



**STATE-BOSTON RETIREMENT SYSTEM**  
(A Component Unit of the City of Boston, Massachusetts)  
Financial Statements and Required Supplementary Information  
December 31, 2011  
(With Independent Auditors' Report Thereon)

**STATE-BOSTON RETIREMENT SYSTEM**  
(A Component Unit of the City of Boston, Massachusetts)  
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December 31, 2011

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## Independent Auditors' Report

The Retirement Board of Boston:

We have audited the accompanying statement of plan net assets of the State-Boston Retirement System (the System), a component unit of the City of Boston, as of December 31, 2011, and the related statement of changes in plan net assets for the year then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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. 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the System at December 31, 2011, and the changes in financial position for the year then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 28, 2012 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, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on 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.

U.S. generally accepted accounting principles require that the Management's Discussion and Analysis on pages 2 through 5 and the supplementary schedules of funding progress and employers' and other contributing entity's contributions on page 19 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

**KPMG LLP**

August 28, 2012

**STATE-BOSTON RETIREMENT SYSTEM**  
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Required Supplementary Information  
Management's Discussion and Analysis  
(Unaudited)

December 31, 2011

The following discussion provides an overview and analysis of the plan net assets and changes in plan net assets of the State-Boston Retirement System (the System or Plan) by management for the year ended December 31, 2011.

**Overview of the Financial Statements**

The System's financial statements comprise a statement of plan net assets, statement of changes in plan net assets, and notes to the financial statements.

The Statement of Plan Net Assets presents information on the System's assets and liabilities and the resulting net assets held in trust for pension benefits. This statement reflects the System's investments at fair value, as well as cash, receivables, and other assets and liabilities.

The Statement of Changes in Plan Net Assets presents information showing how the System's net assets held in trust for pension benefits changed during the year ended December 31, 2011. It reflects contributions by members and participating employers along with deductions for retirement benefits, refunds and withdrawals, and administrative expenses. Investment income from investing and securities lending activities is also presented.

The Notes to the Financial Statements provide additional information that is essential for the reader to gain a full understanding of the data provided in the financial statements.

The Required Supplementary Information includes management's discussion and analysis and schedules of funding progress and employers' and other contributing entity's contributions.

**Financial Highlights and Analysis**

- Net assets are available for payment of monthly retirement benefits and other qualified distributions to the System's participants. Net assets held in trust for pension benefits were \$4.5 billion at December 31, 2011 compared to \$4.6 billion at December 31, 2010. The decrease in net assets of \$.1 billion resulted primarily from a decrease in the fair value of portfolio investments and investment income.
- The System's equity and fixed income investments comprised 54.9% of invested assets; the remaining 45.1% of investments were invested in real estate investments (7.4%), alternative investments, including private equity and hedge fund of funds investments (8.7%), PRIT General Fund (27.0%) and short-term investments (2.0%).
- Receivables decreased by \$137.9 million at December 31, 2011, primarily due to a decrease in contributions receivable from employers by \$125.7 million.
- Liabilities decreased by \$1 million at December 31, 2011, primarily due to a decrease in payable for securities purchased of \$2 million and a decrease in other liabilities of \$14.1 million offset by an increase in collateral held on securities lending transactions of \$15.1 million.
- Employers' contributions are made in accordance with a funding schedule approved by the Massachusetts Public Employee Retirement Administration Commission. The System's funding objective is to meet

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long-term benefit obligations through contributions and investment income. As of January 1, 2011, the funded ratio was 62.2%.

Employer contributions decreased by \$218.4 million (47.1%) compared to contributions received in 2010 primarily due to an extra \$208.8 million in contributions received from the City of Boston in 2010. The City of Boston contributed an extra \$82 million that was included in their 2011 Actuarially Required Contribution (ARC) and contributed an extra \$126.8 million that was not included in their ARC.

**Condensed Financial Information**

(In thousands)

<b>Assets</b>	<b>2011</b>	<b>2010</b>	<b>Percentage change 2011 – 2010</b>
Cash	\$ 145,025	114,716	26.4%
Receivables	113,690	251,606	(54.8)
Investments	4,339,374	4,397,582	(1.3)
Securities lending short-term collateral investment pool	230,145	214,410	7.3
Total assets	<u>4,828,234</u>	<u>4,978,314</u>	(3.0)
<b>Liabilities</b>			
Payables	125,174	141,261	(11.4)
Collateral held – securities lending	231,460	216,333	7.0
Total liabilities	<u>356,634</u>	<u>357,594</u>	(0.3)
Net assets	<u>\$ 4,471,600</u>	<u>4,620,720</u>	(3.2)

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<b>Additions</b>	<b>2011</b>	<b>2010</b>	<b>Percentage change 2011 – 2010</b>
Total contributions	\$ 368,761	590,106	(37.5)%
Net investment (loss) income	(2,229)	520,508	100.4
Intergovernmental	14,567	12,850	13.4
Total additions	<u>381,099</u>	<u>1,123,464</u>	66.1
<b>Deductions</b>			
Benefit payments	469,900	444,535	5.7
Other	60,319	57,995	4.0
Total deductions	<u>530,219</u>	<u>502,530</u>	5.5
Net (decrease) increase in plan assets	\$ (149,120)	620,934	(124.0)
Net Assets - beginning of year	<u>4,620,720</u>	<u>3,999,786</u>	620.9
Net Assets - end of year	<u>4,471,600</u>	<u>4,620,720</u>	149.1

**Plan Investments**

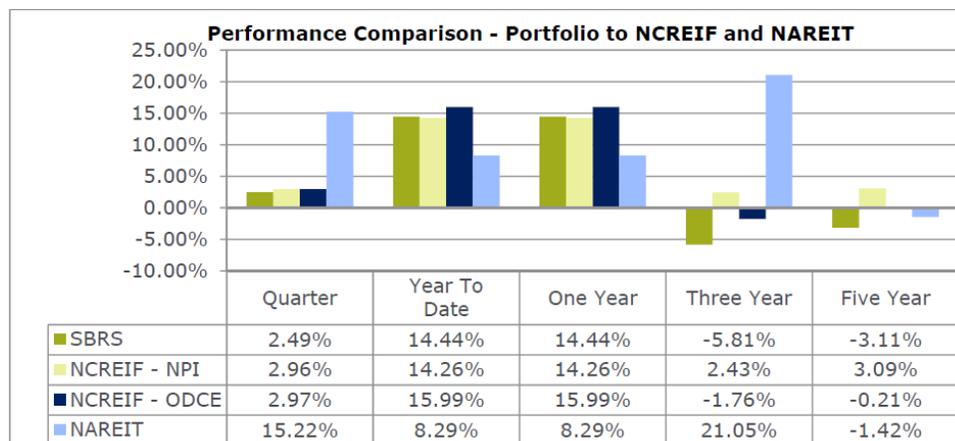
- The total investment return for 2011 was approximately 0.9%. Allocation decisions detracted 100 basis points from performance, while active management added 110 basis points. In 2011, the majority of the System's active managers outperformed their respective indices.
- In 2011, the large cap equity composite returned 0.8% and underperformed the S&P 500 Index, which returned 2.1%. The small cap equity composite returned – 0.2%, outperforming the Russell 2000 Index, which returned – 4.2%.
- The international equity portfolio, which includes investments in both international developed and emerging markets equity, posted a return of – 13.5%. International developed markets outpaced emerging markets in 2011, with the MSCI EAFE outperforming the MSCI EM by 6.3%.
- Domestic fixed income investments posted positive returns in 2011, and gained 9.0%, outperforming the Barclays Aggregate Bond Index, which gained 7.8%. On an absolute basis, the System's high yield manager composite gained 6.3%, outperforming its benchmark, the BC High Yield, by 90 basis points in 2011.
- The System's global bond manager, Loomis, returned 4.9% in 2011, underperforming the Citigroup World Government Bond Index by 150 basis points. The System also added an Emerging Market Debt and Currency investment during 2011; however, it was not held by the System for the full year.

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- Real estate investments yielded a return of 14.4% in 2011. The System's real estate is a combination of core, value-add and opportunistic investment strategies. In 2011, the System committed \$12 million to value-add strategies and \$22 million to opportunistic. A comparison of the real estate portfolio's performance for 2011 against several real estate benchmarks is shown below.



- Private equity performance for 2011 was 5.8%. The System remains committed to the private equity portfolio and plans continued investment. During 2011, the System made additional commitments of \$17.5 million to growth equity, \$7.5 million to buyouts, \$7.5 million to energy and an additional \$5 million to secondary offerings.
- The System's hedge fund composite returned – 3.5% in 2011. The diverse hedge fund portfolio posted returns that ranged from – 2.4% to – 6.6%. For the same period, the HFRI Fund of Funds Index returned – 5.7%.
- During 2011, the PRIT Core Fund returned 0.1%, outperforming the 50% MSCI ACWI/50% Citi WGBI blended benchmark by 20 basis points. At year end, the estimated fair value of the PRIT investment was \$1.17 billion.

**Other Information**

This financial report is designed to provide a general overview of the System's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Boston Retirement Board, Boston City Hall, Room 816, Boston, Massachusetts 02201.

**STATE-BOSTON RETIREMENT SYSTEM**  
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Statement of Plan Net Assets

December 31, 2011

(In thousands)

Assets:	
Cash and cash equivalents	\$ 145,025
Investments, at fair value (note 3):	
Short-term:	
Domestic	80,840
International	5,633
Equity:	
Domestic	962,403
International	606,523
Fixed income:	
Domestic	568,579
International	245,035
PRIT Pooled Fund	1,171,056
Real estate	321,249
Alternative	378,056
	4,339,374
Total investments, at fair value	4,339,374
Securities lending short-term collateral investment pool (note 3)	230,145
Receivables:	
Receivable for securities sold	83,407
Accrued interest, dividends and other receivables	15,323
Contributions receivable from employers:	
City of Boston	1,961
Other employers	12,999
	113,690
Total receivables	113,690
Total plan assets	4,828,234
Liabilities:	
Payable for securities purchased	112,519
Accounts payable, accrued expenses and other liabilities	12,655
Collateral held on securities lending transactions (note 3)	231,460
	356,634
Total plan liabilities	356,634
Net plan assets held in trust for pension benefits (see note 6 and schedule of funding progress on page 19)	\$ 4,471,600

See accompanying notes to financial statements.

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Statement of Changes in Plan Net Assets

Year ended December 31, 2011

(In thousands)

Additions:

Contributions:

Employers	\$ 154,880
Commonwealth of Massachusetts	90,400
Employees	123,481
Total contributions	368,761

Investment income:

Interest and dividends	128,927
Net depreciation in fair value of investments	(114,461)
Less: management and related fees	(17,877)
Net investment loss	(3,411)

Securities lending activity:

Securities lending income	1,665
Less borrower rebates and fees (note 3)	(483)
Net income from securities lending activities	1,182

Total net investment loss (2,229)

Intergovernmental

14,567

Total additions 381,099

Deductions:

Benefit payments to plan members and beneficiaries	469,900
Reimbursements to other systems	10,459
Refunds of contributions and transfers to other systems	43,760
Administrative and other expenses	6,100
Total deductions	530,219

Net decrease in plan net assets (149,120)

Net assets held in trust for pension benefits:

Beginning of year	4,620,720
End of year	\$ 4,471,600

See accompanying notes to financial statements.

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**(1) Plan Description**

The following description of the State-Boston Retirement System (the System or the Plan) is provided for general information purposes only. Participants should refer to the Plan agreement for more detailed information.

**(a) General**

The Plan is a cost-sharing, multiple-employer defined benefit pension plan established under Chapter 32 of the Massachusetts General Laws (M.G.L.). The Plan provides pension benefits for participating employees of the following Plan member governmental units:

- City of Boston (the City)
- Commonwealth of Massachusetts (Other contributing entity – City of Boston Teachers)
- Boston Redevelopment Authority
- Boston Housing Authority
- Boston Water and Sewer Commission
- Public Health Commission
- Sheriff of Suffolk County (Retirees as of 12/31/09, funded by the City)

At December 31, 2011, System membership consisted of:

Active plan members	19,418
Retirees and beneficiaries receiving benefits	14,104
Terminated members entitled to but not yet receiving benefits	16,470
Total membership	49,992
Number of participating employers	6

The Commonwealth of Massachusetts (the Commonwealth) is responsible for funding the employer portion of all teacher pensions in the Commonwealth. All teachers in the Commonwealth are members of the Massachusetts Teachers Retirement System with the exception of teachers employed by the City of Boston (Boston Teachers), who are members of the System. Although Boston Teachers are members of the System, the Commonwealth is the responsible contributing entity.

**(b) Significant Provisions and Requirements**

Participation in the System is mandatory for all permanent, full-time employees immediately upon the commencement of employment. Participants who resign from employment and who are not eligible to receive a retirement allowance or who are under the age of 55 are entitled to request a

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refund of their accumulated total deductions. In addition, depending on the number of years of creditable service, such participants are entitled to receive either none, 50%, or 100% of the regular interest which has accrued on those deductions.

Employees with 10 or more years of service are entitled to pension benefits beginning at retirement age 55; an earlier retirement is allowed upon completion of 20 years of service. The System provides for retirement allowance benefits up to a maximum of 80% of a participant's highest consecutive three-year average annual rate of regular compensation. Benefit payments are based upon a participant's age, length of creditable service, level of compensation, and group classification. Participants become vested after 10 years of creditable service. Effective July 1, 1998, Chapter 32 of the M.G.L. assigns to the local retirement boards authority to establish and amend benefit provisions of the Plan and grant cost-of-living increases.

If a member in service dies, the surviving spouse and/or surviving dependent children may receive benefits, either in a lump sum or in the form of an annuity based on the length of service, contributions, age, and the cause of death. In the event there are no spouse and/or dependent children named, other beneficiaries may be entitled to a lump-sum distribution. Participants who become permanently and totally disabled from further duty may be eligible to receive a disability retirement allowance. The amount of benefits to be received in such cases is dependent upon several factors, including whether or not the disability is work related, the participant's age, years of creditable service, level of compensation, veteran status, and group classification.

**(2) Summary of Significant Accounting Policies**

**(a) *Financial Reporting Entity***

Because of the significance of its operational and financial relationship with the City, the System is included as a pension trust fund in the City's basic financial statements.

**(b) *Basis of Accounting***

The accompanying financial statements are presented on the accrual basis of accounting.

**(c) *Revenue Recognition***

Contributions are recognized as additions in the period when they become due pursuant to formal commitments or statutory or contractual requirements. Investment income is recognized when earned.

**(d) *Benefits and Refunds***

Benefits and refunds to Plan members and beneficiaries are recognized as expenses when due and payable in accordance with the terms of the Plan.

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*(e) Valuation of Investments*

Investments are reported at fair value. Fair values of securities held directly are based on quotations from national securities exchanges, except for pooled funds, alternative investments, and real estate, for which fair values are estimated as detailed below.

**Pooled Funds**

The fair value of shares in managed investment pools is based on unit values reported by the funds.

**Alternative Investments**

Alternative investments include hedge funds, holdings through commingled limited partnerships of venture capital funds, including equity interests in early, middle, and later stage companies, as well as debt and equity interests in buyouts, acquisitions, restructurings, mezzanine structures and special situations. Such investments are recorded at fair value after consideration of pertinent information, including current financial position, and operating results, price-earnings multiples, and available market prices of similar companies' securities, the nature of securities, marketability, restrictions on disposition, and other appropriate information. Values assigned to such investments are based on available information and do not necessarily represent amounts that may ultimately be realized in liquidation. Liquidation values depend largely on future circumstances, including marketability, and frequently cannot reasonably be estimated until at or near the liquidation date.

**Real Estate**

Real estate investments consist of interests in commercial properties held by various partnerships and other limited liability entities, some of which utilize debt financing. Fair values of such holdings are reported based on the net asset values of the entities, which are estimated using third-party appraisals and other information provided by property managers.

*(f) Basis of Investment Transactions*

Purchases and sales of investments are recorded on the trade date. Transactions unsettled as of year-end are recorded as payables for securities purchased and as receivables for securities sold.

*(g) Use of Estimates*

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of additions and deductions during the reporting periods. Actual results could differ from estimates. Fair values of real estate and alternative investment holdings are generally estimated absent readily available market values, and such estimates may be materially different from values that would have been used if a ready market existed.

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**(h) Foreign Currency Contracts**

The System's investment policy permits the System to enter into forward foreign currency contracts for the purpose of hedging foreign currency fluctuations. A forward foreign currency contract is an agreement between two parties to buy or sell a fixed quantity of currency at a set price on a future date. The System may enter into forward foreign currency contracts to hedge its exposure to the effect of changes in foreign currency exchange rates upon its non-U.S. dollar-denominated investments. The contracts are valued daily, and the changes in fair value are recorded by the System as unrealized gains or losses. When the contract is closed, the System records a realized gain or loss equal to the difference between the cost of the contract at the time it was opened and the value at the time it was closed.

**(3) Cash Deposits, Investments, Securities Lending, and Derivatives**

The following disclosures represent essential risk information about the System's deposits and investments.

**(a) Custodial Credit Risk-Deposits**

Custodial credit risk is the risk that in the event of bank failure, the System's deposits may not be returned. The System carries deposits that are fully insured by FDIC insurance or collateralized with securities held by the System or the System's agent in the System's name. As of December 31, 2011, all of the System's deposits were insured or collateralized.

**(b) Investment Policy**

The provisions of M.G.L. C. 32, Sec 23(2) govern the System's investment practice.

Diversification is attained through varied investment management styles that comply with Massachusetts state law. This is accomplished through the retention of investment managers that adhere to M.G.L. C. 32, Sec 3(3), the Prudent Person rule.

The System has retained an investment consultant to work with the Board in a fiduciary capacity to assure that strategic investment diversification is attained, to employ investment managers with expertise in their respective asset classes, and to closely monitor the implementation and performance of the respective investment strategies.

The System is currently invested in stocks (domestic and foreign), fixed income securities (domestic and foreign), real estate, private equity, PRIT and hedge funds.

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(c) **Interest Rate Risk**

The following is a listing of the System's fixed income investments (in thousands) and related maturity schedule (in years) as of December 31, 2011:

<u>Investment type</u>	<u>Fair value</u>	<u>Less than 1</u>	<u>1 – 5</u>	<u>6 – 10</u>	<u>More than 10</u>
U.S. Treasury notes and bonds \$	51,039	—	25,263	7,989	17,787
U.S. agencies	15,792	—	951	3,106	11,735
Domestic corporate	388,254	19,603	203,199	138,705	26,747
Municipal	2,689	—	116	203	2,370
International corporate	122,709	—	83,068	17,572	22,069
International government	122,326	—	58,421	40,728	23,177
Short-term investment funds	86,473	86,473	—	—	—
Asset-backed:					
CMOs	44,737	408	—	7,080	37,249
Mortgage-backed	51,798	—	—	—	51,798
Other	14,270	—	5,111	2,083	7,076
	<u>\$ 900,087</u>	<u>106,484</u>	<u>376,129</u>	<u>217,466</u>	<u>200,008</u>

The System's guidelines do not specifically address limits on maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. The manager of each fixed income portfolio is responsible for determining the maturity and commensurate returns of their portfolio.

The collateralized mortgage obligations (CMOs) held by the System as of December 31, 2011 are highly sensitive to changes in interest rates.

(d) **Credit Risk**

The System allows investment managers to apply discretion under the Prudent Person rule. Investments are made, as a prudent person would be expected to act with discretion and intelligence, to seek reasonable income, preserve capital and, in general, avoid speculative investments.

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The System's fixed income investments as of December 31, 2011 were rated by Standard and Poor's and/or an equivalent national rating organization and the ratings are presented below (in thousands) using the Standard and Poor's rating scale:

<u>Investment type</u>	<u>Fair value</u>	<u>AAA</u>	<u>AA</u>	<u>A</u>	<u>BBB</u>	<u>BB</u>	<u>B</u>	<u>CCC</u>	<u>Not rated</u>
U.S. agencies	\$ 15,792	—	13,260	1,702	175	—	—	—	655
Domestic corporate	388,254	441	19,467	92,608	37,025	70,433	70,711	1,313	96,256
Municipal	2,689	—	680	2,009	—	—	—	—	—
International corp.	122,709	17,955	197	8,684	18,545	6,843	6,653	—	63,832
International gov't	122,326	8,592	10,582	11,758	—	1,199	—	—	90,195
Short-term investment funds	86,473	86,473	—	—	—	—	—	—	—
Asset-backed:									
CMOs	44,737	18,844	14,158	2,757	—	—	—	18	8,960
Mortgage-backed	51,798	—	49,822	—	—	—	—	—	1,976
Other	14,270	7,185	3,331	—	—	—	30	—	3,724
	<u>\$ 849,048</u>	<u>139,490</u>	<u>111,497</u>	<u>119,518</u>	<u>55,745</u>	<u>78,475</u>	<u>77,394</u>	<u>1,331</u>	<u>265,598</u>

In addition to the above schedule, the System has approximately \$51 million invested in U.S. government securities, which are explicitly guaranteed by the U.S. government.

(e) **Concentration Risk**

The System has no investments, at fair value, except for pooled funds, that exceed 5% of the System's total investments as of December 31, 2011.

The System adheres to the provisions of M.G.L. C. 32, Sec 23(2) when managing concentration risk.

(f) **Foreign Currency Risk**

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. Similar to the investments in domestic equities, the System employs or encourages its investment advisor to employ diversification, asset allocation, and quality strategies.

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Risk of loss arises from changes in currency exchange rates. The System's exposure to foreign currency risk is presented on the following table (in thousands):

<u>Currency</u>	<u>Cash and short-term investments</u>	<u>Fixed income</u>	<u>Equity</u>	<u>Alternative</u>	<u>Total</u>
Australian dollar	\$ 203	1,483	25,343	—	27,029
Brazilian real	1,364	476	12,156	—	13,996
Canadian dollar	314	5,607	7,540	—	13,461
Danish krone	327	851	5,841	—	7,019
Euro currency	6,839	37,463	139,855	5,800	189,957
Hong Kong dollar	72	—	25,721	—	25,793
Indian rupee	1,763	762	7,262	—	9,787
Indonesian rupiah	24	1,889	2,528	—	4,441
Israeli shekel	273	—	2,733	—	3,006
Japanese yen	475	54,128	85,909	—	140,512
Malaysian ringgit	547	2,596	2,561	—	5,704
Mexican peso	398	4,738	5,029	—	10,165
New Taiwan dollar	850	—	819	—	1,669
New Zealand dollar	71	1,093	—	—	1,164
Norwegian krone	1,089	5,246	6,151	—	12,486
Pakistan rupee	1	—	—	—	1
Philippine peso	—	878	—	—	878
Polish zloty	84	—	—	—	84
Pound sterling	445	11,889	86,963	—	99,297
Singapore dollar	276	9,156	9,293	—	18,725
South African rand	271	—	8,623	—	8,894
South Korean won	261	3,213	6,084	—	9,558
Swedish krona	7	—	13,323	—	13,330
Swiss franc	130	771	35,972	—	36,873
Thailand Baht	—	—	733	—	733
Turkish lira	21	—	1,260	—	1,281
Uruguayan peso	—	1,052	—	—	1,052
	<u>16,105</u>	<u>143,291</u>	<u>491,699</u>	<u>5,800</u>	<u>656,895</u>
Total securities subject to foreign currency risk					
U.S. dollars (securities held by international investment managers)*	<u>5,668</u>	<u>101,744</u>	<u>114,824</u>	<u>—</u>	<u>222,236</u>
Total international investment securities	<u>\$ 21,773</u>	<u>245,035</u>	<u>606,523</u>	<u>5,800</u>	<u>879,131</u>

\* Short-term investments include cash of approximately \$35

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**(g) PRIT Pooled Fund**

The Commonwealth enacted Chapter 112, Section 17 of the Acts of 2010 that requires the System to invest all assets, current and future, related to Boston Teachers in the Pension Reserves Investment Trust (PRIT) fund. The PRIT fund is an external investment pool that is not registered with the Securities Exchange Commission. PRIT is not a rated fund.

The fair value of the PRIT fund is based on unit value as reported by management of the PRIT fund. The PRIT fund issues separately available audited financial statements with a year-end of June 30.

On July 1, 2010, the System transferred 27% of its assets, or \$1.1 billion, to the PRIT Fund. As of December 31, 2011, the System had the following amounts invested in the PRIT fund (in thousands):

General allocation account	\$	1,171,056
Cash fund		4,001
	\$	1,175,057

As of December 31, 2011, the General Allocation Account is diversified into the following asset classes:

Asset class	Percentage
Core fixed income	14.9%
Domestic equity	21.1
Emerging markets	6.5
Hedge funds	7.3
International equity	17.7
Port. Alpha Wind Down	0.3
Private equity	11.6
Real estate	9.4
Timber Natural Res.	4.0
Value-Added Fixed Inc.	7.2
Total	100.0%

**(h) Securities Lending Transactions**

The Public Employee Retirement Administration Commission of Massachusetts (PERAC) has issued supplemental regulations that permit the System to engage in securities lending transactions. These transactions are conducted by the System's custodian, who lends certain securities owned by the System to broker-dealers and banks pursuant to a form of loan agreement. The System and the borrowers maintain the right to terminate all securities lending transactions on demand.

At the System's direction, the custodian lends the System's securities and receives cash (including both U.S. and foreign currency), U.S. government securities, sovereign debt of foreign countries, and irrevocable bank letters of credit as collateral. The custodian does not have the ability to pledge or

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sell collateral unless the borrower defaults. Borrowers are required to deliver collateral in amounts equal to not less than 100% of the market value of the loaned securities.

The System does not impose any restrictions on the amount of securities lent on its behalf by the custodian. There were no failures by any borrowers to return loaned securities or pay distributions thereon, and there were no losses from a default of the borrowers or the custodian for the year ended December 31, 2011. The cash collateral received by the custodian on each loan was invested, together with the cash collateral of other qualified tax-exempt plan lenders, in a collective investment pool. The relationship between the average maturities of the investment pool and loans was affected by the maturities of the loans made by other plans that invested cash collateral in the collective investment pool, which the System could not determine. At December 31, 2011, the System had no credit risk exposure to borrowers because the amounts the System owed the borrowers exceeded the amounts owed to the System.

At December 31, 2011, the fair value of securities loaned by the System amounted to \$243,504,820, against which was held collateral of \$251,242,830 as follows (in thousands):

Short-term collateral investment pool	\$	230,145
Noncash collateral		19,643
	\$	249,788

**(i) Commitments**

At December 31, 2011, the System had contractual commitments to provide \$84 million of additional funding to private equity funds, and \$76 million to real estate funds.

**(j) Derivatives**

The System trades financial instruments with off-balance-sheet risk in the normal course of its investing activities to assist in managing exposure to market risks. The System uses forward foreign currency contracts to hedge against the risk of future foreign currency fluctuations.

**(4) Funding Policy**

Participating employers are required to pay into the System their share of the remaining actuarially determined contribution and plan administration costs, which are apportioned among the participating employers based on an actuarial computation.

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The participating employers' budgeted contributions to the System for the employer fiscal years ended June 30 were as follows (in thousands):

	<u>2012</u>	<u>2011</u>	<u>2010</u>
City of Boston	\$ 119,660	186,561	107,359
Commonwealth of Massachusetts (Boston Teachers)	90,399	121,290	115,986
Sheriff of Suffolk County	3,924	4,343	10,933
Boston Housing Authority	9,183	7,746	6,430
Public Health Commission	13,294	9,752	9,733
Boston Redevelopment Authority	1,975	1,678	1,739
Boston Water and Sewer Commission	6,845	5,414	5,167
	<u>\$ 245,280</u>	<u>336,784</u>	<u>257,347</u>

As a condition of participation, employees are required to contribute 5% of their salary if hired prior to January 1, 1975, 7% if hired after that date and before January 1, 1984, 8% if hired after that date and before July 1, 1996, and 9% if hired after July 1, 1996. Employees hired after January 1, 1979 contribute an additional 2% of earnings in excess of \$30,000 per year. Additionally, teachers who became members of the System after June 30, 2001, or other teachers who elect this option, are required by law to contribute 11% of their salary. Overtime and extra pay are not subject to these assessments.

**(5) Legally Required Reserve Accounts**

The balances in the System's legally required reserves at December 31, 2011 were as follows (in thousands):

		<u>Purpose</u>
Annuity Savings Fund	\$ 1,420,685	Active members' contribution balance
Annuity Reserve Fund	454,109	Retired members' contribution account
Military Service Fund	50	Members' contribution account while on military leave
Pension Reserve Fund	2,445,574	Amounts appropriated to fund future retirement benefits
Pension Fund	<u>151,182</u>	Remaining net assets
	<u>\$ 4,471,600</u>	

All reserve accounts are funded at levels required by state statute.

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**(6) Funded Status and Funding Progress**

The funded status of the System as of January 1, 2011 is as follows (in thousands):

Actuarially accrued liability (AAL)	\$	7,382,907
Actuarial value of plan assets		4,592,675
		2,790,232
Unfunded actuarial accrued liability (UAAL)	\$	2,790,232
Funded ratio (actuarial value of plan assets/AAL)		62.2%
Covered payroll (active plan members)	\$	1,371,363
UAAL as a percentage of covered payroll		203.5%

In the January 1, 2011 actuarial update, the individual entry age normal actuarial cost method was used. The actuarial assumptions included an 8% investment rate of return, projected salary increases of 5%, and cost-of-living adjustments of 3% up to \$12,000 annually. The actuarial value of assets was determined using the fair value of investments. The System's unfunded actuarial accrued liability is being amortized as a level percentage of pay on an open basis. The remaining amortization period at January 1, 2011 was 15 years.

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

**(7) Contingencies**

There are various pending claims arising in the ordinary course of operations; however, management believes that the probable liability resulting from such claims and litigation would not materially affect the System's financial position.

**(8) Commitments**

During fiscal year 2008, the System signed a memorandum of understanding with the City for the purpose of financing the development, design, purchase, and installation of a Pension Management System. Upon completion of the Pension Management System, the City will transfer the completed asset to the System. The System is committed to repaying the City \$16 million, of which approximately \$4.5 million has been paid through December 31, 2011.

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Required Supplementary Information

Schedules of Funding Progress and Employers' and Other Contributing Entity's Contributions

Year ended December 31, 2011

(Unaudited)

(Dollars in thousands)

**Schedule of funding progress**

<b>Actuarial valuation date</b>	<b>Actuarial value of assets (a)</b>	<b>Actuarial accrued liability (AAL) (b)</b>	<b>Unfunded AAL (UAAL) (b-a)</b>	<b>Funded ratio (a/b)</b>	<b>Covered payroll (c)</b>	<b>UAAL as a percentage of covered payroll (b-a)/(c)</b>
1/1/2011	\$ 4,592,675	7,382,907	2,790,232	62.2%	\$ 1,371,363	203.5%
1/1/2010	4,270,893	7,091,018	2,820,125	60.2	1,306,060	215.9
1/1/2009	4,089,989	6,900,229	2,810,240	59.3	1,364,068	206.0
1/1/2008	4,458,002	6,596,148	2,138,146	67.6	1,299,112	164.6
1/1/2007	4,138,146	6,223,154	2,085,008	66.5	1,221,404	170.7
1/1/2006	3,836,807	5,957,373	2,120,566	64.4	1,168,808	181.4

**Schedule of employers' and other contributing entity's contributions**

<b>Year ended December 31</b>	<b>Annual required contribution</b>	<b>Percentage contributed</b>
2011	\$ 245,280	100%
2010	336,784	138
2009	257,348	100
2008	244,299	100
2007	221,865	100
2006	217,088	100

See accompanying independent auditors' report.