STATE OF NEW YORK INSURANCE DEPARTMENT

REPORT ON EXAMINATION

OF THE

NEW YORK CITY
BOARD OF EDUCATION RETIREMENT SYSTEM
AND
BOARD OF EDUCATION EMPLOYEES'
GROUP LIFE INSURANCE PLAN
OF THE CITY OF NEW YORK

CONDITION:	**JUNE 30, 2003**
DATE OF REPORT:	**JUNE 25, 2009**

STATE OF NEW YORK INSURANCE DEPARTMENT

REPORT ON EXAMINATION

OF THE

NEW YORK CITY
BOARD OF EDUCATION RETIREMENT SYSTEM
AND
BOARD OF EDUCATION EMPLOYEES'
GROUP LIFE INSURANCE PLAN
OF THE CITY OF NEW YORK

AS OF

JUNE 30, 2003

DATE OF REPORT: **JUNE 25, 2009**

EXAMINER: **ANNE FORDE**

TABLE OF CONTENTS

STATE OF NEW YORK
INSURANCE DEPARTMENT
25 BEAVER STREET
NEW YORK, NEW YORK 10004

David A. Patterson
Governor

Eric R. Dinallo
Superintendent

June 25, 2009

Honorable Eric R. Dinallo
Superintendent of Insurance
New York, New York 10004

Sir:

In accordance with instructions contained in Appointment No. 22275, dated January 13, 2005 and annexed hereto, an examination has been made into the condition and affairs of the Board of Education Retirement System of the City of New York, hereinafter referred to as "BERS" or "the System," at its home office located at 65 Court Street, Brooklyn, NY 11201.

Wherever "Department" appears in this report, it refers to the State of New York Insurance Department.

The report indicating the results of this examination is respectfully submitted.

1. EXECUTIVE SUMMARY

This examination covers the period from July 1, 1999 through June 30, 2003. The examination comprised a verification of assets and liabilities as of June 30, 2003 to determine whether the System's 2003 filed annual statement fairly presents its financial condition. This report on examination is confined to financial statements and comments on those matters which involve departure from laws, regulations or rules, or which require explanation or description.

The examination revealed the following key findings and recommendations:

1) Based on the examiner's review, it was revealed that during the period of examination the System did not have a comprehensive Investment Policy Statement that governed, controlled, and monitored its investment activities. However, subsequent to the examination period the System did develop a comprehensive Investment Policy Statement which the Department believes satisfies its concerns about proper governance of the System's investment activities. It is noted that the System and the Comptroller maintain that the System did have various policies and guidelines in place governing investment activities, and that in an effort to consolidate those guidelines an Investment Policy Statement was adopted starting in 2004 (See item 17 of this report)

2) The minutes of the meetings of the board of trustees and its committees indicated that the meetings were not well attended and that several trustees did not attend a majority of the meetings. The examiner recommends that all board members attend scheduled board meetings. (See item 3 of this report)

3) The System violated Section 136.4(g) of Department Regulation No. 85 when it failed to have on its staff an internal auditor. The examiner recommends that the System establish and maintain an independent, adequately resourced, and competently staffed internal audit function to provide management with ongoing assessments of the System's risk management processes and the accompanying system of internal control. (See item 6 of this report)

4) The examiner recommends that the Comptroller's Office facilitate the System and the Department in obtaining proper securities and cash confirmations from its custodian and banks. (See item 7 of this report)

2. SCOPE OF EXAMINATION

The prior examination was conducted as of June 30, 1999. This examination covers the period from July 1, 1999 through June 30, 2003. As necessary, the examiner reviewed transactions occurring subsequent to June 30, 2003, but prior to the date of this report.

The examination comprised a verification of assets and liabilities as of June 30, 2003 to determine whether the System's filed 2003 annual statement fairly presents its financial condition. The examiner reviewed the System's income and disbursements necessary to accomplish such verification and utilized examination procedures, as deemed appropriate, in the review or audit of the following matters:

History of the System
Management and control
Corporate governance
Growth of the System
Accounts and records
Financial statements
Member benefits

The examiner reviewed the corrective actions taken by the System with respect to violations, recommendations and/or comments contained in the prior report on examination. The results of the examiner's review are contained in Item 18 of this report.

This report on examination is confined to financial statements and comments on those matters which involve departure from laws, regulations or rules, or which require explanation or description.

3. DESCRIPTION OF SYSTEM

A. History

The System was established on September 1, 1921 pursuant to the provisions of Section 2575 (formerly 872A) of the New York State Education Law. Pursuant to such statutory authority, the System was empowered to govern the affairs and manage the funding of the retirement of its members as prescribed in its "Rules and Regulations". Subsequent amendments to such "Rules and Regulations" must be adopted by the New York City Board of Education ("Board of Education") and approved by the Teachers Retirement Board. The Teachers Retirement Board, which was established pursuant to Section 13-507 of the New York City Administrative Code, consists of the president of the Board of Education, the comptroller, two mayoral appointees, and three teacher-members.

Substantially all Board of Education non-teaching, full time permanent employees are required to become members of the System's Qualified Pension Plan ("QPP") on the first day of permanent employment. Contributions to the QPP are made by both the members and New York City in accordance with existing state and city statutes and the System's "Rules and Regulations". In addition to pension benefits, the QPP includes provisions for death benefits, disability benefits and group life insurance.

Beginning January 1, 1970, members were given the option to participate in the Tax Deferred Annuity program ("TDA"), which provides a means of deferring income tax payments on their voluntary contributions until after retirement or upon withdrawal. This program was created pursuant to IRS Code Section 403 (b). Members' voluntary contributions to the TDA are co-invested with contributions to the QPP within the fixed and variable annuity investment programs. In addition to pension benefits, the TDA includes provisions for death and disability benefits. The TDA is maintained as a separate plan within the System.

B. Management

The management of the System is vested in the retirement board. The "Rules and Regulations" of the System provide that the retirement board be comprised of the thirteen members of the Board of Education, as stated in Section 2590-b, Article 52-A, Title 2 of the New York State Education Law, and two employee members elected by the System's members.

The 15 board members and their principal business affiliation, as of June 30, 2003, were as follows:

Name	Principal Business Affiliation
Evita Belmonte	Queens Representative
Phillip Berry	Colgate – Palmolive
David C. Chang	Polytechnic University
Natalie M. Gomez-Velez	Bronx Representative
Ramona Hernandez	City University of New York
Jacquelyn Kamin	Manhattan Representative
Augusta Souza Kappner	Bank Street College
James Kelly	Division of School Facilities
Joel I. Klein	Chancellor, Board of Education
Susana Leval	El Musio de Barrio, Director
Joan McKeever-Thomas	Staten Island Representative
Rebecca Marston	District Council 37
Richard Menschel	Goldman Sachs
Marita Regan	Mayoral Representative
Donald Weber	Brooklyn Representative

Changes to the board through 2004 include the following:

In February, 2004, Donald Weber resigned from the board and was replaced by Martine G. Guerrier as the Brooklyn representative.

In March, 2004, Ramona Hernandez, CUNY, Joan McKeever–Thomas, the Staten Island representative, and Susana Torruella Leval, El Musio del Barrio, Director, resigned from the board and were replaced by Alan Aviles, Senior Vice President of the Queens Health Department, Joan Correale, as the Staten Island representative, and Tino Hernandez, as the mayoral appointee.

In August, 2004, James Kelly, Division of School Facilities, retired from the board and was replaced by Thomas Malanga, Division of School Facilities; and Natalie Gomez-Velez resigned from the board and was replaced by Jesse Mojica, as the Bronx representative.

In September, 2004, Evita Belmonte resigned from the board and was replaced by Michael Flowers as the Queens representative.

On December 31, 2004, Rebecca Marston's term expired and she vacated her position on the board and was replaced by Milagros Rodriguez, DC 37 - Local 372, effective January, 2005.

The examiner's review of the minutes of the meetings of the board of trustees and its committees indicated that meetings were not well attended and that over the course of this examination period several trustees did not attend a majority of meetings. Members of the board have a fiduciary responsibility and must demonstrate an ongoing interest in the affairs of the System. It is essential that the trustees attend meetings consistently and set forth their views on relevant matters so that appropriate decisions may be reached by the board. Individuals who fail to attend regular meetings do not fulfill such criteria. The examiner recommends that all board members attend scheduled board meetings.

The following is a listing of the principal officers of the System as of June 30, 2003:

Name	Title
Rebecca Marston	Co-Chairperson
Christine A. Bailey	Executive Director
William C. Thompson, Jr.	Treasurer
Robert C. North, Jr.	Chief Actuary

In January, 2005, Milagros Rodriguez replaced Rebecca Marston as Co-Chairperson.

4. SIGNIFICANT OPERATING RESULTS

Indicated below is significant information concerning the operations of the System during the period under examination as extracted from its filed annual statements. Failure of items to add to the totals shown in any table in this report is due to rounding.

The following table indicates the System's financial growth (decline) during the period under review:

Qualified Pension Plan

	June 30, 1999	June 30, 2003	Increase (Decrease)
Admitted assets	$1,851,950,096	$1,398,594,894	$(453,355,202)
Net Reserves	$1,422,877,134	$1,842,609,175	$ 410,732,041
Benefits due and unpaid	4,976,373	4,441,142	(535,231)
Other liabilities	96,399,676	23,327,626	(73,072,050)
Net reserves and other liabilities	$1,524,253,183	$1,870,377,943	$ 346,124,760
Excess of admitted assets over total net reserves and all other liabilities	$ 327,696,913	$ (471,783,049)	$(799,479,962)
Total	$1,851,950,096	$1,398,594,894	$(453,355,202)

As of June 30, 2003**,** the System's admitted assets were mainly comprised of stocks (54.07%), cash and short-term investments (21.87%) and bonds (17.66%).

The following table indicates the membership of the System during the period of examination:

	2000	2001	2002	2003
Active members	24,720	24,651	25,253	21,678
Service pensioners	8,570	8,927	9,286	9,898
All other pensioners	837	911	989	1,085
Total	34,127	34,489	35,528	32,661

The decline in the number of active members between the years 2002 to 2003 was caused mostly by the significant increase in the line item in Schedule VI of the Annual Statement for

"Decreases by Changing Payroll Status" for active members. This is the number of Active Members that were receiving a salary as of June 30, 2002 but were not receiving a salary as of June 30, 2003. Included in this group are Members who resigned from employment but did not remove their contributions from the System. Also included are members who died or retired during the year 2003 but were not receiving any benefits as of June 30, 2003.

Tax Deferred Annuity Program

	June 30, 1999	June 30, 2003	Increase (Decrease)
Admitted assets	$364,552,419	$417,228,321	$ 52,675,902
Net reserves	$323,631,632	$426,210,802	$102,579,170
Other liabilities	40,920,787	(8,982,481)	(49,903,268)
Total net reserves and other liabilities	$364,552,419	$417,228,321	$52,675,902

The following table extracted from the Annual Statement for the Tax Deferred Annuity Program shows the membership of the System during the period of examination:

	2000	2001
Active members	10,825	11,043
Service pensioners	267	242
All other pensioners	83	79
Total	11,175	11,364

For the years 2002 and 2003, the System did not develop the above data for its annual statement.

5. FINANCIAL STATEMENTS

The following statements show the assets and liabilities of the System as of June 30, 2003, as contained in the System's 2003 filed annual statement; and the comparative statements of income and disbursements for each of the fiscal years under review. The examiner was unable to confirm securities held by the System's custodian or cash held at the System's banks (See section 8 of this report).

A. QUALIFIED PENSION PLAN
STATEMENT OF ASSETS AND LIABILITIES
FISCAL YEAR ENDED JUNE 30, 2003

Assets

Ledger assets

Accounts receivable from investment agents For "Fixed-Dollar" securities sold	$ 166,660,614
Accounts receivable – corporate stock	9,126,536
Accounts receivable – international corporate stock	(15,697,177)
Book value of "Fixed-Dollar" investments	549,435,281
Book value of variable investments	44,112,198
Investments in corporate stock	513,138,381
Investments in international stock	199,146,459
Dividend receivable – corporate stock	720,288
Cash on deposit not on interest	3,576,292
Accounts receivable and other assets – Variable Program	65,064
Loan receivable from members – Tier 1,2	8,934,200
Loan receivable from members – Tier 3,4	22,803,146
Member contributions-in-transit	205,247
Accounts payable – fees	(62,058)
Prepaid expenses (Prudential Insurance Company)	636,912
Accounts payable to investment agents for "Fixed-Dollar" securities purchased	(247,495,319)
Accounts payable – corporate stock	(35,253,215)
Total ledger assets	$1,220,052,849

Non-ledger assets

Interest due and accrued on bonds	$ 5,154,920
Interest due and accrued on variable assets	186
Employer contributions receivable	5,030,600
Employer contributions receivable – School Construction Authority	3,105,356
Market value of stocks (Variable Program) over book value	(1,460,537)
Market value of corporate stocks (Fixed Program) over book value	155,078,065
Market value of international corporate stocks over book value	12,270,367
Total non-ledger assets	$ 179,178,957
Gross assets	$1,399,231,807

Deduct assets not admitted

Prepaid expenses	$ 636,912
Total non-admitted assets	$ 636,912
Total admitted assets	$1,398,594,894

Liabilities

Accumulated contributions of members	$ 19,169,023
Present value of benefits payable on account of beneficiaries now drawing allowances	1,024,724,399
Net reserves for benefits provided by employer for members now in active service	798,715,753
Total net reserves	$1,842,609,175
Benefits due and unpaid	4,441,142
Amount in transit	444,248,660
Reserve to offset amount in transit	(444,248,660)
Due to TDA program	23,327,626
Net reserves and all other liabilities	$1,870,377,943
Excess of admitted assets over total net reserves and all other liabilities	$ (471,783,050)
Total	$1,398,594,894

B. QUALIFIED PENSION PLAN
STATEMENT OF INCOME AND DISBURSEMENTS
FISCAL YEARS ENDED JUNE 30,

	2000	2001	2002	2003
Ledger assets at end of previous year	$1,295,611,341	$1,387,898,453	$1,443,770,088	$1,227,788,227
Income:				
From Members:				
Regular contributions or payments (Tier 1 & 2) (MILSVC)	$ 1,664,950	$ 10,117,194	$ 2,220,778	$ 3,186,398
Regular contributions or payments (Tier 3 & 4)	16,990,656	18,502,740	17,594,873	25,456,103
Receipts on behalf of TDA prgm.	25,963,223	29,095,983	0	0
Contribution – loan liquidation	270,655	233,864	0	0
Special payments – (Tier 1 & 2)	40,506	56,527	0	0
Special payments – (Tier 3 & 4)	409,662	508,097	0	0
Employee contributions 55/25 & 57/10	1,500,026	1,919,679	2,141,358	1,927,948
Employer contributions 55/25 & 57/10	1,499,533	1,918,372	2,136,256	2,004,680
From Employer:				
Contributions S.C.A	1,209,343	0	459,249	1,984,330
Regular budget appropriations	39,306,025	0	54,765,853	69,744,937
Transferred from NYCTRS	51,214	466	44,165	64,252
Reimbursement overhead – NYC agencies	311,858	325,085	343,351	349,314
Transferred from NYC Police Dept.	0	6,193	152,973	1,729
Transferred from NYSTRS	1,654	6,336	5,062	1,544

	2000	2001	2002	2003
Transferred from NYS Employees Retirement System	1,134,952	289,598	921,120	686,599
Transferred from NYC Employees Retirement System	1,805,154	643,933	546,097	506,538
From Interest:				
Security lending income	0	0	504,270	358,152
Gross interest on bonds	45,603,836	50,031,671	35,060,111	28,375,289
Accruals on bonds acquired during the year	(8,300,327)	(5,765,256)	(3,496,039)	(2,396,601)
Dividends on stock – variable	603,125	708,111	462,347	403,496
Dividends on stock – fixed	11,592,408	11,812,046	9,768,099	10,032,022
Service fee income	100,496	98,600	101,560	111,560
Member loans (loan ins.)	77,802	72,550	92,765	69,804
Member loans (loan int.)	1,800,822	1,920,810	1,746,623	1,590,391
Variable programs investments	20,118	17,265	7,664	4,144
Interest income on PRU 4403	50,335	69,663	42,038	43,101
From Other Sources:				
Additional L/T int'l interest income	633,484	689,507	0	849
Misc. income	0	0	108,054	535,279
Gain on sale of bonds	8,555,554	15,428,596	51,019,685	29,958,153
Gain on sale of stocks	138,715,645	75,693,086	1,157,445	35,987,394
Increase book value of bonds	2,289,896	3,933,762	3,991,733	2,990,101
Unreconciled differences	8,364,936	30,875,160	0	0
Total income	$ 302,267,541	$ 249,209,638	$ 181,897,490	$ 213,977,506
Increase in funds or accounts by transfers during the year	$ 120,323,970	$ 121,933,353	$ 81,478	$ 194,226,529
Amounts carried forward	$1,718,202,852	$1,759,041,444	$1,625,749,056	$1,635,992,262

	2000	2001	2002	2003
Disbursements:				
Annual or other periodic payments	$ 87,333,377	$ 91,503,198	$ 91,434,994	$ 109,492,477
Lump sum – bal. of res. Tier 1	566,688	751,015	368,619	814,205
Lump sum – death gamble (presumptive ret)	923,912	529,246	460,272	1,037,600
Payments on account of death before retirement	6,675,249	5,258,512	5,843,873	6,886,190
Payments on account of resignations and dismissals	829,859	747,361	746,696	2,129,470
Other refunds	519,295	435,600	3,918,201	1,957,546
Payments on account of excess contributions	3,910,819	3,700,988	3,118,914	5,440,939
Supplemental retirement allowance	3,825,254	8,997,846	10,352,060	0
Transferred to NYC Employees Retirement System	10,538,019	1,851,443	2,458,830	1,934,587
Transferred to NYS Employees Retirement System	456,387	379,488	746,022	563,293
Transferred to NYC Teachers Retirement System	10,116,676	5,051,748	8,155,221	5,203,047
Transferred to NYS Teachers Retirement System	115,850	231,909	480,447	157,725
Transferred to NYC Police Dept.	45,978	7,529	2,336	6,815
Transferred to NYC Fire Dept.	9,900	5,814	0	0
Payments – (Tier 1 & 2) ¾ annual loan costs	25,208	26,905	2,809,141	23,065

	2000	2001	2002	2003
Admin. expense	58,464	22,518	87,423	97,120
Insured loans – deceased members	121,178	86,684	101,318	17,056
Investment expense – variable prgm	129,124	131,597	86,343	79,621
Investment expense – fixed prgm	949,626	602,400	1,870,830	1,922,200
Investment consultation fee	210,600	203,175	247,622	244,861
Disbursements – TDA pgrm.	20,748,598	16,101,793	134,409,277	0
Death benefit – plan 2 (Tier 2)	222,045	642,634	641,740	0
5/10 yr. Cert.	94,561	359,599	0	17,724,784
SHR overhead – NYC agencies	311,858	325,085	343,351	349,314
Gross loss on sale/maturity				
Bonds	21,547,103	12,762,558	0	25,249,775
Stocks	38,718,044	41,550,960	127,284,945	27,144,364
Transfer charges – GNMA bonds	6,744	14,604	157	0
Decrease in BV – ledger assets				
Bonds	1,040,840	1,055,794	1,364,575	13,236,830
Stocks	0	0	546,143	0
Unreconciled prior year items	(70,827)	0	0	0
Total disbursements	$ 209,980,429	$ 193,338,003	$ 397,879,350	$ 221,712,884
Decrease in funds or accounts by transfers	120,323,970	121,933,353	81,478	194,226,529
Sum of disbursements and decrease by transfers	$ 330,304,399	$ 315,271,356	$ 397,960,828	$ 415,939,413
Ledger assets at end of year	$1,387,898,453	$1,443,770,088	$ 1,227,788,228	$1,220,052,849

C. TAX DEFERRED ANNUITY PROGRAM
ASSETS AND LIABILITIES
FISCAL YEAR ENDED JUNE 30, 2003

Assets	
Ledger assets	
Other accounts receivable	$ 42,068
TDA loan receivable	1,202,176
Variable program investments, book value	216,290,629
Book value of bonds TDA portion	73,083,732
Book value of corporate stocks TDA fixed portion	68,255,660
Book value of int'l corporate stocks TDA fixed portion	26,489,683
Accounts receivable and other assets (net) – fixed & variable program	23,701,542
Cash on deposit on interest, per schedule	475,704
Prepaid expenses (Prudential Insurance Co.)	253,149
Accounts payable	(40,479,149)
Total ledger assets	$379,315,195
Non-ledger assets	
Interest due and accrued on bonds not in default	$ 686,598
Dividends due and accrued variable program & corporate stocks	138,210
Amortized or investment value (Fixed) over book value	(1,084,899)
Market value of stocks (Variable program) over book value	(7,161,294)
Market value of stocks (Fixed program) over book value	20,627,878
Market value of international corporation stocks over book value	1,632,156
Receivable from QPP 8.25% interest guarantee	23,327,626
Total non-ledger assets	$ 38,166,275
Gross assets	$417,481,470
Assets not admitted	
Prepaid expenses (Prudential Insurance Co.)	$ 253,149
Total admitted assets	$417,228,321
Liabilities	
Net reserves and other liabilities	$417,228,321
Total liabilities	$417,228,321

D. TAX DEFERRED ANNUITY PROGRAM
INCOME AND DISBURSEMENTS
FISCAL YEARS ENDED JUNE 30,

	2000	2001	2002	2003
Ledger assets at end of previous year	$253,790,567	$321,957,840	$350,285,607	$381,172,070
Income				
Regular contributions	$ 25,814,441	$ 29,004,545	$ 35,072,212	$ 35,666,863
Special contributions	254,082	480,620	0	0
Transfer from TRS	8,182	0	7,287	36,071
Miscellaneous income	35,200	54,676	35,000	110,201
Gross investment income	6,788,920	7,666,649	7,449,360	6,102,002
Gross profit on sale or maturity of ledger assets	61,273,575	14,936,918	9,103,897	13,626,038
Increase in book value	205,596	393,342	454,264	2,668,548
Prior year adjustment	0	0	14,531,662	0
Unreconciled items	2,954,541	2,954,541	0	0
Total income	$ 97,304,537	$ 55,491,291	$ 66,653,682	$ 58,209,723
Increase in funds or accounts by transfers during the year	$ 9,152,290	$ 20,414,874	$ 38,925,880	$ 12,301,969
Amounts carried forward	$360,247,394	$397,864,005	$455,865,169	$451,683,762
Disbursements				
Periodic retirement benefits	$ 626,006	$ 592,525	$ 465,580	$ 401,986
Death benefits	2,050,216	2,291,599	974,382	1,846,318
Refund of members' contributions on account of resignations	13,034,263	10,529,204	7,757,093	7,887,980
Amortization on bonds	93,451	194,159	0	0
Transfers to other retirement systems	5,038,178	3,552,359	2,148,639	1,201,204
Administrative expenses	419,179	361,321	844,888	692,091
Investment consultant fee	0	0	30,605	0
Investment expenses	518,223	588,627	624,624	577,708
Gross loss on sale or maturity of ledger assets	7,357,748	9,053,729	22,921,409	16,133,959
Decrease in book value of ledger assets	0	0	0	31,325,353
Total disbursements	$29,137,263	$27,163,524	$ 35,767,220	$ 60,066,599
Decrease in funds or accounts by transfers during the year	9,152,290	20,414,874	38,925,880	12,301,970
Sum of disbursements and decreases	$ 38,289,553	$ 47,578,398	$ 74,693,100	$ 72,368,569
Ledger assets, current year	$321,957,840	$350,285,607	$381,172,070	$379,315,195

6. INTERNAL AUDIT

The System does not have an internal auditor on its staff. There were no internal audit reports to review as none were performed during the examination period.

Internal audit is an integral part of corporate governance that also includes the board of trustees, senior management and the external auditors. Consideration of the work of internal auditors is essential for the board of trustees to gain a complete understanding of the System's operations. Internal audit identifies strategic, operational and financial risks facing the System and assesses controls put in place by management to mitigate those risks.

Section 136.4(g) of Department Regulation No. 85 states:

> "Each System shall have on its staff an internal auditor who shall report directly to the administrative head and shall submit to the administrative head regular reports of the audits of the System's records and accounting procedures including recommendations for improvement and correction."

The System violated Section 136.4(g) of Department Regulation No. 85 when it failed to have on its staff an internal auditor.

The examiner recommends that the System establish and maintain an independent, adequately resourced, and competently staffed internal audit function to provide management with ongoing assessments of the System's risk management processes and the accompanying system of internal controls.

7. SECURITIES AND CASH CONFIRMATIONS

Citibank is the custodian of securities for the System. At the beginning of the examination, a letter authorizing Citibank to confirm the System's securities was requested from the System. The System requested this letter from the City Comptroller's office. This letter was never provided from the City Comptroller's office and the examiner was unable to receive a proper confirmation from Citibank. In lieu of a proper confirmation, the System provided the examiner with copies of Citibank's custodian statement for fiscal year 2003 on CD.

The examiner recommends that the Comptroller's Office facilitate the System and the Department in obtaining proper securities confirmations from its custodian.

The System maintains its cash accounts with Citibank, State Street Bank and Banker's Trust. At the beginning of the examination, a request for the System to provide letters to authorize the confirmation of the System's cash accounts was requested. The banks required an authorization letter from the Comptroller, which was requested but never provided. As a result, the examiner was unable to properly verify the cash balances reported by the System as of June 30, 2003.

The examiner recommends that the Comptroller's Office facilitate the System and the Department in obtaining proper cash confirmations from its banks.

8. TREATMENT OF MEMBERS

The examiner reviewed a sample of various types of retirement benefits to members and beneficiaries. The examiner also reviewed the various controls involved, checked the accuracy of the computations and traced the accounting data to the books of account.

Based upon the sample reviewed, no significant findings were noted.

9. TAX DEFERRED ANNUITY PROGRAM

The Board of Education Retirement System of the City Of New York ("System") maintains both a Qualified Pension Plan (QPP) and a Tax Deferred Annuity program (TDA) pursuant to Section 403(b) of the United States Internal Revenue Code. The QPP and the TDA file separate annual statements with the New York Insurance Department.

The TDA program is funded entirely from voluntary member contributions together with investment earnings thereon. Upon retirement, a member may withdraw the balance in his TDA account in whole or in part, or may apply it to provide an annuity at the System's purchase rates. Accordingly, there are no liabilities in the TDA annual statement for benefits provided by the employer for members now in active service. The only liability in the TDA annual statement related to active members is the amount reported on Line 1 of Page 5, "Accumulated Contributions of Members."

Members may choose to invest their contributions in a variable fund (the TDA Variable Annuity Savings Fund) or in a non-variable fund (the TDA Annuity Savings Fund). The TDA Variable Annuity Savings Fund is pooled and invested in common with Variable Fund 'A' of the System. Variable fund earnings are credited to the members through unit values, similar to a unit investment trust. Contributions in the non-variable TDA Annuity Savings Fund are invested in common with the Annuity Savings Fund of the QPP. Interest is credited to both at rates declared by the System's Board of Trustees from time to time. The rate declared in each year of the four-year examination period has been 8¼%.

Liabilities for retired lives in the TDA statement represent the present value of annuities purchased by retired members with their accumulated TDA contributions. Fixed-benefit annuities under the TDA program are fully guaranteed by the System. Variable annuities are guaranteed to the extent that there will be no reduction in benefits on account of adverse mortality experience; however, the monthly benefit may increase or decrease in accordance with the performance of the underlying investments. The assumptions used in actuarial valuations of the TDA have been the same as those used for the QPP. Fixed-benefit annuities are valued using an interest rate of 8%; variable annuities are valued using an interest rate of 4%.

Actuarial gains and losses may be experienced by the TDA as a result of differences between actual investment earnings and interest credited to TDA non-variable funds, as well as differences between actual and expected retired life mortality. Each year's actuarial gains are credited to the TDA Accumulated Earnings Fund, and actuarial losses are charged against that fund. For purposes of computing employer contributions, TDA accumulated earnings are treated as an asset of the QPP (a negative asset in case of a deficit), thereby effectively amortizing each year's TDA gain or loss over the aggregate future working lifetime of the System's members.

The TDA program reported the following liabilities for both the fixed and the variable fund in its annual statements to the New York Insurance Department (dollar amounts are shown to nearest thousand):

Valuation Date	(1) Accumulated Contributions of Members	(2) Present Value of Benefits Payable to Beneficiaries Now Drawing Allowances	(3) Benefits Due and Unpaid	(4) Accumulated Earnings
6/30/99	319,238	4,394	471	40,450
6/30/00	356,493	4,197	1,074	54,695
6/30/01	355,947	3,284	211	29,707
6/30/02	366,648	2,634	582	16,069
6/30/03	423,783	2,428	910	(9,893)

Valuation Date	(5) Net Reserves and All Other Liabilities (1)+(2)+(3)+(4)
6/30/99	364,553
6/30/00	416,459
6/30/01	389,149
6/30/02	385,933
6/30/03	417,228

10. LIABILITIES OF THE QUALIFIED PENSION PLAN

The liabilities of the Qualified Pension Plan as reported in its annual statements to the New York Insurance Department for the period under examination (and the immediately preceding fiscal year) are summarized in the following table (dollar amounts are shown to the nearest thousand):

Valuation Date	(1) Accumulated Contributions of Members	(2) Present Value of Benefits Payable to Beneficiaries Now Drawing Allowances	(3) Present Value of Benefits Provided for Members Now in Active Service	(4) Unfunded Accrued Liability
6/30/99	32,131	676,653	1,265,098	111,589
6/30/00	33,457	825,066	1,507,632	0
6/30/01	27,343	860,142	1,588,191	0
6/30/02	22,229	897,094	1,765,932	0
6/30/03	19,169	1,024,724	1,644,131	8,190

Valuation Date	(5) Present Value of Future Tier 3 & 4 Employee Contributions	(6) Present Value of All Other Prospective Contributions	(7) Benefits and Expenses Due and Unpaid	(8) Funds Due Tax Deferred Annuity Program
6/30/99	178,725	260,690	4,976	96,400
6/30/00	94,075	493,242	4,036	143,281
6/30/01	92,488	567,925	5,569	134,409
6/30/02	112,342	744,591	1,576	0
6/30/03	90,070	747,156	4,441	23,328

Valuation Date	(9) Net Reserves and All Other Liabilities (1)+(2)+(3)-(4) -(5)-(6)+(7)+(8)	(10) Admitted Assets	(11) Excess of Assets over Reserves and Liabilities (10) - (9)
6/30/99	1,524,254	1,851,950	327,696
6/30/00	1,926,155	1,959,933	33,778
6/30/01	1,955,241	1,777,666	(177,575)
6/30/02	1,829,898	1,393,639	(436,259)
6/30/03	1,870,377	1,398,595	(471,782)

11. ACTUARIAL COST METHOD AND EMPLOYER CONTRIBUTION

The actuarial cost method by which employer contributions to the System are computed is the Frozen Initial Liability Actuarial Cost Method. Under this method, the present value of future normal contributions is developed as a balancing item, calculated by subtracting the sum of the actuarial value of assets, the unfunded actuarial accrued liability and the actuarial present value of prospective required employee contributions from the actuarial present value of prospective benefits as of the valuation date. This can be written symbolically as:

$$PVFNC = PVB - (AVA + UAAL + PVFeeC)$$

Where

PVFNC = Present Value of Future Normal (Employer) Contributions

PVB = Present Value of Prospective Benefits

AVA = Actuarial Value of Assets

UAAL = Unfunded Actuarial Accrued Liability

PVFeeC = Present Value of Future Required Employee Contributions

For the June 30, 2002 valuation, the above values are (to the nearest million dollars):

PVB =	2,585	Present value of future benefits
AVA =	1,834	Assets on hand (actuarial value)
UAAL =	8	Portion of future employer contributions
PVFeeC =	107	Present value of employee contributions plus TDA amt due

The present value of future normal employer contributions is then:

$$\begin{aligned} PVFNC &= 2{,}585 - (1{,}834 + 8 + 107) \\ &= 2{,}585 - 1{,}949 \\ &= 636 \end{aligned}$$

This calculation is displayed in more detail in the next table.

As a consequence of this method, actuarial gains and losses (deviations of actual experience from what was assumed) are reflected in the normal contribution rate.

The fiscal year runs from July 1 through June 30. The valuation date (date as of which Retirement System liabilities and assets are determined for the purpose of calculating the employer contribution) is the last day of each fiscal year, June 30. The values determined as of that date are used to calculate the amount of employer contribution due for the next succeeding fiscal year, beginning one day after the valuation date.

The New York City Office of the Actuary, which performs the actuarial valuation, sends an Estimated Appropriation letter to the Retirement System in May or June. This letter informs the System of the estimated amount to be contributed for the fiscal year beginning July 1. This estimated amount is determined by the Office of the Actuary based on current actuarial assumptions, projections of the census data from the prior actuarial valuation, and any known significant legislation. The System then begins making monthly contributions for the fiscal year beginning July 1 on the basis of the Estimated Appropriation letter.

Usually by the spring of the year, the Office of the Actuary has completed the valuation as of the preceding June 30. The Office of the Actuary then sends an Appropriations "True-Up" letter to the System informing it of the actual contribution due for the fiscal year ending on the next June 30. The System adjusts the monthly contributions it is making so that, by June 30, the total amount it has contributed during the fiscal year, including the estimated amounts commencing at the beginning of the fiscal year and the adjusted amounts contributed in the last few months of the fiscal year, is the amount specified by the Appropriations True-Up letter.

For example, for the fiscal year ending June 30, 2002, the events described above were as follows:

June 5, 2001: Office of the Actuary (OA) sends Estimated Appropriation Letter to System stating that the estimated employer contribution for the 2002 fiscal year is $52,859,000.

July, 2001: System begins making monthly contributions of $4,405,000 for 2002 fiscal year based on the Estimated Appropriation Letter.

July, 2001: OA begins work on actuarial valuation for 2002 fiscal year. This valuation is based on census and asset data as of June 30, 2001.

June 10, 2002: OA sends "True-Up" Appropriation Letter to System stating that the employer contribution for the 2002 fiscal year is $56,548,000. At that point, the System has made 11 of the 12 estimated monthly contributions, totaling $48,454,000, for the 2002 fiscal year. The final contribution then becomes $8,094,000, so that the total of the contributions made for the year is $56,548,000.

The formula above shows the development of the Present Value of Future Normal Contributions as a balancing item. The normal contribution rate is calculated by dividing the present value of future normal contributions by the present value of projected future salaries of members on the payroll as of the valuation date. This contribution rate is calculated to be a level percentage of payroll in future years. The employer normal contribution for the ensuing fiscal year is derived by multiplying the normal contribution rate by aggregate annual salaries. The resulting normal contribution is appropriate for a value that is to be paid immediately on the valuation date; in fact, as mentioned above, the contribution is paid throughout the year. To adjust for the timing, the present value of projected future salaries reflects an interest adjustment, so that the resulting normal cost is appropriate for a mid-year contribution.

The total employer contribution is made up of several components. The normal contribution, described above, is generally the largest component. Other components are described below.

Amortization of unfunded actuarial accrued liability (UAAL contribution): This component is itself made up of one or more components, each one of which is a contribution to amortize a liability amount that is not being funded through the normal cost. The UAAL is described further in this report.

Investment Expenses: Beginning with the June 30, 1999 actuarial valuation, investment expenses were explicitly addressed in the calculation of the employer contribution; previously, the amount of investment expenses had been implicitly recognized in the calculation of the normal cost. The investment expense included in the total employer contribution for a fiscal year is the actual investment expense for the preceding fiscal year increased by the assumed interest rate; i.e., multiplied by 1.08.

Group Term Life Insurance (GTLI) Premium: In addition to retirement benefits, the System provides death benefits for members. Internal Revenue Code section 79 states that the first $50,000 of group life insurance benefits has no tax consequences to the employee or the employer; amounts of insurance in excess of $50,000 are included in employee income. To accommodate that distinction, the first $50,000 of life insurance benefit paid on account of death in active service in the Retirement System is paid from the funds of the Group Term Life Insurance Plan. The amount in excess of $50,000 is paid from the funds of the Retirement

System. The GTLI premium is the amount of the employer contribution necessary to fund the benefits to be paid from the Group Term Life Insurance Plan. The GTLI premium is not shown as a separate cost component, but is part of the normal contribution described above.

The following table, and many of the subsequent tables in this section of the report, includes values for those four fiscal years, as well as values for the immediately preceding fiscal year, ending June 30, 1999. The values determined as of June 30, 1999, are used to determine the employer contribution to be made during the fiscal year ending June 30, 2000.

Employer contributions were computed as follows (dollar amounts shown to nearest thousand):

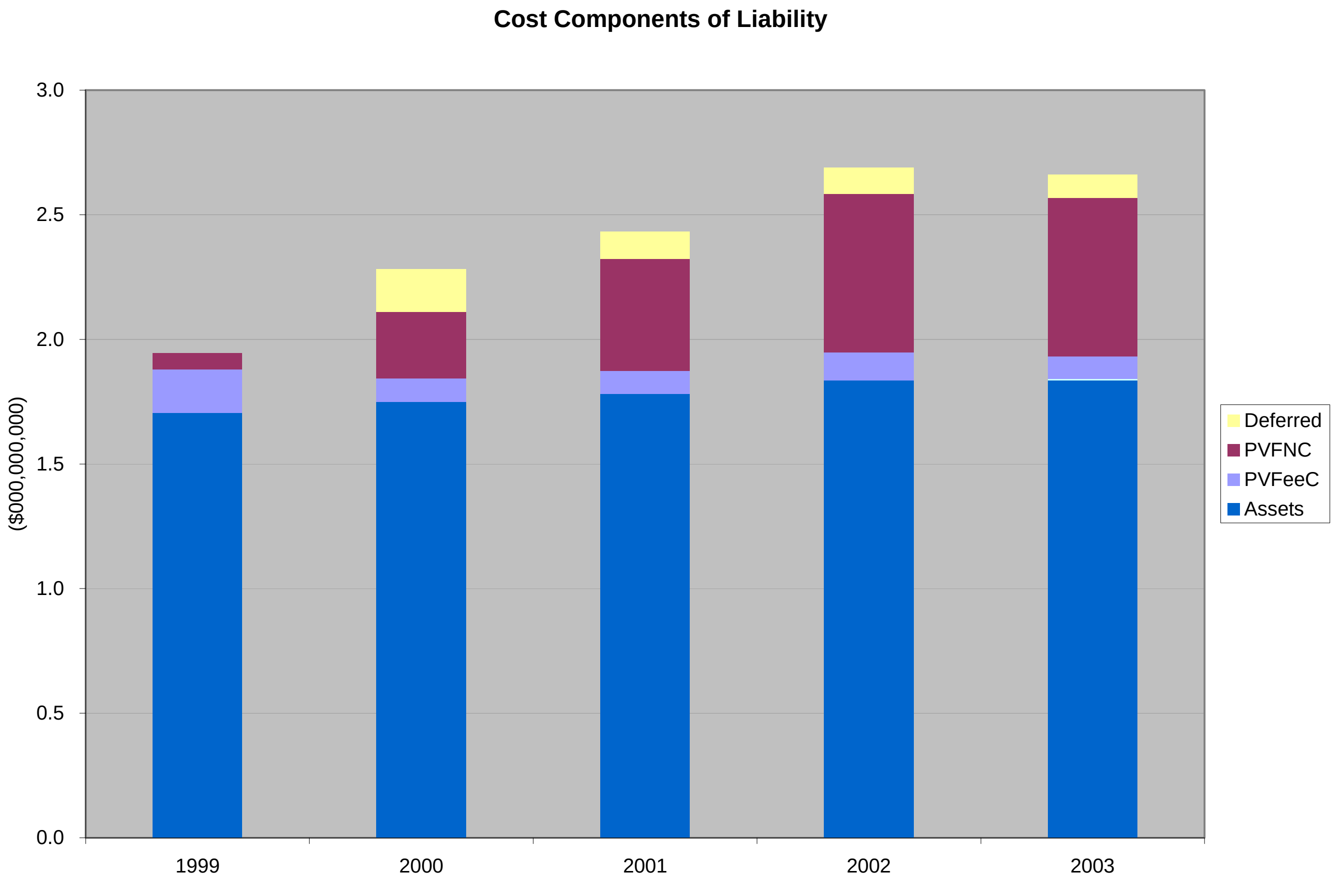
	6/30/99	6/30/00	6/30/01	6/30/02	6/30/03
Liabilities					
PV Benefits for beneficiaries	686,874	718,327	750,314	780,157	900,030
PV Supplemental Benefits	20,808	106,739	109,828	116,938	124,695
PV Benefits for Actives	1,276,950	1,511,656	1,581,974	1,795,608	1,654,488
Total	1,984,632	2,336,722	2,442,116	2,692,703	2,679,213
Deferred per 2000/125 [1]	-	141,252	1,697,537	106,137	93,488
Net Total	1,984,632	2,336,722	2,442,116	2,586,566	2,585,725
Assets					
Actuarial Asset Value	1,705424	1,749,405	1,781,702	1,835,770	1,833,798
Prospective Assets					
PV Future UAL Contribs	0	0	0	0	8,190
PV Future Employee Contribs	173,130	94,075	92,488	112,342	90,070
Due from TDA Program	40,831	54,217	10,626	4,017	17,466
Total	1,919,385	1,897,697	1,884,816	1,952,129	1,949,524
PV Future Normal Contribs	65,247	439,025	557,300	634,437	636,201
PV Future Salaries	5,217350	5,848,715	6,012,053	6,378,237	5,557,443
Normal Rate	1.251%	7.506%	9.270%	9.947%	11.448%
Annual Salaries	592,169	666,033	694,179	736,741	651,033
Components of Contribution					
Normal Contribution	7,408	49,992	64,350	73,284	74,530
Contribution credit per 2000/125 [1]	-	(12,868)	(10,113)	(5,450)	0
UAL Contribution	0	0	0	0	1,974
Administrative expenses	0	0	0	0	5,124
Investment expenses	2,106	2,078	2,310	2,381	2,426
Total Pension Expense	9,514	39,202	56,547	70,215	84,054
City Rate	1.607%	5.886%	8.146%	9.530%	12.911%

[1] Sections 13-696.i and .j of the Administrative Code of the City of New York, as added by Chapter 125 of the Laws of 2000 and amended by Chapter 278 of the Laws of 2002, requires that the funding for the additional liability attributable to the automatic cost-of-living adjustments provided by Chapter 125 of the Laws of 2000 be deferred.

The table above shows that the normal contribution, the largest single component of the total employer contribution, increased significantly from 1999 to 2003. The normal contribution had decreased to a relatively low level in the late 1990's due to significant investment gains, as well as changes in actuarial assumptions and methodology. During the period this examination covers, investment results were significantly less than expected. In addition, significant benefit increases were provided. As a result, the normal contribution rate, as developed by the traditional actuarial process, has begun to increase.

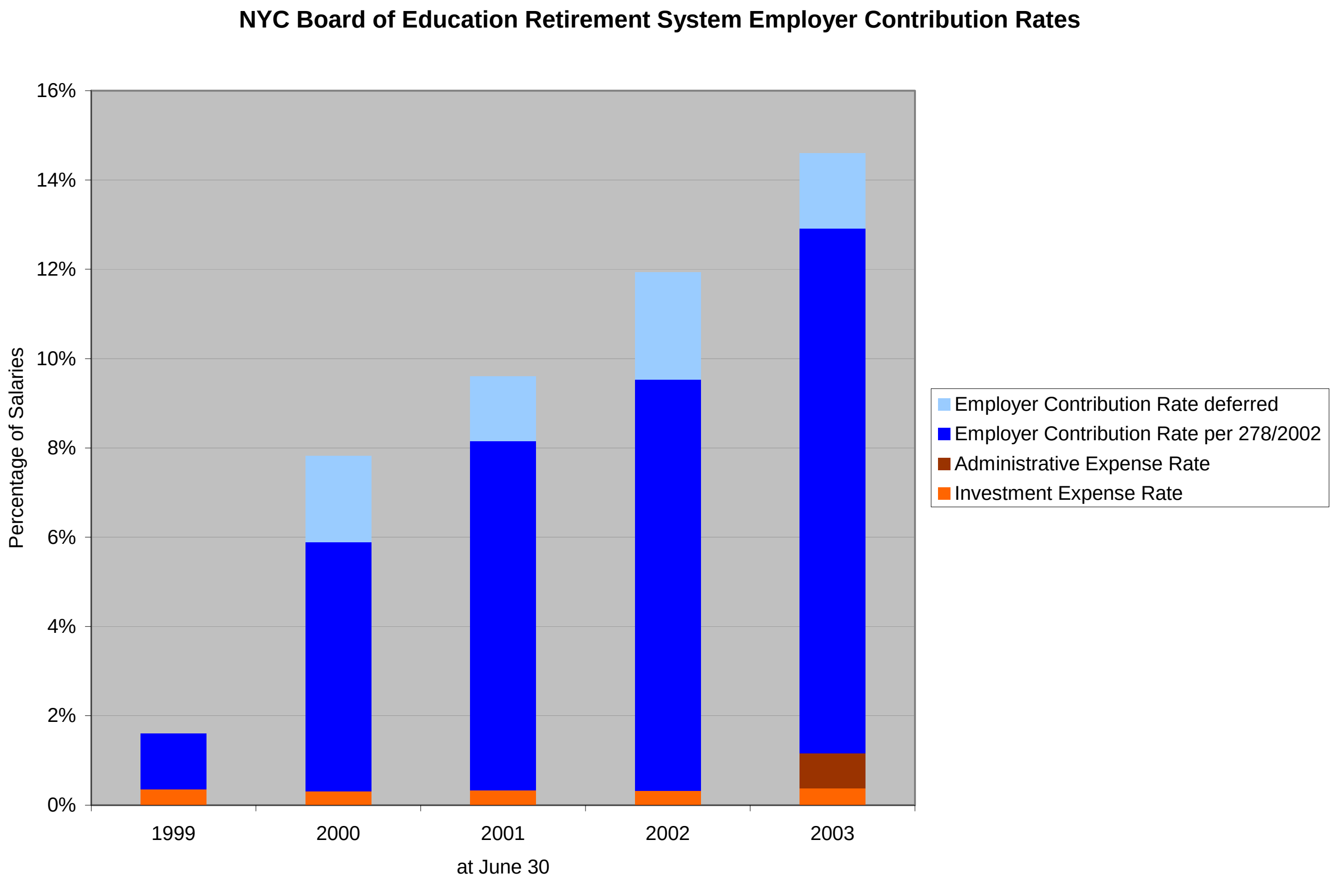
However, a legislative change has delayed some of the effect of the actuarial increase in the employer normal contribution. Chapter 125 of the Laws of 2000 provided automatic cost-of-living allowances to retirees, reduced member contributions for certain members, and other benefit increases. That Chapter also required that the funding for the additional liability created by the Chapter be phased in over five years. Chapter 278 of the Laws of 2002 modified that phase-in period so that the additional liability created by Chapter 125 was phased in over a ten year period.

Shown below is a chart of the primary asset and liability components.



This chart illustrates the major components that were used to develop the employer contribution requirement. The total height of each bar represents the total plan liability – the present value of benefits to be eventually provided to members. The darker blue portion of the bars represents the actuarial value of assets, and the lighter blue portion represents the present value of future employee contributions. The remaining portion of each bar shows the amount of liability that is to be paid by the employer: the maroon color shows the amount to be paid in the current year, and the lighter color shows the amount that is deferred based on Chapter 278 of the Laws of 2002. The chart illustrates that, as the liabilities have increased at a more rapid rate than the assets in the last four years, the amounts to be contributed by the employer (both current and deferred) have increased.

The following chart illustrates the components of employer costs as a percentage of salaries. The investment expenses are the costs to manage the investments of the System. The employer cost for benefits is shown in two components: the portion being contributed in the current year, and the portion being deferred to future years according to Chapter 278 of the Laws of 2002. The total employer contribution, including expenses and the normal cost, has, since 1981, decreased from over 20% to less than 2% of salaries in 2000. Since 2000 the funded status of the plan has decreased, and as a result, the employer contribution has begun to increase. In the next few years, the employer cost is expected to increase to more historically average levels.



12. UNFUNDED ACTUARIAL ACCRUED LIABILITY

The unfunded actuarial accrued liability (UAAL) of a pension plan refers to the present value of required employer contributions other than normal contributions. Generally, UAAL is liability that is attributable to benefit increases. UAAL is not a measure of the overall funding status of the pension plan. Such measures are discussed elsewhere in this report in the section titled Funding Ratios.

The items to be funded through UAAL contributions, and the computation of the initial UAAL balance, are affected by the choice of funding method. Under the System's funding method, new unfunded accrued liability balances generally are established in connection with improvements in member benefits attributable to past service and in connection with changes in actuarial assumptions. The amount of such new UAAL balances is computed by the Entry Age Normal Cost Method.

The System's total UAAL at any point in time is the aggregate present value of the remaining payments in amortization of all previously established UAAL balances.

As of June 30, 1999, just prior to the examination period, the UAAL was zero; the previous UAAL had been eliminated due to a reestablishment of the UAAL as of June 30, 1999 as specified by Chapter 85 of the Laws of 2000. The elimination of the UAAL due to the reestablishment does not reduce the measurement of the total plan liability; it merely shifts the liability from the UAAL component, where it would have been amortized over a fixed number of years, to the Normal Cost component, where it is funded over the remaining working lifetime of the active participants.

During the first three years of this examination period, the UAAL remained at zero. Effective June 30, 2003, an additional liability was recognized due to Chapter 69 of the Laws of 2002, which provided an early retirement incentive. The resulting UAAL, about $8 million, is to be amortized over five years at almost $2 million per year.

The total UAAL and the total annual amortization payment during the examination period are shown below.

Valuation Date June 30	Total UAAL	Payment
1999	$0	$0
2000	0	0
2001	0	0
2002	0	0
2003	8,189,794	1,973,735

13. ACTUARIAL ASSET VALUATION METHOD

Assets are reported in the System's annual statements at amortized value for bonds and market value for stocks. More than half of the System’s total assets are invested in stocks, and their market value is considered too volatile to use directly in computing employer contributions. Accordingly, for purposes of computing employer contributions, market values are smoothed by the use of an actuarial asset valuation (AAV) method.

The AAV method (adopted with the June 30, 1991 valuation) adjusts the current year's market value to recognize “unexpected return” over a five year period. “Unexpected return” is defined as the excess of actual investment income, including realized and unrealized changes in market value, over expected investment income. Expected investment income, in turn, is defined to be the valuation interest rate multiplied by the mean actuarial value of investable assets.

Within a short period prior to this examination period, a “market value restart” was implemented two times, on June 30, 1995 and June 30, 1999. In a market value restart, the actuarial value of assets is set equal to the market value of assets. On both of those dates, prior to the restart, the actuarial value of assets was less than the market value of assets. Therefore, as a result of the restarts, the new actuarial value of assets was higher than what it otherwise would have been. It is recognized that the change in actuarial asset valuation method is being made in conjunction with other changes in actuarial assumptions and methods. However, the actuarial standard of practice regarding actuarial asset valuation methods promulgated by the Actuarial Standards Board requires that the general effect of this recent change in the actuarial asset valuation method be disclosed. (This standard was discussed beginning in 2002, and has since become effective.) While the published reports on the 1995 and 1999 actuarial valuations stated that the actuarial asset valuation method was changed, there was no mention of the general effect of that change, as would be required by the actuarial standard of practice. In fact, the consequence of both changes was a reduction in current employer contribution requirements, and therefore an increase in later employer contribution requirements; i.e., a deferral of employer contribution requirements to later years. During this examination period there were no market value restarts.

In the annual statements filed by the System with the New York Insurance Department, the balance sheet entry, "Excess of admitted assets over total net reserves and all other liabilities," embodies the difference between admitted assets and the actuarial value of assets. To arrive at the actuarial asset value used in computing pension expense, it is necessary to deduct amounts not available for future benefits, such as benefits due and unpaid and mortgage escrow.

Until the June 30, 2002 valuation, it had been the System's practice to deduct member loans from both assets and liabilities in the pension expense computations. That practice was changed with the June 30, 2002 valuation: member loans were viewed as another form of investment for the fund, and were thus included in the determination of plan assets.

The table below shows the relationship between the actuarial value of assets for pension expense purposes and the assets in the annual statement ($000):

	(1)	(2)	(3)	(4)	(5)
Valuation Date	Assets for Pension Expense	Excess of Book Value over Market Value of Bonds	Deferred Employer Contributions	Net Receivable Due to TDA	Accrued Benefits Payable
6/30/99	1,740,493	5,725	0	8,447	4,976
6/30/00	1,771,619	(2,527)	30,875	8,447	4,036
6/30/01	1,546,410	59,940	0	8,447	5,569
6/30/02	1,438,374	(46,020)	0	0	1,576
6/30/03	1,410,600	(15,809)	0	0	4,441

	(6)	(7)	(8)	(9)	(10)
Valuation Date	Due to BERS TDA	Loan Receivables	Non-admitted Assets	Other	Assets Annual Statement
6/30/99	96,400	31,646	(35,069)	(667)	1,851,951
6/30/00	112,406	29,433	0	5,644	1,959,933
6/30/01	134,409	34,323	0	(11,432)	1,777,666
6/30/02	0	0 [a]	0	(291)	1,393,639
6/30/03	0	0 [a]	0	(637)	1,398,595

[a] Beginning with the June 30, 2002 valuation, member loans were not excluded from plan assets, so this adjustment was not necessary.

14. INTEREST EARNED AND INTEREST REQUIRED

Included in the System's annual statements to the Insurance Department are the total investment income actually earned during the year, including realized and unrealized changes in market values and, for fixed (non-variable) funds, the amount of interest required to maintain those funds. Investment experience on variable funds passes directly to the members via changes in unit values; consequently, interest required to maintain variable funds would not be a meaningful concept.

Interest required to maintain funds is computed by multiplying the assumed valuation interest rate by the mean actuarial value of assets. Thus, the amount reported as interest required to maintain funds represents the expected investment income for the fiscal year.

Fixed funds of the Tax Deferred Annuity Program and the Qualified Pension Plan are invested in a common pool, and the resulting investment income is shared between the two. It is therefore useful to compare interest earned with interest required for the TDA and QPP in combination. The amounts of interest earned and interest required during the period under examination for the QPP and the non-variable funds of the TDA in combination were as follows ($000):

Fiscal Year ending 6/30	(1) Interest Earned	(2) Interest Required	(3) Excess (1) - (2)	(4) Ratio (1) ÷ (2)
1999	263,562	117,592	145,970	224%
2000	168,699	131,617	37,082	128%
2001	(148,887)	173,865	(322,752)	(86%)
2002	(200,249)	174,492	(374,741)	(115%)
2003	57,676	165,044	(107,368)	35%
TOTAL	(142,573)	762,608	(621,811)	(19%)

As the table indicates, actual investment earnings were over twice the expected investment income during the 1999 fiscal year, then began a significant drop. The magnitude of the investment losses during each of the 2001 and 2002 fiscal years was larger than the expected investment earnings, but in the opposite direction.

15. FUNDING RATIOS

Attachment B of the System's annual statements to the Insurance Department provides, as a measure of funding adequacy, the ratio of assets available for active members to the projected benefit obligation (PBO) for active members.

The PBO is the present value of pension benefits resulting from employee service up to the date of the annual statement, based on salaries projected to the date of retirement. (PBO thus is different from the annual statement's “Present Value of Benefits for Members now in Active Service,” which is based on members’ total anticipated service as of the date of retirement.) The PBO includes vested benefits for terminated members.

The PBO was developed according to Statement No. 5 of the Government Accounting Standards Board (GASB 5), even though GASB 5 has been largely superseded by GASB 27. However, according to both GASB 5 and GASB 27, where the actuarial cost method is the Frozen Entry Age, for purposes of computing the PBO, the member's total projected benefit at retirement is prorated uniformly over total anticipated service, even if the plan's benefit formula provides a non-uniform pattern of benefit accrual. For many members the System's benefits accrue more rapidly in the earlier years of a member's service than in the later years. For such members the uniform prorate required by GASB produces a lower PBO, and hence a more favorable funding ratio, than would be produced by prorating benefits strictly according to the benefit formula.

Assets available for active members are the System's admitted assets reduced by the following: present value of benefits to beneficiaries now drawing allowances, accumulated member contributions, benefits due and unpaid and other miscellaneous liabilities. Amounts relating to group life insurance benefits are excluded from assets as well as from the PBO.

A strength of this funding ratio as a measure of funding adequacy is that it is independent of the actuarial cost method used for determining contributions to the pension plan. Its weakness is that it is dependent on the actuarial assumptions used for determining those contributions. Actuarial assumptions that are more optimistic lead to a lower level of future funding requirements, and produce a more favorable funding ratio.

Funding ratios, as reported in Schedule B of the Annual Statement, are shown below ($000,000):

Valuation Date	(1) Assets Available for Active Members	(2) Projected Benefit Obligation	(3) Funding Ratio (1) ÷ (2)
6/30/99	1,023	677	151%
6/30/00	935	806	116%
6/30/01	733	862	85%
6/30/02	456	980	47%
6/30/03	310	955	32%

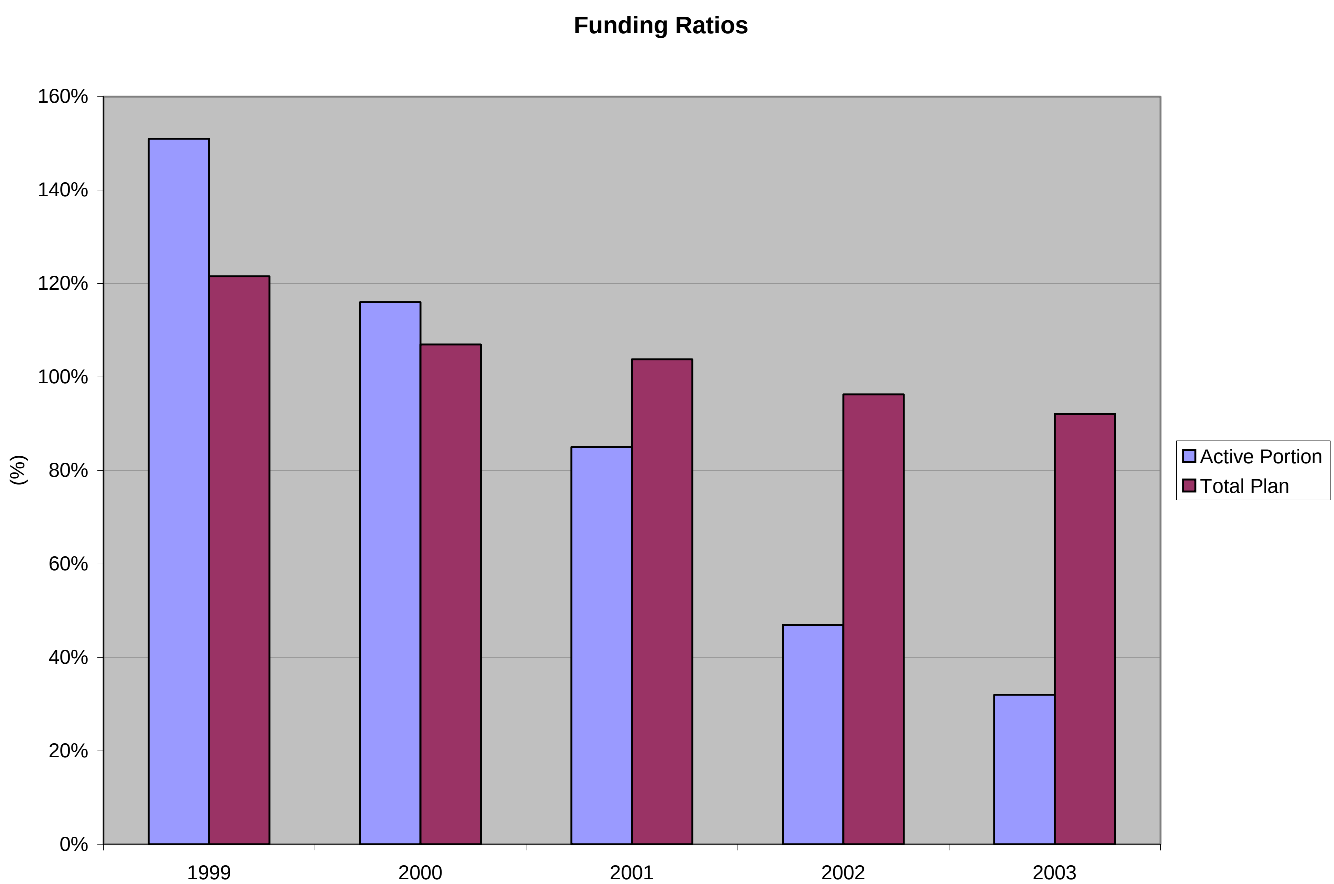
The decrease in Funding Ratio shown above is due primarily to the decrease in investment yield referred to earlier in this report.

It should be noted that the decrease in Funding Ratio shown above does not reflect the change in funded status of the entire Plan. The Funding Ratio above is based on a comparison between the liabilities for active members and assets "available" for active members; this measurement excludes liabilities attributable to retirees, etc., and to assets that could be allocated to those retirees. The value of assets "available" for active members is the total plan assets reduced by the liability attributable to non-active members. Thus, for the purpose of this measurement, all plan investment gains or losses flow through to this funding ratio, which excludes non-active members. This "leveraging" effect magnifies the apparent change in funded status of the entire plan.

The table below shows the funding ratios for total plan assets and liabilities ($000,000).

Valuation Date	(1) Assets	(2) Projected Benefit Obligation	(3) Funding Ratio (1) ÷ (2)
6/30/99	1,705	1,402	122%
6/30/00	1,749	1,635	107%
6/30/01	1,782	1,717	104%
6/30/02	1,836	1,907	96%
6/30/03	1,834	1,991	92%

The first table, reflecting only a portion of plan assets and liabilities, shows a decrease in funding ratio from 151% to 32%. The second table, reflecting all plan assets and liabilities, shows a somewhat less steep reduction, from 122% to 92%. This relationship can be seen in the chart below.



16. ACTUARIAL ASSUMPTIONS AND METHODS

Several changes in assumptions and methods were proposed by the Office of the Actuary for the June 30, 1999 valuation, just prior to the beginning of the four-year period this examination covers. These changes were implemented in Chapter 85 of the Laws of 2000, and included the following:

- The actuarial interest rate was changed from 8.75% to 8.00%.
- The General Wage Increase component of the salary scale assumption was changed from 4% to 3%.
- The assumed rates of mortality, withdrawal, retirement and disability were changed based on recent experience studies.
- The Unfunded Actuarial Accrued Liability was consolidated and reestablished using the Entry Age Actuarial Cost Method, and the Balance Sheet Liability (BSL) was eliminated. The resulting UAAL was $0.
- The actuarial asset value was reset to market value.
- The investment expenses were reimbursed to the Fund as a separately-identified contribution amount.

During the examination period the System engaged a pension consulting organization (Gabriel, Roeder, Smith & Company) to analyze System experience in relation to the actuarial assumptions. The study reviewed experience data from June 30, 1988 to June 30, 2001. The consulting organization issued a final report dated October, 2003 in which a number of changes in actuarial assumptions were recommended. Because the publication date of the report was a relatively short time before the completion of this examination, it would not be reasonable to expect that any of the changes recommended in the report would have been implemented by the completion of this examination. The recommendations in the consultant's report included making changes in the salary scale assumption, withdrawal assumption, and mortality assumption, among others.

The principal actuarial assumptions include an interest assumption (the assumed investment yield, which is also the rate at which liabilities are discounted), a salary scale assumption (the assumed percentage increase in salaries), and assumptions regarding the rate at which members leave active status according to reason: mortality, retirement, withdrawal or disability. A selected summary of the assumptions is shown below:

Interest: 8% per year

Salary Scale:

Age	Annual Percentage Increase
25	6.50%
40	5.00
55	4.30

Withdrawal from active service (for other than service retirement):
Rates shown are for males, who comprise about 60% of total plan liability.

Age	Termination	Ordinary Disability Retirement	Ordinary Death
25	12.51%	.02%	.04%
40	3.39	.07	.12
55	2.10	.10	.57

Withdrawal from active service (for service retirement):
Rates shown are for members not electing Optional Retirement Program.

	- - Years of service since eligibility - -		
Age	0-1	1-2	2+
50	12%	0%	0%
55	12	10	8
60	12	10	8
65	30	30	30
70	100	100	100

Both the interest assumption and the salary scale assumption are made up of other, more fundamental, components. The interest assumption is composed of a price inflation assumption and a “real” interest rate; i.e., a rate of return in the absence of any price inflation. The salary scale assumption is composed of the price inflation assumption, a “real” wage increase (in the absence of any price inflation), and a merit/promotion increase. The merit/promotion increase assumption varies by age and service. The components of the interest assumption and the salary scale assumption can be illustrated as follows:

Component	Investment Return	Salary Scale
Price Inflation	2.5%	2.5%
Real interest rate	5.5	---
Real wage growth	---	.5
Merit/Promotion	---	varies by age and service
Total	8.0%	3.0% plus value that varies by age and service

Actuarial Standard of Practice No. 27 (ASOP 27), “Selection of Economic Assumptions for Measuring Pension Obligations”, provides professional actuarial guidelines for choosing an investment return assumption; generally, the discount rate, used in determining the present value of expected future plan payments, is the same as the investment return assumption. ASOP 27 states that, for the investment return assumption, the actuary should choose a single point that is within a “best-estimate range”, which is also developed by the actuary.

The prior report on examination (for the period July 1, 1994 to June 30, 1999) contained a comment related to the “spread”, or excess of the interest rate assumption over the wage growth assumption. The wage growth assumption is the sum of the price inflation and the real wage growth. The spread for the four-year period of this examination, based on the values shown in the table above, is 8.0 – (2.5 + .5) = 8.0 – 3.0 = 5.0%. The comment in the prior report noted that the spread has increased from 2% to 5% over the previous eleven years. An increasing spread results in decreasing employer contributions. The comment in the prior report was meant to raise awareness of the fact that the spread has been increasing, resulting in a less conservative funding approach. Although the spread did not increase further during the four years covered by this examination (July 1, 1999 to June 30, 2003), it still remains at a relatively high level compared to the spread for this system for much of its history. The spread is also higher than that of most other public retirement systems in this country during the same time period. As mentioned above, a higher spread results in lower current contributions, but also higher contributions in subsequent years; i.e., a deferral of a portion of the otherwise required employer contribution.

17. INVESTMENT MANAGEMENT OPERATIONS

The highest governing body at the System is its board of trustees. The members of the retirement board are the trustees of the funds of the System and, as such, are fiduciaries for the System, its members and its retirees. The trustees delegate the System's investment functions to the New York City Comptroller, pursuant to Section 13-702 of the New York City Administrative Code. The investment powers transferred to the Comptroller are subject to written delegations which may not exceed one year. Although this authority is renewed annually, the System is not required to use the Comptroller for investment services. The investment services provided to the System by the Comptroller are provided through the Bureau of Asset Management (BAM), a division of the Comptroller's office. The delegated powers authorize the Comptroller of the City of New York to make any investment which the System trustees are authorized to make. Also, the Comptroller is authorized to hold, sell, assign, transfer, or dispose of any of the properties, securities or investments in which any of the funds of the System have been invested.

> Section 136.2 of Department Regulation No. 85 states in part:
>
> (b) "*Administrative head* shall mean,…the board of trustees of a retirement system, in their individual and collective capacities"
>
> Section 136.6 of Department Regulation No. 85 states in part:
>
> "(a) The administrative heads are fiduciaries and as such shall act solely in the interests of the members and beneficiaries of the systems they administer. They

> shall perform their responsibilities in a manner consistent with those of a reasonably prudent person exercising care, skill and caution. (b) The assets of a system shall at all times be under the control of the administrative head. (c) No investment or loan transaction shall be made by a system unless the same has been approved by the administrative head. The administrative head may delegate its powers of investment to a committee or agent of the administrative head within well-defined established guidelines. Such committee or agent shall render timely written reports of its activities to the administrative head under a schedule to be established by the administrative head and shall render special reports whenever requested by the administrative head. (d) In respect to the delegation of investment powers, the administrative head shall periodically review: (1) the present holdings in the investment account; (2) any marked changes in the account during the preceding period; (3) the reasons for such changes and the results achieved thereby; (4) the investment activity in the account including the rate of turnover; and (5) any other factors the administrative head considers pertinent to an analysis of the financial performance and planning, consistent with its obligation as a fiduciary."

As outlined in Department Regulation No. 85, the trustees are the fiduciaries of the System and as such must act solely in the interests of its members and beneficiaries. No board collectively, no trustee individually, nor any administrative head, can delegate their fiduciary obligations to others. They must perform their responsibilities in a manner consistent with those of a reasonably prudent person exercising care, skill and caution. The Regulation requires that the assets, at all times, be under the control of the trustees and that investments and loan transactions be approved by the trustees. Department Regulation No. 85 allows the trustees to delegate its investment powers within well–defined established guidelines and with the rendering of timely written reports of its activities to the trustees under a schedule established by the trustees. At a minimum, the Department believes that appropriate implementation of such guidelines requires a comprehensive Investment Policy Statement.

A. <u>Investment Policy Statement</u>

The examiner reviewed a sample of the transcripts of the meetings of the board of trustees for the period under examination, and made the following findings:

1. The sampled transcripts revealed instances where the trustees were concerned about the lack of an overall Investment Policy Statement.

2. The sampled transcripts show that the board began to formulate a comprehensive investment policy statement only toward the end of the period that is the subject of this review. The transcripts reveal no material substantive consideration of an investment policy statement's specific contents or provisions before the end of that period. Similarly, in the following areas, where the responsibility to establish standards belongs to the trustees, the board meeting transcripts reveal little board discussion:

    a. The sampled transcripts reveal no board discussion of establishing an investment policy statement of sufficient detail to guide a third party when trying to implement the trustees' instructions.
    b. The sampled transcripts do not reveal a clear definition of the duties and responsibilities of the investment committee, the Comptroller's office (either as custodian or as fund manager), the investment consultants, or the separate account managers.

Based on the examiner's review, it was revealed that during the period of examination the System did not have a comprehensive Investment Policy Statement that governed, controlled, and monitored its investment activities. However, subsequent to the examination period the System did develop a comprehensive Investment Policy Statement which the Department believes satisfies its concerns about proper governance of the System's investment activities. It is noted that the System and the Comptroller maintain that the System did have various policies and guidelines in place governing investment activities, and that in an effort to consolidate those guidelines an Investment Policy Statement was adopted starting in 2004.

18. PRIOR REPORT SUMMARY AND CONCLUSIONS

Following are the violations, recommendations and comments contained in the prior report on examination and the subsequent actions taken by the System in response to each citation:

Item	Description
A	The examiner recommends that the System's "Rules and Regulations" be updated and recodified on a timely basis and that the updated "Rules and Regulations" be submitted to the Department for review. The Rules and Regulations were updated with the latest update in January, 2005. Updates will be made as deemed necessary. The Rules and Regulations have not been submitted to the Department for review.
B	The examiner recommends that the System facilitate the Department in obtaining proper security confirmations from its custodian. The System sent memos to the City Comptroller's office in an attempt to assist the examiner; however no response was received from the Comptroller's office.
C	The examiner recommends that the System facilitate the Department in obtaining proper cash confirmations from its bank. The System sent memos to the City Comptrollers office in an attempt to assist the examiner; however no response was received from the Comptroller's office.
D	The System violated Section 310(a)(2) of the New York Insurance Law and Section 136.4 of Department Regulation No. 85 by failing to provide work papers for the preparation of its annual statement. The System was more responsive to the requests of the examiners during the current examination.
E	The prior report commented on the fact that the actuarial value of assets was adjusted twice recently, as of June 30, 1995 and June 30, 1999, in such a way as to reduce the employer contribution each time. The report recommended that, if the System continued to make adjustments to the actuarial value of assets, it do so in such a way as to not consistently bias the level of contributions (in either direction). During the four years of this examination, the System has not made any similar asset adjustments.

19. SUMMARY AND CONCLUSIONS

Following are the violations, recommendations and comments contained in this report:

Item	Description	Page No(s).
A	The minutes of the meetings of the board of trustees and its committees indicated that the meetings were not well attended and that several trustees did not attend a majority of the meetings. The examiner recommends that all board members attend scheduled board meetings.	6
B	The System violated Section 136.4(g) of Department Regulation No. 85 when it failed to have on its staff an internal auditor. The examiner recommends that the System establish and maintain an independent, adequately resourced, and competently staffed internal audit function to provide management with ongoing assessments of the System's risk management processes and the accompanying system of internal control.	18
C	The examiner recommends that the Comptroller's Office facilitate the System and the Department in obtaining proper securities and cash confirmations from its custodian, and banks.	19
D	The examination noted that the "spread" which has increased over the years prior to the examination period still remains at a relatively high level compared to the spread for this system for much of its history.	42
E	Based on the examiner's review, it was revealed that during the period of examination the System did not have a comprehensive Investment Policy Statement that governed, controlled, and monitored its investment activities. However, subsequent to the examination period the System did develop a comprehensive Investment Policy Statement which the Department believes satisfies its concerns about proper governance of the System's investment activities. It is noted that the System and the Comptroller maintain that the System did have various policies and guidelines in place governing investment activities, and that in an effort to consolidate those guidelines an Investment Policy Statement was adopted starting in 2004.	44

Respectfully submitted,

_____________/s/___________
Anne L. Forde
Principal Insurance Examiner

STATE OF NEW YORK)
)SS:
COUNTY OF NEW YORK)

Anne L. Forde, being duly sworn, deposes and says that the foregoing report, subscribed by her, is true to the best of her knowledge and belief.

_____________/s/___________
Anne L. Forde

Subscribed and sworn to before me

this__________ day of ____________________2009

Respectfully submitted,

_____________/s/____________
Michael J. Lambert
Supervising Actuary

STATE OF NEW YORK)
)SS:
COUNTY OF NEW YORK)

Michael J. Lambert, being duly sworn, deposes and says that the foregoing report, subscribed by him, is true to the best of his knowledge and belief.

_____________/s/____________
Michael J. Lambert

Subscribed and sworn to before me

this__________ day of ____________________2009

APPOINTMENT NO. *22275*

STATE OF NEW YORK

INSURANCE DEPARTMENT

I, ***LOUIS PIETROLUONGO*** *, First Deputy Superintendent of Insurance of the State of New York, pursuant to the provisions of the Insurance Law, do hereby appoint:*

WILLIAM TARDOGNO

as a proper person to examine into the affairs of the

BOARD OF EDUCATION RETIREMENT SYSTEM OF THE CITY OF NEW YORK

and to make a report to me in writing of the condition of the said

SYSTEM

with such other information as he shall deem requisite.

In Witness Whereof, I have hereunto subscribed by name
and affixed the official Seal of the Department
at the City of New York

this 13th day of January ,2005

LOUIS PIETROLUONGO
First Deputy Superintendent of Insurance

First Deputy Superintendent