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**STATE OF RHODE ISLAND  
EMPLOYEES' RETIREMENT SYSTEM  
FISCAL YEAR ENDED JUNE 30, 2010**

Dennis E. Hoyle, CPA  
Acting Auditor General

State of Rhode Island and Providence Plantations  
General Assembly  
Office of the Auditor General

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STATE of RHODE ISLAND and PROVIDENCE PLANTATIONS

GENERAL ASSEMBLY

OFFICE of the AUDITOR GENERAL

- ◆ INTEGRITY
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- ◆ ACCOUNTABILITY

December 21, 2010

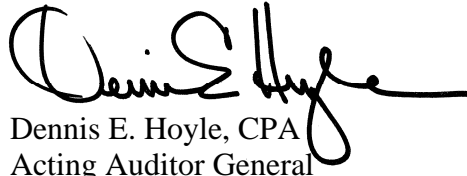
JOINT COMMITTEE ON LEGISLATIVE SERVICES:

SPEAKER Gordon D. Fox, Chairman

Senator M. Teresa Paiva-Weed  
Senator Dennis L. Algiere  
Representative Nicholas A. Mattiello  
Representative Robert A. Watson

We have completed our audit of the financial statements of the Employees' Retirement System of the State of Rhode Island for the fiscal year ended June 30, 2010 in accordance with Chapter 36-8-19 of the Rhode Island General Laws. Our report is contained herein as outlined in the Table of Contents.

Sincerely,



Dennis E. Hoyle, CPA  
Acting Auditor General

**EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF RHODE ISLAND**  
**FISCAL YEAR ENDED JUNE 30, 2010**

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## **INDEPENDENT AUDITOR'S REPORT**

JOINT COMMITTEE ON LEGISLATIVE SERVICES, GENERAL ASSEMBLY  
STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS:

RETIREMENT BOARD OF THE EMPLOYEES' RETIREMENT SYSTEM OF THE  
STATE OF RHODE ISLAND:

We have audited the accompanying basic financial statements of the plans which comprise the Employees' Retirement System of the State of Rhode Island (the System) as of June 30, 2010 and for the year then ended, as listed in the table of contents. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audit.

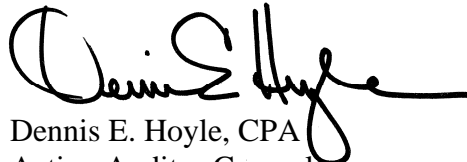
We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America. Those standards require that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

As discussed in Note 1(a), the financial statements present only the Pension Trust Funds of the State of Rhode Island and Providence Plantations (the State) and do not purport to, and do not, present fairly the financial position of the State, as of June 30, 2010, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net assets of the plans within the System as of June 30, 2010, and the changes in fiduciary net assets for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we will issue our report dated December 20, 2010 on our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis beginning on page 3, the Schedules of Funding Progress and the Schedules of Contributions from the Employers and Other Contributing Entity on pages 38 and 39, are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.



Dennis E. Hoyle, CPA  
Acting Auditor General

December 20, 2010

## **Management's Discussion and Analysis**

Management of the Employees' Retirement System of the State of Rhode Island (the System) provides this Management's Discussion and Analysis of their financial performance for the readers of the System's financial statements. This narrative provides an overview of the System's financial activity for the fiscal year ended June 30, 2010. This analysis is to be considered in conjunction with the financial statements to provide an objective analysis of the System's financial activities based on the status of the System and issues currently facing management.

### **Understanding the Employees' Retirement System Financial Statements**

The System administers defined benefit pension plans for state employees, teachers, state police, judges and participating municipal employees. State employees and teachers are combined in one plan while state police, judges and municipal employees each have separate plans. The *Statements of Fiduciary Net Assets* provide a snapshot of the financial position of the System at June 30, 2010. The *Statements of Changes in Fiduciary Net Assets* summarize the additions and deductions that occurred during the fiscal year. The *Notes to the Financial Statements* provide additional information that is essential to a full understanding of the financial statements. The *Required Supplementary Information* consists of schedules and related notes, which demonstrate the System's progress in accumulating funds to meet future pension benefits for members of the System as well as the funding progress for employees of the System participating in the Rhode Island Retiree Health Care Benefit Plan.

### **Financial Highlights for the Fiscal Year Ended June 30, 2010**

- ❑ The System's fiduciary net assets increased by \$508 million from \$6.1 billion at June 30, 2009 to \$6.6 billion at June 30, 2010.
- ❑ Total pension benefits paid to members were \$817 million, an increase of \$46.1 million or 5.9% compared to the fiscal year ended June 30, 2009.
- ❑ Total employee and employer contributions into the System's plans decreased \$16.6 million compared to the prior year. Contributions to all plans from both employers and employees at June 30, 2010 were \$511.9 million.
- ❑ The System incurred a net gain from investing activities of \$830.5 million for the fiscal year ended June 30, 2010.

EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF RHODE ISLAND

Management's Discussion and Analysis

Assets, Liabilities and Fiduciary Net Assets (in millions)		
	June 30, 2010	June 30, 2009
<b>Assets:</b>		
Cash and cash equivalents	\$ 7.0	\$ 3.3
Investments	6,512.5	5,983.7
Contributions and other receivables	57.0	80.1
Property and equipment	<u>4.1</u>	<u>5.9</u>
Total assets	<u>6,580.6</u>	<u>6,073.0</u>
<b>Liabilities:</b>		
Accounts payable and other liabilities	<u>3.5</u>	<u>4.0</u>
Total liabilities	<u>3.5</u>	<u>4.0</u>
<b>Net assets:</b>	<u>\$ 6,577.1</u>	<u>\$ 6,069.0</u>

Summary of Changes in Fiduciary Net Assets (in millions)		
	Year Ended June 30, 2010	Year Ended June 30, 2009
<b>Additions:</b>		
Contributions	\$ 511.9	\$ 528.6
Net investment gain (loss)	830.6	(1,546.1)
Miscellaneous revenue	<u>.3</u>	<u>.2</u>
Total Additions	<u>1,342.8</u>	<u>(1,017.3)</u>
<b>Deductions:</b>		
Benefits	817.0	770.8
Refunds of contributions	9.8	10.9
Administrative expenses	<u>7.9</u>	<u>8.6</u>
Total Deductions	<u>834.7</u>	<u>790.3</u>
<b>Increase (Decrease) in Net Assets:</b>	508.1	(1,807.6)
<b>Net Assets:</b>		
Beginning of year	<u>6,069.0</u>	<u>7,876.6</u>
End of year	<u>\$ 6,577.1</u>	<u>\$ 6,069.0</u>

**Management's Discussion and Analysis**

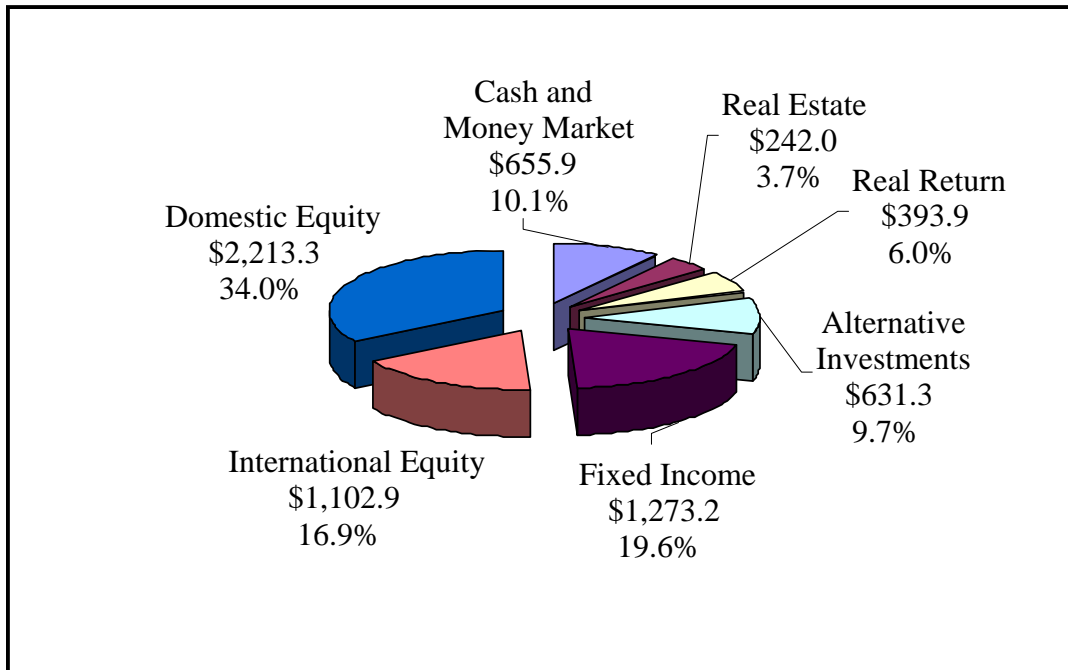
**Investments**

The State Investment Commission (SIC) establishes long-term asset allocation policy and monitors investment performance of the plan. An asset/liability (A/L) study is conducted every two to three years to identify an optimal diversified investment portfolio that maximizes return within an acceptable level of risk. As long-term investors, the SIC is committed to its strategic asset allocation that has been developed as part of a comprehensive A/L study which incorporates capital market return expectations, risks and correlations associated with each asset class as well as the unique profile and objectives of the System. As a defined benefit plan, the System generally has a much longer time horizon than individual investors and is better positioned to withstand short-term volatility of the capital markets.

The following asset allocation targets were in place at June 30, 2010.

<b>Fiscal 2010 – Asset Allocation Targets</b>	
Domestic Equity	36.0%
International Equity	17.5%
US Fixed Income	22.0%
Real Return	10.0%
Alternative Investments	7.5%
Real Estate	5.0%
Cash	2.0%

**Asset Allocation – Actual - Fair Value (in millions) at June 30, 2010**



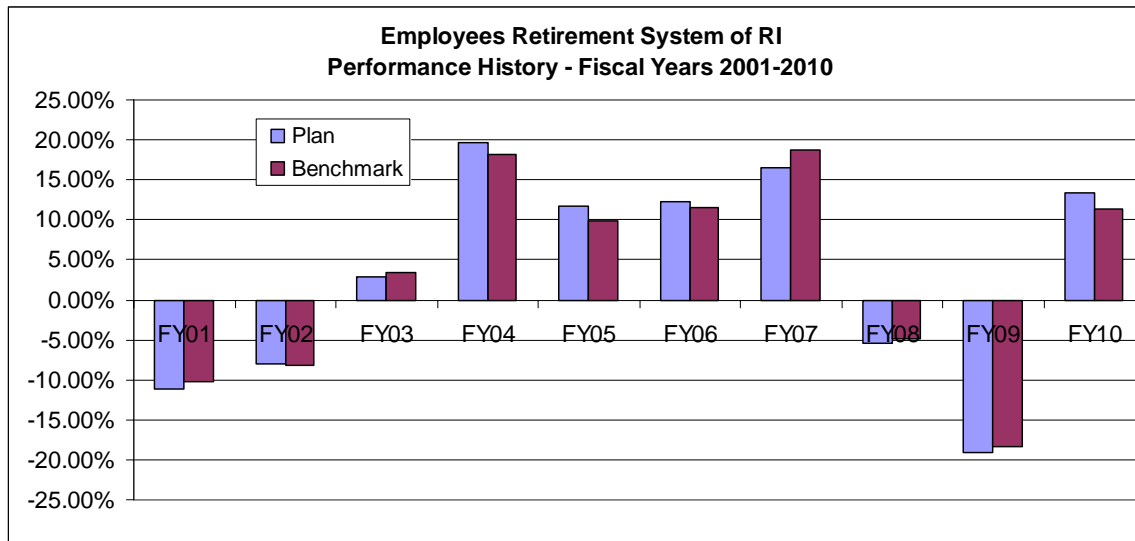


**Management's Discussion and Analysis**

The allocation of assets among stocks, bonds and alternative investments can have a significant impact on investment performance. In light of its long time horizon, the SIC is able to take advantage of historical long-term return opportunities offered by equity investments.

**Investment Performance**

The System's one-year, time weighted rate of return was 13.46% which was 214 basis points better than the 11.32% return for the benchmark. The three-year average was -4.6% which was 70 bps better than the -5.3% benchmark return, and the five-year average was 2.6% which was 20 bps better than the 2.4% benchmark return.



The composite benchmark is weighted based on asset allocation targets. It is currently comprised: 36.0% Russell 3000; 22% Barclay's Aggregate; 17.5% MSCI ACWI EX US; 10% CPI + 4%; 7.5% S&P 500 + 3%; 5% NCREIF Property Index Lagged; and 2% 91 day Treasury Bill. The composite benchmark for each of the years shown in the chart reflects the asset allocation targets in place for that fiscal year and the related indices used to measure performance.

For the fiscal year ended June 30, 2010 the fund's domestic equity portfolio was up 16.1% (vs. 15.7 for the Russell 3000), the international portfolio increased 10.5% (vs. 10.4% for the MSCI ACWI ex US) and the fixed income composite returned 10.6% (vs. 9.5% for the Barclay's Aggregate).

The System's actuarial investment return assumption is 8.25%. Actuarial value of assets is determined based on a five-year smoothing methodology.

**Management's Discussion and Analysis**

**Funding Status**

Independent actuarial valuations are conducted of the System each year. As part of this valuation, the progress toward funding pension obligations of the System is measured by comparing the actuarial value of assets to the actuarial accrued liability. This measure is referred to as the funded ratio or funded status. As reflected in the most recent actuarial valuation (June 30, 2009), the funded ratio decreased to 59.0% for State Employees and 58.1% for Teachers within the Employees' Retirement System plan. The funded ratio for the Judges' plan decreased to 88.3%. The State Police plan's funded ratio increased to 79.8%. The Municipal Employees' Retirement System plan's funded ratio decreased with an overall average ratio of 88.3%.

Details of the funded status of each plan within the System are included in the Schedules of Funding Progress on page 38.

All employers participating in the System's plans contributed 100% of their annual required contribution.

**Next Year's Contribution Rates and Economic Outlook**

Pension reform initiatives during fiscal 2010 resulted in the enactment of Article 16 of Chapter 23 of the 2010 Public Laws on June 12, 2010. The legislation modifies the Cost of Living Adjustment (COLA). The COLA now applies to the first thirty-five thousand dollars (\$35,000) of retirement allowance, indexed annually, and shall commence upon the retiree's third (3<sup>rd</sup>) anniversary of the date of retirement or when the retiree reaches age sixty-five (65), whichever is later. The thirty-five thousand dollar (\$35,000) limit will increase annually by the percentage increase in the Consumer Price Index for all Urban Consumers (CPI-U) as published by the United States Department of Labor Statistics, determined as of September 30 of the prior calendar year or three percent (3%), whichever is less. These pension benefit changes affected all active state employees, teachers and judges who were not eligible to retire as of June 12, 2010.

The fiscal 2011 employer contribution rates (state employees, teachers, and judges) are all based upon the actuarial valuation performed at June 30, 2008 (restated), which reflects the pension reform provision enacted in the General Laws. The employer contribution rates for fiscal 2011 will be 20.78% for State employees, 19.01% for Teachers, 16.19% for Judges and 24.58% for State Police.

Subsequent to June 30, 2010, the system has seen a continuation of the recovery that began during fiscal 2009. A focus on cost reduction and risk management has produced one of the greatest margins of outperformance (over 200 basis points) and subsequent to June 30 that outperformance has continued. Record low interest rates have put an unprecedented reliance on risk-based assets, and that has been, and will be an ongoing concern for long term planning.

**Management's Discussion and Analysis**

During fiscal 2011, the Board will be conducting another periodic experience study. These studies are routinely done by the Board to examine the actuarial assumptions underlying the development of the annual actuarial valuations of the plans and compare them to actual experience. As is customary, the experience study will include analysis of the investment rate of return assumption. Any changes in actuarial assumptions resulting from the experience study could affect the unfunded actuarial accrued liability of the plans and future employer contribution rates.

**Contacting the System's Management**

This discussion and analysis presentation is designed to provide a general overview of the System's financial activity. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Employees' Retirement System, 40 Fountain Street, Providence, RI, 02903.

**EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND**

**Statement of Fiduciary Net Assets**

**June 30, 2010**

	<u>ERS</u>	<u>MERS</u>	<u>SPRBT</u>	<u>JRBT</u>	<u>Memorandum Total</u>
<b>Assets</b>					
Cash and cash equivalents (Note 3)	\$ 5,654,076	\$ 628,326	\$ 780,742	\$ 545	\$ 7,063,689
Receivables					
Contributions	29,382,627	3,673,930	1,826	15,511	33,073,894
Due from State for teachers	23,342,734	-	-	-	23,342,734
Other	588,895	24,177	-	-	613,072
Total receivables	<u>53,314,256</u>	<u>3,698,107</u>	<u>1,826</u>	<u>15,511</u>	<u>57,029,700</u>
Investments at fair value - equity in pooled trust (Note 3)	<u>5,428,178,534</u>	<u>996,127,568</u>	<u>55,688,729</u>	<u>32,479,143</u>	<u>6,512,473,974</u>
Property and equipment at cost net of accumulated depreciation (Note 4)	<u>3,532,636</u>	<u>521,606</u>	<u>9,499</u>	<u>6,112</u>	<u>4,069,853</u>
<b>Total Assets</b>	<u>5,490,679,502</u>	<u>1,000,975,607</u>	<u>56,480,796</u>	<u>32,501,311</u>	<u>6,580,637,216</u>
<b>Liabilities</b>					
Accounts payable	2,660,826	478,313	15,317	9,198	3,163,654
Deferred revenue	-	-	-	224,185	224,185
Net OPEB liability (Note 8)	94,888	16,159	752	459	112,258
<b>Total Liabilities</b>	<u>2,755,714</u>	<u>494,472</u>	<u>16,069</u>	<u>233,842</u>	<u>3,500,097</u>
<b>Net assets held in trust for pension benefits</b> (Schedules of funding progress for each plan are presented on page 38)	<u>\$ 5,487,923,788</u>	<u>\$ 1,000,481,135</u>	<u>\$ 56,464,727</u>	<u>\$ 32,267,469</u>	<u>\$ 6,577,137,119</u>

The accompanying notes are an integral part of this financial statement.

**EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND**

**Statement of Changes in Fiduciary Net Assets**

**Fiscal Year Ended June 30, 2010**

	<u>ERS</u>	<u>MERS</u>	<u>SPRBT</u>	<u>JRBT</u>	<u>Memorandum Total</u>
<b>Additions</b>					
Contributions (Note 5)					
Member contributions	\$ 144,511,346	\$ 24,960,269	\$ 1,218,394	\$ 638,181	\$ 171,328,190
Employer contributions	234,942,088	31,269,020	3,590,615	1,180,817	270,982,540
State contribution for teachers	68,542,956	-	-	-	68,542,956
Interest on service credits purchased	805,416	249,480	267	-	1,055,163
Service credit transfers	1,899	-	-	-	1,899
Total contributions	<u>448,803,705</u>	<u>56,478,769</u>	<u>4,809,276</u>	<u>1,818,998</u>	<u>511,910,748</u>
Investment Income					
Net appreciation in fair value of investments	632,613,969	110,917,130	5,595,516	3,431,848	752,558,463
Interest	65,933,587	11,786,446	627,141	374,748	78,721,922
Dividends	2,080,283	371,934	19,783	11,832	2,483,832
Other investment income	8,301,108	1,448,739	75,070	45,405	9,870,322
	<u>708,928,947</u>	<u>124,524,249</u>	<u>6,317,510</u>	<u>3,863,833</u>	<u>843,634,539</u>
Less investment expense	(10,843,741)	(2,023,927)	(115,607)	(68,581)	(13,051,856)
Net investment income	<u>698,085,206</u>	<u>122,500,322</u>	<u>6,201,903</u>	<u>3,795,252</u>	<u>830,582,683</u>
Miscellaneous Revenue	230,226	22,886	-	-	253,112
<b>Total Additions</b>	<u>1,147,119,137</u>	<u>179,001,977</u>	<u>11,011,179</u>	<u>5,614,250</u>	<u>1,342,746,543</u>
<b>Deductions</b>					
Benefits					
Retirement benefits	562,361,852	54,861,279	234,504	995,605	618,453,240
Cost of living adjustments	154,967,870	9,572,932	17,250	39,971	164,598,023
SRA Plus option	27,210,019	2,486,632	-	-	29,696,651
Supplemental benefits	1,105,478	-	-	-	1,105,478
Death benefits	2,391,600	706,200	-	12,000	3,109,800
Total benefits	<u>748,036,819</u>	<u>67,627,043</u>	<u>251,754</u>	<u>1,047,576</u>	<u>816,963,192</u>
Refund of contributions	7,826,477	1,951,464	-	-	9,777,941
Administrative expense (Note 6)	6,713,985	1,108,245	42,192	28,290	7,892,712
Service credit transfers	-	1,899	-	-	1,899
<b>Total Deductions</b>	<u>762,577,281</u>	<u>70,688,651</u>	<u>293,946</u>	<u>1,075,866</u>	<u>834,635,744</u>
<b>Net Increase</b>	384,541,856	108,313,326	10,717,233	4,538,384	508,110,799
<b>Net assets held in trust for pension benefits</b>					
Beginning of year	5,103,381,932	892,167,809	45,747,494	27,729,085	6,069,026,320
End of year	<u>\$ 5,487,923,788</u>	<u>\$ 1,000,481,135</u>	<u>\$ 56,464,727</u>	<u>\$ 32,267,469</u>	<u>\$ 6,577,137,119</u>

The accompanying notes are an integral part of this financial statement.

*EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF RHODE ISLAND*

*Notes to Financial Statements  
Fiscal Year Ended June 30, 2010*

## **1. Plan Descriptions**

### **(a). General**

The Employees' Retirement System of the State of Rhode Island (the System) acts as a common investment and administrative agent for pension benefits to be provided for four defined benefit retirement plans as listed below:

<i>Plan Name</i>	<i>Type of Plan</i>
<b>Employees' Retirement System (ERS)</b>	Cost-sharing multiple-employer defined benefit plan
<b>Municipal Employees' Retirement System (MERS)</b>	Agent multiple-employer defined benefit plan
<b>State Police Retirement Benefits Trust (SPRBT)</b>	Single-employer defined benefit plan
<b>Judicial Retirement Benefits Trust (JRBT)</b>	Single-employer defined benefit plan

Although the assets of the plans are commingled for investment purposes, each plan's assets are accounted for separately and may be used only for the payment of benefits to the members of that plan, in accordance with the terms of that plan.

The System's financial statements are included as Pension Trust Funds within the Fiduciary Funds in the Comprehensive Annual Financial Report of the State of Rhode Island and Providence Plantations.

The System is administered by the State of Rhode Island Retirement Board which was authorized, created and established in the Office of the General Treasurer as an independent retirement board to hold and administer, in trust, the funds of the retirement system. The fifteen members of the retirement board are: the general treasurer or his or her designee who shall be a subordinate within the general treasurer's office; the director of administration or his or her designee who shall be a subordinate within the department of administration; a representative of the budget office or his or her designee from within the budget office, who shall be appointed by the director of administration; the president of the league of cities and towns or his or her designee; two (2) active state employee members of the retirement system or officials from state employee unions to be elected by active state employees; two (2) active teacher members of the retirement system or officials from a teachers union to be elected by active teachers; one active municipal employee member of the retirement system or an official from a municipal employees union to be elected by active municipal employees; two (2) retired members of the retirement system to be elected by retired members of the system; and four (4) public members, all of whom shall be competent by training or experience in the field of finance, accounting or pensions; two (2) of the public members shall be appointed by the governor, one of whom shall serve an initial term of three (3) years and one of whom shall serve an initial term of four (4) years and until his or her successor is appointed and qualified; and two (2) of the public members shall be appointed by the general treasurer, one of whom shall serve an initial term of three (3) years and one of whom shall serve an initial term of four (4) years and until his or her successor is appointed and qualified. Thereafter, the term of these four (4) public members shall be for four (4)

*EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF RHODE ISLAND*

*Notes to Financial Statements  
Fiscal Year Ended June 30, 2010*

**1. Plan Descriptions (continued)**

**(a). General**

years or until their successors are appointed and qualified by the Senate.

The System's purpose is to provide retirement benefits to state employees, public school teachers, certain general and public safety municipal employees, state police officers, and judges.

A summary of membership by plan as of the June 30, 2009 actuarial valuation follows:

	<i>Retirees and beneficiaries</i>	<i>Terminated plan members entitled to but not yet receiving benefits</i>	<i>Active Vested</i>	<i>Active Non-vested</i>	<i>Total by Plan</i>
<b><u>ERS</u></b>					
State Employees	11,142	2,496	6,309	4,714	24,661
Teachers	9,749	2,466	7,984	5,705	25,904
<b><u>MERS</u></b>					
General Employees	3,894	2,318	3,060	3,494	12,766
Public Safety	495	112	681	717	2,005
<b><u>SPRBT</u></b>	4	2	-	176	182
<b><u>JRBT</u></b>	10	-	7	38	55
<i>Total by type</i>	25,294	7,394	18,041	14,844	65,573

**(b). Membership and Benefit Provisions**

**(1) EMPLOYEES' RETIREMENT SYSTEM (ERS)**

The ERS was established under section two of chapter 2334 of the Rhode Island Public Laws of 1936 and placed under the management of the Retirement Board for the purpose of providing retirement allowances for employees of the State of Rhode Island under the provisions of chapters 8 to 10, inclusive, of title 36, and public school teachers under the provisions of chapters 15 to 17, inclusive, of title 16 of the Rhode Island General Laws.

The plan covers most State employees other than certain personnel at the State colleges and university (principally faculty and administrative personnel). Elected officials may become members on an optional basis. Membership in the plan is compulsory for teachers, including superintendents, principals, school nurses, and certain other school officials in the public schools in the cities and towns. Rhode Island Airport Corporation (RIAC) employees hired

*EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF RHODE ISLAND*

*Notes to Financial Statements  
Fiscal Year Ended June 30, 2010*

**1. Plan Descriptions (continued)**

**(b). Membership and Benefit Provisions**

before July 1, 1993 are also covered and have the same benefits as State employees. Rhode Island Economic Development Corporation (RIEDC) employees who were (1) active contributing members and employees of the Department of Economic Development of the State of Rhode Island before October 31, 1995, and (2) elected to continue membership in the plan are also covered and have the same benefits as State employees. Narragansett Bay Water Quality District Commission employees who are members of a collective bargaining unit are also covered and have the same benefits as State employees.

The plan provides a two-tier benefit structure referred to as Schedules A and B.

***Schedule A Benefits***

Schedule A benefits are available to members who possessed 10 years or more of contributory service on or before July 1, 2005. Schedule A provides unreduced benefits of 1.7% of earnings for each of the first ten years of service; 1.9% for each of the next ten years; 3.0% per year for each of the next fourteen years; and 2% for the 35th year. Joint and survivor options are available as well as the Service Retirement Allowance (SRA) Plus option that provides for the payment of a larger benefit before the attainment of age sixty-two (62) and a reduced amount thereafter. The reduced amount is equal to the benefit before age sixty-two (62), including cost-of-living increases, minus the member's estimated social security benefit payable at age sixty-two (62). The maximum benefit is 80% of final average earnings after 35 years of service. Such benefits are available to members at least age 60 with 10 years of service, or after 28 years at any age. A different benefit formula applies to State correctional officers who may retire at age 50 if they have 20 years of service. Benefits for all employees are based on the average of the highest three consecutive years' earnings, exclusive of overtime.

On the third January after retirement, a cost-of-living increase of 3% (compounded annually) is provided independent of actual changes in the consumer price index. The plan also provides nonservice-connected disability benefits after five years of service; service-connected disability pensions with no minimum service requirement; vested benefits after ten years of service; survivor's benefits for service-connected death; and certain lump sum death benefits.

***Schedule B Benefits***

Schedule B benefits are provided to members who had less than 10 years of contributory service on or before July 1, 2005. For Schedule B members, the plan provides unreduced benefits of 1.6% of earnings for each of the first ten years of service; 1.8% for each of the next ten years; 2.0% per year for years 21 through 25 inclusive; 2.25% per year for years 26 through 30 inclusive; 2.50% per year for years 31 through 37 inclusive and 2.25% for the 38th year. Only single life, and joint and survivor options are available. The maximum



*EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF RHODE ISLAND*

*Notes to Financial Statements  
Fiscal Year Ended June 30, 2010*

**1. Plan Descriptions (continued)**

**(b). Membership and Benefit Provisions**

benefit is 75% of his or her average highest three (3) years of compensation after 38 years of service. Such benefits are available to members at least age 65 with 10 years of service, or after 29 years of service and age 59. Actuarially reduced retirement is available at age 55 and 20 years of service, the benefit is reduced actuarially for each month that the age of the member is less than sixty-five (65) years.

On the month following the third anniversary date of the retirement, and on the month following the anniversary date of each succeeding year, a cost-of-living increase of 3% (compounded annually) or the percentage of increase in the Consumer Price Index for all Urban Consumers (CPI-U) as published by the United States Department of Labor Statistics, determined as of September 30 of the prior calendar year, whichever is less is provided for Schedule B members.

Rhode Island General Laws relating to state employees and teachers benefits were amended during the fiscal year ended June 30, 2009. Members eligible to retire as of September 30, 2009 are not affected by the changes. The legislation established a minimum retirement age of 62 for all members, except those Schedule B members who retire with less than 29 years of service, their retirement eligibility remains 65 years old with a minimum of 10 years of service credit. In addition, the changes established a minimum retirement age of 55 with 25 years of service credit for correctional officers and registered nurses at the Department of Behavioral Healthcare, Developmental Disabilities, and Hospitals. For affected state employees and teachers the law provides a proportional downward adjustment of the minimum retirement age based on the years of service credit of a member at September 30, 2009, a final average salary based on the 5 consecutive highest years of salary and a cost of living adjustment (COLA) from 3% compounded annually to the COLA provided under Schedule B which is the lower of the Consumer Price Index (CPI) or 3%, compounded annually, and requires a full three year anniversary for receipt.

This legislation also amended the disability retirement provision for state employees and teachers. Effective for applications filed after September 30, 2009, accidental disability will be available at 66 2/3% for members who are permanently and totally disabled as determined by the Retirement Board. If the disability is determined to be partial and the member is able to work in other jobs, the benefit will be limited to 50%. Both benefits will be subject to an annual review by ERSRI.

The law also required service credit purchases, excluding contribution refund paybacks and military service, requested after June 16, 2009 to be calculated at full actuarial cost.

Rhode Island General Laws relating to state employees and teachers benefits were amended during the fiscal year ended June 30, 2010. Members eligible to retire as of June 12, 2010 are not affected by the legislation. The legislation modifies the Cost of Living Adjustment (COLA). The COLA now applies to the first thirty-five thousand dollars (\$35,000) of

EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF RHODE ISLAND

Notes to Financial Statements  
Fiscal Year Ended June 30, 2010

**1. Plan Descriptions (continued)**

**(b). Membership and Benefit Provisions**

retirement allowance, indexed annually, and shall commence upon the retiree's third (3<sup>rd</sup>) anniversary of the date of retirement or when the retiree reaches age sixty-five (65), whichever is later. The thirty-five thousand dollar (\$35,000) limit will increase annually by the percentage increase in the Consumer Price Index for all Urban Consumers (CPI-U) as published by the United States Department of Labor Statistics, determined as of September 30 of the prior calendar year or three percent (3%), whichever is less.

The plan also provides benefits to legislators elected to office prior to January 1, 1995, of \$600 for every year served up to a maximum of \$12,000, annually. Such benefits are available to legislators 55 and over with at least 8 years of service or, at any age with 20 or more years of service.

The plan provides a survivor benefit to public school teachers via a "Teachers Survivor Benefits Fund" in lieu of Social Security. Not all school districts participate in the plan. The cost of the benefits provided by the plan are two percent (2%) of the member's annual salary up to but not exceeding an annual salary of \$9,600; one-half (1/2) of the cost is contributed by the member by deductions from his or her salary, and the other half (1/2) is contributed and paid by the respective city, town, or school district by which the member is employed. These contributions are in addition to the contributions required for regular pension benefits.

Spouse, parents, family and children's benefits are payable following the death of a member. A spouse shall be entitled to benefits upon attaining the age of sixty (60) years. Children's benefits are payable to the child, including a stepchild or adopted child of a deceased member if the child is unmarried and under the age of eighteen (18) years or twenty-three (23) years and a full time student, and was dependent upon the member at the time of the member's death. Family benefits are provided if at the time of the member's death the surviving spouse has in his or her care a child of the deceased member entitled to child benefits. Parents benefits are payable to the parent or parents of a deceased member if the member did not leave a widow, widower, or child who could ever qualify for monthly benefits on the member's wages and the parent has reached the age of 60 years, has not remarried, and received support from the member. In January, a yearly cost-of-living adjustment for spouse's benefits is paid and based on the annual social security adjustment.

The Teachers Survivor Benefits Fund provides benefits based on the highest salary at the time of retirement of the teacher. Benefits are payable in accordance with the following table:

<u>Highest Annual Salary</u>	<u>Spousal Monthly Minimum Benefit</u>
\$17,000 or less	\$ 750
\$17,001 to \$25,000	\$ 875
\$25,001 to \$33,000	\$ 1,000
\$33,001 to \$40,000	\$ 1,125
\$40,001 and over	\$ 1,250

EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF RHODE ISLAND

Notes to Financial Statements

Fiscal Year Ended June 30, 2010

**1. Plan Descriptions (continued)**

**(b). Membership and Benefit Provisions**

Benefits payable to children and families are equal to the spousal benefit multiplied by the percentage below:

Parent and 1 Child	Parent and 2 Children	Parent and more than 2 Children	One Child Alone	Two Children Alone	Three or more Children Alone
150%	175%	175%	75%	150%	175%

**(2) MUNICIPAL EMPLOYEES' RETIREMENT SYSTEM (MERS)**

The MERS was established under section one of chapter 2784 of the Rhode Island Public Laws of 1951 and placed under the management of the Retirement Board for the purpose of providing retirement allowances to employees of municipalities, housing authorities, water and sewer districts, and municipal police and fire persons that have elected to participate. The plan generally provides retirement benefits equal to 2% of a member's final average salary multiplied by the number of years of total service up to a maximum of 75%. Joint and survivor options are available as well as the Service Retirement Allowance (SRA) Plus option that provides for the payment of a larger benefit before the attainment of age sixty-two (62) and a reduced amount thereafter. The reduced amount is equal to the benefit before age sixty-two (62), including cost-of-living increases, minus the member's estimated social security benefit payable at age sixty-two (62). Such benefits are available to members at least age 58 with 10 years of service or after 30 years of service at any age. Police and fire personnel may retire at age 55 if they have 10 years of service or after 25 years of service at any age. An optional cost-of-living provision may be elected for police and fire personnel and general employees. An option may be elected to provide a 20 year service pension with a benefit equal to 2.5% for each year of service up to a maximum of 75% for police and fire personnel. Benefits are based on the average of the highest three consecutive years' earnings, exclusive of overtime.

The plan also provides nonservice-connected disability benefits after 5 years of service; service-connected disability pensions with no minimum service requirement; vested benefits after 10 years of service; survivor's benefits; and certain lump sum death benefits. A summary of participating employers is listed below:

Municipalities, housing authorities, water and sewer districts	66
Municipal police and fire departments	<u>43</u>
Total participating units as of the actuarial valuation at June 30, 2009	<u>109</u>

*EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF RHODE ISLAND*

*Notes to Financial Statements  
Fiscal Year Ended June 30, 2010*

**1. Plan Descriptions (continued)**

**(b). Membership and Benefit Provisions**

**(3) STATE POLICE RETIREMENT BENEFITS TRUST (SPRBT)**

The State Police Retirement Benefits Trust was established under Rhode Island General Law Section 42-28-22.1 and was placed under the management of the Retirement Board for the purpose of providing retirement allowances to State Police.

The plan covers all State Police and Superintendents hired after July 1, 1987.

The plan generally provides retirement benefits equal to 50% of final salary after 20 years of service, plus 3.0% of final salary times service in excess of 20 years through 25 years to a maximum of 65% of final salary. Such benefits are available to members after 20 years of service regardless of age. The Superintendent of the State Police will receive 50% of his/her final salary and may retire after attainment of age 60 and 10 years of service. A cost-of-living adjustment of \$1,500 per annum beginning on January 1st of the year in which a member attains his/her third anniversary of retirement is provided to all members.

Benefits are based on the final base salary earned at retirement including longevity increment, holiday pay, clothing allowance and up to 400 overtime hours.

The plan also provides nonservice-connected disability benefits after 10 years of service and service-connected disability pensions with no minimum service requirement.

During the fiscal year ended June 30, 2008 the General laws were amended such that any member of the state police, other than the superintendent, who is hired on or after July 1, 2007 and who has served for twenty-five (25) years shall be entitled to a retirement allowance of 50% of the final salary. In addition, any member may serve up to a maximum of 30 years, and shall be allowed an additional amount equal to 3.0% for each completed year served after 25 years to a maximum retirement allowance not to exceed 65% of the final salary.

**(4) JUDICIAL RETIREMENT BENEFITS TRUST (JRBT)**

The Judicial Retirement Benefits Trust was established under Rhode Island General Laws 8-8.2-7; 8-3-16; 8-8-10.1; 28-30-18.1; and was placed under the management of the Retirement Board for the purpose of providing retirement allowances to Justices of the Traffic Tribunal, Supreme, Superior, Family, District and Workers Compensation courts. The plan covers all Judges appointed after December 31, 1989. Certain survivor benefits are also provided to judges who are plan members which is 50% of the benefit amount payable to the judicial member.

Judges appointed after December 31, 1989 but before July 2, 1997 are generally provided retirement benefits equal to 75% of the final salary at the time of retirement after 20 years of service, or 10 years of service and attainment of age 65. Judges retiring after 20 years of

*EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF RHODE ISLAND*

*Notes to Financial Statements  
Fiscal Year Ended June 30, 2010*

**1. Plan Descriptions (continued)**

**(b). Membership and Benefit Provisions**

service after age 65 or 15 years of service after age 70 will receive full retirement benefits, which is the final salary at time of retirement.

For judges appointed subsequent to July 2, 1997, salary is the average highest three (3) consecutive years of compensation rather than final salary.

During the fiscal year ended June 30, 2008 the General Laws were amended for judges appointed on or after January 1, 2009. Judges with 20 years of service after age 65 or judges with 15 years of service after age 70 will receive 90% of the average of the highest three consecutive years of compensation. Judges appointed on or after January 1, 2009 with 10 years of service and age 65 or 20 years of service at any age are entitled to a reduced benefit of 70% of the average highest three consecutive years of compensation. Judges designating a survivor benefit with 20 years of service and age 65 or 15 years of service and age 70 would receive a reduced benefit equal to 80% of the average highest three consecutive years of compensation. Judges designating a survivor benefit with 10 years of service after age 65 or 20 years of service at any age would receive a reduced benefit equal to 60% of the average highest three consecutive years of compensation.

Rhode Island General Laws relating to judges benefits was amended during the fiscal year ended June 30, 2009 for judges appointed on or after July 1, 2009. Judges with 20 years of service after age 65 or with 15 years of service after age 70 will receive 80% of the average of the highest five consecutive years of compensation. Judges with 10 years of service and age 65 or 20 years of service at any age are entitled to a reduced benefit of 65% of the average highest five consecutive years of compensation.

All judicial plan members eligible to retire on or before June 12, 2010 receive, beginning on the third January after the date of retirement, a cost-of-living increase amounting to 3% not compounded. This benefit is provided to Supreme, Superior, Family and District Court Judges, independent of actual changes in the consumer price index. Traffic Tribunal and Workers' Compensation Court Judges, on the third January after the date of retirement, receive a cost-of-living increase amounting to 3% compounded annually.

Rhode Island General Laws relating to judicial benefits were amended during the fiscal year ended June 30, 2010. The legislation modifies the Cost of Living Adjustment (COLA). The new provisions are as follows:

Members whom are justices of supreme, superior, family, and district courts and were not retired or eligible to retire as of June 12, 2010 will receive the first COLA upon the later of their third anniversary of retirement or when the member reaches age 65.

The annual increase in the member's benefit will be equal to the lesser of their original benefit and the COLA limit in effect in the year the member retires, multiplied by the percentage increase in CPI up to a maximum of 3.0% per year. The COLA will be provided on a simple basis. The applicable annual COLA limit will initially be \$35,000, and increase annually by the percentage increase in the Consumer Price Index (CPI) up to a maximum of

*EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF RHODE ISLAND*

*Notes to Financial Statements  
Fiscal Year Ended June 30, 2010*

## **1. Plan Descriptions (continued)**

### **(b). Membership and Benefit Provisions**

3.0% per year. No COLA would be paid on any part of the annual benefit in excess of this limit. The annual increase in the COLA limit will be determined on a compound basis.

Members whom are judges of the administrative adjudication court, traffic tribunal, and workers' compensation court and were not retired or were not eligible to retire as of June 12, 2010 will receive the first COLA upon the later of their third anniversary of retirement or when the member reaches age 65. The annual increase in the member's benefit will be equal to the lesser of the current benefit and the current COLA limit, multiplied by the percentage increase in CPI up to a maximum of 3.0% per year. The COLA will be provided on a compound basis. The applicable annual COLA limit will initially be \$35,000, and increase annually by the percentage increase in the Consumer Price Index (CPI) up to a maximum of 3.0% per year. No COLA would be paid on any part of the annual benefit in excess of this limit. The annual increase in the COLA limit will be determined on a compound basis.

## **2. Summary of Significant Accounting Policies**

These financial statements were prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). The Governmental Accounting Standards Board (GASB) is responsible for establishing generally accepted accounting principles for defined benefit pension plans established by governmental entities. In accordance with GASB Statement No. 20, in the absence of specific guidance from a GASB pronouncement, pronouncements of the Financial Accounting Standards Board (FASB) issued on or before November 30, 1989 have been followed.

**Basis of Accounting** - The financial statements of the System are prepared on the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded when incurred. Plan member contributions are recognized in the period in which the contributions are withheld from payroll. Employer contributions to each 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 each plan. Dividend income is recorded on the ex-dividend date.

Investment transactions are recorded on a trade date basis. Gains or losses on foreign currency exchange contracts are included in income consistent with changes in the underlying exchange rates.

**Method Used to Value Investments** - Investments are recorded in the financial statements at fair value. Fair value is the amount that a plan can reasonably expect to receive for an investment in a current sale between a willing buyer and a willing seller - that is, other than a forced liquidation sale.

*EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF RHODE ISLAND*

*Notes to Financial Statements  
Fiscal Year Ended June 30, 2010*

## **2. Summary of Significant Accounting Policies (continued)**

Short-term investments are generally carried at cost which approximates fair value.

The fair value of fixed income securities and domestic and international equity securities is generally based on published market prices and quotations from national security exchanges and securities pricing services.

Commingled funds consist of institutional domestic equity index, international equity index, real estate funds, and an ETF (exchange traded fund) commodity fund. The fair value of the commingled funds is based on the reported net asset value (NAV) of the respective fund based upon the fair value of the underlying securities or assets held in the commingled fund.

Futures contracts are valued at the settlement price established each day by the board of trade or exchange on which they are traded.

The System also trades in foreign exchange contracts to manage exposure to foreign currency risks. Such contracts are used to purchase and sell foreign currency at a guaranteed future price. The change in the estimated fair value of these contracts, which reflects current foreign exchange rates, is included in the determination of the fair value of the System's investments.

Other investments that are not traded on a national security exchange (primarily private equity and real estate investments) are generally valued based on audited December 31 net asset values adjusted for (1) cash flows for the period January 1 to June 30 (which principally include additional investments and partnership distributions), and (2) significant changes in fair value as determined or estimated by the general partners as of June 30. The general partners estimate the fair value of the underlying investments held by the partnership periodically. Publicly traded investments held by the partnerships are valued based on quoted market prices. If not publicly traded, the fair value is determined by the general partner. Financial Accounting Standards Board ASC Topic 820, *Fair Value Measurements and Disclosures*, requires private equity and real estate limited partnership general partners to value non-publicly traded assets at current fair value, taking into consideration the financial performance of the issuer, cash flow analysis, recent sales prices, market comparable transactions, a new round of financing, a change in economic conditions, and other pertinent information. ERSRI management considers the fair values reported by the general partners at June 30 in addition to the audited net asset values at December 31 adjusted for cash flows for the period January 1 to June 30 in determining the fair value of private equity and real estate investments on the financial statements of ERSRI.

Private equity and real estate investments represented 9.7% and 3.7%, respectively of the total reported fair value of all ERSRI investments at June 30, 2010. Of the underlying holdings within private equity investments, approximately 10% were valued based on quoted market prices. The remaining underlying assets were valued generally following the objectives outlined above. Because these fair values were not determined based on quoted

*EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF RHODE ISLAND*

*Notes to Financial Statements  
Fiscal Year Ended June 30, 2010*

### **3. Summary of Significant Accounting Policies (continued)**

market prices, the fair values may differ from the values that would have been determined had a ready market for these investments existed.

**Cash and Cash Equivalents** - Cash represents cash held in trust in a financial institution. Cash equivalents are highly liquid investments with a maturity of three months or less at the time of purchase.

**Property and Equipment** – These assets represent the Line of Business System and computer equipment recorded at cost. Depreciation is provided on a straight-line basis over the estimated useful lives, ten and five years respectively. Depreciation of the Line of Business System commences as each stage is implemented. Property and equipment is allocated to each plan based on its proportionate share of net assets.

**Memorandum Total Columns** - Total columns on the financial statements are captioned “memorandum only” to indicate that they are presented only to facilitate financial analysis. Data in these columns are not comparable to a consolidation. Inter-fund eliminations have not been made in the aggregation of this data.

**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 disclosures of contingencies. These estimates are subject to a certain amount of uncertainty in the near term, which could result in changes in the values reported for those assets in the statements of fiduciary net assets. Because of the inherent uncertainty in the valuation of privately held securities, the fair value may differ from the values that would have been used if a ready market for such securities existed, and the difference can be material. Estimates also affect the reported amounts of income/additions and expenses/deductions during the reporting period. Actual results could differ from these estimates.

**New Accounting Pronouncements** – the System adopted the following new accounting pronouncements during fiscal 2010:

Governmental Accounting Standards Board Statement No. 51 – *Accounting and Financial Reporting for Intangible Assets* - adoption of this pronouncement required no modification of amounts reported in the financial statements or note disclosures.

Governmental Accounting Standards Board Statement No. 53 – *Accounting and Financial Reporting for Derivative Instruments* during fiscal 2010. The new accounting pronouncement modified the System’s disclosures about derivative instruments as included in Note 3.



EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF RHODE ISLAND

Notes to Financial Statements  
Fiscal Year Ended June 30, 2010

### 3. Cash Deposits and Investments

#### (a). Cash Deposits and Cash Equivalents

At June 30, 2010, the carrying amounts of the plans' cash deposits are listed below:

	<u>ERS</u>	<u>MERS</u>	<u>SPRBT</u>	<u>JRBT</u>	<u>Total</u>
<b>Cash Deposits:</b>					
Book balance	\$ 3,553,073	\$ 628,326	\$ 780,742	\$ 545	\$ 4,962,686
Bank balance	5,900,801	702,481	768,040	545	7,371,867
<b>Cash Equivalents:</b>	\$ 2,101,003	\$ -	\$ -	\$ -	\$ 2,101,003
<b>Total Cash Deposits and Cash Equivalents</b>	\$ 5,654,076	\$ 628,326	\$ 780,742	\$ 545	\$ 7,063,689

The bank and book balances represent the plans' deposits in short-term trust accounts which include demand deposit accounts and interest-bearing, collateralized bank deposit accounts. Of the bank balance, the entire amount is covered by federal depository insurance and is also fully collateralized. Cash equivalent type investments consist of money market mutual funds totaling \$2,101,003. The money market mutual fund (BlackRock Liquidity Funds: FedFund (Institutional Shares)) is invested in a portfolio of U.S. Treasury bills, notes and obligations guaranteed by the U.S. government and its agencies and instrumentalities and repurchase agreements are fully collateralized by such obligations. The fund was rated AAAM by Standard & Poors and had an average maturity of 42 days at June 30, 2010.

In accordance with Rhode Island General Law Chapter 35-10.1, depository institutions holding deposits of the State, its agencies or governmental subdivisions of the State shall, at a minimum, insure or pledge eligible collateral equal to one hundred percent of time deposits with maturities greater than sixty days. Any of these institutions that do not meet minimum capital standards prescribed by federal regulators shall insure or pledge eligible collateral equal to one hundred percent of deposits, regardless of maturity. None of the System's deposits were required to be collateralized at June 30, 2010. However, the State Investment Commission has adopted a collateralization requirement for institutions holding the State's deposits. Financial institutions are required to pledge collateral equal to 102% of the deposit amounts.

#### (b). Investments

The State Investment Commission oversees all investments made by the State of Rhode Island, including those made for the System. Investment managers engaged by the Commission, at their discretion and in accordance with the investment objectives and guidelines for the System, make certain investments. The General Treasurer makes certain short-term investments on a daily basis. Rhode Island General Law Section 35-10-11 (b)(3) requires that all investments shall be made in securities as would be acquired by prudent persons of discretion and intelligence who are seeking a reasonable income and the preservation of capital.

*EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF RHODE ISLAND*

*Notes to Financial Statements  
Fiscal Year Ended June 30, 2010*

### 3. Cash Deposits and Investments (continued)

#### (b). Investments

On July 1, 1992, the State Investment Commission pooled the assets of the ERS with the assets of the MERS for investment purposes only, and assigned units to the plans based on their respective share of market value. On September 29, 1994 and November 1, 1995, the assets of the SPRBT and the JRBT, respectively, were added to the pool for investment purposes only. The custodian bank holds assets of the System in a Pooled Trust and each plan holds units in the trust. The number of units held by each plan is a function of each plans' respective contributions to, or withdrawals from, the trust.

Investment expense is allocated to each plan based on the plan's units in the Pooled Trust at the end of each month.

The following table presents the fair value of investments by type that are held within in the Pooled Trust at June 30, 2010:

<u>Investment Type</u>	<u>Fair Value</u>
Cash Deposits	\$ 13,910,595
Money Market Mutual Fund	718,500,904
US Government Securities	497,740,175
US Government Agency Securities	443,963,629
Collateralized Mortgage Obligations	22,896,744
Corporate Bonds	702,458,610
Domestic Equity Securities	65,996,650
International Equity Securities	8,796,444
Commingled Funds - Domestic Equity	2,147,313,902
Commingled Funds - International Equity	1,094,165,337
Private Equity	631,262,768
Real Estate	
Limited Partnerships	99,927,414
Commingled Funds	95,358,154
Real Estate Investment Trusts	46,687,206
	<b>\$ 6,588,978,532</b>
<b>Net investment receivable (payable)</b>	<b>(76,504,558)</b>
<b>Total Investments at Fair Value</b>	<b>\$ 6,512,473,974</b>

Consistent with an target asset allocation model adopted by the State Investment Commission, the System directs its investment managers to maintain well diversified portfolios by sector, credit rating and issuer using the prudent person standard, which is the standard of care employed solely in the interest of the participants and beneficiaries of the

EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF RHODE ISLAND

Notes to Financial Statements  
Fiscal Year Ended June 30, 2010

### 3. Cash Deposits and Investments (continued)

#### (b). Investments

funds and for the exclusive purpose of providing benefits to participants and defraying reasonable expenses of administering the funds.

Specific manager performance objectives are outlined, generally stated in relation to a benchmark or relevant index. These guidelines also include prohibited investments, limitations on maximum exposure to a single industry or single issuer, a minimum number of holdings within the manager's portfolio and, for fixed income managers, minimum credit quality ratings and duration/maturity targets.

#### (c). Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

Duration is a measure of a debt security's exposure to fair value changes arising from changes in interest rates. It uses the present value of cash flows, weighted for those cash flows as a percentage of the investment's full price. The System manages its exposure to interest rate risk by comparing each fixed income manager portfolio's effective duration against a predetermined benchmark index based on that manager's mandate. The fixed income indices currently used by the System are:

- Citigroup Broad Investment Grade Bond Index
- Barclays MBS Index
- Barclays Credit Index
- Credit Suisse First Boston Global Hi Yield Index
- Barclays US Tips Index

At June 30, 2010, no fixed income manager was outside of the policy guidelines.

The following table shows the System's fixed income investments by type, fair value and the effective duration at June 30, 2010:

<b>Investment Type:</b>	<b>Fair Value (in thousands)</b>	<b>Effective Duration</b>
US Government Securities	\$ 497,740	3.66
US Government Agency Securities	443,964	2.78
Collateralized Mortgage Obligations	22,897	3.68
Corporate Bonds	702,459	5.59
Total Fixed Income	<u>\$ 1,667,060</u>	4.23

The System also invested in a short-term money market mutual fund (State Street Bank Institutional Liquid Reserves) that held investments with an average maturity of 29 days.

The System invests in various mortgage-backed securities, such as collateralized mortgage obligations (CMO), interest-only and principal-only (PO) strips. They are reported in U.S.

*EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF RHODE ISLAND*

*Notes to Financial Statements  
Fiscal Year Ended June 30, 2010*

### 3. Cash Deposits and Investments (continued)

#### (c). Interest Rate Risk

Government Agency Securities and Collateralized Mortgage Obligations in the table above. CMO's are bonds that are collateralized by whole loan mortgages, mortgage pass-through securities or stripped mortgage-backed securities. Income is derived from payments and prepayments of principal and interest generated from collateral mortgages. Cash flows are distributed to different investment classes or tranches in accordance with the CMO's established payment order. Some CMO tranches have more stable cash flows relative to changes in interest rates while others are significantly sensitive to interest rate fluctuations.

The System may invest in interest-only (IO) and principal-only strips (PO) in part to hedge against a rise in interest rates. Interest-only strips are based on cash flows from interest payments on underlying mortgages. Therefore, they are sensitive to pre-payments by mortgagees, which may result from a decline in interest rates. Principal-only strips receive principal cash flows from the underlying mortgages. In periods of rising interest rates, homeowners tend to make fewer mortgage prepayments.

#### (d). Credit Risk

The System manages exposure to credit risk generally by instructing fixed income managers to adhere to an overall target weighted average credit quality for the portfolio and by establishing limits on the percentage of the portfolio that is invested in non-investment grade securities. The System's exposure to credit risk as of June 30, 2010 is as follows:

<u>Rating (1)</u>	<u>Collateralized Mortgage Obligations</u>	<u>US Government Agency Securities</u>	<u>Corporate Bonds</u>
Aaa	\$ 12,831,259	\$ 443,963,629	\$ 118,586,142
Aa	1,363,337		56,022,745
A	2,881,927		150,763,452
Baa	3,068,016		200,148,408
Ba	5,479		61,924,386
B	2,265,495		71,098,177
Caa	414,486		15,586,140
Ca			189,763
C			
D			511,132
Not Rated	66,745		27,628,265
<b>Fair Value</b>	<u>\$ 22,896,744</u>	<u>\$ 443,963,629</u>	<u>\$ 702,458,610</u>

(1) Moody's Investors Service

The System's investment in a short-term money market mutual fund (State Street Bank Institutional Liquid Reserves) was rated AAAM by Standard & Poors Investors Service.

#### (e). Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a System's investments in a single issuer. There is no single issuer exposure within the System's portfolio that comprises 5% of the overall portfolio.

*EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF RHODE ISLAND*

*Notes to Financial Statements  
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### 3. Cash Deposits and Investments (continued)

#### (f). Custodial Credit Risk

For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the System will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. At June 30, 2010 all securities were registered in the name of the System (or in the nominee name of its custodial agent) and were held in the possession of the System's custodial bank, State Street Bank and Trust.

#### (g). Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely impact the fair value of an investment. Portfolios are diversified to limit foreign currency and security risk and the System's investment asset allocation policy targets non-US equity investments at 17.50%. The System may enter into foreign currency exchange contracts to minimize the short-term impact of foreign currency fluctuations on foreign investments. The System's exposure to foreign currency risk at June 30, 2010, was as follows:

<b>Currency</b>	<b>Commingled Fund</b>	<b>Equities</b>	<b>Private Equity</b>	<b>Total</b>
Australian Dollar	\$ 59,494,047	\$	\$	\$ 59,494,047
Brazilian Real	38,510,572			38,510,572
Canadian Dollar	84,467,639	249,491	17,899,434	102,616,564
Chilean Peso	3,875,115			3,875,115
Colombian Peso	1,967,018			1,967,018
Czech Koruna	963,426			963,426
Danish Krone	7,580,070			7,580,070
Egyptian Pound	1,262,171			1,262,171
Euro Currency	218,643,403	254	81,278,804	299,922,461
Hong Kong Dollar	66,759,850	4,844,139		71,603,989
Hungarian Forint	1,105,586			1,105,586
Indian Rupee	21,268,497			21,268,497
Indonesian Rupiah	6,078,522	866,393		6,944,915
Israeli Shekel	6,362,035			6,362,035
Japanese Yen	171,042,437			171,042,437
Malaysian Ringgit	7,474,945			7,474,945
Mexican Peso	11,203,376			11,203,376
Moroccan Dirham	379,861			379,861
New Taiwan Dollar	27,217,704			27,217,704
New Zealand Dollar	671,617			671,617
Norwegian Krone	5,401,553			5,401,553
Philippine Peso	1,220,640			1,220,640
Polish Zloty	3,223,931			3,223,931
Pound Sterling	153,329,785			153,329,785
Singapore Dollar	12,779,229			12,779,229
South African Rand	18,364,659			18,364,659
South Korean Won	34,244,361	2,836,166		37,080,527
Swedish Krona	21,482,285		98,101	21,580,386
Swiss Franc	59,185,344			59,185,344
Thailand Baht	3,904,120			3,904,120
Turkish Lira	4,105,835			4,105,835
Total	\$ 1,053,569,633	\$ 8,796,443	\$ 99,276,339	\$ 1,161,642,415
US Dollar	40,595,704			
Commingled Fund	\$ 1,094,165,337			

### 3. Cash Deposits and Investments (continued)

#### (h). Derivatives and Other Similar Investments

Certain of the System's investment managers are allowed to invest in derivative type transactions consistent with the terms and limitations governing their investment objective and related contract specifications. Derivatives and other similar investments are financial contracts whose value depends on one or more underlying assets, reference rates, or financial indices.

The System's derivative investments include forward foreign currency transactions, futures contracts, options, securities purchased prior to issuance, and short sales. The System enters into these transactions to enhance performance, rebalance the portfolio consistent with overall asset allocation targets, gain exposure to a specific market, or mitigate specific risks. According to investment policy guidelines, derivative type instruments may be used for hedging purposes and not for leveraging plan assets.

**Forward foreign currency contracts** – The System enters into foreign currency exchange contracts to minimize the short-term impact of foreign currency fluctuations on foreign investments. A currency forward is a contractual agreement to pay or receive specific amounts of foreign currency at a future date in exchange for another currency at an agreed upon exchange rate. These contracts involve risk in excess of the amount reflected in the System's Statements of Fiduciary Net Assets. The face or contract amount in U.S. dollars reflects the total exposure the System has in that particular currency contract. The U.S. dollar value of forward foreign currency contracts is determined using forward currency exchange rates supplied by a quotation service. Losses may arise due to changes in the value of the foreign currency or if the counterparty does not perform under the contract.

**Futures contracts** – The System uses futures to manage its exposure to the domestic and international equity, money market, and bond markets and the fluctuations in interest rates and currency values. Futures are also used to obtain target market exposures in a cost effective manner and to narrow the gap between the System's actual physical exposures and the target policy exposures. Using futures contracts in this fashion is designed to reduce (or hedge) the risk of the actual plan portfolio deviating from the policy portfolio more efficiently than by using physical securities. The program is only used to manage intended exposures and asset allocation rebalancing.

Buying futures tends to increase the System's exposure to the underlying instrument. Selling futures tends to decrease the System's exposure to the underlying instrument, or hedge other System investments. Losses may arise from changes in the value of the underlying instruments and if there is an illiquid secondary market for the contracts.

Through commingled funds, the System also indirectly holds derivative type instruments, primarily equity index futures.

The System invests in mortgage-backed securities, which are included in the categories described as collateralized mortgage obligations and U.S. Government Agency Securities in

*EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF RHODE ISLAND*

*Notes to Financial Statements  
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### 3. Cash Deposits and Investments (continued)

#### (h). Derivatives and Other Similar Investments

Note 3(b). These securities are based on the cash flows from interest and principal payments by the underlying mortgages. As a result, they are sensitive to prepayments by mortgagees, which are likely in declining interest rate environments, thereby reducing the value of these securities. Additional information regarding interest rate risks for these investments is included in Note 3(c) *Interest Rate Risk*.

Mortgage backed securities of U.S. Government Agencies are also bought and sold in the “to be announced” or TBA market, which performs as a forward or delayed delivery market. The System will enter into a forward contract to buy (or sell) mortgage backed securities in the TBA market, promising to purchase (or deliver) mortgage backed securities on a settlement date sometime in the future. The actual security that will be dealt to fulfill a TBA trade is not designated at the time the trade is originated.

The System may sell a security in anticipation of a decline in the fair value of that security or to lessen the portfolio allocation of an asset class. Short sales may increase the risk of loss to the System when the price of a security underlying the short sale increases and the System is obligated to deliver the security in order to cover the position.

The following summarize the System’s exposure to specific derivative investments at June 30, 2010.

<u>Investment Derivative Instruments</u>	<u>Change in fair value included in investment income</u>	<u>Fair Value at June 30, 2010</u>	<u>Notional Amount</u>
Equity options written	\$ 89,472	\$ -	\$ -
Fixed income futures - long	12,861,942	1,543,868	171,014,461
Fixed income futures - short	79,062	-	-
Foreign currency forward contracts	5,150,811	457,415	(a)
Index futures - long	16,386,116	(65,785)	2,109,043
Index futures - short	4,964,597	1,556,823	58,739,865
"To-be announced" securities - long	5,877,558	1,161,597	118,250,000
"To-be announced" securities - short	45,832	(50,262)	(8,400,000)
Warrants	(37,643)	24,375	325
<b>Total</b>	<b>\$ 45,417,747</b>	<b>\$ 4,628,031</b>	

*EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF RHODE ISLAND*

*Notes to Financial Statements  
Fiscal Year Ended June 30, 2010*

### 3. Cash Deposits and Investments (continued)

#### (h). Derivatives and Other Similar Investments

(a) - Foreign Currency Forward Contracts:

Pending receivable	\$ 42,434,291
Pending payable	<u>(41,976,876)</u>
Foreign currency forward contract asset (liability)	<u>\$ 457,415</u>

The System is exposed to credit risk on derivative instruments that are in asset positions. The aggregate fair value of derivative instruments in asset positions at June 30, 2010 was \$477,604. This represents the maximum loss that would be recognized if all counterparties failed to perform as contracted. Risk is mitigated by using a continuous linked settlement process.

The System executes (through its investment managers) derivative instruments with various counterparties. The credit ratings of counterparties for all but 2% (which were unrated) were Aa3 (Moody's) or better.

#### (i). Securities Lending

At June 30, 2010, the System had indirect exposure to securities lending activity through participation in a commingled fund. The commingled fund participates in a securities lending program administered by a related party of the manager of the commingled fund. During fiscal 2009, the commingled fund manager imposed withdrawal restrictions from the commingled fund due to market conditions which adversely impacted its securities lending collateral pool. The restrictions generally limited withdrawals from the lending fund to no more than 4% of the participant balance per month. The State Investment Commission has authorized withdrawals from the lending commingled fund to be reinvested in a similar non-lending commingled fund consistent with the limitations imposed by the commingled fund manager. The System's investment at June 30, 2010 in the commingled fund which participates in securities lending activity was \$653,366,538. In August 2010, the commingled fund manager removed the withdrawal restrictions and in November 2010, the System completed its conversion of units from the lending commingled fund to a similar non-lending commingled fund.

### 4. Property and Equipment

Property and equipment consist of the line of business system and computer equipment at historical cost. Balances at June 30, 2010 were:

	ERS	MERS	SPRBT	JRBT	Total
Line of Business System	\$ 15,544,862	\$ 2,287,990	\$ 38,780	\$ 24,973	\$ 17,896,605
Equipment	\$ 160,074	\$ 25,213	\$ 842	\$ 550	\$ 186,679
Property and Equipment	\$ 15,704,936	\$ 2,313,203	\$ 39,622	\$ 25,523	\$ 18,083,284
Accumulated Depreciation	<u>(12,172,300)</u>	<u>(1,791,598)</u>	<u>(30,122)</u>	<u>(19,411)</u>	<u>(14,013,431)</u>
Net Property and Equipment	<u>\$ 3,532,636</u>	<u>\$ 521,605</u>	<u>\$ 9,500</u>	<u>\$ 6,112</u>	<u>\$ 4,069,853</u>



*EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF RHODE ISLAND*

*Notes to Financial Statements  
Fiscal Year Ended June 30, 2010*

## **5. Contributions**

Contribution requirements for plan members and employers are established pursuant to Rhode Island General Laws. Employers are required to contribute at an actuarially determined rate. Plan member contributions are fixed by statute.

### **(a). Funding Policy**

The funding policies, as set forth in Rhode Island General Law, Section 36-10-2 and 45-21-42 provide for actuarially determined periodic contributions to the plans. The actuarial valuation uses the Entry Age Normal actuarial cost method. Under this method, the employer contribution rate is the sum of (i) the employer normal cost rate, and (ii) a rate that will amortize the unfunded actuarial liability. The valuation is prepared on the projected benefit basis, under which the present value, at the assumed rate of return (currently 8.25 percent), of each participant's expected benefit payable at retirement or death is determined, based on age, service, gender and compensation.

The employer contributions required to support the benefits of the Plan are determined following a level funding approach, and consist of a normal contribution and an accrued liability contribution. The normal contribution is determined using the "entry age normal" method. Under this method, a calculation is made to determine the average uniform and constant percentage rate of employer contribution which, if applied to the compensation of each new participant during the entire period of his anticipated covered service, would be required in addition to the contributions of the participant to meet the cost of all benefits payable on his behalf. The unfunded accrued liability contributions are determined by subtracting the actuarial value of assets from the actuarial accrued liability and amortizing the result over a period not to exceed 30 years from June 30, 1999.

Effective July 1, 2005, the law as amended requires, in addition to the contributions provided for by the funding policy, commencing in fiscal year 2006, and each year thereafter, for each fiscal year in which the actuarially determined state contribution rate for state employees and teachers is lower than that for the prior fiscal year, the governor shall include an appropriation to that system equivalent to twenty percent (20%) of the rate reduction to be applied to the actuarial accrued liability. The amounts to be appropriated shall be included in the annual appropriation bill and shall be paid by the general treasurer into the retirement system. The retirement system's actuary shall not adjust the computation of the annual required contribution for the year in which supplemental contributions are received; such contributions once made may be treated as reducing the actuarial liability remaining for amortization in the next following actuarial valuation to be performed.

### **(b). Contribution rates**

Employer contribution rates for fiscal 2010 (for state employees, teachers, and judges) were developed based on an actuarial valuation performed as of June 30, 2008 (restated). Employer contribution rates for MERS were developed based on an actuarial valuation performed as of June 30, 2007 and for SPRBT based on a valuation as of June 30, 2007 (restated). The table below displays the contribution rates for the year ended June 30, 2010:

*EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF RHODE ISLAND*

*Notes to Financial Statements  
Fiscal Year Ended June 30, 2010*

**5. Contributions (continued)**

**(b). Contribution rates**

<b>Plan</b>	<b>Employee</b>	<b>Employer</b>
<b>ERS</b>		
State Employees	8.75%	20.78*
Teachers <i>Municipal funded</i>	9.50%	11.25% (10.60% for towns not participating in the 1990 early retirement incentive)*
<i>State funded</i>		7.76% (7.32% for towns not participating in the 1990 early retirement incentive)*
<b>MERS</b>		
General Employees	6.00% (additional 1% with a cost-of-living adjustment)	66 Municipalities, housing authorities, water and sewer districts contributed various actuarially determined rates.
Public Safety	7.00% (additional 1% with a cost-of-living adjustment and /or 1% with a 20 year service plan), Cranston Police and Cranston Fire are contributing 10% due to special plan provisions	43 Municipal police and fire departments contributed various actuarially determined rates.
<b>SPRBT</b>	8.75%	26.03%
<b>JRBT</b>	8.75%	16.19%*
* Based on the June 30, 2008 (restated) actuarial valuation reflecting Article 16 of Chapter 23 of the Public Laws of 2010 as enacted on June 12, 2010.		

**(c). Funded Status and Funding Progress**

The table below displays the funded status of each plan at June 30, 2009, the most recent actuarial valuation date:

	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) - Entry Age - (b)	Unfunded AAL (UAAL) (b - a)	Funded Ratio (a / b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b - a) / c)
<b>ERS</b>						
<i>State Employees</i>	\$ 2,646,081,020	\$ 4,482,244,291	\$ 1,836,163,271	59.0%	\$ 605,872,460	303.1%
<i>Teachers</i>	\$ 4,008,931,337	\$ 6,900,963,108	\$ 2,892,031,771	58.1%	\$ 987,463,633	292.9%
<b>MERS</b>	\$ 1,196,366,995	\$ 1,355,652,690	\$ 159,285,696	88.3%	\$ 306,587,441	52.0%
<b>SPRBT</b>	\$ 60,232,045	\$ 75,480,005	\$ 15,247,960	79.8%	\$ 17,096,202	89.2%
<b>JRBT</b>	\$ 36,839,221	\$ 41,738,040	\$ 4,898,819	88.3%	\$ 6,843,454	71.6%

The schedules of funding progress, presented as required supplementary information (RSI), present multiyear trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the Actuarial Accrued Liabilities (AAL) for benefits. Additional information as of the June 30, 2009 actuarial valuations:

*EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF RHODE ISLAND*

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**5. Contributions (continued)**

**(c). Funded Status and Funding Progress**

	ERS		MERS	SPRBT	JRBT
	<i>State Employees</i>	<i>Teachers</i>			
Valuation Date	6/30/09	6/30/09	6/30/09	6/30/09	6/30/09
Actuarial Cost Method	Entry Age Normal	Entry Age Normal	Entry Age Normal	Entry Age Normal	Entry Age Normal
Amortization Method	Level Percent of Payroll – Closed	Level Percent of Payroll – Closed	Level Percent of Payroll – Closed	Level Percent of Payroll – Closed	Level Percent of Payroll – Closed
Equivalent Single Remaining Amortization Period	20 years	20 years	20 Years	20 years	20 years
Asset Valuation Method	5 Year Smoothed Market	5 Year Smoothed Market	5 Year Smoothed Market	5 Year Smoothed Market	5 Year Smoothed Market
Actuarial Assumptions					
Investment Rate of Return	8.25%	8.25%	8.25%	8.25%	8.25%
Projected Salary Increases	4.50% to 9.00%	4.50% to 13.25%	<u>General Employees</u> 4.50% to 8.50%  <u>Police &amp; Fire Employees</u> 4.75% to 14.75%	4.50% to 12.50%	4.50%
Inflation	3.00%	3.00%	3.00%	3.00%	3.00%
Cost of Living Adjustments	Schedule A – <ul style="list-style-type: none"> <li>▪ members eligible at 9/30/09 - 3.0% compounded</li> <li>▪ members not eligible at 9/30/09 - 2.5% <sup>1</sup> compounded</li> </ul> Schedule B members – 2.5% <sup>1</sup> compounded	Schedule A – <ul style="list-style-type: none"> <li>▪ members eligible at 9/30/09 - 3.0% compounded</li> <li>▪ members not eligible at 9/30/09 - 2.5% <sup>1</sup> compounded</li> </ul> Schedule B members – 2.5% <sup>1</sup> compounded	3.0% Non-compounded with a few exceptions	\$1,500 per annum	3.0% (see Note 1(b)(4) to the financial statements)
<p>Schedule A - ERS members are those with 10 years or more of contributory service on or before July 1, 2005.</p> <p>Schedule B - ERS members are those with less than 10 years of contributory service on or before July 1, 2005. The plan provisions for Schedule A and B members are described in Note 1(b) to the financial statements entitled <i>Plan Descriptions – Membership and Benefit Provisions</i>.</p> <p>Note 1 – Cost of Living Adjustments (COLA) are based on the actual Consumer Price Index or 3%, whichever is lower. For actuarial purposes, the actuary assumes a 2.5% COLA increase.</p>					

*EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF RHODE ISLAND*

*Notes to Financial Statements  
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## **6. Administrative Expenses**

Pursuant to General Law section 36-8-10.1, administrative costs of the System are financed through investment earnings up to a maximum of .175% of the average total investments before lending activities as reported in the annual report of the Auditor General for the next preceding five (5) fiscal years. Such amounts are transferred to a restricted receipt account within the State's general fund. Any unencumbered funds on June 30 of any fiscal year are credited to the plans in the same proportion as their contributions to the restricted receipt account.

## **7. Commitments**

The State Investment Commission has committed to fund certain private equity and real estate investment managers at a predetermined subscription amount. Outstanding unfunded investment commitments at June 30, 2010 totaled \$289 million. These commitments will be funded through cash available within the pooled investment trust generated through investment income and/or liquidation of other investments.

The System's investments include a commingled fund that has imposed withdrawal limitations effective March 2009 due to market conditions which have adversely impacted its securities lending collateral pool. Withdrawals are generally limited to 4% per month. The State Investment Commission has authorized withdrawals from the commingled fund consistent with these limitations and has reinvested the proceeds in another commingled fund with similar investment objectives but without securities lending participation. Subsequent to June 30, 2010, the commingled fund manager removed the withdrawal limitations in August 2010. In November 2010, all amounts invested in the securities lending commingled fund were withdrawn and reinvested in a similar commingled fund without securities lending participation.

## **8. Postemployment Healthcare Plan**

### **(a). Plan Description**

The System participates in a State administered defined benefit post-employment health care plan known as the Rhode Island Retiree Health Care Benefit Plan (RIRHCBP). The RIRHCBP is an agent multiple employer plan.

The RIRHCBP is reported in an internal service fund of the State using the accrual basis of accounting. The fund reports all employer and retiree (plan member) contributions to the plan. Contributions are recognized when made. Benefits (health care claims) and refunds are recognized when due and payable in accordance with the terms of the plan. A liability for incurred but not reported claims is determined based on past claims payment trends and is included in the State's financial statements. Working premium rates are determined by the State each fiscal year after consultation with an employee benefits consultant and are designed to fund current claims incurred during the fiscal year as well as the costs of administering the plan. For the year ended June 30, 2010, the plan operated on a pay as you

*EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF RHODE ISLAND*

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**8. Postemployment Healthcare Plan (continued)**

**(a). Plan Description**

go basis and no provision has been made to fund future benefits to be provided to RIRHCBP members. The RIRHCBP does not issue a stand-alone financial report.

Pursuant to legislation enacted by the General Assembly the State will establish a trust in fiscal year 2011 to accumulate assets and pay benefits and other costs associated with the RIRHCBP. In addition, effective in fiscal year 2011, all participating employers will be required to fully fund the actuarially determined annual required contribution.

**(b). Funding Policy**

RIGL Sections 36-10-2, 36-12.1, 36-12.2.2 and 36-12-4 govern the provisions of the RIRHCBP. The contribution requirements of plan members, the State and other participating employers are established and may be amended by the General Assembly.

For anyone who retired on or before September 30, 2008, the State provides two types of subsidies for health care benefits. The Tier I subsidy applies to non-Medicare eligible retirees and provides that the State will pay the portion of the cost of post-retirement health care for the retiree and any dependents above the active group rate. The retiree pays the active monthly rate and the State pays the difference between the active group rate and the early retiree rate. This subsidy is not based on years of service and ends at age 65. In addition to the Tier I benefits, the State pays a portion of the cost of post-retirement health care above the Tier I costs for certain retirees meeting eligibility requirements based upon the age and service of the retiree, which is referred to as the Tier II benefit.

For those retiring on or before September 30, 2008, fiscal 2010 contributions are as follows:

Retiree Age	Years of Service	Amount of Cost Paid by Retiree
Below 60: (1)	28-34	10%
	35+	0%
Retiree Age from 60 to 65: (2)	10 - 15	50%
	16 - 22	30%
	23 - 27	20%
	28+	0%
Retiree Age Greater than 65: (3)	10 - 15	50%
	16 - 19	30%
	20 - 27	10%
	28+	0%
1) The monthly premium rate for fiscal year 2010 was \$789.76 for the individual plan. The retiree's cost is then calculated based on a maximum of \$501.68 (the active plan rate).		
(2) The monthly premium rates are the same as indicated above for the Retiree Age Below 60 category.		
(3) The monthly premium rate for the Medicare Supplemental plan is \$218.54 for the individual plan, and the monthly premium for the Medicare HMO plan was \$115 for the first six months of fiscal year 2010 and \$142 thereafter. Retirees can choose between the two plans. The retiree's cost is then calculated based on their years-of-service subsidy above.		

*EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF RHODE ISLAND*

*Notes to Financial Statements  
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**8. Postemployment Healthcare Plan (continued)**

**(b). Funding Policy**

For anyone who retired on or after October 1, 2008, age 59 through 64, with a minimum of 20 years of service, the State will pay 80% of the actual cost of health care coverage. The State contributed \$631.81 per month for these retirees during fiscal 2010. For eligible retirees ages 65 or older, the State pays 80% of the cost of the Medicare supplement products as described in note (3) above.

**(c). Annual OPEB Cost and Net OPEB Obligation**

As required by GASB Statement 45, the System recognized an expense equal to; a.) the annual required contribution of the employer (ARC), which was actuarially determined to be 7.91% of covered payroll for all State employees for fiscal year 2010, plus b.) interest on the net OPEB obligation at the beginning of the fiscal year, and less c.) the ARC adjustment (discounted present value of the OPEB liability at the beginning of the fiscal year). The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal costs each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. The ARC for fiscal 2010 was determined based on an actuarial valuation performed as of June 30, 2007. For fiscal year 2010, the ARC, based on the System's covered payroll of \$2,050,042 totaled \$162,158. The System actually contributed \$115,212, which was 5.62% of annual covered payroll for fiscal 2010. The System's annual OPEB cost and the net OPEB obligation for fiscal 2010, were as follows:

Annual required contribution (ARC)	\$ 162,158
Plus: Interest on net OPEB obligation at beginning of year	2,324
Less: Adjustment to ARC	<u>(2,197)</u>
<b>Annual OPEB cost</b>	<b>\$ 162,285</b>
Contributions made	<u>(115,212)</u>
Increase in OPEB obligation	47,073
Net OPEB obligation at beginning of year	<u>65,184</u>
<b>Net OPEB obligation at end of year</b>	<b><u><u>\$ 112,257</u></u></b>

The System's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for 2010, 2009, and 2008 was as follows:

<b>Fiscal Year Ended</b>	<b>Annual OPEB Cost</b>	<b>Percentage of Annual OPEB Cost Contributed</b>	<b>Net OPEB Obligation</b>
June 30, 2008	\$152,173	65.0%	\$ 53,172
June 30, 2009	\$153,877	92.2 %	\$ 65,183
June 30, 2010	\$162,285	71.0%	\$ 112,257

*EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF RHODE ISLAND*

*Notes to Financial Statements  
Fiscal Year Ended June 30, 2010*

**8. Postemployment Healthcare Plan (continued)**

**(d). Funded Status and Funding Progress**

The State has obtained an actuarial valuation for the RIRHCBP, which determined the collective Actuarial Accrued Liabilities (AAL) and Unfunded Actuarial Accrued Liabilities for all State employees participating in the plan and separate liability amounts for each discretely presented component unit with employees participating in the plan. The liabilities relating to the System's employees, as part of the primary government, are included in the collective amounts reported for all State employees. The AAL and UAAL for the RIRHCBP will be reported in the State's Comprehensive Annual Financial Report for the fiscal year ended June 30, 2010.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The Schedule of Funding Progress for RIRHCBP shows whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits. This schedule will be included in the State's Comprehensive Annual Financial Report for the fiscal year ended June 30, 2010.

**(e). Actuarial Methods and Assumptions**

Projections of benefits for financial reporting purposes are based on the plan and include the types of benefits provided at the time of each valuation. The actuarial assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

The Annual Required Contribution for fiscal year 2010 was determined based on the June 30, 2007 valuation. The Unfunded Actuarial Accrued Liability (UAAL) was amortized by a level (principal and interest combined) percent of payroll contribution for each component unit employer. The UAAL was determined using the actuarial value of assets and actuarial accrued liability calculated as of the valuation date. The UAAL is being amortized over the remainder of a closed 30-year (or shorter) period from June 30, 2006.

Plan changes effective for employees retiring after October 1, 2008 have been reflected in the actuarial valuations performed as of June 30, 2007.

The individual entry-age actuarial cost method is used to determine the annual required contribution amounts and the annual net OPEB obligation. The actuarial assumptions include a 3.566% discount rate based upon the average rate of return during the 10 years ended June 30, 2008 for short term investments of the State's General Fund; an annual

## **8. Postemployment Healthcare Plan (continued)**

### **(e). Actuarial Methods and Assumptions**

healthcare cost trend rate of 10% progressively declining to 4.50% after 8 years; and a salary growth rate of 9% in the first year of service to 4.5% in year 15 and beyond. Other assumptions including those relating to rates of termination, rates of retirement, percent married, and retiree health care election rates were based on the experience study for the Employees' Retirement System of Rhode Island as well as anticipated experience changes in conjunction with the adopted retirement plan changes recently enacted through legislation.

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events in the future. Examples include assumptions about employment, mortality and healthcare cost trends. Actuarial valuations are subject to continual revision as actual results are compared to past expectations and new estimates are formulated about the future.

## **9. Contingencies**

On May 12, 2010, unions, which represent state employees and teachers, filed a lawsuit against the State of Rhode Island challenging legislative changes made in 2009 to pension benefit provisions within the ERS plan for state employees and teachers. The lawsuit was later amended to include the 2010 legislative changes. Various parties have been named as defendants in the lawsuit including the System and the Board of Directors.

Management cannot estimate the likelihood of loss to the State or the System, if any. If challenges to the statutory changes were successful, future contribution rates for the ERS plan and the unfunded actuarial accrued liability could be materially impacted.



**Employees' Retirement System of the State of Rhode Island**

***Required Supplementary Information***

# EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF RHODE ISLAND

## REQUIRED SUPPLEMENTARY INFORMATION

### Schedules of Funding Progress

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) - Entry Age - (b)	Unfunded AAL (UAAL) (b - a)	Funded Ratio (a / b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b - a) / c)
<b>ERS (State Employees )</b>						
6/30/2009	\$ 2,646,081,020	\$ 4,482,244,291	\$ 1,836,163,271	59.0%	\$ 605,872,460	303.1%
6/30/2008 **	2,700,368,568	4,331,504,516	1,631,135,948	62.3%	587,500,000	277.6%
6/30/2007	2,493,428,522	4,332,888,818	1,839,460,296	57.5%	660,044,273	278.7%
6/30/2006	2,256,979,077	4,131,157,601	1,874,178,524	54.6%	644,980,127	290.6%
6/30/2005	2,163,391,323	3,843,518,875	1,680,127,552	56.3%	606,474,789	277.0%
6/30/2004	2,202,900,345	3,694,787,818	1,491,887,473	59.6%	606,087,585	246.2%
<b>ERS (Teachers )</b>						
6/30/2009	\$ 4,008,931,337	\$ 6,900,963,108	\$ 2,892,031,771	58.1%	\$ 987,463,633	292.9%
6/30/2008 **	4,044,954,378	6,632,016,708	2,587,062,330	61.0%	985,898,174	262.4%
6/30/2007	3,737,981,686	6,750,125,236	3,012,143,550	55.4%	959,372,837	314.0%
6/30/2006	3,394,086,565	6,444,693,666	3,050,607,101	52.7%	914,985,746	333.4%
6/30/2005	3,280,977,321	5,919,156,211	2,638,178,890	55.4%	898,051,154	293.8%
6/30/2004	3,340,527,073	5,634,195,435	2,293,668,362	59.3%	866,532,598	264.7%
<b>SPRBT</b>						
6/30/2009	\$ 60,232,045	\$ 75,480,005	\$ 15,247,960	79.8%	\$ 17,096,202	89.2%
6/30/2008	54,927,390	69,029,513	14,102,123	79.6%	16,698,764	84.5%
6/30/2007 *	45,996,910	60,427,947	14,431,037	76.1%	15,836,354	91.1%
6/30/2006	36,314,689	42,216,142	5,901,453	86.0%	13,474,588	43.8%
6/30/2005	29,616,896	37,510,992	7,894,096	79.0%	13,225,400	59.7%
6/30/2004	24,767,014	32,689,173	7,922,160	75.8%	11,421,880	69.4%
<b>JRBT</b>						
6/30/2009	\$ 36,839,221	\$ 41,738,040	\$ 4,898,819	88.3%	\$ 6,843,454	71.6%
6/30/2008 **	34,670,394	38,115,602	3,445,208	91.0%	6,601,889	52.2%
6/30/2007 *	29,630,637	35,355,326	5,724,689	83.8%	6,451,666	88.7%
6/30/2006	23,873,009	27,504,102	3,631,093	86.8%	6,313,069	57.5%
6/30/2005	19,347,372	22,250,728	2,903,356	87.0%	5,684,585	51.1%
6/30/2004	16,019,053	21,845,744	5,826,691	73.3%	5,637,865	103.3%
<b>MERS</b>						
6/30/2009	\$ 1,196,366,995	\$ 1,355,652,690	\$ 159,285,696	88.3%	\$ 306,587,441	52.0%
6/30/2008	1,174,567,205	1,266,286,829	91,719,624	92.8%	304,952,020	30.1%
6/30/2007	1,064,615,664	1,179,233,489	114,617,825	90.3%	298,234,571	38.4%
6/30/2006	945,876,282	1,085,648,196	139,771,914	87.1%	281,291,831	49.7%
6/30/2005	886,964,787	1,017,254,365	130,289,578	87.2%	265,123,725	49.1%
6/30/2004	879,449,653	943,536,048	64,086,395	93.2%	258,985,220	24.7%

\*\* Reflects adoption of Article 16 of Chapter 23 of the 2010 Public Laws enacted on June 12, 2010

\* Restated June 30, 2007 actuarial valuation after 2008 amendment to General Laws

See notes to required supplementary information.

**EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF RHODE ISLAND**

*REQUIRED SUPPLEMENTARY INFORMATION*

*Schedules of Contributions From the Employers*

*And Other Contributing Entity*

<b>ERS</b>		State Employees		Teachers (State)		Teachers (Employers)	
Fiscal		Annual Required	Percentage	Annual Required	Percentage	Annual Required	Percentage
Year Ended		Contribution	Contributed	Contribution	Contributed	Contribution	Contributed
June 30							
2010	**	\$ 123,547,738	100%	\$ 68,542,956	100%	\$ 109,566,352	100%
2009	*	126,297,706	100%	73,600,069	100%	115,234,100	100%
2008		131,560,248	100%	82,455,777	100%	122,906,860	100%
2007		118,300,522	100%	70,531,472	100%	109,415,227	100%
2006		91,254,063	100%	54,537,733	100%	83,794,372	100%
2005		66,087,984	100%	48,834,755	100%	73,006,173	100%

<b>MERS</b>		
Fiscal		
Year Ended	Annual Required	Percentage
June 30	Contribution	Contributed
2010	\$ 31,269,020	100%
2009	33,514,681	100%
2008	33,415,530	100%
2007	26,697,326	100%
2006	20,127,099	100%
2005	13,081,956	100%

<b>SPRBT</b>		
Fiscal		
Year Ended	Annual Required	Percentage
June 30	Contribution	Contributed
2010	\$ 3,590,615	100%
2009	3,340,746	100%
2008	3,720,281	100%
2007	4,038,828	100%
2006	3,174,903	100%
2005	2,614,503	100%

<b>JRBT</b>		
Fiscal		
Year Ended	Annual Required	Percentage
June 30	Contribution	Contributed
2010	** \$ 1,180,817	100%
2009	* 1,700,174	100%
2008	2,127,643	100%
2007	2,362,671	100%
2006	2,291,665	100%
2005	2,056,558	100%

\* Reflects adoption of H5983Aaa, Article 7, Substitute A as amended, enacted on June 30, 2009

\*\* Reflects adoption of Article 16 of Chapter 23 of the 2010 Public Laws enacted on June 12, 2010

See notes to required supplementary information.

**EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF RHODE ISLAND**

*Notes to Required Supplementary Information*

*Fiscal Year Ended June 30, 2010*

**1. Actuarial Assumptions and Methods**

The information presented in the required supplementary schedules was determined as part of the actuarial valuations at the dates indicated. Additional information as of the latest actuarial valuation, June 30, 2009, follows.

	ERS		MERS	SPRBT	JRBT
	<i>State Employees</i>	<i>Teachers</i>			
Valuation Date	6/30/09	6/30/09	6/30/09	6/30/09	6/30/09
Actuarial Cost Method	Entry Age Normal	Entry Age Normal	Entry Age Normal	Entry Age Normal	Entry Age Normal
Amortization Method	Level Percent of Payroll – Closed	Level Percent of Payroll – Closed	Level Percent of Payroll – Closed	Level Percent of Payroll – Closed	Level Percent of Payroll – Closed
Equivalent Single Remaining Amortization Period	20 years	20 years	20 Years	20 years	20 years
Asset Valuation Method	5 Year Smoothed Market	5 Year Smoothed Market	5 Year Smoothed Market	5 Year Smoothed Market	5 Year Smoothed Market
<b>Actuarial Assumptions</b>					
Investment Rate of Return	8.25%	8.25%	8.25%	8.25%	8.25%
Projected Salary Increases	4.50% to 9.00%	4.50% to 13.25%	<u>General Employees</u> 4.50% to 8.50%  <u>Police &amp; Fire Employees</u> 4.75% to 14.75%	4.50% to 12.50%	4.50%
Inflation	3.00%	3.00%	3.00%	3.00%	3.00%
Cost of Living Adjustments	Schedule A – <ul style="list-style-type: none"> <li>▪ members eligible at 9/30/09 - 3.0% compounded</li> <li>▪ members not eligible at 9/30/09 - 2.5%<sup>1</sup> compounded</li> </ul> Schedule B members – 2.5% <sup>1</sup> compounded	Schedule A – <ul style="list-style-type: none"> <li>▪ members eligible at 9/30/09 - 3.0% compounded</li> <li>▪ members not eligible at 9/30/09 - 2.5%<sup>1</sup> compounded</li> </ul> Schedule B members – 2.5% <sup>1</sup> compounded	3.0% Non-compounded with a few exceptions	\$1,500 per annum	3.0% (see Note 1(b)(4) to the financial statements)

Schedule A - ERS members are those with 10 years or more of contributory service on or before July 1, 2005.

Schedule B - ERS members are those with less than 10 years of contributory service on or before July 1, 2005. The plan provisions for Schedule A and B members are described in Note 1(b) to the financial statements entitled *Plan Descriptions – Membership and Benefit Provisions*.

Note 1 – Cost of Living Adjustments (COLA) are based on the actual Consumer Price Index or 3%, whichever is lower. For actuarial purposes, the actuary assumes a 2.5% COLA increase.

*EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF RHODE ISLAND*  
*Notes to Required Supplementary Information*  
*Fiscal Year Ended June 30, 2010*

## **2. Schedules of Funding Progress**

The MERS funded ratio is a composite of all units in the plan. The System performs a separate valuation for each unit.

### ***Changes affecting the June 30, 2009 actuarial valuation:***

The June 30, 2009 valuation for the Employees' Retirement System and the Judicial Retirement Benefit Trust reflects the enactment of Article 16 of Chapter 23 of the 2010 Public Laws which amended the laws governing benefits for state employees, teachers and judges not eligible to retire by June 12, 2010 – see note 1(b) to the financial statements entitled *Plan Descriptions – Membership and Benefit Provisions*.

The changes enacted as a result of Article 16 of Chapter 23 of the 2010 Public Laws governing benefit provisions for the Employees' Retirement System and the Judicial Retirement Benefit Trust are reflected and were applied in determining the contributions rates for the fiscal years ended June 30, 2010 and June 30, 2011 - see note 1(b) to the financial statements entitled *Plan Descriptions – Membership and Benefit Provisions*.

### ***Changes affecting the June 30, 2008 actuarial valuation:***

The June 30, 2008 valuation for the Employees' Retirement System and the Judicial Retirement Benefit Trust reflects the enactment of H5983Aaa, Article 7, Substitute A to the laws governing benefits for state employees and teachers not eligible to retire by September 30, 2009 and judges appointed after July 1, 2009 – see note 1(b) to the financial statements entitled *Plan Descriptions – Membership and Benefit Provisions*.

The changes enacted as a result of Article 7 Substitute A to the laws governing benefits provisions for the Employees' Retirement System and the Judicial Retirement Benefit Trust are reflected and were applied in determining the contributions rates for the fiscal years ended June 30, 2009, June 30, 2010 and June 30, 2011 - see note 1(b) to the financial statements entitled *Plan Descriptions – Membership and Benefit Provisions*.

### ***Changes affecting the June 30, 2007 actuarial valuation:***

The June 30, 2007 actuarial accrued liability was restated for the Judicial Retirement Benefit Trust to reflect the amendment to the law governing benefits for judges appointed after January 1, 2009 – see note 1(b) to the financial statements entitled *Plan Descriptions – Membership and Benefit Provisions*.

The June 30, 2007 actuarial accrued liability was restated for the State Police Retirement Benefit Trust to reflect the amendment to the law governing benefits for state police hired on or after July 1, 2007 – see note 1(b) to the financial statements entitled *Plan Descriptions – Membership and Benefit Provisions*.

*EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF RHODE ISLAND*  
*Notes to Required Supplementary Information*  
*Fiscal Year Ended June 30, 2010*

## **2. Schedules of Funding Progress (continued)**

### *Changes affecting the June 30, 2006 actuarial valuation:*

Material changes were made to increase the salary, payroll growth and termination assumptions. In addition, there were changes in the Post-retirement mortality rates for non-disabled retirees. Currently rates are based on the 1994 Group Annuity Mortality Tables for males and females, with adjustments to the tables for male teachers and male state employees. The tables are then compared to the A/E ratio (actual deaths to expected deaths). It was determined the tables for state employees required no changes. However, the A/E ratios for teachers were lower than the acceptable actuarial ranges. Therefore, new mortality tables have been constructed and adopted for teachers based on teacher mortality rates in another state with similar life expectancies. The pre-termination mortality currently uses the post-retirement mortality assumption. The rates for pre-termination mortality are computed at a rate equal to 65% of the post-retirement rates.

The base salary rate for ERS and MERS General Employees remained unchanged. Judges base salary rates decreased from 5.25% to 4.50% and State Police decreased from 5.00% to 4.50%. The salary rate increase for state employees changed from 4.50% - 8.25% to 4.50% - 9.00%. Teachers changed from a range of 4.50% - 17.00% to 4.50% - 13.25%. MERS General Employees changed from a range of 4.50% - 9.00% to 4.50% - 8.50%. MERS Police & Fire Employees changed from a range of 5.00% - 15.50% to 4.75% - 14.75%.

The payroll growth rate was increased from 3.75% to 4.25% for ERS and MERS; it also increased from 3.75% to 4.5% for State Police and decreased from 5.25% to 4.5% for Judges. The marriage assumption for members being married was changed from 100% to 85%.

## **3. Schedules of Employer Contributions**

Employer contributions for the ERS plan included in the Schedules of Contributions from the Employers and Other Contributing Entity do not include Teacher Survivor Benefits as described in Note 1(b) and any employer contributions related to supplemental pension benefits that are attributable and paid by a specific employer. These amounts are not included in the annual required contribution.

The Plans began using the entry age normal cost method as the basis for determining employer costs in fiscal year 2002. The unfunded liabilities of the plans are amortized over a 30 year period from June 30, 1999. The closed period ends 30 years from June 30, 1999.