MARIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION

FINANCIAL STATEMENTS
WITH
INDEPENDENT AUDITOR'S REPORT

FOR THE FISCAL YEARS
ENDED JUNE 30, 2010 AND 2009

**MARIN COUNTY EMPLOYEES'
RETIREMENT ASSOCIATION
JUNE 30, 2010**

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INDEPENDENT AUDITOR'S REPORT

To the Board of Retirement
Marin County Employees' Retirement Association

We have audited the accompanying statement of plan net assets of the Marin County Employees' Retirement Association (MCERA) as of June 30, 2010 and 2009, and the related statement of changes in plan net assets for the years then ended. These financial statements are the responsibility of management of MCERA. 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 2 to the financial statements, MCERA adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 51, *Accounting and Financial Reporting for Intangible Assets,* and Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*.

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the MCERA as of June 30, 2010 and 2009, and its changes in plan net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis as listed in the Table of Contents is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The required supplementary information as listed in the accompanying table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements of MCERA. The required supplementary information have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

BROWN ARMSTRONG
ACCOUNTANCY CORPORATION

Bakersfield, California
October 5, 2010

MARIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2010

This Management's Discussion and Analysis (MD&A) of the financial activities of Marin County Employees' Retirement Association (MCERA) is an overview of its fiscal operations for the year ended June 30, 2010. Readers are encouraged to consider the information presented in conjunction with the Financial Statements and Notes to the Basic Financial Statements.

We are pleased to provide this overview and analysis of the financial activities of MCERA for the year ended June 30, 2010. MCERA is the public employee retirement system established by the County of Marin on July 1, 1950, and is administered by the Board of Retirement to provide retirement, disability, and death and survivor benefits for its employees under the County Employees Retirement Act of 1937.

Financial Highlights

MCERA's plan net assets as of June 30, 2010, were $1,211,230,219. The plan net assets are held in trust for payment of pension benefits to participants and their beneficiaries and all of the net assets are available to meet MCERA's ongoing obligations.

- Net assets increased by $81,208,934, primarily as a result of earnings from investments.
- Total additions as reflected in the Statement of Changes in Plan Net Assets were an increase of $373,541,397, primarily as a result of earnings from investments.
- Deductions in plan net assets increased from $82,063,426 to $88,453,569 versus the prior year. The increase was due to an increase in retiree pension benefits.
- MCERA's funding objective is to meet long-term benefit obligations through contributions and investment income. As of June 30, 2009, the date of the last actuarial evaluation, the funded ratio for all MCERA agencies was 72.12%. In general, this indicates that for every dollar of benefits due we had approximately $0.7212 of assets available for payment as of that date. The funding ratios of the employer entities included in MCERA were: 74.21% for the County of Marin and agencies, 63.15% for San Rafael, and 76.60% for Novato.

Overview of the Financial Statements

This MD&A serves as an introduction to the basic financial statements. MCERA has two basic financial reports, the notes to the basic financial statements, and two required supplementary schedules of historical trend information. The basic financial statements and the required disclosures are in compliance with the accounting principles and reporting guidelines as set forth by the Governmental Accounting Standards Board, utilizing the accrual basis of accounting.

Please note, however, that this report also contains other supplementary information in addition to the basic financial statements themselves.

The Statement of Plan Net Assets is the first basic financial report. This is a snapshot of account balances at fiscal year end. This statement reflects assets available for future payments to retirees and their beneficiaries and any current liabilities that are owed as of fiscal year end. The Net Assets Held in Trust for Pension Benefits, which are the assets less the liabilities, reflect the funds available for future use.

The Statement of Changes in Plan Net Assets is the second basic financial report. This report reflects all the activities that occurred during the fiscal year, and shows the impact of those activities as Additions or Deductions to the plan. The trend of Additions versus Deductions to the plan will indicate the condition of MCERA's financial position over time.

Both statements are in compliance with Governmental Accounting Standard Board (GASB) Pronouncements 25, 26, 28, 33, 34, 40, 44, 50, 51, 53, 55, and 56. These pronouncements require certain disclosures and also require the state and local governments to report using the full accrual method of accounting. MCERA complies with all material requirements of these pronouncements.

The Statement of Plan Net Assets and the Statement of Changes in Plan Net Assets report information about MCERA's activities. These statements include all assets and liabilities using the full accrual basis of accounting as practiced by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid. Investment gains and losses are reported on a trade-date basis and both realized and unrealized gains and losses on investments are shown.

These two statements report MCERA's net assets held in trust for pension benefits (net assets) – the difference between assets and liabilities – as one way to measure MCERA's financial position. Over time, increases and decreases in MCERA's net assets is one indicator of whether its financial health is improving or deteriorating. Other factors, such as market conditions, should also be considered in measuring MCERA's overall health.

The Notes to the Basic Financial Statements (Notes) are an integral part of the financial reports. The Notes provide detailed discussion of key policies, programs and activities that occurred during the year.

The *Schedule of Funding Progress* required supplementary schedule includes historical trend information about the actuarially funded status of MCERA, and the progress made in accumulating sufficient assets to pay benefits when due. The other required supplementary schedule, the *Schedule of Employer Contributions*, presents historical trend information about the annual required contributions of the employer and the actual contributions made. These schedules provide information to help promote understanding of the changes in the funded status of MCERA over time.

Financial Analysis

The reserves needed to finance retirement benefits are accumulated through the collection of employer and employee contributions and through earnings on investment income (net of investment expense). Net assets held in trust for pension benefits as of June 30, 2010, totaled $1,211,230,219, an increase of $81,208,934 over the prior year. MCERA's assets exceeded its liabilities at the end of the year. The Total Plan Net Assets represent funds available for future payments. However, of importance, is the fact that unlike private pension funds, public pension funds are not required to report the future liability of obligations owed to retirees. Only current liabilities are reported in the Statement of Plan Net Assets. Below is a comparison of current and prior year balances:

	2010	2009	2008	Increase (Decrease) 2010/2009	Increase (Decrease) 2009/2008
Investments at fair value	$ 1,068,714,633	$ 1,005,525,154	$ 1,364,854,777	$ 63,189,479	$ (359,329,623)
Cash and cash equivalents	135,783,006	118,021,449	51,958,299	17,761,557	66,063,150
Capital assets (net of accumulated depreciation)	7,189,149	6,104,088	3,528,012	1,085,061	2,576,076
Collateral held for securities loaned	85,912,381	48,596,264	109,220,513	37,316,117	(60,624,249)
Receivables and other assets	8,726,306	8,515,264	15,655,601	211,042	(7,140,337)
Total assets	1,306,325,475	1,186,762,219	1,545,217,202	119,563,256	(358,454,983)
Total liabilities	95,095,256	56,740,934	129,641,659	38,354,322	(72,900,725)
Net assets	$ 1,211,230,219	$ 1,130,021,285	$ 1,415,575,543	$ 81,208,934	$ (285,554,258)

In order to determine whether Plan Net Assets will be sufficient to meet future obligations, the actuarial funded status needs to be calculated. An actuarial valuation is similar to an inventory process. On the valuation date, the assets available for the payment of retirement benefits are appraised. These assets are compared with the actuarial liabilities, which are the actuarial present value of all future benefits expected to be paid for each member. The purpose of the valuation is to determine what future contributions by the members and the County of Marin are needed to pay all expected future benefits.

MCERA's independent actuary, EFI Actuaries, performed an actuarial valuation as of June 30, 2009, and determined that the funded ratio of the actuarial assets to the actuarial accrued liability is 72.12%. The actuarial valuation as of June 30, 2008 determined the funded ratio to be 83.97%.

Additions to Plan Net Assets

There are three primary sources of funding for MCERA retirement benefits: earnings (losses) on investments of assets and employer and employee contributions. Income sources for the fiscal years June 30, 2010 and 2009, totaled $169,662,503 and $(203,878,894), respectively.

	2010	2009	2008	Increase (Decrease) 2010/2009	Increase (Decrease) 2009/2008
Employer contributions	$ 56,270,346	$ 54,555,518	$ 58,089,688	$ 1,714,828	$ (3,534,170)
Plan members contributions	17,419,684	17,397,816	15,881,073	21,868	1,516,743
Total net investment income (loss)	95,972,473	(275,832,228)	(98,656,557)	371,804,701	(177,175,671)
Total	$ 169,662,503	$ (203,878,894)	$ (24,685,796)	$ 373,541,397	$ (179,193,098)

Deductions from Plan Net Assets

MCERA was created to provide lifetime retirement annuities, survivor benefits, and permanent disability benefits to qualified members and their beneficiaries. The cost of such programs includes recurring benefit payments, as designated by the plan, refund of contributions to terminated employees, and the cost of administering the system. Below is a comparison of selected current and prior year balances:

	2010	2009	2008	Increase (Decrease) 2010/2009	Increase (Decrease) 2009/2008
Retirement benefits	$ 83,704,078	$ 77,417,556	$ 72,188,685	$ 6,286,522	$ 5,228,871
Refund of contributions	993,559	1,065,627	530,647	(72,068)	534,980
Administrative	2,961,121	2,701,167	2,929,645	259,954	(228,478)
Legal expenses	595,410	762,963	563,428	(167,553)	199,535
Litigation settlement	-	13,000	-	(13,000)	13,000
Actuarial expenses	199,401	103,113	89,641	96,288	13,472
Total deductions	$ 88,453,569	$ 82,063,426	$ 76,302,046	$ 6,390,143	$ 5,761,380

The Retirement Fund as a Whole

Despite variations in the stock market, MCERA's management believes that MCERA is in reasonably sound financial position to meet its obligations to the retired and current employees. The current financial position results from a diversified investment program that prudently manages risk to minimize loss, an effective system of cost control and strategic planning. Management believes there will continue to be sufficient assets to meet all benefit obligations.

Requests for Information

This financial report is designed to provide the Retirement Board, our membership, taxpayers, and investment managers with a general overview of MCERA finances and to demonstrate MCERA's accountability for the funds under its stewardship.

Please address any questions about this report or requests for additional financial information to:

Marin County Employees' Retirement Association
One McInnis Parkway, Suite 100
San Rafael, CA 94903

Respectively submitted,

/s/ Lisa Jackson
Lisa Jackson
Senior Accountant

BASIC FINANCIAL STATEMENTS

MARIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION
STATEMENT OF PLAN NET ASSETS
AS OF JUNE 30, 2010 AND 2009

	June 30, 2010	June 30, 2009
Assets		
Cash and short-term investments		
Cash and cash equivalents	$ 135,783,006	$ 118,021,449
Collateral held for securities loaned	85,912,381	48,596,264
Total Cash and Short-Term Investments	221,695,387	166,617,713
Receivables		
Contributions	3,199,854	1,971,016
Interest and dividends	1,929,369	1,845,957
Due from brokers for securities sold	1,894,835	3,173,376
Other receivables	1,083,897	825,830
Total Receivables	8,107,955	7,816,179
Investments at fair value		
Domestic fixed income	161,598,315	124,423,217
International fixed income	16,348,909	9,953,463
Domestic equities	523,754,964	474,172,067
International equities	237,228,105	237,693,275
Private equity	8,442,491	3,958,762
Real estate	121,341,849	155,324,370
Total Investments	1,068,714,633	1,005,525,154
Capital assets (net of accumulated depreciation)	7,189,149	6,104,088
Prepaid insurance	618,351	699,085
Total Assets	1,306,325,475	1,186,762,219
Liabilities		
Accounts payable and accrued expenses	1,517,441	1,883,639
Due to brokers for securities purchased	5,987,937	4,543,172
Rental security deposits	669,091	717,859
Retiree payroll payable	8,406	-
Health insurance payable	1,000,000	1,000,000
Collateral held for securities loaned	85,912,381	48,596,264
Total Liabilities	95,095,256	56,740,934
Net Assets Held in Trust for Pension Benefits	$ 1,211,230,219	$ 1,130,021,285

(A schedule of funding progress is presented in the Required Supplementary Information in this Financial Section.)

The accompanying notes are an integral part of these financial statements.

MARIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION
STATEMENT OF CHANGES IN PLAN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2010 AND 2009

	June 30, 2010	June 30, 2009
Additions		
Contributions		
Employer	$ 56,270,346	$ 54,555,518
Plan member	17,419,684	17,397,816
Total Contributions	73,690,030	71,953,334
Investment income (loss)		
Net appreciation (depreciation) in fair value of investments	80,864,466	(296,120,833)
Interest and dividends	15,662,211	21,857,378
Real estate operating income, net	7,191,292	5,045,796
Other investment income	483,780	510,941
Total investment income (loss)	104,201,749	(268,706,718)
Less investment expenses	8,462,445	7,955,952
Net investment income (loss)	95,739,304	(276,662,670)
Securities lending activities		
Securities lending income	437,969	1,806,467
Less expenses from securities lending activities	204,800	976,025
Net securities lending income	233,169	830,442
Total net investment income (loss)	95,972,473	(275,832,228)
Total Additions (Declines)	169,662,503	(203,878,894)
Deductions		
Benefits	83,704,078	77,417,556
Refunds	993,559	1,065,627
Administrative expenses - Note 8	2,961,121	2,701,167
Legal expense	595,410	762,963
Litigation settlement	-	13,000
Actuarial expenses	199,401	103,113
Total Deductions	88,453,569	82,063,426
Net Increase (Decrease)	81,208,934	(285,942,320)
Net Assets Held in Trust for Pension Benefits, Beginning of Year	1,130,021,285	1,415,575,543
Prior Period Adjustment	-	388,062
Net Assets Held in Trust for Pension Benefits, as Restated	1,130,021,285	1,415,963,605
Net Assets Held in Trust for Pension Benefits, End of Year	$ 1,211,230,219	$ 1,130,021,285

The accompanying notes are an integral part of these financial statements.

NOTE 1 – PLAN DESCRIPTION

The Marin County Employees' Retirement Association (MCERA) was formed July 1, 1950, by the adoption of the County Employees' Retirement Law of 1937 (State of California Government Code Section 31502) by the Marin County Board of Supervisors pursuant to a vote of the people of Marin County. MCERA is a cost-sharing, multiple-employer defined benefit plan (the Plan) covering the employees of Marin County and various special districts. MCERA, with its own governing boards, is an independent governmental entity separate and distinct from the County of Marin (County). MCERA's Annual Financial Statements are included in the County's Annual Financial Report as a pension trust fund. Maintaining appropriate controls and preparing the financial statements are the responsibility of MCERA management. On July 1, 1977, the City of San Rafael, San Rafael Redevelopment Agency, and the Novato Fire Protection District also became participants in the program.

MCERA is an agent multiple-employer public employee retirement system (PERS). Such plans cover employees of more than one employer and pool administrative and investment functions as a common investment and administrative agent for each employer. Administrative costs of MCERA are financed through investment earnings and paid by MCERA. As required under California Government Code Section 31520.1, MCERA is governed by the following Board of Retirement:

	Term Expires
Maya Gladstern	10/31/10
Sherry Sweet	10/31/11
James Hufford	10/31/10
Karen Wofford, Safety Alternate	10/31/10
Allen Haim	10/31/12
Sean Webb, Retiree Alternate	10/31/12
Greg Brenk	10/31/11
James Phillips	10/31/10
Gerald Richardson	10/31/11
Bernadette Bolger	10/31/12
Michael J. Smith	Ex-Officio
Roy Given	Ex-Officio Alternate

MCERA is operated under Section 31450 of the California Government Code related to employees. At June 30, 2010, the number of participating local government employers was:

County	1
City	1
California Superior Courts, Marin	1
Special Districts	7
Total	10

NOTE 1 – PLAN DESCRIPTION (Continued)

MCERA's membership consisted of the following as reported in the most recent actuarial valuation dated June 30, 2009:

	June 30, 2009	June 30, 2008
Active Members (vested and non-vested)	2,763	2,818
Retired Members and Beneficiaries	2,335	2,294
Terminated Vested (deferred)	717	724
Total Membership	5,815	5,836

As required by state statutes and MCERA by-laws, all regular-hire employees considered at least three-quarter time must participate in the County's pension plans. Under the provisions of the County's pension plan, pension benefits vest after five years of credited service. Employees are eligible to receive benefits upon reaching the age of 50 and 10 years of credited service or after 30 years of service (Safety, 20 years of service). Pension benefit amounts vary based on the individual's age and number of years in the retirement system. The maximum pension benefit is 100% of final compensation. Also, the pension plan provides for death benefits and disability benefits. All pension, death and disability benefits are determined in accordance with state statutes.

Contributions are determined based on a percentage of compensation for each entry age so as to provide a lifetime annuity commencing at age 50. For the County of Marin members hired on or after July 1, 2008, and for Marin County Superior Courts members hired on or after January 1, 2008, the lifetime annuity commences at age 55.

MCERA also facilitates for the County of Marin a healthcare premium benefit provided to retirees with five or more years of qualifying service credit (substantially all retirees). MCERA does not hold any funds in a 401h account related to these benefits. As a result, the actuarial information presented on pages 17 through 18 excludes obligations for future health benefits. Separate asset reserves are maintained for health benefits for retirees of the City of San Rafael. All health benefits are funded on a pay-as-you-go basis.

Employer and employee contributions are based on actuarial valuations that cover the mortality, service, and compensation experience of the members and beneficiaries, and the evaluation of the assets and liabilities of the retirement fund. The Board of Supervisors makes the necessary changes in County contribution rates and interest rates based upon the valuations and recommendations of the actuary. According to the June 30, 2009, actuarial valuation, depending on the age and classification at hire date, employees' weighted contributions are 9.64% of covered payroll for the County; San Rafael employees' weighted contributions are 10.77%; and Novato employees' weighted contributions are 13.12%.

Retiree and survivor benefits are adjusted annually for cost of living by the annual increase or decrease in the Consumer Price Index (CPI). In years when the CPI changes by more than specified limits, the excess is accumulated and applied to future years when the change in the CPI is less than those limits. The following limits are currently in effect: (a) 3% for City of San Rafael, (b) 2% for County retirees hired after June 30, 1980, and (c) 4% for all other retirees.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

MCERA follows the accounting principles and reporting guidelines as set forth by the Governmental Accounting Standards Board.

The financial statements are prepared using the accrual basis of accounting. Plan member contributions are recognized in the period in which the contributions are due. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investments are reported at fair value, except that short-term investments are reported at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates or by various outside pricing sources. The fair value of real estate investments is based on independent appraisals.

Cash

Cash includes deposits with various financial institutions, the County trust fund, and international currency holdings, which have original maturities of less than 90 days, translated to U.S. dollars using the exchange rates in effect at June 30, 2010 and 2009.

Capital Assets

Capital assets are valued at historical cost less accumulated depreciation. Capital assets with an initial cost of more than $5,000 and an estimated useful life in excess of one year are depreciated. Depreciation is calculated using the straight-line method over the estimated useful lives of the depreciable assets. Equipment has a useful life of ten years, leasehold improvements and office space forty years, and twelve years for the CPAS pension system.

MCERA signed an agreement on July 2, 2007, for the purchase of a building located on One McInnis Parkway, San Rafael, CA 94903. The final purchase price for the building was $17,300,000 and was finalized in October 2007. MCERA occupied the building on November 14, 2008.

MCERA occupies 33% of the building and leases the other 67%. Therefore, the portion of the building occupied by MCERA was capitalized and is being depreciated over its useful life. The remaining 67% will be treated as an investment and accordingly marked to market in addition to recognizing any earned income and expenses incurred. As of June 30, 2010, the capitalized portion of the building was $3,920,691 and computers and equipment were $3,445,337, net of accumulated depreciation.

Use of Estimates

The preparation of MCERA's financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the basic financial statements and accompanying notes. Actual results could differ from these estimates.

Reclassifications

Comparative data for the prior year has been presented in the selected sections of the accompanying Statements of Plan Net Assets and Changes in Plan Net Assets. Also, certain accounts presented in the prior year's data may have been reclassified in order to be consistent with the current year's presentation.

Implementation of New Accounting Pronouncements

MCERA adopted Governmental Accounting Standards Board (GASB) Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, and GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, effective June 30, 2010. As MCERA records all of its investments at fair market value and has no hedging derivatives, there was no financial statement effect from implementing the new standards. Further disclosure on the derivative positions held at fiscal year-end are contained in these notes to the basic financial statements.

NOTE 2 – <u>SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES</u> (Continued)

<u>Reserves</u>

The reserves represent the components of MCERA's net assets. Reserves are established from employee and employer contributions and the accumulation of investment income after satisfying investment and administrative expenses. The reserves do not represent the present value of assets needed, as determined by actuarial valuation, to satisfy requirements and other benefits as they become due.

The Contingency Reserve is established as required by the County Employees Retirement Law of 1937 to absorb possible future losses on investments. The reserve balance, per the County Employees Retirement Law of 1937, is one percent (1%) of the total market value of assets if excess earnings exist. MCERA's policy sets the targeted rate at 3%. The Contingency Reserve is 3% and 3% of the market value of total assets at June 30, 2010 and 2009, respectively. During fiscal year 2009, due to the severe financial crisis, MCERA did not have excess earnings to fund the Contingency Reserve.

NOTE 3 – <u>DEPOSIT AND INVESTMENT RISK DISCLOSURE</u>

The County Employees Retirement Law of 1937 (Retirement Law) vests the Board of Retirement (Board) with exclusive control over MCERA's investment portfolio. The Board established an Investment Policy Statement in accordance with applicable local, State, and Federal laws. The Board members exercise authority and control over the management of MCERA's assets (the Plan) by setting policy which the Investment Staff executes either internally, or through the use of external prudent experts. The Board oversees and guides the Plan subject to the following basic fiduciary responsibilities:

- Solely in the interest of, and for the exclusive purpose of, providing economic benefits to participants and their beneficiaries, minimizing contributions thereto, and defraying reasonable expenses of administering the Plan.

- Invest and manage Plan assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the Plan. In satisfying this standard of care, the trustees shall exercise reasonable care, skill, and caution.

- Diversify the investments of the Plan so as to minimize the risk of loss and to maximize the rate of return, unless under the circumstances, it is clearly prudent not to do so. Diversification is applicable to the deployment of the assets as a whole.

The Investment Policy Statement encompasses the following:

- Criteria for Selecting & Terminating Investment Managers

- Investment Objective & Guidelines by Asset Class

- Duties & Responsibilities of the MCERA Board

- Duties & Responsibilities of Staff, Investment Managers, Custodian & Investment Consultant

- Proxy Voting

- Statement of Objectives, Guidelines & Procedures for each Investment Manager

<u>Credit Risk</u>

Credit Risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. MCERA seeks to maintain a diversified portfolio of fixed income instruments in order to obtain the highest total return for the fund at an acceptable level of risk within this asset class. To control Credit Risk, credit quality guidelines have been established.

NOTE 3 – DEPOSIT AND INVESTMENT RISK DISCLOSURE (Continued)

Credit Risk (Continued)

The Domestic Fixed Income Core Portfolio must meet the following credit qualities:

- The portfolio will be invested only in investment grade securities as defined by one of the major rating agencies. The Core Fixed Income manager will maintain an overall portfolio quality rating of "AA-Aa3" or equivalent or better.

- The Core Fixed Income manager may invest up to 10% of the portfolio in 144A securities.

The Domestic Fixed Income Core Plus Portfolio must meet the same credit qualities listed above, except for the following:

- The Core Plus Fixed Income manager may invest up to 20% of the portfolio in securities rated below investment grade by at least one of the major rating agencies.

- The Core Plus Fixed Income may invest up to 20% of the portfolio in 144A securities.

As of June 30, 2010, the total MCERA fixed income portfolio maintained an Aa2 rating (as represented by Moody's). The Core fixed income manager maintained an Aa2 rating, while the Core Plus Fixed Income manager maintained an Aa1 rating.

Custodial Credit Risk

Custodial Credit Risk for deposits is the risk that in the event of a financial institution's failure, MCERA would not be able to recover its deposits. Deposits are exposed to custodial credit risk if they are not insured or not collateralized. MCERA's deposits are not exposed to custodial credit risk as its deposits are eligible for and covered by "pass-through insurance" in accordance with applicable law and FDIC rules and regulations. Additional insurance against loss and theft is provided through a Financial Institution Bond.

Custodial Credit Risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, MCERA would not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in MCERA's name, and held by the counterparty. MCERA's investment securities are not exposed to custodial credit risk because all securities are held by MCERA's custodial bank in MCERA's name. MCERA has investments in commingled funds that are not held by MCERA's custodial bank. However, investments in open-end mutual funds are not exposed to custodial credit risk because their existence is not evidenced by securities that exist in physical or book entry form. MCERA has no general policy on custodial credit risk for investments.

Concentration of Credit Risk

As of June 30, 2010, MCERA did not hold any investments in any one issuer that would represent five percent (5%) or more of total investments. Investments issued or explicitly guaranteed by the U.S. government and pooled investments are excluded from this requirement.

Interest Rate Risk

Interest Rate Risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Duration is a measure of the price sensitivity of a fixed income portfolio to changes in interest rates. It is calculated as the weighted average time to receive a bond's coupon and principal payments. The longer the duration of a portfolio, the greater its price sensitivity to changes in interest rates.

MCERA does not have a general policy to manage interest rate risk. To manage interest rate risk, the modified adjusted duration of the Domestic Fixed Income Core and Core Plus Portfolios are restricted to +/- 25% of the Lehman Brothers Aggregate Bond Index's modified adjusted duration. Deviations from any of the stated guidelines require prior written authorization from MCERA.

NOTE 3 – DEPOSIT AND INVESTMENT RISK DISCLOSURE (Continued)

Interest Rate Risk (Continued)

As of June 30, 2010, MCERA's Core Fixed Income Manager had a duration of 3.93 years, while MCERA's Core Plus Fixed Income Manager had a duration of 4.37 years.

Foreign Currency Risk

Foreign Currency Risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or deposit. Forward currency contracts and currency futures (maturity ranging from at least 30 days and not to exceed one year for either instrument) are permitted for currency hedging.

MCERA's exposure to Foreign Currency Risk in U.S. dollars as of June 30, 2010 and 2009, was $0 and $0, respectively.

MCERA invests indirectly, through its portfolio managers, in foreign currency forward transactions to limit its exposure to fluctuations in foreign currency exchange rates. Aside from net currency gains or losses reported as a component of investment income, no other amounts are recorded on the financial statements.

These forward transactions typically range from one to six months. When used in a hedging strategy, a loss in value of the underlying security, due to a weakening of a foreign currency relative to the U.S. dollar will result in an opposite gain in value of the gift foreign currency transaction. The reverse is true for a foreign currency, which strengthens relative to the U.S. dollar.

Foreign currency forward transactions are typically transacted with highly rated (usually AA or better) financial institutions, typically major worldwide commercial or investment banks. Counterparty risk occurs when the financial institution (who engages in the forward transaction with MCERA) has a liability due to MCERA and is unable to pay. This risk is monitored on a daily basis by the investment advisors and limited to maximum levels of exposure for the entire portfolio.

Derivatives

The investment derivatives schedule below reports the fair value balances, changes in fair value, and notional amounts of derivatives outstanding as of and for the year ended June 30, 2010, classified by type. For financial reporting purposes, all MCERA derivatives are classified as investment derivatives.

The fair values of currency forward contracts are determined using a proprietary pricing service, which uses published foreign exchange rates as the primary source. The fair values of credit rate swaps, interest rate swaps, and warrants are determined using the custodian pricing vehicles. The fair value of TBA transactions are also determined by the custodian pricing vehicles.

Investment derivatives for the year ended June 30, 2010, were as follows:

	Changes in Fair Value	Fair Value	Notional Value
Fixed Income Futures Long	$ 5,939,986	$ 542,522	$ 34,800,000
Fixed Income Futures Short	(956,221)	(258,232)	(15,900,000)
Futures Options Bought	(5,588)	76,481	283,500
Futures Options Written	72,913	(124,369)	(760,500)
Index Futures Long	22,607,935	(7,637,601)	144,600
TBA Transactions Long	160,669	(1,284)	2,000,000
Total	$ 27,819,694	$ (7,402,483)	

NOTE 3 – DEPOSIT AND INVESTMENT RISK DISCLOSURE (Continued)

Custodial Credit Risk – Derivatives – As of June 30, 2010, MCERA's investments did not include collateral associated with derivatives activity.

Credit Risk – Derivatives – MCERA is exposed to credit risk on investment derivatives that are traded over the counter and are reported in asset positions. Derivatives exposed to credit risk include credit default and interest rate swaps, currency forward contracts, rights, warrants, and TBA transactions. To minimize credit risk exposure, MCERA investment managers continuously monitor credit rating of counterparties. Should there be a counterparty failure, MCERA would be exposed to the loss of fair value of derivatives that are in asset positions and any collateral provided to the counterparty, net of the effect of applicable netting arrangements. MCERA has no general investment policy with respect to netting arrangements or collateral requirements. Netting arrangements legally provide MCERA with a right of offset in the event of bankruptcy or default by the counterparty. As of June 30, 2010, MCERA had no exposure to loss in case of default of a counterparty. In addition, MCERA had no collateral reducing exposure or liabilities subject to netting arrangements.

NOTE 4 – REAL ESTATE

The following is a listing of California real estate held by MCERA (dollars in thousands):

Location	Appraised Value 2010	Appraised Value 2009
Separate Properties:		
Sacramento	$ 3,370	$ 6,110
Sunnyvale*	4,250	6,100
South San Francisco	8,000	9,250
Foster City	22,000	26,000
San Bruno*	17,900	21,800
Pleasanton*	23,540	33,070
Richmond*	12,370	16,620
1 McInnis*	7,860	9,490
Total	99,290	128,440
AEW Capital Management	1,780	1,649
ING Clarion	17,073	20,654
RREEF America REIT III	3,199	4,581
Total	22,052	26,884
Grand Total	$ 121,342	$ 155,324

* Properties appraised as of December 31, 2009, and February 15, 2010. Updated appraisals will be performed during the June 30, 2011, fiscal year and reflected in those financial statements.

MCERA, like all who invest in the real estate arena, has seen substantial losses in the real estate portfolio. This decline, while other segments of the investment market are in recovery, continues to decline due to the lag period between appraisals of properties in the various portfolios.

Commercial real estate investment has suffered from a severe credit crunch for commercial sectors, sustained job losses and weak consumer spending, although the decline appears to be slowing. The national economy has begun a slow and cautious recovery, but the labor market, which often lags the broader economy, will turn around only gradually with sustained improvement unlikely before the second half of 2010. Because commercial real estate lags the labor market, it still has a ways to go before reaching its own low point.

NOTE 4 – REAL ESTATE (Continued)

MCERA continues to closely monitor our real estate portfolio and expect improvement to assessed values later this year.

NOTE 5 – SECURITIES LENDING TRANSACTIONS

State statutes and the investment policies of MCERA allow the Plan to enter into securities lending transactions (loans of securities to broker-dealers and other entities for collateral with a simultaneous agreement to return the collateral for the same securities in the future). Securities loaned are secured by cash collateral of 103% of the fair value of the loaned securities plus accrued interest. MCERA is not exposed to credit risk on security lending transactions because its custodian is required to indemnify MCERA against any related losses.

Securities loaned include U.S. government and agencies securities, corporate bonds, and domestic corporate stock. MCERA is not restricted as to the amount of loans that can be made. MCERA cannot pledge or sell collateral securities received unless the borrower defaults. As of June 30, 2010 and 2009, the value of securities loaned by MCERA totaled $83,522,419 and $47,164,924, respectively. As of June 30, 2010 and 2009, the value of collateral held for securities loaned was $85,912,381 and $48,596,264, respectively.

NOTE 6 – CONCENTRATIONS

MCERA has entered into a custodial agreement with State Street. State Street custodies securities, and collects income for MCERA. The value of MCERA's investments under State Street's custodianship at June 30, 2010 and 2009, was approximately $641,785,584 and $526,941,588, respectively.

The following firms professionally manage MCERA's investments (dollars in thousands):

	Value of Investments	
	2010	2009
Woodmont Real Estate Services	$ 99,290	$ 128,440
Western Asset Management	141,002	77,204
Wellington Management Company	131,933	125,598
Columbus Circle	41,605	-
Dodge & Cox	87,428	77,578
RCM Global Investors	104,139	97,727
Blackrock Global Investors	79,123	70,392
Dimensional Fund Advisors	53,702	40,561
AXA Rosenberg International Small Cap Equity	-	13,074
Artisan Funds	85,572	79,224
Morgan Stanley	97,040	93,080
First Quadrant	-	17,456
Numeric Investors LP	29,227	27,641
Fidelity Market Neutral	33,391	35,862
Fidelity Small Cap International	32,904	16,119
Analytic Investors - US	21,863	21,871
Analytic Investors - Japan	-	20,190
AEW Partners	1,780	1,649
ING Clairon	17,073	20,654
RREEF	3,199	4,581
Abbott	5,705	3,512
Pathway	2,738	447

NOTE 7 – OPERATING LEASES

MCERA holds real property on which it collects rental income under several operating lease arrangements. Generally, these leases provide for renewal options at the conclusion of fixed terms that vary in length. Rental income on all operating leases of MCERA amounted to $9,773,080 and $10,005,646 for the years ended June 30, 2010 and 2009, respectively.

NOTE 8 – ADMINISTRATIVE EXPENSES

California Government Code §31580.2 requires that the Board of Retirement may expend no more than .18% of the total assets of the retirement system for administrative expenses. However, per §31580.3 if during the year the expense of administration of the retirement system includes expenditures for software, hardware, and computer technology consulting services in support of that software or hardware, the expense incurred may not exceed the greater of the following: (1) the sum of eighteen hundredths of 1 percent of the total assets of the retirement system plus one million ($1,000,000) or (2) twenty-three hundredths of 1 percent of the total assets of the retirement system.

For the years ended June 30, 2010 and 2009, administrative expenses were $2,961,121, or .23%, and $2,701,167, or .23%, respectively, of the total assets of the Plan at year-end. Due to the exclusion in §31580.3 mentioned above, MCERA is in compliance due to the implementation of new CPAS software. Administrative costs of the plan are financed through investment plan assets.

NOTE 9 – RISK MANAGEMENT

MCERA is exposed to various risks of loss related to torts, theft or damage to, or destruction of, assets, injuries to employees, and errors and omissions. To address these risk items, MCERA is covered by the following policies and programs:

$10,000,000	General Liability Edgewood Partners Insurance Center $1,000,000 per occurrence
$ 1,000,000	Workers' Compensation CSAC Excess Insurance Authority Liability Program Self-insured retention of $500,000 per occurrence County of Marin
$10,000,000	Fidelity and Performance Bond National Union Fire Insurance $2,500 deductible per occurrence County of Marin

For each of the above self-insurance coverage limits, the County maintains a separate Internal Service Fund. Funding for each fund is actuarially determined.

$10,000,000	Fiduciary Liability National Union Fire Insurance Self-insured retention, $100,000 per occurrence MCERA (includes waiver of trustee liability*)

* Premium for this waiver has been paid by each trustee individually.

In addition to the above, each investment manager and the Fund's custodian carries a separate fidelity bond as well as errors and omissions insurance at levels consistent with their total funds under management.

NOTE 10 – ACTUARIAL VALUATIONS

Pursuant to provisions in the Retirement Law, MCERA engages an independent actuarial firm to perform an annual actual valuation. A system actuarial valuation is performed every three (3) years (i.e., triennial valuation). The economic and non-economic assumptions are updated at the time each triennial valuation is performed. Triennial valuations serve as the basis for changes in member contribution rates necessary to properly fund the Plan. MCERA also hires an independent actuarial firm to audit the results of each triennial valuation.

The information displayed below presents the funded status of the most recent actuarial valuation. The Schedule of Funding Progress in the Required Supplementary Information section immediately following the notes to the financial statements presents multiyear trend information regarding whether the actual value of plan assets is increasing or decreasing over time, relative to the actuarial accrued liability of benefits.

(In Thousands)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Annual Covered Payroll ((b-a)/c)
6/30/2009	$ 1,343,253	$ 1,862,434	$ 519,182	72.12%	$ 219,556	236.47%

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

Valuation date	June 30, 2009
Actuarial cost method	Entry age normal method
Amortization method	Level percentage, open/close
Asset valuation method	5-year smoothing process
Annual inflation rate	3.50%
Investment rate of return	7.75%
Postretirement benefit increase	COLA, maximum of 2/3/4% based on Tier
Projected salary increases	3.50%, plus service-based rates
Remaining amortization periods	
County of Marin	17 years
City of San Rafael	17 years
California Superior Court, Marin	17 years
Novato Fire Protection District	17 years
Southern Marin Fire Protection District	17 years
LAFCO	17 years
Marin Sonoma Mosquito Abatement	17 years
Tamalpais Community Service District	17 years
San Rafael Redevelopment Agency	17 years
Marin City Community Services District	17 years

NOTE 11 – COMMITMENTS AND CONTINGENCIES

Litigation

MCERA is defendant in various lawsuits and other claims arising in the ordinary course of its operations. MCERA's management and legal counsel estimate the ultimate outcome of such litigation will not have a material effect on MCERA's basic financial statements.

Capital Commitments

MCERA real estate and Private Equity investment managers identify and acquire investments on a discretionary basis. Each manager's investment activity is controlled by the Manager Investment Plan, which identifies the limitations on each manager's discretion. Such investment activities are further restricted by the amount of capital allocated or committed to each manager. Both the Manager Investment Plan and capital commitments are subject to approval by the MCERA Board of Retirement and may be updated as often as necessary to reflect MCERA investment preferences, as well as changes in market conditions.

As of June 30, 2010, outstanding commitments to the various investment managers, as approved by the Board, totaled $189,582,500. Subsequent to June 30, 2010, MCERA funded $10,417,500 of these capital commitments.

NOTE 12 – SUBSEQUENT EVENTS

Subsequent to June 30, 2010, and through October 5, 2010, the date through which management evaluated subsequent events and on which the financial statements were issued, MCERA did not identify any subsequent events that require disclosure.

REQUIRED SUPPLEMENTARY INFORMATION

MARIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION
SCHEDULE OF FUNDING PROGRESS
(DOLLAR AMOUNTS IN THOUSANDS)

Schedule of Funding Progress

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Annual Covered Payroll ((b-a)/c)
County of Marin						
6/30/2004	$ 843,169	$ 938,211	$ 95,042	90.00%	$ 143,107	66.40%
6/30/2005	858,183	992,226	134,043	86.49%	141,272	94.88%
6/30/2006	908,767	1,090,344	181,578	83.00%	149,527	121.40%
6/30/2007	1,013,543	1,141,736	128,193	88.80%	159,177	80.50%
6/30/2008	1,111,115	1,280,206	169,091	86.80%	173,735	97.33%
6/30/2009	1,002,218	1,350,528	348,310	74.21%	178,027	195.65%
City of San Rafael (including RDA)						
6/30/2004	188,956	248,665	59,709	76.00%	29,299	203.80%
6/30/2005	195,698	265,205	69,507	73.79%	28,357	245.11%
6/30/2006	209,785	306,079	96,294	68.54%	28,606	336.62%
6/30/2007	235,756	325,219	89,463	72.49%	30,180	296.43%
6/30/2008	262,677	360,298	97,621	72.91%	31,854	306.46%
6/30/2009	239,841	379,801	139,960	63.15%	32,413	431.80%
Novato Fire Protection District						
6/30/2004	84,814	90,861	6,047	93.00%	7,616	79.40%
6/30/2005	86,839	98,787	11,948	87.91%	7,889	151.45%
6/30/2006	92,390	109,131	16,741	84.66%	7,990	209.52%
6/30/2007	102,658	115,974	13,316	88.50%	7,881	168.96%
6/30/2008	112,126	129,116	16,989	86.80%	8,860	191.75%
6/30/2009	101,194	132,105	30,912	76.60%	9,116	339.10%
Total						
6/30/2004	1,116,939	1,277,737	160,798	87.42%	180,022	89.32%
6/30/2005	1,140,720	1,356,218	215,498	84.11%	177,518	121.40%
6/30/2006	1,210,942	1,505,554	294,613	80.43%	186,123	158.29%
6/30/2007	1,351,957	1,582,929	230,972	85.41%	197,238	117.10%
6/30/2008	1,485,918	1,769,620	283,701	83.97%	214,449	132.29%
6/30/2009	1,343,253	1,862,434	519,182	72.12%	219,556	236.47%

MARIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION
SCHEDULE OF EMPLOYER CONTRIBUTIONS
(DOLLAR AMOUNTS IN THOUSANDS)

Schedule of Employer Contributions

Year Ended June 30,	Annual Required Contribution	Percentage Contributed
County of Marin		
6/30/2004	$ 21,254	100%
6/30/2005	22,085	100%
6/30/2006	36,870	100%
6/30/2007	42,416	100%
6/30/2008	39,656	100%
6/30/2009	36,638	100%
City of San Rafael (including RDA)		
6/30/2004	7,364	100%
6/30/2005	7,653	100%
6/30/2006	4,231	100%
6/30/2007	11,187	100%
6/30/2008	14,068	100%
6/30/2009	13,702	100%
Novato Fire Protection District		
6/30/2004	2,259	100%
6/30/2005	2,343	100%
6/30/2006	2,526	100%
6/30/2007	3,612	100%
6/30/2008	4,366	100%
6/30/2009	4,215	100%
Total		
6/30/2004	30,877	100%
6/30/2005	32,081	100%
6/30/2006	43,627	100%
6/30/2007	57,215	100%
6/30/2008	58,090	100%
6/30/2009	54,555	100%