EMPLOYEES' RETIREMENT SYSTEM
OF THE STATE OF HAWAII

Financial Statements

June 30, 2010

(With Independent Auditors' Report Thereon)

Submitted by

THE AUDITOR
STATE OF HAWAII

EMPLOYEES’ RETIREMENT SYSTEM
OF THE STATE OF HAWAII

Table of Contents

KPMG LLP
PO Box 4150
Honolulu, HI 96812-4150

Independent Auditors' Report

The Auditor
the State of Hawaii:

We have audited the accompanying combining statement of plan net assets – all trust and agency funds of the Employees' Retirement System of the State of Hawaii (the ERS) as of June 30, 2010 and the related statement of changes in plan net assets – all trust funds for the year then ended. These financial statements are the responsibility of the ERS' 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 ERS' 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 plan net assets of the Employees' Retirement System of the State of Hawaii as of June 30, 2010, and its changes in plan net assets 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 April 8, 2013, on our consideration of the ERS' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on 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.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 10 and Required Supplementary Information on pages 39 through 40 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.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements of the ERS taken as a whole. The supplementary information included in schedules 1 through 4 for the year ended June 30, 2010 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The supplementary information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

KPMG LLP

April 8, 2013

EMPLOYEES' RETIREMENT SYSTEM
OF THE STATE OF HAWAII

Management's Discussion and Analysis

June 30, 2010

Management's Discussion and Analysis (MD&A) of the Employees' Retirement System of the State of Hawaii (the ERS) provides highlights and comparisons of the financial position and performance of the ERS as of and for the year ended June 30, 2010. The MD&A is presented as a narrative overview and analysis in conjunction with the Letter of Transmittal, which is included in the Introductory Section of the ERS Comprehensive Annual Financial Report (CAFR). For more detailed information pertaining to the ERS' financial activities, the reader should also review the actual financial statements, including the notes and supplementary schedules.

Overview of the Financial Statements

The ERS is responsible for administering a defined benefit pension plan for state government, local government, and public education employees in the State of Hawaii (the State). The ERS also oversees the short-term investments of the federal Social Security employer contributions for the State in the Social Security Contribution Fund (Contribution Fund).

The ERS' financial statements include fiduciary type funds that are used to account for resources held for the benefit of parties outside of the ERS. The primary fund is defined as a Pension Trust fund as these assets are held for the benefit of its members and their beneficiaries for the payment of pension benefits, while the Contribution Fund is an agency type fund that is custodial in nature. Throughout this discussion and analysis, units of measure (i.e., billions, millions, and thousands) are approximate, being rounded up or down to the nearest tenth of the respective unit value.

This discussion and analysis is intended to serve as an introduction to the ERS' financial reporting, which comprises the following components:

- The combining statements of plan net assets provide a snapshot of the financial position of the ERS at June 30, 2010. These financial statements reflect the resources available to pay benefits to members, including retirees and beneficiaries, at the end of the fiscal years reported.
- The statements of changes in plan net assets summarize the ERS' financial activities that occurred during the fiscal year from July 1, 2009 to June 30, 2010 (FY 2010). The financial statements measure the changes in the resources available to pay pension benefits to members, retirees, and beneficiaries for fiscal year 2010.
- The notes to financial statements provide additional information that is essential to a full understanding of the financial statements. The notes are an integral part of the financial statements and include detailed information that is essential to a full understanding of the data provided in the basic financial statements.
- The required supplementary information immediately following the notes to financial statements provides two schedules showing historical actuarial information concerning the funded status of the ERS and the employer contributions, along with related notes.

The remaining supplementary information provides additional detailed information concerning the changes in operating funds established by legislation, and the operating and investment related expenses of the ERS.

Financial Highlights

- As of June 30, 2010, plan net assets were $9.8 billion, or an increase of about $1.0 billion during the fiscal year then ended. This represents an increase of approximately 11.4% from the $8.8 billion in plan net assets available as of June 30, 2009. The increase of plan assets in FY 2010 reflects the improved market conditions following two years of negative investment returns due to instability in the global markets and loss of investor confidence worldwide that started in 2008.
- During FY 2010, the ERS earned a positive return of 12.0% on pension plan assets after a 17.5% loss on investments during FY 2009. All asset classes earned positive returns for FY 2010 as the overall market conditions improved, with the equity markets outperforming other asset classes. During FY 2009, most asset classes experienced negative returns due to worldwide economic troubles; although, the fixed income continued to have positive returns.
- No significant legislation was enacted during the 2010 legislative session that impacted the benefit provisions of the Pension Trust. The employer contribution requirements increased effective July 1, 2008, in order to improve the funding status of the Pension Trust. A historical summary of legislation impacting the ERS actuarial valuations is located in the "Summary of Plan Changes" in the Actuarial Section.
- The funded ratio decreased to 61.4% as of June 30, 2010 from 64.6% as of June 30, 2009 with the continued recognition of investment losses experienced during the two previous years. The corresponding unfunded actuarial accrued liability (UAAL) of the ERS increased to $7.1 billion as of June 30, 2010 from $6.2 billion on June 30, 2009. Like most pension funds across the country, the ERS was significantly impacted by the severe downturn in the investment markets during FY 2009.
- Total member and employer contributions increased by $151.3 million, or 20.0%, during FY 2010. The contributions increase during FY 2010 is primarily attributed to one-time Hybrid Plan Upgrade Payments received from Hybrid Plan members that elected to "upgrade" their retirement benefits to hybrid service from noncontributory service. Normal employer and member contributions declined in FY 2010 due to a decrease in covered payroll resulting from fewer members and pay reductions for certain employee groups.
- Total pension plan benefit payouts increased by $71.6 million, or 8.6%, to $905.3 million in FY 2010 compared to $833.7 million during FY 2009. Pension benefits continues to increase due to 3.9% more retirees and beneficiaries (38,441 in 2010 and 36,999 in 2009), an increase in the average pension benefit for new retirees, and the annual 2.5% postretirement increase.
- Administrative expenses decreased by $0.6 million in FY 2010 to $12.4 million compared to $13.0 million in FY 2009. Administrative expenses for all years were within the ERS' budgeted amounts. In FY 2010, the ERS experienced a decrease in payroll-related and computer system maintenance costs, that was offset by increased costs to obtain resources for a one-time project. The payroll-related costs in FY 2010 resulted from ERS employees being placed on furlough and certain staff vacancies not being filled. Computer system maintenance decreased in FY 2010 after experiencing a spike in FY 2009 for out-of-warranty maintenance costs of implementing a new computer system. These savings were offset by costs related to the one-time Hybrid Plan Upgrade Payments communications program. In addition, a consultant was hired to assist the 24,000+ ERS members make an informed decision about whether they should make the permissive service credit purchase as discussed in Pension Plan Changes below.

Analysis of Plan Net Assets for Pension Trust

Summary of Plan Net Assets

June 30, 2010

(Dollars in millions)

		2010	2009	FY 2010 percentage change
Assets:				
Cash and short-term investments	$	525.4	413.5	27.1 %
Receivables		521.9	443.3	17.7
Investments		9,521.0	8,922.1	6.7
Invested securities lending collateral		722.4	758.8	(4.8)
Capital assets		10.0	11.6	(13.8)
Total assets		11,300.7	10,549.3	7.1
Liabilities:				
Securities lending liability		722.4	758.8	(4.8)
Investment accounts and other payables		754.1	975.2	(22.7)
Total liabilities		1,476.5	1,734.0	(14.9)
Plan net assets	$	9,824.2	8,815.3	11.4

Summary of Changes in Plan Net Assets

June 30, 2010

(Dollars in millions)

		2010	2009	FY 2010 percentage change
Additions:				
Contributions	$	907.7	756.4	20.0%
Net investments income (loss)		1,026.5	(1,937.3)	153.0
Total additions		1,934.2	(1,180.9)	263.8
Deductions:				
Retirement benefit payments		905.3	833.7	8.6
Refund of contributions		7.6	3.9	94.9
Administrative expenses		12.4	13.0	(4.6)
Total deductions		925.3	850.6	8.8
Increase (decrease) in plan net assets	$	1,008.9	(2,031.5)	149.7

Investments, Investment Income, and Investment Expense

The ERS is a long-term investor and manages its pension assets with long-term objectives in mind. A primary element of the ERS' investment philosophy is diversification among various asset classes. The ERS makes estimates of long-term market returns and establishes an asset allocation strategy taking into account the risks associated with each asset class.

During FY 2010, the ERS investment portfolio earned a 12.0% return on assets with positive returns in all asset classes from general improvements in global markets and continued recovery of the domestic economy. This compares with a 17.5% loss on investment assets in FY 2009 as a result of double-digit negative returns in the real estate and equity markets.

The domestic equity, domestic fixed income, and international equity exceed the 8% portfolio benchmark for FY 2010 with returns of 15.3%, 13.6%, and 11.3%, respectively. These were followed by alternative investments, international fixed income, and real estate with earnings of 7.5%, 4.0%, and 1.0%, respectively. Total net investment gains during FY 2010 were $1,026.5 million after net investment losses of $1,937.3 million in FY 2009.

The asset distribution of the ERS' investment securities for the Pension Trust, excluding pending trade settlements and securities lending collateral, at June 30, 2010 and 2009, is presented below at fair value. Investment balances between the asset classes will change over time based on market sectors' performance and our rebalancing efforts to maintain asset allocation targets. Changes will also occur for financial reporting since certain real estate and alternative investments are reported on the consolidated method of accounting using the value of the underlying investments since ERS is the majority owner of the business organization. Please refer to the Investment Section of the CAFR for a discussion on asset allocation plan targets and investments by investment strategy.

Investments in short-term securities and cash are held by external investment managers for liquidity to settle pending trades and investments, and should not exceed 10 percent of the investments. Fluctuations will occur based on the trading activity and timing of the settlements. The allocation to equity securities, including alternative investments, increased during FY 2010, due to positive investment returns, portfolio rebalancing, and changes in investment managers. The decrease for fixed income securities in FY 2010 resulted from cash requirements to pay pension benefits that were offset by the positive investment earnings for the class. The slight increase in real estate assets for FY 2010 reflects the modest investment return and increased allocation to the asset class.

Asset Class

June 30, 2010

(Dollars in millions)

	2010	Percentage	2009	Percentage
Short-term investments and cash	$ 525.4	5.2%	$ 413.5	4.4%
Equity securities	5,350.6	53.3	4,541.7	48.6
Fixed income	2,699.6	26.9	3,000.9	32.1
Real estate	974.3	9.7	950.0	10.2
Alternative investments	496.4	4.9	429.5	4.6
Total assets	10,046.3	100.0%	9,335.6	100.0%
Less loans on real estate and alternative investments	263.8		257.9	
Total	$ 9,782.5		$ 9,077.7	

Investment expenses consist primarily of investment management fees paid to external investment advisor firms that oversee the ERS' investment portfolio. The increase in investment expenses for management fees in FY 2010 relative to FY 2009 reflects an increase in overall asset values during FY 2010. The FY 2009 investment management fees includes the elimination of accrued incentive fees for certain real estate managers since certain assets values fell below the threshold return, which incentive fees are earned from. Incentive fees are only paid to real estate managers upon the final disposition of the asset, although the net increase/decrease in the estimated fee is accrued for financial statement presentation annually. Net changes in the incentive fees are included in the liability for accounts and other payables on the combined statements of plan net assets.

The ERS requires external managers to provide the ERS with a "most favored nations" contract clause that guarantees the ERS with the lowest management fees the managers offer their clients for investment accounts with similar investment mandates and similar account size. Certain investment managers may receive an incentive fee for superior investment returns while maintaining an acceptable level of investment risk.

Contributions

Contributions from employers and employees totaled $907.7 million and $756.4 million during FY 2010 and FY 2009, respectively. During FY 2010, total contributions increased by $151.3 million, or 20.0%, with member contributions increased by $182.3 million, or 102.5%, while employer contributions decreased by $31.0 million, or (5.4)%. Total one-time payments of permissive service credit purchases, including hybrid upgrade payments, amounted to about $189.2 million, while normal member contributions from payroll decreased about $6.9 million, or (3.9)%, to $170.9 million. The decrease in member contributions from payroll (excludes one-time payments) and decrease in employer contributions is due to a decrease in covered payroll from fewer active members during the year and furloughs of certain employee groups. Please refer to the Financial Section in the ERS 2010 and 2009 CAFR for more information.

Pension Plan Benefits and Expenses

Pension benefit payments are the primary expense of the ERS with payments totaling $905.3 million during FY 2010 and $833.7 million during FY 2009. Pension benefits continued to increase with additional number of new retirees, higher pension benefits for recent retirees, and the annual postretirement increase for ERS' retirees.

Refunds to terminating members continued to increase slightly due to an increase in members making contributions under the Hybrid Plan and taking a refund compared previously to most members not making contributions to the ERS as a member of the Noncontributory Plan.

Administrative expenses decreased $0.6 million in FY 2010 due to lower payroll-related costs (salaries and fringe benefits) from furloughs and staff vacancies, and computer maintenance costs. These decreases were offset by an increase in special project consulting fees related to the one-time Hybrid Plan Upgrade Payments communications program.

Pension Plan Changes

Pension plan changes, including legislative and Board of Trustees' actions, are summarized in the Introductory Section and Actuarial Section of the CAFR. The "contributory" Hybrid Plan that became effective July 1, 2006 provides benefit enhancements to the members compared to the Noncontributory Plan, and was implemented on a cost-neutral basis to the employers.

During FY 2010, following resolution of certain tax issues the ERS started the Hybrid Plan Upgrade Program (covered by 2005 legislation) that provided about 24,000+ qualified Hybrid Plan members a one-time opportunity to increase their future monthly ERS retirement pension by upgrading all or a portion of the Noncontributory service to Hybrid service. The member's upgrade cost was based on their age, occupation, service, and base salary as of December 31, 2008. The election period was from September 1, 2009 to April 3, 2010, and ERS was required to receive all payments by September 30, 2010.

There is a three-year moratorium on benefit enhancements from January 2, 2008 to January 2, 2011, if there is a UAAL in the pension trust. This moratorium on benefit enhancements until the ERS is fully funded was made permanent effective April 28, 2011.

Actuarial Valuations and Funded Status

The ERS uses an actuarial reserve type of funding that is financed by member contributions, employer contributions, and earnings from invested assets. Member and employer contributions are based on the member's pension plan (contributory, noncontributory, or hybrid), pay and job classification. The ERS' investment rate of return actuarial assumption is set by state law at 8.0% per annum. Material differences in the actual amounts compared to the actuarial assumptions for a given year may have a significant impact on the ERS' funded status. Changes in significant assumptions between valuation periods, such as the actuarial investment return, may also have a significant impact on the funded status of a pension plan.

An independent actuarial valuation of the ERS' actuarial assets and liabilities is performed annually. As part of this valuation, the progress toward funding pension obligations of the retirement system is measured by comparing the actuarial value of assets to actuarial accrued liability. This measurement is expressed as a percentage referred to as the funded ratio or funded status. The UAAL is that portion of the actuarial accrued liability (including the present value of benefits presently being paid to retired members) that exceeds the value of current actuarial assets expressed as an amount.

The funded ratio decreased to 61.4% as of June 30, 2010 from 64.6% as of June 30, 2009. The ERS' UAAL was $7.1 billion and $6.2 billion as of June 30, 2010 and 2009, respectively. The decline in FY 2010 from FY 2009 is primarily the result of investment losses in the fiscal years ended June 30, 2009 and 2008 since ERS uses a four-year smoothing of investment market gains and losses to reduce volatility of the required contribution rates. Based on the actuarial valuation as of June 30, 2010, ERS' unfunded status increased significantly because of the continued recognition of the investment market losses.

Under the percentage of payroll methodology for employer contribution funding, one of the primary purposes of the valuation report is to determine whether the adequacy of the current employer contribution rates is sufficient to amortize the UAAL within a specific number of years. The employee and employer contribution rates have been set by State law and are intended to provide for the normal cost plus the level percentage of payroll required to amortize the UAAL over a period not in excess of 30 years. Under the standards established by the Governmental Accounting Standards Board Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans* (GASB No. 25) that the ERS implemented in 1997, the amortization period used to determine the annual required contribution rates should not exceed 30 years.

The aggregate funding period of the UAAL, including the value of future employer and employee contributions, for the ERS as of June 30, 2010 and 2009 was 41.3 years and 28.2 years, respectively.

Initiatives to Improve Funding (subsequent to June 30, 2010)

Hawaii Revised Statutes §88-122(e)(1) state that the employer contribution rates are subject to adjustment when the funding period is in excess of 30 years. As a result of the June 30, 2010 valuation, the 2011 State Legislature made significant changes to employer contribution rates per Act 163 (SLH 2011). The employer contribution rate of 19.70% for Police and Fire employees will gradually increase to 25.00% and the 15.00% rate for All Other Employees will gradually increase to 17.00%. This legislation also reduced the actuarial investment return assumption from 8.00% to 7.75% and made changes to the benefits and member contribution rates for new members hired after June 30, 2012. Changes affecting new members are discussed in more details in the notes to the financial statements.

While lowering the ERS' investment return assumption significantly increased the UAAL, there was a partially offsetting liability experience gain from lower than expected salary increase resulting in a net increase of the UAAL to $8.2 billion as of June 30, 2011. Based on the future increased contribution rates the aggregate funding period of the UAAL as of June 30, 2011 decreased to 25.0 years as determined in the June 30, 2011 actuarial valuation (available on the ERS website at http://ers.ehawaii.gov/).

Requests for Information

This financial report is designed to provide a general overview of the Employees' Retirement System of the State of Hawaii's finances. For questions concerning any information in this report or for additional information, contact the Employees' Retirement System of the State of Hawaii, 201 Merchant Street, Suite 1400, Honolulu, Hawaii 96813.

EMPLOYEES' RETIREMENT SYSTEM
OF THE STATE OF HAWAII

Combining Statement of Plan Net Assets – All Trust and Agency Funds

June 30, 2010

	Pension Trust Employees' Retirement System	Agency Social Security Contribution	Total
Assets:			
Cash and short-term investments (notes C(2) and F):			
Cash	$ 32,159,104	—	32,159,104
Short-term investments	493,231,761	—	493,231,761
	525,390,865	—	525,390,865
Receivables:			
Accounts receivable and others	8,962,646	—	8,962,646
Investment sales proceeds	419,310,775	—	419,310,775
Accrued investment income	36,934,377	—	36,934,377
Employer appropriations	52,198,687	—	52,198,687
Member contributions	4,480,870	—	4,480,870
	521,887,355	—	521,887,355
Investments, at fair value (notes C(2) and F):			
Equity securities	5,350,603,332	—	5,350,603,332
Fixed income securities	2,699,629,677	—	2,699,629,677
Real estate investments	974,304,500	—	974,304,500
Alternative investments	496,438,668	—	496,438,668
	9,520,976,177	—	9,520,976,177
Other:			
Invested securities lending collateral (note F)	722,388,201	—	722,388,201
Equipment, at cost, net of depreciation	10,041,575	—	10,041,575
	732,429,776	—	732,429,776
Total assets	11,300,684,173	—	11,300,684,173
Liabilities:			
Disbursements in excess of cash balances (note F)	7,779,388	—	7,779,388
Accounts and other payables	45,701,112	—	45,701,112
Payable for securities purchased	436,860,788	—	436,860,788
Securities lending collateral (note F)	722,388,201	—	722,388,201
Notes payable (note C(2))	263,786,865	—	263,786,865
Total liabilities	1,476,516,354	—	1,476,516,354
Commitments and contingencies (notes F, G, and H)			
Net assets held in trust for pension benefits (note D) (a schedule of funding progress is presented on page 39)	$ 9,824,167,819	—	9,824,167,819

See accompanying notes to financial statements.

EMPLOYEES' RETIREMENT SYSTEM
OF THE STATE OF HAWAII

Statement of Changes in Plan Net Assets – All Trust Funds

Year ended June 30, 2010

Additions:		
Contributions (notes A(4) and E):		
Employers contributions	$	547,669,675
Members contributions		360,047,068
Total contributions		907,716,743
Investment income (note F):		
From investing activities:		
Net appreciation in fair value of investments		777,422,767
Interest on fixed income securities		128,853,068
Income on real estate investments		3,741,235
Dividends on equity securities		81,356,030
Interest on short-term investments		107,976,159
Alternative investment income		18,142,427
Miscellaneous		3,757,107
		1,121,248,793
Less investment expenses		97,373,545
Net investment income from investing activities		1,023,875,248
From securities lending activities:		
Securities lending income		2,539,147
Securities lending expenses:		
Borrower rebates		(502,727)
Management fees		455,912
Total securities lending activities expenses		(46,815)
Net investment income from securities lending activities		2,585,962
Total net investment income		1,026,461,210
Total additions		1,934,177,953
Deductions:		
Benefit payments (note A(3))		905,315,348
Refunds of member contributions		7,573,619
Administrative expenses		12,406,339
Total deductions		925,295,306
Net increase in net assets		1,008,882,647
Net assets held in trust for pension benefits (note D):		
Beginning of year		8,815,285,172
End of year	$	9,824,167,819

See accompanying notes to financial statements.

Note A – Description of the ERS

1. General

The Employees' Retirement System of the State of Hawaii (the ERS) began operations on January 1, 1926, having been established by the Territorial Legislature in the preceding year. The ERS is a cost-sharing, multiple-employer public employee retirement system established to administer a pension benefits program for all State and county employees, including teachers, police officers, firefighters, correction officers, judges, and elected officials. The ERS provides retirement, survivor, and disability benefits with multiple benefit structures known as the contributory, hybrid, and noncontributory plans.

Employer, pensioner, and employee membership data as of March 31, 2010 are as follows:

Employers:	
State	1
County	4
Total employers	5
Pensioners and beneficiaries currently receiving benefits:	
Pensioners currently receiving benefits:	
Police and firefighters	3,043
All others employees	32,720
Total pensioners	35,763
Beneficiaries currently receiving benefits:	
Police and firefighters	198
All others employees	2,480
Total beneficiaries	2,678
Total pensioners and beneficiaries	38,441
Terminated vested members entitled to benefits but not yet receiving benefits:	
Police and firefighters	241
All others employees	6,654
Total terminated vested members	6,895

Current employees:	
Vested:	
Police and firefighters	3,971
All other employees	38,271
Nonvested:	
Police and firefighters	969
All other employees	22,679
Total current employees	65,890
Total membership	111,226

2. *The Financial Reporting Entity*

As required by U.S. generally accepted accounting principles, these financial statements present the ERS (the primary government) as a separate reporting entity from the State of Hawaii (the State). The ERS is not part of the State's financial reporting entity because it is a separate legal entity that is fiscally independent of the State. The ERS was established by Chapter 88 of the Hawaii Revised Statutes and is governed by a Board of Trustees (the Board) as discussed below. The ERS comprises the Employees' Retirement System and Social Security Contribution Funds.

The Board administers the ERS on behalf of public employees of both the State and county governments. Except for limited administrative functions, the State does not have the power to supervise or control the Board in the exercise of its functions, duties, and powers. The Board consists of eight members. The State Director of Finance is a statutory member of the Board. Four members of the Board are elected by members of the ERS and the other three members of the Board are appointed by the Governor. Decisions are made with the concurring vote of five members of the Board. The Board appoints the Administrator and Chief Investment Officer and engages actuarial and other services required to transact the business of the ERS.

3. *Plan Descriptions and Funding Policy*

Members of the ERS belong to the contributory, hybrid, or noncontributory plan. All assets of the ERS (in the Pension Trust) may be used to pay benefits to any member of the ERS. Contribution rates are determined by state law. Effective July 1, 2008, the employer contribution rate for employees in the Police and Fire category increased from 15.75% to 19.70%, and the rate for employees in the All Other category increased from 13.75% to 15.00%. Per legislation passed in 2011, the current 19.70% rate for Police and Fire will gradually increase to 25.00% and the current 15.00% rate for all other employees will gradually increase to 17.00%. These employer contribution rates are applied to the total covered payroll in each respective category to determine the required employer contributions. Administration of the Pension Trust is financed through contributions from the employers and employees (if applicable) and investment earnings.

Employees covered by Social Security on June 30, 1984 were given the option of joining the noncontributory plan or remaining in the contributory plan. All new employees hired after June 30, 1984 and before July 1, 2006, who are covered by Social Security, were generally required to join the noncontributory plan. Qualified employees in the contributory and noncontributory plan were given the option of joining the Hybrid Plan effective July 1, 2006, or remaining in their existing plan. Starting July 1, 2006, all new employees covered by Social Security are required to join the Hybrid Plan.

The three plans provide a monthly retirement allowance equal to the benefit multiplier % (generally 1.25% or 2.00%) multiplied by the average final compensation (AFC) multiplied by years of credited service. The benefit multiplier decreased by 0.25% for new hybrid and contributory plan members hired after June 30, 2012. The AFC is the average salary earned during the five highest paid years of service, including the payment of salary in lieu of vacation, or three highest paid years of service, excluding the payment of salary in lieu of vacation, if the employee became a member prior to January 1, 1971. The AFC for members hired on or after this date is based on the three highest paid years of service excluding the payment of salary in lieu of vacation. For new members hired after June 30, 2012, the AFC is based on the five highest paid years of service excluding the payment of salary in lieu of vacation.

For postretirement increases, every retiree's original retirement allowance is increased by 2½% on each July 1 following the calendar year of retirement. This cumulative benefit is not compounded and increases each year by 2½% of the original retirement allowance without a ceiling (2½% of the original retirement allowance the first year, 5% the second year, 7½% the third year, etc.). For new members hired after June 30, 2012, the post-retirement annuity increase was decreased to 1.5% per year.

The following summarizes the three plan provisions relevant to the largest employee groups of the respective plan. Retirement benefits for certain groups, such as police officers, firefighters, some investigators, sewer workers, judges, and elected officials, vary from general employees. All contributions, benefits, and eligibility requirements are governed by Chapter 88 of the Hawaii Revised Statutes. For a more detailed summary of benefits for general employees and a description of special provisions to other groups of employees, refer to the Summary of Retirement Benefit Plan Provisions contained in the Introductory Section of this report.

Contributory Plan

General employees in the contributory plan are required to contribute 7.8% of their salary and are fully vested for benefits upon receiving 5 years of credited service. Under the contributory plan, members may retire with full benefits at age 55 and 5 years credited service, or may retire early at any age with at least 25 years of credited service and reduced benefits. The benefit multiplier is 2% for employees covered by Social Security.

New general employees in the contributory plan hired after June 30, 2012 are required to contribute 9.8% of their salary and are fully vested for benefits upon receiving 10 years of credited service. These members may retire with full benefits at age 60 and 10 years of credited service, or may retire at age 55 with 25 years of credited service with reduced benefits. The benefit multiplier is 1.75% for employees covered by Social Security.

Police officers, firefighters, and certain other members that are not covered by Social Security contribute 12.2% of their salary and receive a retirement benefit using the benefit multiplier of 2½% for qualified service, up to a maximum of 80% of AFC. These members may retire at age 55 with 5 years of credited service or at any age with 25 years of credited service, provided the last 5 years of credited service is any of the qualified occupations.

New police officers, firefighters and certain other members that are not covered by Social Security first hired after June 30, 2012 contribute 14.2% of their salary and receive a retirement benefit using the benefit multiplier of 2.25% for qualified service, up to a maximum of 80% of AFC. These members may retire at age 60 with 10 years of credited service or at age 55 with 25 years of credited service with reduced benefits, provided the last 5 years of credited service is any of the qualified occupations.

Hybrid Plan

General employees in the Hybrid Plan are required to contribute 6% of their salary and are fully vested for benefits upon receiving 5 years of credited service. Employees may retire with full benefits at age 62 and 5 years of credited service or at age 55 and 30 years of credited service, or may retire at age 55 and 20 years service with reduced benefits. The benefit multiplier used to calculate retirement benefits is 2%. Members in the hybrid plan are covered by Social Security.

New general employees in the Hybrid Plan hired after June 30, 2012 are required to contribute 8% of their salary and are fully vested for benefits upon receiving 10 years of credited service. Employees may retire with full benefits at age 65 and 10 years of credited service or at age 60 and 30 years of credited service, or may retire at age 55 and 20 years service with reduced benefits. The benefit multiplier used to calculate retirement benefits is 1.75%. Members in the hybrid plan are covered by Social Security.

Noncontributory Plan

General employees in the noncontributory plan are fully vested upon receiving 10 years of credited service. The employer is required to make all contributions for these members. Employees may retire with full benefits at age 62 years and 10 years of credited service or age 55 and 30 years of credited services or age 55 years and 20 years of credited service with reduced benefits. The benefit multiplier used to calculate retirement benefits is 1¼%.

Ordinary disability retirement benefits require a minimum of 10 years of service, whereas service-connected disability resulting from a job-related accident does not have any service requirement. Under all three plans, there is no age requirement.

Ordinary death benefits under the contributory, hybrid, and noncontributory plans require at least one year, five years, and ten years of service, respectively. Under all three plans, there is no service requirement for service-connected death benefits.

Schedule of Funded and Funding Progress

Actuarial valuation date		June 30, 2010
Actuarial value of assets	$	11,345,618,006
Actuarial Accrued Liability (AAL):		
Entry age		18,483,668,591
Unfunded AAL (UAAL)	$	7,138,050,585
Percent funded		61.4%
Annual covered payroll	$	3,895,661,820
UAAL percentage of covered payroll		183.2%

Multiyear trend information regarding whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits can be found in the required supplementary information following the notes to the financial statements.

Additional information as of the June 30, 2010 actuarial valuation is as follows:

Valuation date	June 30, 2010
Actuarial cost method	Entry age normal
Amortization method	Level percent, open
Remaining amortization period as of June 30, 2010	30 years
Asset valuation method	4-year smoothed market
Actuarial assumptions	
Investment rate of return (set by statute)*	8.00%
Projected salary increases*	4.00% to 17.75%
*Includes inflation at	3.00%
Cost of living adjustments (COLAs)**	2.50%

** COLAs are not compounded; they are based on original pension amounts.

Per legislation passed in 2011, the actuarial investment rate of return assumption was reduced from 8.00% to 7.75%.

4. *The ERS as Employer*

As an employer, the ERS participates in its pension benefits program, through the State. The ERS provides benefits for all of its full-time employees through the contributory or noncontributory plan. Contributions are calculated as part of the State's total contribution requirements and are reimbursed to the State's General Fund as part of the fringe benefit rate on the ERS' employees' actual salaries.

(Continued)

The required pension contributions by all participating employers (in thousands) for the years ended June 30, 2010, 2009, and 2008 were $536,237, $526,538, and $510,727, respectively, which represented 13.8%, 13.1%, and 13.5%, respectively, of covered payroll. Actual contributions (in thousands) by all employers for the years ended June 30, 2010, 2009, and 2008 were $547,670, $578,672, and $488,770, respectively, which represented 102.1%, 109.9%, and 95.7%, respectively, of the required contributions for each year.

5. Other Post Employment Benefits (OPEB)

In addition to the retirement benefits provided by the ERS Pension Trust, the participating employers, pursuant to Hawaii Revised Statutes (HRS) Chapter 87, provide certain healthcare and life insurance benefits to all qualified employees and retirees. The Employer-Union Health Benefits Trust Fund (EUTF) was established on July 1, 2003 to design, provide, and administer medical prescription, drug, dental, vision, chiropractic, dual-coverage medical and prescription, and group life benefits.

For employees hired before July 1, 1996, the employer pays the entire monthly healthcare premium for employees retiring with ten or more years of credited service, and 50% of monthly premiums for employees retiring with fewer than ten years of credited services.

For employees hired after June 30, 1996, and who retire with fewer than 10 years of service, the employer makes no contributions. For those retiring with more than 10 years but fewer than 15 years, the employer pays 50% of the retired employees' monthly Medicare or non-Medicare premium. For employees hired after June 30, 1996 and who retire with at least 15 years but fewer than 25 years of credited service, the employer pays 75% of the retired employees' monthly Medicare or non-Medicare premium; for those retiring with over 25 years of credited service, the employer pays the entire healthcare premium.

Retirees are eligible for $2,372 of employer-sponsored, basic life insurance coverage with premiums paid entirely by the employer.

The net assets of the EUTF are not included in the ERS plan net assets. The EUTF issues a financial report that includes financial statements and required supplementary information.

Note B – Social Security Contribution Fund

The Social Security Contribution Fund (Contribution Fund) was established under Section 88-224 of the HRS for the following purposes:

1. To receive all federal Social Security employers' contributions from the State and interest and penalties on unpaid amounts;
2. To receive any appropriations to the Contribution Fund;
3. To pay amounts required to be paid to the Internal Revenue Service (IRS); and
4. To invest and collect income on resources held by the Contribution Fund.

All other non-State governmental agencies remit Social Security contributions directly to the IRS. Social Security contributions withheld from employees are remitted directly to the IRS by the employers. The Contribution Fund is considered an agency fund for financial reporting purpose.

Note C – Summary of Accounting Policies

A summary of the significant accounting policies consistently applied in the preparation of the accompanying financial statements is as follows:

1. *Basis of Accounting*

Fiduciary funds are used to account for assets held by the ERS in a trustee capacity or as an agent for individuals, private organizations, other governments, and/or other funds. The fiduciary fund types used by the ERS are a Pension Trust fund and an agency fund. Each of the fiduciary funds is considered a separate fiscal and accounting entity with a self-balancing set of accounts that comprise its assets, liabilities, equity, revenues and expenditures, or expenses, as appropriate. The accounting and reporting treatment applied to a fund is determined by its measurement focus. The Pension Trust Fund is accounted for on a flow of economic resources measurement focus. As an agency fund, the Contribution Fund is custodial in nature and does not measure results of operations.

The financial statements are prepared using the accrual basis of accounting under which expenses are recorded when the liability is incurred, and revenues are recorded in the accounting period in which they are earned and become measurable. Employer and member contributions are recognized in the period in which the contributions are due. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan. Investment purchases and sales are recorded as of their trade date. Administrative expenses are financed exclusively with investment income.

2. *Cash and Investments*

Cash includes amounts in demand deposits and invested funds held by ERS investment managers. Investments are governed pursuant to Sections 88-119 and 88-119.5 of the HRS. The Pension Trust Fund may invest in real estate loans and mortgages; preferred and common stocks; government obligations; corporate obligations; certain other debt obligations (such as obligations secured by collateral of certain other authorized securities listed here, obligations issued or guaranteed by certain development banks, and insurance company obligations); real property; alternative investments; and other securities and futures contracts. The investment decision is further dictated by internal investment policies and asset allocation established by the Board. Use of leverage is restricted to certain asset classes in order to enhance yields of approved investments and/or to facilitate diversification of the portfolio. The use of debt must result in positive leverage where cash flow is in excess of debt service. Assets in the Pension Trust Fund may be invested in any of these assets, while investments in the Contribution Fund are limited to investment grade, short-term marketable securities.

Investments are reported at fair value. Unrealized gains and losses are included as investment income in the statement of changes in plan net assets. The net assets of the Pension Trust Fund and Contribution Fund (the Retirement Funds) are valued on a monthly basis using the following sources:

Publicly Traded Securities (Corporate stock, Investment derivatives, and Fixed Income): Fair values are based on published market prices, quotations from national security exchanges, and security pricing services as of each month end closing of the New York Stock Exchange.

Fixed income securities (including investment derivatives not publicly traded): Fair values are based on equivalent values of comparable securities with similar yield and risk.

Pooled Equity and Fixed Income Funds (not publicly traded): Fair value are based on the ERS’ pro-rata ownership percentage of the fund reported by the fund manager based on the fair value of the underlying assets that is determined by published market prices, or quotations from national security exchanges. The pooled funds’ annual financial statements are audited by independent auditors.

Limited Partnerships: The fair value of investments that are organized as limited partnerships and have no readily ascertainable fair value (such as private equity, real estate, and tangible assets) are valued based on their respective net asset value (NAV), and are generally audited annually. The most significant element of NAV is the fair value of the investment holdings. These holdings are valued by the general partners using valuation assumptions based on both market and property specific inputs which are not observable and involve a certain degree of expert judgment. Because of the inherent uncertainties in estimating fair values, it is at least reasonably possible that the estimates will change in the near term.

Private Equity Limited Partnerships: The fair value of individual capital account balances is based on the valuations reported by private equity partnerships using the following methodologies to value the underlying portfolio companies:

- Valuations of publicly traded portfolio companies are based on active exchanges using quoted market prices as of the close of trading for each month-end.
- When a portfolio company investment does not have a readily available market price, but has a return that is determined by reference to an asset for which a market price is readily available, valuations are based on the closing market price of the reference asset on the valuation date, adjusted for factors that affect the fair value of the investment held.
- When the portfolio company investments are private holdings and are not traded on active security exchanges, valuation methodologies used consist primarily of income and market approaches. The income approach involves a discounted cash flow analysis based on portfolio companies’ projections. The market approach involves valuing a company at a multiple of a specified financial measure (generally EBITDA) based on multiples at which comparable company’s trade.

Real Estate and Alternative Investments Limited Partnerships and Limited Liability Companies – Consolidated: The ERS has a controlling interest in certain real estate and alternative investment partnerships and limited liability companies. These investment companies provide quarterly valuations based on the most recent capital account balance to ERS management. Individual properties are valued internally by the company at least annually, in accordance with standard industry practice and are adjusted as frequently as quarterly if material market or operational changes have occurred. Properties are generally valued every one to three years by external third-party appraisers, depending upon the investment company. Structured finance investments receive quarterly value adjustments by the investment companies, generally applying the assumption that all such positions will be held to maturity. Alternative investments are valued using their respective NAV, and are generally audited annually. The most significant element of NAV is the fair value of the investment holdings. These holdings are valued by the general partners in conjunction with management, investment advisors, and valuation specialists. The valuation techniques vary based on investment type and involve a certain degree of expert judgment. The fair value for these investments could differ significantly if a ready market for these assets existed. Annual audits of most partnerships and limited liability companies include a review of compliance with the investment company's valuation policies. Real estate and alternative investments consists of the value of real property within the limited liability companies and limited partnerships.

Notes payable are shown at estimated fair values. Notes payable consist of mortgage notes within the limited liability companies and limited partnerships that are secured by real estate of the respective company.

Revenue Recognition: Interest and dividend income is recognized when earned. Capital gains and losses are recognized on a trade-date basis. Purchases and sales of investments are also recorded on a trade-date basis.

Securities Lending: The Retirement Funds record collateral received under securities lending agreements where the Retirement Funds have the ability to spend, pledge, or sell the collateral without borrower default. Liabilities resulting from these transactions are also reported. Additionally, costs associated with securities transactions, broker commissions paid, and lending agent management fees are reported as investment expenses in the accompanying financial statements. The statement of plan net assets does not include detailed holdings of securities lending collateral by investment classification.

Investments and Withdrawals: Investments and withdrawals are recorded when received or paid.

3. Interest and Earnings Allocation

Pursuant to Sections 88-21 and 88-107 of the HRS, the Board shall annually allocate interest and other earnings of the Pension Trust Fund to the funds of the Pension Trust Fund, as follows:

a. Annuity Savings Fund – Fixed at 4½% regular interest rate

b. Expense Fund – To be credited with all money to pay the administrative expenses of the ERS

c. Pension Accumulation Fund – To be credited with any remaining investment earnings

4. Risk Management

The ERS reports liabilities, as discussed in note G, related to certain types of losses (including torts, theft of, damage to, or destruction of assets, errors or omissions, natural disasters, and injuries to employees) when it is probable that the losses have occurred and the amount of those losses can be reasonably estimated.

5. Use of Estimates

In preparing financial statements in conformity with U.S. generally accepted accounting principles, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Investments in limited partnerships and other alternative investments tend to be illiquid and the underlying assets are generally not publicly traded companies. Because of the inherent uncertainty in valuing privately held securities, the fair value may differ from the values that would have been used had a ready market for such securities existed, and the difference can be material. Accordingly, the realized value received upon the sale of the asset may differ from the recorded fair value.

6. Recently Adopted Accounting Policies

Effective July 1, 2009, the ERS implemented the provisions of Government Accounting Standards Board (GASB) Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, which addresses the recognition, measurement, and disclosure of information in the financial statements regarding derivative instruments entered into by state and local governments. Derivative instruments are often complex financial arrangements that governments enter into and are classified as (i) investment derivative instruments (primarily entered into for purpose of obtaining income or profit, or that the government determines are ineffective as hedges) or (ii) as hedging derivative instruments (primarily as hedges of identified financial risks associated with assets or liabilities, or expected transactions; or to lower the costs of borrowings). This statement requires governments to report most of their derivatives at fair value on their statement of net assets and establishes different criteria for recognition of changes in the fair value on the statement of changes in net assets for these two classifications. As the ERS reported all investments, including investment derivative instruments, at fair value in prior fiscal years, the implementation of GASB Statement No. 53 does not have a significant impact on the financial statements for the fiscal year ended June 30, 2010. Disclosure details for investment derivative instruments can be found in Note F.9.

Note D – Description of Funds

Section 88-109 of the HRS requires the establishment and maintenance of specific funds within the ERS. The funds in the Pension Trust Fund and their purposes are described hereunder:

1. Pension Accumulation Fund

To accumulate contributions made by the State and counties, transfers of retired members' contributions plus related interest income from the Annuity Savings Fund, and income from investments. All pension benefits, including the pensioners' bonus, are paid through this fund.

2. Annuity Savings Fund

To accumulate members' contributions and related interest income. Upon a member's retirement, the accumulated contributions and related interest income are transferred to the Pension Accumulation Fund or refunded to the member upon termination.

3. Expense Fund

To pay all the expenses necessary in connection with the administration and operation of the ERS. The Board estimates the amount of money necessary to be paid into the expense fund for the ensuing biennium to provide for the expense of operation of the ERS, and pays that amount into the expense account from the investment earnings of the ERS, subject to review by the legislature and approval by the Governor.

Net assets held in trust for pension benefits as of June 30, 2010 are as follows:

Pension Accumulation Fund	$ 8,288,395,807
Annuity Savings Fund	1,522,699,554
Expense Fund	13,072,458
Total net assets held in trust for pension benefits	$ 9,824,167,819

Note E – Contributions

The ERS' funding policy provides for periodic employer contributions expressed as a percentage of annual covered payroll. The funding method used to calculate the total employer contribution required is the entry age normal actuarial cost method. Employer contributions are governed by Chapter 88 of the HRS.

Since July 1, 2005, employer contribution rates are a fixed percentage of compensation, including the normal cost plus amounts required to pay for the unfunded actuarial accrued liability. As of July 1, 2008, employers contribute 19.70% for their police officers and firefighters, and 15.00% for all other employees. Employer rates are set by statute based on the recommendation of the ERS actuary resulting from an experience study conducted every five years.

From July 1, 2005 to June 30, 2008, the required contribution rates for employers were 15.75% for their police officers and firefighters, and 13.75% for all other employees.

Prior to July 1, 2005, the actuary calculated an annual contribution amount for the employer contribution consisting of the "normal cost" plus the level annual payments required to amortize the unfunded actuarial accrued liability over the closed period ending June 30, 2029. The employer normal cost is the level percentage of payroll contribution required to pay all benefits. Actuarial gains and losses resulting from differences between actual and assumed experience are reflected in the employer unfunded accrued liability.

Member contributions rates are statutorily established in accordance with Chapter 88 of the HRS, and are discussed in note A(3). Plan Descriptions and Funding Policy above.

Note F – Deposits and Investments

1. Deposits

The deposits are held in several financial institutions, including the custodian bank for processing investment transactions. Per State statute, deposits, held by banks located in the State, in excess of Federal Deposit Insurance Corporation (FDIC) coverage are guaranteed by securities pledged as collateral by the bank with the State Director of Finance. Uninsured and uncollateralized amounts are primarily cash held by the investment custodian for settlement of investment transactions. The float caused by outstanding checks in the operating funds is invested, thus causing a possible negative book balance. Deposits are presented in the basic financial statements at cost, which represents market or fair value. The float for outstanding checks is included in the liabilities section of the combining statement of plan net assets.

Custodial Credit Risk for Deposits is the risk that in the event of a bank failure, the ERS' deposits may not be returned to them. The ERS has not adopted a formal policy specific to custodial credit risk. The ERS' policy is to deposit cash in excess of operating requirements in income producing investments to maximize investment income.

At June 30, 2010, the carrying amount of deposits totaled approximately $24,379,716 and the corresponding bank balance was $32,316,670, all of which was exposed to custodial credit risk. The following shows the aggregate book and bank balances of all cash accounts:

Carrying amounts of deposit – book:		
Cash	$	32,159,104
Disbursements in excess of cash balances		(7,779,388)
Total book balance	$	24,379,716
Depository accounts:		
Total bank balances	$	32,316,670

(Continued)

2. Investments

As a long-term investor, the ERS has established through its investment policy that preservation of capital is the primary goal of the ERS. Preservation of capital is to be attained with a consistent, positive return for the fund by diversifying the investment portfolio. The ERS recognizes risk associated for individual securities or asset classes may be reduced through diversification. Investments will be prudent and consistent with the best investment practices, in accordance with the Board's asset allocation strategy, assigned investment mandate, and in compliance with Chapter 88, HRS, as amended. The following table shows the investments of the ERS by investment type as of June 30, 2010. Please refer to note C(2) above for a discussion of fair value on investments.

Cash and short-term investments	$ 515,139,725
Debt securities:	
Asset-backed securities	94,829,501
Collateralized mortgage obligations	96,683,392
Commercial mortgage-backed securities	77,124,455
Corporate	1,006,516,007
Government	579,436,540
Government agencies	217,544,329
Guaranteed corporate	63,323,201
Index-linked government bonds	2,031,766
Other asset-backed securities	5,087,324
Residential mortgage-backed securities	449,378,516
State or local governments	85,848,042
Pooled and others	21,026,080
Derivatives:	
Forwards	10,251,140
Options	(2,134,482)
Rights/warrants	7,964
Swaps	2,935,006
Equities	5,350,595,368
Real estate	974,304,500
Alternative investments	496,438,668
Total investments	$ 10,046,367,042
Short-term instruments for securities lending collateral pool	$ 722,388,201

3. Credit Risk Debt Securities

The ERS utilizes two fixed income mandates: (i) a "Diversified Manager" whose benchmark is 85% Lehman Universal/15% Lehman Multiverse ex-USD Hedged Index and (ii) an "International Mandate" whose benchmark is Lehman Multiverse ex-USD Hedged Index. The ERS expects its debt securities investment managers to maintain diversified portfolios within the mandate assigned by the Board using the following guidelines:

- Securities with a quality rating of below BBB are considered below investment grade.

- Invest in money market instruments; commercial paper (rated A1/P1); certificates of deposits and bankers acceptance; U.S. Treasury bonds, notes and bills; U.S. government and agency securities; municipal bonds; 144A private placements; bank loans; non-leveraged structured notes; convertible bonds; mortgages, collateralized mortgage obligations (CMO) and asset-backed securities (backed by pools of mortgages guaranteed by the U.S. government or its agencies or corporate issues rated at least AAA); investment grade corporate debt issues, emerging markets debt, preferred stock and common stock; sovereign debt instruments (issued by agencies of, or guaranteed by foreign governments); and certain foreign securities (corporate debt issues, asset-backed securities, CMOs, 144A private placements, convertibles, and supranational issues). The minimum issuance size is $150 million.
- Summary of concentration limits for debt securities are:
  - Specific Issue or Issuer of 5% (excludes supranationals, U.S. Treasuries, U.S. agencies, and sovereign debt and equivalently rated agencies of Organization for Economic Co-operation and Development (OECD) governments).
  - All fixed income manager portfolios are limited to (i) 15% in below investment grade securities with no more than 2% below a B rating; (ii) 10% in private placements; (iii) 5% in convertible securities; (iv) 10% in preferred stocks and common stocks (common stock holdings not to exceed 180 days); and (v) 10% in non-U.S. agency CMOs.
  - Diversified managers are limited to (i) 10% in emerging markets (local currency and debt); (ii) 30% of non-U.S. dollar denominated securities (excludes money market securities and money market futures); (iii) a 15% net foreign currency exposure (as measured by net amount of currency's outstanding long and short positions versus the U.S. dollar); and (iv) a 30% gross foreign currency exposure (as measured by absolute value of all country-level currency long and short currency positions versus the U.S. dollar).
  - International managers are limited to (i) 20% in emerging markets (local currency and debt); and (ii) 25% of U.S. dollar denominated securities (excludes money market securities and money market futures).

A table of the ERS' fixed income securities as of June 30, 2010 is below. Securities below investment grade of BBB and non-rates issues amounted to $254,396,425 or 8.8% of total fixed income investments. All short-term investments, not held in a pooled investment, are rated A1/P1 or better.

Credit Rating – Moodys as of June 30, 2010

Ratings	Cash and cash equivalents	Asset-backed securities	Corporate bonds	Guaranteed fixed income	Municipal/ provincial bonds	Non-government-backed C.M.O.s	Pooled and others	Total	Percentage total
AAA	$ —	107,566,437	40,109,563	63,323,201	29,001,473	69,096,694	—	$ 309,097,368	10.7%
AA	—	10,421,373	114,643,528	—	38,718,275	6,058,401	—	169,841,577	5.9%
A	—	40,164,895	380,653,005	—	13,682,425	1,261,942	—	435,762,267	15.1%
BBB	—	1,005,001	292,699,713	—	4,445,869	1,113,956	—	299,264,539	10.4%
BB	—	800,603	103,814,246	—	—	1,713,085	—	106,327,934	3.7%
B	—	720,000	65,962,272	—	—	2,786,341	971,500	70,440,113	2.4%
CCC	—	4,269,978	20,000	—	—	12,358,335	—	16,648,313	0.6%
CC	—	31,561	—	—	—	2,294,638	—	2,326,199	0.1%
C	—	—	234,187	—	—	—	—	234,187	—%
D	—	—	39,013	—	—	—	—	39,013	—%
NR	29,985,606	—	8,340,480	—	—	—	20,054,580	58,380,666	2.0%
	$ 29,985,606	164,979,848	1,006,516,007	63,323,201	85,848,042	96,683,392	21,026,080	1,468,362,176	51.0%
						U.S. government backed		1,408,326,726	49.0%
						Total		$ 2,876,688,902	100.0%
						Derivatives		800,524	
						Cash and cash equivalents		(29,985,606)	
						Short term investments		(147,874,143)	
						Total fixed income securities		$ 2,699,629,677	

4. *Custodial Credit Risk*

Custodial credit risk for investments is the risk that, in the event of a failure of the counterparty, the ERS will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. All securities, except certain pooled funds, are registered in the name of the ERS and are held in the possession of the ERS' custodial bank, Northern Trust. Pooled funds not held by the custodial bank, such as certain equity investments, are registered in the name of the ERS.

Custodial credit risk summary:	
Exposed to custodial credit risk	$ 31,574,754
Not subject to custodial credit risk	3,359,008,603
Not exposed – registered	5,955,705,977
Not exposed – securities on loan	700,077,708
Total investments	$ 10,046,367,042

5. Concentrations of Credit Risk

The ERS' debt securities managers are expected to maintain diversified portfolios by sector, quality, and maturity as discussed above in Credit Risk Debt Securities.

Equity securities shall be diversified by industry and in number. An investment manager may not hold more than 5% of an individual company's stock; if that company's securities represent less than 3% of the investment manager's respective benchmark. (If those securities constitute more than 3% of the respective benchmark, then the manager shall not hold more than the benchmark weight plus 2% points.)

At June 30, 2010, there was no single issuer exposure within the ERS' portfolio that comprises over 5% of the overall portfolio, or an investment that exceeded the above manager guidelines, and therefore, there is no concentration of credit risk.

6. Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The ERS has not adopted a formal policy that limits investment maturities as a means of managing its exposure to fair value changes arising from changing interest rates. External investment managers are given full discretion within their operational guidelines and are expected to maintain a diversified portfolio between and within sectors, quality, and maturity.

Duration is a measure of a debt investment'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. At June 30, 2010, the table below shows fixed income investment securities by investment type, amount, and the effective weighted duration for the ERS' total portfolio. Interest rate risk associated with swaps and other derivative instruments are discussed in the derivatives disclosure below:

Effective duration of fixed income assets by security type

	Fair value	Effective weighted duration (years)
Cash and short term instruments	$ 177,859,749	0.2
Debt securities:		
Asset-backed securities	94,829,501	1.3
Collateralized mortgage obligations	96,683,392	1.0
Commercial mortgage-backed securities	77,124,455	5.4
Other asset-backed securities	5,087,324	6.7
Corporate	1,006,516,007	5.1
Government	579,436,540	7.5
Government agencies	217,544,329	4.4
Guaranteed corporate	63,323,201	0.9
Index-linked government bonds	2,031,766	9.4
Residential mortgage-backed securities	449,378,516	1.9
State or local governments	85,848,042	5.4
Pooled and others	21,026,080	n/a
Total fixed income securities	$ 2,876,688,902	

7. *Foreign Currency Risk*

Foreign currency risk is the risk that changes in exchange rates will adversely impact the fair value of an investment. The foreign currency risk exposure to the ERS arises from the international fixed income and international equity investment holdings. Board policy limits the use of foreign currency as a defensive measure to protect the portfolio value of non-U.S. equity and non-U.S. fixed income investments. External investment managers authorized to invest in these securities are given full discretion regarding their respective portfolio's foreign currency exposures, including using currency forward contracts, as established by their investment mandate. Cross-hedging is only allowed in non-U.S. fixed income portfolios. Counterparties for foreign currency derivatives must be rated A or equivalent. Derivatives investments are discussed in more detail in Note G.

The following table summarizes the ERS' exposure to foreign currency risk in U.S. dollars as of June 30, 2010. (Securities denominated in U.S. dollars are not presented.)

	Cash and short-term instruments	Debt securities	Derivatives	Equities	Alternative	Real estate	Grand total
Australian dollar	$ —	86,817,642	15,878	41,924,430	—	—	128,757,950
Bulgarian new lev	—	—	—	183,521	—	—	183,521
Brazilian real	—	794,608	596,257	14,030,953	—	—	15,421,818
Canadian dollar	5,995,998	18,578,400	—	16,700,110	—	—	41,274,508
Swiss franc	—	—	—	112,890,527	—	—	112,890,527
Czech koruna	—	—	—	2,690,153	—	—	2,690,153
Danish krone	—	23,691	—	5,021,909	—	—	5,045,600
Egyptian pound	—	—	—	1,346,308	—	—	1,346,308
Euro	—	214,574,870	90,256	323,591,074	—	—	538,256,200
British pound sterling	—	51,562,758	—	225,278,979	—	—	276,841,737
Hong Kong dollar	—	—	—	80,489,959	—	—	80,489,959
Hungarian forint	—	—	—	1,444,385	—	—	1,444,385
Indonesian rupiah	—	—	—	5,700,663	—	—	5,700,663
New Israeli shekel	—	—	—	151,001	—	—	151,001
Japanese yen	—	64,856,758	—	212,094,979	—	—	276,951,737
South Korean won	—	—	—	29,556,857	—	—	29,556,857
Moroccan dirham	—	—	—	183,140	—	—	183,140
Mexican peso	—	—	285,615	4,339,614	—	—	4,625,229
Malaysian ringgit	—	—	—	11,139,868	—	—	11,139,868
Norwegian krone	—	20,157,241	—	16,404,738	—	—	36,561,979
New Zealand dollar	—	54,718,149	—	—	—	—	54,718,149
Philippine peso	—	—	—	516,397	—	—	516,397
Polish zloty	—	34,878,400	—	5,425,189	—	—	40,303,589
Swedish krona	—	—	—	8,346,369	—	—	8,346,369
Singapore dollar	—	—	—	15,075,728	—	—	15,075,728
Thai baht	—	—	—	9,885,168	—	—	9,885,168
Turkish lira	—	—	—	5,588,914	—	—	5,588,914
New Taiwan dollar	—	—	—	25,424,379	—	—	25,424,379
South African rand	—	21,726,833	—	4,853,633	—	—	26,580,466
Various countries	308,846,371	—	10,251,140	238,956,857	—	—	558,054,368
Total	$ 314,842,369	568,689,350	11,239,146	1,419,235,802	—	—	2,314,006,667

8. *Securities Lending*

The ERS participated in a securities lending program administered by its bank custodians. Under this program, which is permissible under Chapter 88 of the HRS, certain equity and fixed income securities of the ERS were lent to participating broker-dealers and banks (borrowers). In return, the ERS received cash, securities issued or guaranteed by the U.S. government, and/or letters of credit as collateral. The ERS did not have the ability to pledge or sell collateral securities absent of borrower default. Borrowers were required to deliver collateral for each loan equal to: (a) in the case of loaned fixed income securities and loaned equity securities denominated in U.S. dollars or whose primary trading market was located in the U.S., 102% of the market value of the loaned securities; and (b) in the case of loaned equity securities not denominated in U.S. dollars or whose primary trading market was not located in the U.S., 105% of the market value of the loaned securities. The collateral was marked to market daily. If the market value of the collateral fell below the minimum collateral requirements, additional collateral was provided. At June 30, 2010, the ERS had no credit risk exposure to borrowers because the market value of collateral held by the ERS exceeded the market value of securities loaned. In addition, the bank custodians indemnified the ERS by agreeing to purchase replacement securities or return cash collateral in the event the borrower failed to return the

(Continued)

loaned security or failed to pay the ERS for income distributions by the securities' issuers while the securities are on loan.

The ERS did not impose any restrictions on the amount of loans the bank custodian made on behalf of the ERS. Also, the ERS and the borrowers maintained the right to terminate securities lending transactions on demand. Northern Trust invests the cash collateral related to the ERS' loaned securities in a separate account, according to the ERS investment policies and procedures as discussed above in Note C(2). As such, the maturities of the investments made with cash collateral generally did not match the maturities of the securities loans. The extent of such mismatch as of June 30, 2010 was 80 days.

The following represents the balances relating to the securities lending transactions as of June 30, 2010.

Market value of loaned securities by type of collateral received

	Fair value of underlying securities			Collateral received		
	Cash	**Noncash**	**Total**	**Cash**	**Noncash**	**Total**
Fixed income U.S.	$ 245,475,192	—	245,475,192	252,086,086	—	252,086,086
Fixed income, global	1,745,937	—	1,745,937	1,847,890	—	1,847,890
Equities, U.S.	345,199,647	111,072	345,310,719	355,243,563	114,342	355,357,905
Equities, global	107,255,740	290,120	107,545,860	113,210,662	306,015	113,516,677
Total	$ 699,676,516	401,192	700,077,708	722,388,201	420,357	722,808,558

9. *Derivative Financial Instruments*

Derivatives are instruments (securities or contracts) whose value is dependent on such things as stock or bond prices, interest rate levels, or currency exchange rates. These are financial arrangements between two parties whose payments are based on or "derived" from the performance of some agreed-upon benchmark. As with any investment, derivative contracts are subject to various types of credit and market risks. Notably, these would include the possible inability of a counterparty to meet the terms of the contract, changes in the market value of the underlying collateral, or changes in the interest rate environment. The ERS enters into various derivative investment contracts to hedge, for the minimization of transaction costs and as a means of implementing value-added strategies to enhance returns as authorized by Board policy.

Generally, derivatives are subject both to market risk and counterparty risk. The derivatives utilized by the ERS typically have no greater risk than their physical counterparts, and in many cases are offset by exposures elsewhere in the portfolio. Counterparty risk, the risk that the "other party" to a contract will default, is managed by utilization of exchange-traded futures and options where practicable (in which case the futures exchange is the counterparty and guarantees performance) and by careful screening of counterparties where use of exchange-traded products is impractical or uneconomical. ERS investment managers seek to control this risk through counterparty credit evaluations and approvals, counterparty credit limits, posting collateral and exposure monitoring procedures. The ERS anticipates that counterparties will be able to satisfy their obligations under the contracts.

Derivative securities are priced and accounted for at their fair value. For exchange-traded securities such as futures and options, closing prices from the securities exchanges are used. Foreign exchange contracts are valued at the price at which the transaction could be settled by offset in the forwards markets.

The following tables summarize the ERS' investments in derivative securities and contracts held at June 30, 2010 and their associated risks. The various risks associated with these investments are included in the tables expressed in terms of market values, summarized by the type of contract as follows: credit, equity, foreign exchange, interest, and other. Due to the level of risk associated with certain derivative investment securities, it is reasonably possible that changes in the values of investment securities will occur in the near term, and such changes could affect the amounts reported in the financial statements. ERS could be exposed to risk if the counterparties to the contracts are unable to meet the terms of the contracts. ERS investment managers seek to control this risk through counterparty credit evaluations and approvals, counterparty credit limits, posting collateral, and exposure monitoring procedures.

The notional amount is the nominal or the underlying face amount that is used to calculate payments made on that instrument or contract. Changes in the market value of all derivative contracts are recorded as net appreciation (depreciation) in fair value of investments in the statement of changes in plan net assets.

Summary of Derivative Risk Types:

		Fair value
Credit contracts:		
Swaps	$	(1,060,448)
Equity contracts:		
Rights/Warrants		7,964
Foreign exchange contracts:		
Forwards		10,251,140
Options		(153,832)
Interest rate contracts:		
Futures		—
Options		(46,111)
Swaps		3,967,006
Other contracts:		
Swaptions		(1,934,539)
Swaps		28,448
Total derivatives	$	11,059,628

(Continued)

The following table summarizes the ERS' investments in derivative securities and contracts held at June 30, 2010:

Asset categories				Notional values	Market value	(Change in fair value)
Forwards	Currency purchases		$	—	751,269,718	—
	Currency sales			—	(741,018,578)	—
	Total forwards			—	10,251,140	10,249,654
Futures	Interest rate contracts	Longs		472,343,272	—	—
		Shorts		(149,262,094)	—	—
	Futures total			323,081,178	—	—
Options	Caps and floors			—	(74,242)	(14,607)
	Options			—	(153,832)	(69,934)
	Options on futures	Short		—	(149,844)	159,840
		Long		—	177,975	97,436
	Swaption			—	(1,934,539)	(94,685)
	Options total			—	(2,134,482)	78,050
Rights/warrants				—	7,964	7,052
Swaps	Credit default swaps			—	(1,060,448)	1,765,226
	Interest rate swaps			—	3,967,006	(472,264)
	Total return swaps			—	28,448	65,963
	Swaps total			—	2,935,006	1,358,925
	Grand total		$	323,081,178	11,059,628	11,693,681

Forward Currency Exchange Contracts

The ERS enters into various forward currency exchange contracts to manage exposure to changes in foreign currency exchange rates and to facilitate the settlement of foreign security transactions. A forward contract is an agreement to buy or sell a specific amount of currency at a specific delivery or maturity date for an agreed-upon price. Risks associated with such contracts include movements in the value of the foreign currency relative to the U.S. dollar and the ability of the counterparty to perform in accordance with the terms of the contract.

Futures

Futures represent commitments to purchase (asset) or sell (liability) securities at a future date and at a specified price. Futures contracts are traded on organized exchanges (exchange traded) thereby minimizing the ERS' credit risk. The net change in the futures contracts value is settled daily in cash with the exchanges. Net gains or losses arising from the daily settlements are included in the net appreciation in fair value of securities in the statement of changes in plan net assets – all trust funds. At June 30, 2010, the net notional value of futures contracts was $323,081,178.

Options

Options represent or give the buyers the right, but not the obligation, to buy or sell an asset at a preset price over a specified period. The option's price is usually a small percentage of the underlying asset's value. As a writer of financial options, the ERS receives a premium at the outset of the agreement and bears the risk of an unfavorable change in the price of the financial instrument underlying the option. As a purchaser of financial options, the ERS pays a premium at the outset of the agreement and the counterparty bears the risk of an unfavorable instrument underlying the option.

Swaps

Swaps represent an agreement between two or more parties to exchange sequences of cash flows over a period in the future. At June 30, 2010, the ERS had interest rate, credit default swaps, and total return swaps as allowed by Board policy. In the most common type of interest rate swap arrangement, one party agrees to pay fixed-interest payments on designated dates to a counterparty, who, in turn, agrees to make return interest payments that float with some reference rate. Credit default swaps are the most common global credit market derivative that allows flexibility as an active portfolio management tool based on its ability to customize the exposure to corporate credit such as credit spreads and default risks. Total return swaps combine both market risk and credit risk in a single product as the holder also receives capital gains or losses. Credit default spreads and total return swaps are also used to gain access to global markets that do not have the transparency or efficiency of the U.S. credit markets. Gains and losses from swaps are determined on market values and are included in the net appreciation in fair value of securities in the statement of changes in plan net assets – all trust funds.

Derivatives, such as interest rate swaps, total return swaps, and credit default swaps, are a tool or instrument used to manage interest rate, credit quality, and yield curve exposures of the investments. In certain situations, derivatives may result in a lower overall cost to the portfolio than owning individual securities underlying the derivatives. When evaluating securities, risk and return are measured at the security and portfolio levels.

On June 30, 2010, the ERS' investments in swaps were as follows:

		Fair value
Credit default swaps:		
Buy protection	$	(45,558)
Sell protection		(1,014,890)
Interest rate swaps:		
Pay floating		(34,519,482)
Receive fixed		39,675,143
Pay fixed		(1,322,823)
Receive floating		134,168
Total return swaps		28,448
Total swaps	$	2,935,006

On June 30, 2010, credit ratings of the counterparty for ERS' investments in derivatives were as follows:

Derivatives Counterparty Credit Ratings – Moody's

	Exchge trades	A1	A2	A3	Aa1	Aa3	Baa1	N/A	Grand total
Futures and options (no counterparty avail)	$ 28,131	—	—	—	—	—	—	7,964	36,095
Banc of America Futures	—	—		—	—	—	158,692	—	158,692
Bank of America N.A.	—	—	(24,359)	—	—	—	—	—	(24,359)
Barclays Cap Secs London	—	—	—	—	—	218,944	—	—	218,944
Barclays Capital Securities Ltd.	—	—	—	—	—	(938,556)	—	—	(938,556)
BNP Paribas SA Paris	—	—	—	—	—	66,332	—	—	66,332
Citibank N.A. New York	—	(382,973)	—	—	—	—	—	—	(382,973)
Credit Suisse First Boston	—	—	—	—	(575,795)	—	—	—	(575,795)
Credit Suisse International London	—	—	—	—	(77,127)	—	—	—	(77,127)
Deutsche Bank Government Sec Inc.	—	—	—	—	—	(342,266)	—	—	(342,266)
Deutsche Bank London	—	—	—	—	—	93,076	—	—	93,076
Deutsche Bank Securities Corp.	—	—	—	—	—	87,923	—	—	87,923
Goldman Sachs & Company	—	(286,379)	—	—	—	—	—	—	(286,379)
Goldman Sachs Bank USA	—	(259,078)	—	—	—	—	—	—	(259,078)
Goldman Sachs New York	—	21,068	—	—	—	—	—	—	21,068
Greenwich Capital Markets Inc.	—	—	—	117,231	—	—	—	—	117,231
HSBC Bank USA NY	—	—	—	—	—	149,339	—	—	149,339
J.P. Morgan Clearing Corp	—	—	—	—	—	(136,866)	—	—	(136,866)
JP Morgan Chase Bank/HSBCSI	—	—	—	—	—	(206,223)	—	—	(206,223)
Merrill Lynch Capital Services Inc.	—	—	—	—	—	—	8,527	—	8,527

Derivatives Counterparty Credit Ratings – Moody's

		Exchge trades	A1	A2	A3	Aa1	Aa3	Baa1	N/A	Grand total
Merrill Lynch International	$	—	—	—	—	—	—	3,815	—	3,815
Morgan Stanley Capital Group Inc. New York		—	—	(55,736)	—	—	—	—	—	(55,736)
Morgan Stanley Capital Services New York		—	—	652,428	—	—	—	—	—	652,428
Various Foreign Currency Forwards		—	—	—	—	—	—	—	10,105,936	10,105,936
Royal Bank of Canada, Montreal		—	—	—	—	117,865	—	—	—	117,865
Royal Bank of Scotland Finland Markets Fixed		—	—	—	2,483,227	—	—	—	—	2,483,227
UBS AG		—	—	—	—	—	47,306	—	—	47,306
UBS London DSA 'Algos' (US)		—	—	—	—	—	—	—	8,610	8,610
UBS Securities		—	—	—	—	—	(31,428)	—	—	(31,428)
Total	$	28,131	(907,363)	572,333	2,600,458	(535,057)	(992,419)	171,035	10,122,510	11,059,628

On June 30, 2010, the time duration for ERS' investments in derivatives were as follows:

Derivatives Segmented Time Distribution

		Fair values	Average yrs-to-maturity
Forwards	$	10,251,140	0.20
Futures		—	0.32
Caps and floors		(74,242)	9.74
Options		(153,832)	0.06
Options on futures		28,131	0.17
Swaption		(1,934,539)	0.26
Rights/warrants		7,964	7.99
Credit default swaps		(1,060,448)	28.42
Interest rate swaps		3,967,006	9.74
Total return swaps		28,448	0.26
Grand total	$	11,059,628	

Note G – Risk Management

The ERS is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; natural disasters; and injuries to employees. As required by state law, the ERS participates in coverage with the State. The State retains various risks and insures certain excess layers with commercial insurance policies. The excess layers are consistent with the prior fiscal year. Settled claims for the State did not exceed the coverage provided by commercial insurance policies during the year ended June 30, 2010. Losses not covered by insurance are generally paid from legislative appropriations.

1. Torts

The ERS is involved in various litigation and claims, including claims regarding retirement benefits, the outcome of which cannot be presently determined. In the opinion of management, the outcome of these actions will not have a material adverse effect on the ERS' financial position.

2. Property and Liability Insurance

The ERS also purchased property and liability insurance for all real estate owned from outside carriers. During the past three fiscal years, no loss settlements exceeded insurance coverages.

3. Workers' Compensation Policy

The State has a self-insured workers' compensation policy. Workers' compensation claims are paid from legislative appropriations.

Note H – Commitments

In the normal course of business, the ERS enters into commitments with associated risks. The ERS adheres to the same credit policies, financial and administrative controls, and risk limiting and monitoring procedures for these commitments as for all investments.

The ERS has future financial commitments of up to $360,000,000 as of June 30, 2010, consisting of $82,000,000 in real estate investments, and $278,000,000 in alternative investments.

Note I – Deferred Compensation Plan

The ERS does not sponsor a deferred compensation program. The ERS' employees are eligible to participate in the deferred compensation plan sponsored by the State. The State-sponsored plan was created in accordance with Internal Revenue Code Section 457. The plan, available to all ERS employees, permits them to defer a portion of their salaries. The deferred compensation is not available to the employees until termination, retirement, death, or an unforeseeable emergency. All compensation deferred under the plan is held in trust by a custodian for the exclusive benefit of participants and beneficiaries.

EMPLOYEES' RETIREMENT SYSTEM
OF THE STATE OF HAWAII

Required Supplementary Information – Unaudited

June 30, 2010

Schedule of Funding Progress

Actuarial valuation date	Actuarial value of assets (1)	Actuarial accrued liability (AAL) (2)*	Unfunded actuarial accrued liability (UAAL) (3)* = (2)-(1)	Funded ratio (4) = (1)/(2)	Annual covered payroll (5)	UAAL as a percentage of annual covered payroll (6) = (3)/(5)
			(In thousands)			
June 30:						
2010	$ 11,345,618	18,483,669	7,138,051	61.4%	$ 3,895,662	183.2%
2009	11,400,117	17,636,432	6,236,315	64.6	4,030,121	154.7
2008	11,380,961	16,549,069	5,168,108	68.8	3,782,103	136.6
2007 **	10,589,773	15,696,546	5,106,773	67.5	3,507,040	145.6
2006 *	9,529,371	14,661,399	5,132,028	65.0	3,238,267	158.5
2005	8,914,839	12,985,989	4,071,150	68.6	3,041,083	133.9

Note:

* Assumption changes and new Hybrid Plan effective June 30, 2006.

** New salary scale assumption effective June 30, 2007.

Schedule of Employer Contributions

(In thousands)

	Annual required contribution	Actual contribution	Percentage contributed
Year ended June 30:			
2010	$ 536,237	547,670	102.1%
2009	526,538	578,672	109.9
2008	510,727	488,770	95.7
2007	476,754	454,494	95.3
2006 *	423,446	423,446	100.0
2005	328,717	328,717	100.0

* Effective July 1, 2005, the required contributions are based on contribution rates and not specific dollar amounts.

EMPLOYEES' RETIREMENT SYSTEM
OF THE STATE OF HAWAII

Note to Required Supplementary Information – Unaudited

June 30, 2010

The information presented in the required supplementary schedules was determined as part of the actuarial valuation at the dates indicated. Additional information as of the latest actuarial valuation follows:

Valuation date	June 30, 2010
Actuarial cost method	Entry age normal
Amortization method	Level percent, open
Remaining amortization period as of June 30, 2010*	30 years
Asset valuation method	4-year smoothed market
Actuarial assumptions:	
Investment rate of return (set by statute)**	8.0%
Projected salary increases**	4.0% to 17.75%
**Includes inflation at 3.0%	
Cost-of-living adjustments (COLAs)***	2.5% (not compounded)

* Remaining amortization period for Annual Required Contribution is 30 years. The current statutory contribution rates have a remaining amortization period of 41 years.

*** COLAs are not compounded; they are based on original pension amount.

Schedule 1

EMPLOYEES' RETIREMENT SYSTEM
OF THE STATE OF HAWAII

Supplementary Information – Combining Schedule of Changes in Plan Net Assets – All Trust Funds

Year ended June 30, 2010

	Pension Accumulation Fund	Annuity Savings Fund	Expense Fund	Total
Additions:				
Appropriations and contributions:				
Employers	$ 547,669,675	—	—	547,669,675
Members	—	360,047,068	—	360,047,068
Net investment gain	1,026,461,210	—	—	1,026,461,210
Total additions	1,574,130,885	360,047,068	—	1,934,177,953
Deductions:				
Benefit payments	905,315,348	—	—	905,315,348
Refunds of member contributions	—	7,573,619	—	7,573,619
Administrative expenses	—	—	12,406,339	12,406,339
Total deductions	905,315,348	7,573,619	12,406,339	925,295,306
Other changes in net assets held in trust for pension benefits:				
Transfer due to retirement of members	155,880,113	(155,880,113)	—	—
Transfer of interest allocation	(55,344,988)	55,344,988	—	—
Transfer to pay administrative expenses	(11,317,896)	—	11,317,896	—
Return of unrequited funds due to savings in administrative expenses	—	—	—	—
	89,217,229	(100,535,125)	11,317,896	—
Net increase (decrease)	758,032,766	251,938,324	(1,088,443)	1,008,882,647
Net assets held in trust for pension benefits:				
Beginning of year	7,530,363,041	1,270,761,230	14,160,901	8,815,285,172
End of year	$ 8,288,395,807	1,522,699,554	13,072,458	9,824,167,819

See accompanying independent auditors' report.

Schedule 2

EMPLOYEES' RETIREMENT SYSTEM
OF THE STATE OF HAWAII

Supplementary Information – Social Security Contribution Fund

Statement of Changes in Assets and Liabilities

Year ended June 30, 2010

Assets		**Beginning balance**	**Additions**	**Deductions**	**Ending balance**
Cash	$	—	—	—	—
Total assets	$	—	—	—	—
Liabilities					
Due to employers	$	—	198,231,903	198,231,903	—
Total liabilities	$	—	198,231,903	198,231,903	—

See accompanying independent auditors' report.

Schedule 3

EMPLOYEES' RETIREMENT SYSTEM
OF THE STATE OF HAWAII

Supplementary Information – Schedule of Administrative Expenses

Year ended June 30, 2010

Personnel services:		
Salaries and wages	$	4,113,803
Fringe benefits		1,436,047
Net change in unused vacation credits		49,251
Total personnel services		5,599,101
Professional services:		
Actuarial		93,000
Auditing and tax consulting		37,503
Disability hearing expenses		134,605
Legal services		284,625
Medical		405,618
Other services		1,894,515
Total professional services		2,849,866
Communication:		
Postage		116,757
Printing and binding		67,504
Telephone		68,279
Travel		16,006
Total communication		268,546
Rentals:		
Rental of equipment		70,549
Rental of premises		19,237
Total rentals		89,786
Other:		
Armored car service		12,807
Computer and office automation systems		40,169
Repairs and maintenance		1,309,992
Stationery and office supplies		50,634
Miscellaneous		51,202
Total other		1,464,804
Depreciation		2,134,236
	$	12,406,339

See accompanying independent auditors' report.

Schedule 4

EMPLOYEES' RETIREMENT SYSTEM
OF THE STATE OF HAWAII

Supplementary Information – Schedule of Investment Expenses

Year ended June 30, 2010

Real estate and alternative investment expenses:		
Operating expenses	$	51,285,262
Mortgage interest		14,332,890
Total real estate and alternative investment expenses		65,618,152
Investment expenses:		
Investment manager/advisor fees		31,246,317
Bank custodian fees		150,000
Other investment expenses		359,076
Total investment expenses		31,755,393
Securities lending expenses:		
Borrower rebates		(502,727)
Management fees		455,912
Total securities lending expenses		(46,815)
	$	97,326,730

See accompanying independent auditors' report.