COLAs are amortized over an open 15-year period; plan amendments and changes in interest crediting rate are amortized over 20-year closed periods |
| Equivalent single amortization period | 12.8 years as of July 1, 2011 13.4 years as of July 1, 2010 |
| Asset valuation method | 5-year smoothing of return over and under expected return |
| Actuarial assumptions: | |
| Investment rate of return | 7.66% as of July 1, 2011 7.75% as of July 1, 2010 |
| Projected wage increases | 3.91% as of July 1, 2011 4.00% as of July 1, 2010 Additional for merit and promotion: 0.85% to 15.00% based on a participant's years of service and membership group |
| Cost of living adjustments | |
| Old Plans – Police and Fire | Post-7/1/1975 retirement: 4.00% to 5.00% per year; Pre-7/1/1975 retirement: 3.00% per year |
| Old Plans – Miscellaneous | 2.00% per year |
| New Plans – all members | 2.00% per year |

Required and actual employer contribution rates for the years ended June 30, 2013 and 2012 as a percentage of covered payrolls averaged the following:

| | Fiscal Year 2013 | Fiscal Year 2012 |
|----------------------------|---------------------|---------------------|
| Police plan members | 17.71% - 20.71% | 18.09% |
| Fire plan members | 17.71% - 20.71% | 18.09% |
| Miscellaneous plan members | 17.71% - 20.71% | 18.09% |

(b) Funded Status

The provisions of the City and County Charter state that an actuarial valuation shall occur at least every even-numbered year and that actuarial experience investigations shall occur as determined necessary by the Retirement Board. Actuarial valuations and a limited economic experience analysis are generally carried out each year. The latest actuarial valuation of the Retirement System was completed in January 2013 by the actuarial firm Cheiron and was based upon employee data and asset information as of July 1, 2012. The projection of benefits for financial reporting purposes does not explicitly incorporate the potential effects of legal or contractual funding limitations.

SAN FRANCISCO CITY AND COUNTY EMPLOYEES' RETIREMENT SYSTEM

Notes to Financial Statements
Years Ended June 30, 2013 and 2012
(Dollar amounts in thousands)

The following table shows the funded status of the Retirement System as of July 1, 2012, the most recent actuarial valuation date.

Funded Status as of July 1, 2012
(Dollars in thousands)

| Valuation Date | Actuarial Value of Assets (AVA) | Actuarial Liability (AAL) | Unfunded | | Covered Payroll (CP) | UAAL as a Percent of Payroll (UAAL / CP) |
|----------------|---------------------------------|---------------------------|----------------------------|--------------------------|----------------------|--|
| | | | Actuarial Liability (UAAL) | Funded Ratio (AVA / AAL) | | |
| July 1, 2012 | \$ 16,027,683 | \$ 19,393,854 | \$ 3,366,171 | 82.6% | \$ 2,393,842 | 140.6% |

The schedule of funding progress, presented as required supplementary information (RSI) following the notes to the financial statements, presents multiyear trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the actuarial accrued liability for benefits.

The Retirement System's unfunded actuarial accrued liability (UAAL) increased by \$1,080,563 from the July 1, 2011 valuation. The primary cause of this increase was the investment experience during Fiscal Years 2008-2009 and 2011-2012 that is being recognized over the trailing five years under the asset valuation method adopted by the Retirement Board. The actuarial value of assets is smoothed in order to mitigate the impact of investment performance volatility on employer contribution rates. For example, under the 5-year smoothing policy, the investment losses from FY 2008-2009 will not be fully recognized until the July 1, 2013 actuarial valuation, which determines contribution rates for FY 2014-2015. As a result, the City and County's contribution rate is expected to continue to increase over the next three fiscal years even if the fund achieves its investment return assumption.

Additional information regarding the actuarial methods and significant assumptions used in the most recent actuarial valuation follows:

| | |
|---------------------------------------|--|
| Valuation date | July 1, 2012 |
| Actuarial cost method | Entry age normal |
| Amortization method | Rolling and fixed depending upon source |
| Amortization period | Actuarial gains and losses, assumption changes, and supplemental COLAs are amortized over an open 15-year period; plan amendments and changes in interest crediting rate are amortized over 20-year closed periods |
| Equivalent single amortization period | 13.3 years |
| Asset valuation method | 5-year smoothing of return over and under expected return |
| Actuarial assumptions: | |
| Investment rate of return | 7.58% |
| Projected wage increases | 3.83% |
| | Additional for merit and promotion: 0.85% to 15.00% based on a participant's years of service and membership group |
| Consumer Price inflation | 3.33% |

SAN FRANCISCO CITY AND COUNTY EMPLOYEES' RETIREMENT SYSTEM

Notes to Financial Statements
Years Ended June 30, 2013 and 2012
(Dollar amounts in thousands)

| | |
|-----------------------------|---|
| Cost of living adjustments | |
| Old Plans – Police and Fire | Post-7/1/1975 retirement: 4.00% to 5.00% per year; Pre-7/1/1975 retirement: 3.00% per year |
| Old Plans – Miscellaneous | 2.00% per year |
| New Plans – all members | 2.00% per year |

At its January 2013 meeting, after review of the analysis and recommendation prepared by the consulting actuarial firm, the Retirement Board voted to continue to phase in reductions to the Retirement System's long-term investment earnings assumption, long-term wage/inflation assumption and long-term consumer price index assumption over a three-year period as previously approved in December 2011. The three-year reductions are as follows: long-term investment earnings assumption from 7.75% to 7.50% (7.66% for the 2011 valuation; 7.58% for the 2012 valuation; and 7.50% for the 2013 valuation); long-term wage inflation assumption from 4.00% to 3.75% (3.91% for the 2011 valuation; 3.83% for the 2012 valuation; and 3.75% for the 2013 valuation); and long-term consumer price index assumption from 3.50% to 3.25% (3.41% for the 2011 valuation; 3.33% for the 2012 valuation; and 3.25% for the 2013 valuation). These economic assumptions together with demographic assumptions based on periodic demographic studies are utilized to prepare the actuarial valuation of the Retirement System each year.

(10) Postemployment Healthcare Plan

(a) Health Care Benefits

Health care benefits of the Retirement System's employees, retired employees and their beneficiaries are financed by the City and County through the City and County of San Francisco Health Service System (the Health Service System).

The City and County has determined a City-wide annual required contribution (ARC), interest on net OPEB obligation, ARC adjustment, and OPEB cost based upon an actuarial valuation performed in accordance with GASB Statement No. 45, by the City and County's actuary. The City and County's allocation of the OPEB-related costs to the Retirement System for the years ended June 30, 2013 and 2012 based upon its percentage of City-wide payroll costs is presented below. Included in the Retirement System's payments for all health care benefits amounts are approximately \$534 and \$503 for the years ended June 30, 2013 and 2012, respectively, to provide postretirement benefits for retired employees on a pay-as-you-go basis. The OPEB expense for the Retirement System is included in other administrative expenses for fiscal years 2013 and 2012.

| Plan Fiscal year Ending June 30 | Annual OPEB Cost | Percentage of OPEB Cost Contributed | Net OPEB Obligation |
|--|-------------------------|--|--------------------------------|
| 2011 | \$ 1,264 | 38.4% | \$ 3,233 |
| 2012 | 1,255 | 40.1% | 3,985 |
| 2013 | 1,349 | 39.6% | 4,800 |

SAN FRANCISCO CITY AND COUNTY EMPLOYEES' RETIREMENT SYSTEM

Notes to Financial Statements
Years Ended June 30, 2013 and 2012
(Dollar amounts in thousands)

The following table shows the components of the City and County's annual OPEB allocations for the Retirement System, for the amount contributed to the OPEB plan, and changes in the Retirement System's net OPEB obligation:

| | <u>2013</u> | <u>2012</u> |
|--|-----------------|-----------------|
| Annual required contribution | \$ 1,317 | \$ 1,231 |
| Interest on net OPEB obligation | 185 | 144 |
| Adjustment to annual required contribution | <u>(153)</u> | <u>(120)</u> |
| Annual OPEB cost | 1,349 | 1,255 |
| Contribution made | <u>(534)</u> | <u>(503)</u> |
| Increase in net OPEB obligation | 815 | 752 |
| Net OPEB obligation - beginning of year | <u>3,985</u> | <u>3,233</u> |
| Net OPEB obligation - end of year | <u>\$ 4,800</u> | <u>\$ 3,985</u> |

The City and County issues a publicly available financial report that includes the complete note disclosures and RSI related to the City and County's postemployment health care obligations. The report may be obtained by writing to the City and County of San Francisco, Office of the Controller, 1 Dr. Carlton B. Goodlett Place, Room 316, San Francisco, California 94102, or by calling (415) 554-7500.

(11) Commitments and Contingencies

(a) Unfunded Investments Commitments

The Retirement System has unfunded commitments to contribute capital for real estate in the amount of \$259,707 and alternative investments in the amount of \$1,050,898, totaling \$1,310,605 as of June 30, 2013.

(b) Legal

During the year ended June 30, 2013, the Retirement System was involved in various petitions, lawsuits, and threatened lawsuits relating to individuals' benefits due under the Retirement System, which management does not expect to have a material impact on the net position available for pension benefits. The results of such actions are included in the Retirement System's experience factors used in its actuarial valuations and accordingly, are eventually considered in establishing the City and County's required annual contributions.

SAN FRANCISCO CITY AND COUNTY EMPLOYEES' RETIREMENT SYSTEM

Required Supplementary Information - Unaudited

June 30, 2013

(Dollar amounts in thousands)

Schedule of Funding Progress

| Valuation Date | Actuarial Value of Assets (AVA) | Actuarial Accrued Liability (AAL) | Unfunded Actuarial Accrued Liability (Surplus) (UAAL) | Funded Ratio (AVA / AAL) | Covered Payroll | UAAL as a Percent of Covered Payroll |
|-----------------------|--|--|--|---------------------------------|------------------------|---|
| July 1, 2012 | \$ 16,027,683 | \$ 19,393,854 | \$ 3,366,171 | 82.6% | \$ 2,393,842 | 140.6% |
| July 1, 2011 | 16,313,120 | 18,598,728 | 2,285,608 | 87.7% | 2,360,413 | 96.8% |
| July 1, 2010 | 16,069,058 | 17,643,394 | 1,574,336 | 91.1% | 2,398,823 | 65.6% |
| July 1, 2009 | 16,004,730 | 16,498,649 | 493,919 | 97.0% | 2,537,785 | 19.5% |
| July 1, 2008 | 15,941,390 | 15,358,824 | (582,566) | 103.8% | 2,457,196 | -23.7% |
| July 1, 2007 | 14,929,287 | 13,541,388 | (1,387,899) | 110.2% | 2,376,221 | -58.4% |

Schedule of Employer Contributions

| Year ended June 30 | Annual required contribution | Percentage contributed |
|---------------------------|-------------------------------------|-------------------------------|
| 2013 | \$ 442,870 | 100.0% |
| 2012 | 410,797 | 100.0% |
| 2011 | 308,823 | 100.0% |
| 2010 | 223,614 | 100.0% |
| 2009 | 119,751 | 100.0% |
| 2008 | 134,060 | 100.0% |

See accompanying note to required supplementary information.

SAN FRANCISCO CITY AND COUNTY EMPLOYEES' RETIREMENT SYSTEM

Note to Required Supplementary Information - Unaudited

June 30, 2013

(Dollar amounts in thousands)

The information presented in the required supplementary schedules was determined as part of the actuarial valuations at the dates indicated.

As a result of the Retirement Board's January 2013 decision to continue to phase in a reduction of the Plan's assumed investment rate of return from 7.75% to 7.50% over three years, the assumed investment rate of return used for the most recent actuarial valuation as of July 1, 2012 was 7.58%. The unfunded actuarial liability (UAL) as of July 1, 2012 was \$3.4 billion, an increase of \$1.1 billion from the UAL of \$2.3 billion as of July 1, 2011. This increase in the unfunded liability is primarily due to a loss on the actuarial value of assets reflecting the continued impact of the five-year smoothing of FY 2008-2009 investment losses and FY 2011-2012 actuarial investment losses (the investment return for FY 2011-2012 was 0.52% which was lower than the assumed rate of investment return of 7.66% for that fiscal year). In addition, economic assumption changes approved by the Retirement Board increased actuarial liabilities.

The July 1, 2012 valuation results incorporate the following significant assumption changes approved by the Retirement Board at its January 2013 Board meeting:

- Investment Rate of Return Assumption – decrease from 7.66% to 7.58%
- Wage/inflation Assumption – decrease from 3.91% to 3.83%
- Long-term Consumer Price Index Assumption – decrease from 3.41% to 3.33%

In the actuarial valuation as of July 1, 2011, the unfunded actuarial liability increased to \$2.3 billion from \$1.6 billion as of July 1, 2010, which reflects investment experience during the year ended June 30, 2010 that is being recognized over five years as well as liability experience losses related to changes to the economic and demographic assumptions approved by the Retirement Board.

The July 1, 2011 valuation results incorporate the following significant assumption changes approved by the Retirement Board at its December 2011 Board meeting:

- Investment Rate of Return Assumption – decrease from 7.75% to 7.66%
- Wage/inflation Assumption – decrease from 4.00% to 3.91%
- Long-term Consumer Price Index Assumption – decrease from 3.50% to 3.41%