POLICEMEN'S ANNUITY AND BENEFIT FUND OF CHICAGO, ILLINOIS

COMPREHENSIVE ANNUAL FINANCIAL REPORT

a component unit of the City of Chicago

for the year ended December 31, 2006

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Comprehensive Annual Financial Report

Policemen's Annuity and Benefit Fund

A Component unit
of the City of Chicago
for the year ended
December 31, 2006

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POLICEMEN'S ANNUITY AND BENEFIT FUND OF CHICAGO
Component Unit Financial Report
Year Ended December 31, 2006

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Certificate of Achievement for Excellence in Financial Reporting

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Policemen's Annuity and Benefit Fund of Chicago

Illinois

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
December 31, 2005

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.

GOVERNMENT FINANCE OFFICERS ASSOCIATION OF THE UNITED STATES AND CANADA CORPORATION SEAL CHICAGO

President

Executive Director

THE RETIREMENT BOARD
of the
Policemen's Annuity and Benefit Fund
City of Chicago

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to the Retirement Board

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Retirement Board of the Policemen's Annuity and Benefit Fund of Chicago
Chicago, Illinois

The Policemen's Annuity and Benefit Fund of Chicago hereby submits the comprehensive annual financial report (CAFR) for the Fund, year ending December 31, 2006. The Fund accepts responsibility for the accuracy of the data and the completeness and fairness of presentation, including disclosures. To the best of our knowledge and belief, the enclosed data are accurate in all material respects and are reported in a manner designed to present fairly the financial position and results of operations of the Fund. All disclosures necessary to enable the reader to understand the Fund's financial activities have been included.

Any employee of the City of Chicago employed under the provisions of the municipal personnel ordinance as police service is covered by the Policemen's Annuity and Benefit Fund of Chicago. The Fund is governed under Illinois State Statutes (Chapter 40, Pension, Article 5, Illinois Compiled Statutes) and may be amended only by the Illinois Legislature.

The Fund was established in 1921 with the mission of providing retirement benefits to the members of the Chicago Police Department and their spouses. To properly execute this mission the Fund is administered by an eight (8) member Board of Trustees. The Board is composed of four (4) elected members, with one elected from each rank of police officer, sergeant, lieutenant and above, and a member from the retired members and their widows. The Mayor of Chicago appoints four members. The Retirement Board then elects a Board President, a Vice-President and a Recording Secretary from its own membership.

The Retirement Board is charged with many duties including: approval of all applications for benefits and annuities, investment of Fund monies in a manner prescribed by the State Statutes and Fund policy, adoption of rules and regulations for the proper conduct of the affairs of the Fund, an annual audit conducted by a certified public accountant certifying financial results for each year and the filing of a detailed report of the affairs of the Fund to the State of Illinois Department of Insurance and the City of Chicago each year. A summary of plan provisions adopted by the Retirement Board are presented as part of this CAFR.

This report presents the financial activities of the Fund and is composed of five (5) sections:

1. The introductory section contains the table of contents, this transmittal letter, a listing of the Retirement Board members and office staff members, a listing of professional consultants, the Fund's organizational chart and a summary of plan provisions;

2. The financial section contains the report of the independent auditors, management discussion and analysis, the financial statements and accompanying notes, required supplementary information and supporting schedules of the Fund;

3. The investment section reports on activity, policy, results, allocation, fees and commissions and includes an investment summary;

4. The actuarial section contains the report of the Fund's actuary with supporting actuarial assumptions, schedules and tables;

5. The statistical section provides membership data for both active members and annuitants of the Fund as well as a history of investment yields.

Financial Information

The management of the Fund is responsible for establishing and maintaining an internal control structure designed to ensure the safety of the Fund's assets from loss, theft or misuse and to ensure that adequate accounting data are compiled to allow for the preparation of financial statements that conform to generally accepted accounting principles. The internal control system is included in the auditor's review and is designed to provide reasonable, but not absolute, assurance that these objectives are being met. The concept of reasonable assurance recognizes that: (1) the cost of a control should not exceed the benefits likely to be derived; and (2) the valuation of costs and benefits requires estimates and judgments by management.

Users of this report are strongly encouraged to review the **Management’s Discussion and Analysis** portion of the Financial Section in order to obtain a more complete understanding of the Fund’s financial condition and activity.

The Budget Process

The Fund's budget is prepared through a process that originated in 1975. At that time, a budget for only the Fund's administrative expenses was prepared and approved. The 1990 budget was expanded to include all revenue and expense categories, including employer and employee contributions, investment income, annuity, death and disability benefit expenses. The 1992 budget was further developed to include a complete listing of the goals, programs and projects of the Fund. The 2007 budget process builds from recent years' strengths and includes additional charts and graphs. Policies and procedures have remained substantially consistent with those of the prior year, with the exception that the ideas for new projects were sought beginning in July. The current fiscal planning and budgeting process then formally begins in July and ends in December with the approval by the Board of Trustees.

Revenues

Revenues are needed to finance retirement benefits and are accumulated from the contributions of active police officers, the corresponding employer contributions and investment income. The following summarizes revenue collections for the years of 2006, 2005, and 2004 by source along with a percentage of 2006 total income detailed.

Source of Revenue	2006	Percent of Revenue	2005	% Increase /(Decrease) 2005-06	2004
Employer Contributions	157,689,286	22.59%	177,910,607	(11.4%)	135,668,860
Employee Contributions	91,965,685	13.18%	89,109,811	3.2%	78,800,816
Investment Income	447,275,047	64.08%	261,389,227	71.1%	367,908,110
Other Revenue	1,069,991	0.15%	367,764	190.9%	75,313
Total Revenue	**698,000,009**	**100.00%**	**528,777,409**	**32.0%**	**582,453,099**

Gross revenues for 2006 increased a total of $169.2 million as compared to 2005. The increase is attributable to the appreciation in the unrealized fair value of investments for 2006 as compared to 2005.

Expenses

The expenses paid in 2006 by the Fund include annuity payments, benefit payments and administration expense. Total Fund expenses for 2006, 2005, and 2004 by type are as follows:

Type of Expense	2006	Percent of Expense	2005	% Increase /(Decrease) 2005-06	2004
Annuities	421,116,037	91.40%	399,843,737	5.3%	371,684,017
Disability	21,783,830	4.73%	22,184,204	(1.8%)	20,250,689
Death Benefits	1,886,443	0.41%	1,500,000	25.8%	1,837,006
Refunds	5,271,842	1.14%	5,644,241	(6.6%)	5,781,659
Hospitalization	8,001,771	1.74%	7,917,077	1.1%	7,747,390
Administration	2,700,475	0.58%	2,660,819	1.5%	2,626,056
Total Expenses	**460,760,398**	**100.00%**	**439,750,078**	**4.8%**	**409,926,817**

The expenses paid by the Fund for 2006 total $460,760,398, an increase of 4.8% when compared to a total of $439,750,078 for 2005. The increase in benefit payments accounted for most of the increase in expenses in 2006 over 2005.

Total revenues over expenses for 2006 produced a net increase in net assets held in trust for pension benefits of $237,239,611 compared to $89,027,331 for 2005, a 166.5% increase. This increase can be attributed to significantly greater market value appreciation on assets as compared to 2005. Investment management expenses for 2006 were $13,377,464 (.32% of net assets held in trust at December 31, 2006 or 32 basis points), which compares favorably with other public employee pension funds. The Police Fund charges investment management cost as a reduction of investment income which is the same treatment currently used by many plans. The Fund also generated income from security lending activity totaling $1,384,335 in 2006 compared to $830,491 in 2005. Administrative expenses for 2006 were $2,700,475 (.06% of net assets held in trust at December 31, 2006 or 6 basis points).

Funding Status

In 2006 revenues of $ 698,000,009 exceeded expenses of $ 460,760,398 by $ 237.2 million. This increase brought the plan's net asset base to $4.19 billion. The net asset base currently funds 51.65 % on a fair value basis of the aggregate actuarial liability of $8.11 billion. For the purposes of this report, the actuarial section details the GASB 25 funding ratio method used by the actuary, which is a five-year market-smoothing period to arrive at the actuarial value of assets. The actuarial funded ratio of 49.26% is a decrease of 1.43% from 2005 and is considered below normal levels. It should be noted that there has been no increase in the employer contribution requirement (tax multiplier) since 1982 when the rate was increased from 1.97 to 2.00 times the employee contribution two years prior. The Fund has and will continue to perform asset liability modeling studies to assist the Board in administering the plan.

Investment Policy and Performance

The investment portfolio is a financial resource that is the leading contributor to the Plan. In 2006, the investment portfolio returned 12.1%, exceeding the actuarial assumed return of 8.0%. 33 professional investment management firms currently manage the investment portfolio. These firms make investment decisions under the prudent person rule authorized by state statutes and investment policy guidelines adopted by the Board of Trustees. The Board also employs an investment consultant to monitor investment performance, to aid in the selection of investment management firms and assist in the development of investment policy.

Plan management's uppermost investment goal is to optimize the total return of the Plan's assets through a policy of diversification while achieving maximum rates of return within a parameter of prudent risk as measured on the total portfolio.

The Total Fund underperformed its policy portfolio by 120 basis points, returning 12.1% versus a policy portfolio return of 13.3%. The Fund also trailed the Russell/Mellon Public Fund Index by 170 basis points (12.1% vs. 13.8%). The Index represents the median return of all U.S. public funds, regardless of their individual asset allocations. The Fund's domestic equity portfolio under-performed the DJ Wilshire 5000 Index by 3.6% (12.2% vs. 15.8%). Absolute returns for foreign equity in 2006 were 23.7% compared to the MSCI-All Country World ex-U.S. Index, which returned 26.7%. The Fund's fixed income portfolio outperformed its benchmark, the Lehman Brothers Aggregate Index 4.6% versus 4.3%.

Economic Condition and Outlook

As a long-term institutional investor, the Fund set forth investment guidelines and objectives and continues to abide by this policy. A major consideration of that policy is portfolio diversification.

In 1984, the Fund adopted the present guidelines under Illinois State statutes and the results have been very good since then and are expected to remain so. A third party custodial agent holds the Funds' investments.

Major Initiatives

The Fund will continue to strive for customer service excellence by improving the operational efficiencies and service delivery to the membership. For the 2006 budget year, the Board approved an expansion of the existing office space to allow for a more accommodating reception area as well as a larger conference room. We have also joined with several other local public pension funds in obtaining space to use as a disaster recovery center. With the help of automation, the Fund expects to deliver all its financial and personal reports to the membership in a more reasonable time frame. Governmental obligations will be met on a timely basis. The Fund has established, and continues to expand, a web-site with the web address of ***chipabf.org*.**

The Investment Committee will continue to use the Investment Policy Manual that is now the comprehensive source of investment information and will also provide guidelines for current and future trustees and staff. The Fund has offered a deferred compensation investment program to its employees since January 1, 1993.

Professional Services

The Fund's actuarial services are provided by Gabriel, Roeder, Smith & Company. The annual audit is conducted by Hill Taylor LLC, Certified Public Accountants. In addition to the annual financial audit for 2006, Hill Taylor performed a special bi-annual compliance audit of the Fund as mandated by the Illinois State Department of Insurance to ensure conformity with Illinois State statues. The audit revealed no issues.

In 2006, the Fund hired Courtland Partners, Ltd. as real estate investment advisors. Courtland advised the Fund on making allocations to several real estate managers in 2006.

Given the recent nature of these investments, no substantial financial performance data existed as of December 31, 2006.

The Fund employed 33 investment managers as of December 31, 2006. A complete listing of professional managers is detailed in the CAFR's introductory section.

Awards

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting for the year ended December 31, 2005. The Certificate of Achievement is a prestigious national award recognizing conformance with the highest standards for preparation of state and local government financial reports and the Fund has received the certificate for 15 out of the past 16 years.

In order to be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements and we are submitting it to GFOA to determine its eligibility for another certificate.

Acknowledgments

On behalf of the Board of Trustees, I wish to express appreciation to the staff and professional consultants who work so effectively to ensure the continued successful operation of the Fund. It is an honor and a privilege to serve the men and women of the Chicago Police Department and the City of Chicago. I extend my appreciation to all Fund participants for their interest and involvement in all plan activities. With our office improvements, we will be better able to serve you going forward and, as always, welcome your comments or suggestions.

Respectfully submitted,

John J. Gallagher, Jr.
Executive Director
June 30, 2007

RETIREMENT BOARD MEMBERS AND OFFICE STAFF

December 31, 2006

PROFESSIONAL CONSULTANTS

LEGAL ADVISOR
David R. Kugler, Esquire

MEDICAL ADVISOR
S. David Demorest, M.D.

INVESTMENT CONSULTANTS
Ennis, Knupp and Associates
Courtland Partners, Ltd.

CONSULTING ACTUARY
Gabriel, Roeder, Smith & Company

AUDITOR
Hill, Taylor L.L.C.

MASTER CUSTODIAN
The Northern Trust Company

COMMERCIAL BANK
Chase

INVESTMENT MANAGERS

ABR Chesapeake
Adams Street Partners
Ariel Capital Management
Artisan Partners
Capital Guardian Trust Co.
Chancellor
Channing Capital
Chicago Equity Partners
Cordillera Asset Management
Dearborn Partners
Denali Advisors
DV Urban Realty
Great Lakes Advisors
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Harris Investment Management
Holland Capital Management
Invesco Capital Management
JP Morgan Fleming Asset Management
LM Capital Group
McKinley Capital Management
Mesirow
Montag & Caldwell
Muller & Monroe
Morgan Stanley Prime Property
Northern Trust Global Investments
Piedmont Investment Advisors
Piedra Capital Ltd.
Quadrant Real Estate Advisors
Taplin, Canida & Habacht
UBS Global Asset Management, Inc.
Wellington Management Company
Wells Capital Management
William Blair & Company
Zenna Financial Services

ORGANIZATION CHART

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Kenneth A. Hauser, Vice-President
Dana R. Levenson, Investment Committee Chairman
Michael J. Lazzaro, Recording Secretary
Stephanie D. Neely, Treasurer
Steven J. Lux, Trustee
James P. Maloney, Trustee
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EXECUTIVE DIRECTOR
John J. Gallagher, Jr.

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PROFESSIONAL CONSULTANTS
Legal Advisor
Medical Advisor
Investment Consultants
Consulting Actuary
Auditor
Master Custodian
Investment Managers

COMPTROLLER
Charles A. McLaughlin, CPA
ASSISTANT COMPTROLLER
Pacifico V. Panaligan, CPA

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BENEFIT CALCULATIONS	**BENEFIT CLAIMS**	**BENEFIT COUNSELING**	**BENEFIT DISBURSEMENTS**
Richard A.Wrobel	Kay Hylton	Maggie O'Grady	Kristi R. Matalik

Financial Section

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Of Certified Public Accountants

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Illinois CPA Society

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INDEPENDENT AUDITORS' REPORT

Board of Trustees
Policemen's Annuity and Benefit
Fund of Chicago

We have audited the accompanying statements of plan net assets of the Policemen's Annuity and Benefit Fund of Chicago (Fund) as of December 31, 2006 and 2005, and the related statements of changes in plan net assets for the years then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the Policemen's Annuity and Benefit Fund of Chicago as of December 31, 2006 and 2005, and the changes in plan net assets for the years then ended, in conformity with accounting principles generally accepted in the United States of America..

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

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The required supplemental schedules listed in the table of contents are required by the GASB. The other supplementary schedules of administrative expenses and consulting costs are presented for the purpose of additional analysis and are not a required part of the basic financial statements of the Fund. The required supplementary information and other supplemental schedules of administrative expenses and consulting costs are the responsibility of the management of the Fund. The information on those schedules has been subjected to the auditing procedures applied in the audits of the basic financial statements of the Fund and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Hill, Taylor LLC

April 9, 2007

Management's Discussion and Analysis

The Management's Discussion and Analysis section of this report is intended to serve as an introduction to the Policemen's Annuity and Benefit Fund of Chicago's financial statements and to supplement the information contained therein.

OVERVIEW OF FINANCIAL STATEMENTS AND ACCOMPANYING INFORMATION

The basic financial statements are prepared in accordance with generally accepted accounting principles as established by the Governmental Accounting Standards Board (GASB) and are described below:

- **The Statements of Plan Net Assets** report the Fund's assets, liabilities and the resultant net assets where Assets minus Liabilities equal Net Assets available at the end of the year.

- **The Statements of Changes in Plan Net Assets** show the sources and uses of funds during the calendar year, where Additions minus Deductions equal the Net Increase (or Decrease) in Net Assets available for the year.

- **The Notes to the Financial Statements** are an integral part of the financial statements and include important information and schedules to provide a better understanding of the data provided in the financial statements. Information contained in the note disclosures discusses the accounting policies, benefits, contributions, fund reserves and various other relevant topics.

Due to the long-term nature of the Fund, additional information is provided to supplement the information included in the financial statements. Several required supplementary schedules for the Pension and Health Insurance have been provided.

- **The Schedule of Funding Progress** contains actuarial valuations of the status of the plan in an ongoing as well as a historical basis. Actuarial Liabilities in excess of Actuarial Valuation of Assets indicates that insufficient assets have been accumulated to fund future benefits of current members and retirees.

- **The Schedule of Employer Contributions** contains historical trend information regarding the value of total annual contributions that the employer must pay (as determined under the parameters of GASB Statement No. 25 for the Pension and GASB Statement No. 43 for the Health Insurance) and the related percentage the employer has contributed to meet its requirement.

- **The Notes to the Required Supplementary Information** provides background information and the actuarial method and assumptions used to aid in understanding the required supplementary schedules.

Additional schedules provided include the *Schedule of Administrative Expenses* and the *Schedule of Consulting Expenses* to reflect the costs involved in managing a defined benefit pension plan.

FINANCIAL HIGHLIGHTS

- The Retirement Board of the Policemen's Annuity and Benefit Fund of Chicago's net assets increased by $237.2 million or 6.0% to $4.19 billion, in 2006 from $3.95 billion at year-end 2005. The increase was mainly attributable to appreciation in the fair value of investments. The investment return for 2006 was 12.1%, primarily due to higher returns in the equity markets, both domestic and foreign, in 2006.

- The funding objective of the Plan is to meet its long-term defined pension benefit obligations. The Funding Ratio of the plan on a market value basis experienced an increase of 0.4% to a level of 51.7% at year-end 2006. The Fund uses a 5-year actuarial smoothing method in valuing its assets to determine both its funded status and the required contributions necessary to fund the plan going forward. This actuarial valuation method reduces the effect of short-term market volatility and provides more stable trend valuation for the long-term planning needs of the Fund.

- Revenues for the Fund were consistent with 2005 except for investment income. For 2006, the net appreciation of $373.6 million contributed to the overall increase in net assets of $237.3 million. Total contributions by the employees and employer were $249.7 million for 2006 as compared to $267.0 million for 2005. This is due to the fact that the regular 2005 employer contributions were supplemented by one-time debt proceeds of $20 million that was not repeated in 2006.

- Expenses for the Fund are, of course, primarily composed of benefit payments due to annuitants and disability recipients. Benefit payments for 2006, excluding death benefits and refunds, were $450.9 million, up from $430.0 million in 2005. Death benefits and refunds of employee deductions remained consistent from 2005 to 2006 and account for only 1.6% of total benefit expenses. The Fund's administrative expenses for 2006 were $2.7 million, comparable to $2.6 million in 2005.

- Investment management fees increased from $11.0 million in 2005 to $13.4 million in 2006, reflecting a re-allocation of fund assets from passive index funds to actively-managed funds with the greater expense incurred by the latter type of asset management. The move towards actively-managed funds in 2006 is in keeping with the Fund's investment policy of increasing the portfolio's rate-of-return. The move towards actively-managed funds has also led to an increase in net income from securities lending activities from $0.8 million in 2005 to $1.4 million in 2006 resulting from a material increase in the portfolio's pool of securities eligible for securities lending.

PLAN NET ASSETS

A summary of the Plan's Net Assets is presented below:

Plan Net Assets
(In millions)
As of December 31, 2006, 2005, and 2004

	2006	2005	2005-06 Change $	2005-06 Change %	2004
Cash and cash equivalents	$ 99.2	$ 62.6	$ 36.6	58.5%	$ 68.3
Receivables	172.2	171.0	1.2	0.7	151.2
Brokers – unsettled trades	177.1	80.7	96.4	119.5	56.1
Investments, at fair value	3,930.3	3,742.6	187.7	5.0	3,661.3
Invested securities lending collateral	564.2	323.0	241.2	74.7	301.8
Total assets	4,943.0	4,379.9	563.1		4,238.7
Brokers – unsettled trades	180.0	97.4	82.6	84.8	65.0
Securities lending payable	564.2	323.0	241.2	74.7	301.8
Accounts payable and accrued expenses	6.7	4.7	2.0	42.6	6.1
Total liabilities	750.9	425.1	325.8		372.9
Net Plan Assets	$ 4,192.1	$ 3,954.8	$ 237.3	6.0%	3,865.8

Advancing financial markets produced a significant increase in the investments at fair value for 2006.

CHANGES IN PLAN NET ASSETS

The following table reflects a comparative summary of various changes in Plan Net Assets.

Changes in Plan Net Assets
(In millions)
Years Ended December 31, 2006, 2005 and 2004

	2006	2005	2005-06 Change $	2005-06 Change %	2004
Additions:					
Member contributions	$ 92.0	$ 89.1	$ 2.9	3.3%	$ 78.8
Employer contributions	157.7	177.9	(20.2)	(11.4)	135.7
Net investment gains (losses) and investment income	445.9	260.6	185.3	71.1	367.4
Securities lending income	1.4	0.8	0.6	75.0	0.5
Miscellaneous income	1.1	0.4	0.7	175.0	0.1
Total additions	698.1	528.8	169.3		582.5

	2006	2005	2005-06 Change $	2005-06 Change %	2004
Deductions:					
Annuity and disability benefits	$ 452.8	$ 431.4	$ 21.4	5.0%	$ 401.5
Refunds of contributions	5.3	5.6	(0.3)	(5.4)	5.8
Administrative expenses	2.7	2.7	0.0	0.0	2.6
Total deductions	460.8	439.7	21.1		409.9
Net Increase	$ 237.3	$ 89.1	$ 148.2	166.3%	$ 172.6

REVENUES – ADDITIONS TO PLAN NET ASSETS

- Member contributions increased by 3.3% to $92.0 million in 2006 from $89.1 million in 2005. This increase reflects the impact of retroactive salary increases for the active membership under the employment contract covering the period July 1, 2003 through June 30, 2007.

- Employer contributions decreased from the prior year by 11.4% (from $177.9 million received in 2005 to $157.7 million received in 2006). This was the result of the Fund receiving one-time debt proceeds of $20 million in 2005 in addition to its normal distributions of real estate tax receipts from the employer. Employer contributions are mandated by a statutorily set multiplier of 2.0 times total member contributions collected two years prior.

- The net gain on total investment activity of $445.9 million in 2006, compared to $260.6 million in 2005, was significant. Net investment activity increased due to increased market appreciation in 2006, which produced a 12.1% return for the year compared to a 7.3% gain for 2005.

EXPENSES – DEDUCTIONS FROM PLAN NET ASSETS

- Pension, disability, and death benefits rose from $431.4 million to $452.8 million in 2006, an increase of 5.0%. The increases in benefits were attributable to two factors, a statutory change that improved the formula for employee annuity benefits as well as retroactive annuity adjustments due to a new employment contract. Also, benefit payments increased because of the 3% automatic increase (cost of living) payable for those retired annuitants eligible to receive it contributed to the total increase in benefit payments.

PLAN MEMBERSHIP

The following table reflects the changes in plan membership over the past three years.

Changes in Plan Membership
As of December 31, 2006, 2005 and 2004

	2006	2005	2005-06 Change	%	2004
Retirees and beneficiaries receiving benefits	12,026	11,999	27	0.2%	11,808
Active employees	13,749	13,462	287	2.1	13,569
Terminated (inactive members) employees entitled to benefits or refunds of contributions	595	587	8	1.4	501
Total	26,370	26,048	322	1.2%	25,878

The actuarial value of assets, using the GASB 25 method, for the December 31, 2006 valuation was $4.0 billion and the actuarial liability was $8.1 billion. The actuarial liability increased significantly by $393.8 million in 2006, from $7.7 billion in 2005 to $8.1 billion in 2006. The assets currently fund 49.3% of this liability, a decrease from the 50.7% funded ratio in 2005. The decrease in the funded ratio resulted from a combination of increases in the actuarial liabilities and the lingering effects of poor investment returns for the years 2001 and 2002. These poor return years are still being absorbed in a five-year actuarial smoothing of assets method used to determine the actuarial value of assets. As markets continue to advance, as they did in 2006, the Fund expects a more positive trend to return to the funded ratio.

INVESTMENT ACTIVITIES

At year-end 2006, the Fund assets achieved a total fund return of 12.1% compared to 7.3% in 2005. Most of this increase was due to outstanding returns in the equity markets. Domestically, the fund managers returned 12.2% in 2006, up 80% from the average return of 6.8% in 2005. International stocks returned an average of 23.7% for the year, up 50% from a return of 15.9% in 2005. Markets continued to rebound from a very poor 2002 and these positive returns in excess of 10% in foreign equities in all likelihood will not be sustained going forward. The Fund's investment asset allocation stayed within policy limits with 44.5% of assets invested in domestic equity, 18.0% in international equity, 32.6% invested in fixed income, 4.1% in private equity, and 0.8% in real estate.

Investment Returns
Years Ended December 31, 2006, 2005, and 2004

	2006	2005	2004
Total Fund	12.1%	7.3%	11.0%
Benchmark Portfolio	13.3	6.5	10.9
@EKA Public Fund Index	13.8	8.4	12.0
Domestic Equities	12.2%	6.8%	13.2%
Benchmark (Wilshire 5000)	15.8	6.4	12.5
International Equities	23.7%	15.9%	15.7%
Benchmark (MSCI All-Country)	26.7	16.6	20.9
Fixed Income	4.6%	2.5%	4.4%
Benchmark (Lehman Aggregate)	4.3	2.4	4.3

EFFECTS OF ECONOMIC FACTORS

The financial position of the plan has declined during the past three years due to major weakness in the financial markets at the start of the decade and increasing liabilities due to plan benefit improvements. The Fund participated in the market recovery in 2003 and 2004 but significant market losses sustained in 2001 and 2002 have yet to be fully absorbed. Total fund return for 2006 (12.1%) did exceed the actuarial assumption of 8%.

CONTACT INFORMATION

This financial report is designed to provide the employer, plan participants and others with a general overview of the Plan's finances and to show accountability for the monies received. Questions concerning any data provided in this report can be submitted to:

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Executive Director
Policemen's Annuity and Benefit
Fund of Chicago
221 N. LaSalle Street
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Chicago, IL 60601

POLICEMEN'S ANNUITY AND BENEFIT FUND OF CHICAGO

STATEMENTS OF PLAN NET ASSETS

DECEMBER 31, 2006 AND 2005

	2006	2005
Assets		
Cash	$ 250	$ 250
Receivables:		
Employer tax levies, net of allowance for loss of $15,751,762 in 2006 and $15,153,701 in 2005	152,064,197	158,248,942
Member contributions	8,173,403	7,866,389
Interest and dividends	11,950,142	4,923,396
Accounts receivable - due from brokers	177,139,566	80,722,437
	349,327,308	251,761,164
Investments at fair value:		
Common stock and other equity	1,569,866,651	1,029,856,869
Collective investment, stock	410,476,372	759,173,352
Collective investment, fixed income	381,052,756	793,245,855
International equity	548,499,467	684,478,951
Bonds and notes	828,525,881	337,747,964
Short term instruments	99,206,041	62,591,616
Real estate	27,579,058	1
Venture capital	164,262,438	138,079,627
	4,029,468,664	3,805,174,235
Invested securities lending cash collateral	564,202,733	322,994,408
Total Assets	4,942,998,955	4,379,930,057
Liabilities		
Refunds and accounts payable	6,697,824	4,654,720
Trade accounts payable - due to brokers	180,022,199	97,444,341
Security lending cash collateral	564,202,733	322,994,408
Total Liabilities	750,922,756	425,093,469
Net assets held in trust for pension benefits		
	$ 4,192,076,199	$ 3,954,836,588

See accompanying notes to financial statements.

POLICEMEN'S ANNUITY AND BENEFIT FUND OF CHICAGO

STATEMENTS OF CHANGES IN PLAN NET ASSETS

YEARS ENDED DECEMBER 31, 2006 AND 2005

	2006	2005
Additions		
Contributions		
Employer	$ 157,689,286	$ 177,910,607
Plan member salary deductions	91,965,685	89,109,811
Total contributions	249,654,971	267,020,418
Investment income:		
Net appreciation in fair value		
of investments	373,574,074	201,504,360
Interest	47,278,483	42,490,023
Dividends	38,141,915	27,560,397
Real estate	273,704	46,135
	459,268,176	271,600,915
Investment activity expenses:		
Investment management fees	(12,477,272)	(10,394,381)
Custodial fees	(521,115)	(452,210)
Investment consulting fees	(379,077)	(195,588)
Total investment activity expenses	(13,377,464)	(11,042,179)
Net income from investing activities	445,890,712	260,558,736
From securities lending activities:		
Security lending income	29,767,186	9,460,764
Borrower rebates	(27,921,696)	(8,330,251)
Bank fees	(461,155)	(300,022)
Net income from securities lending activities	1,384,335	830,491
Total net investment income	447,275,047	261,389,227
Miscellaneous income	1,069,991	367,764
Total Additions	698,000,009	528,777,409
Deductions		
Pension and disability benefits	450,901,638	429,945,018
Death benefits	1,886,443	1,500,000
Refunds of employee deductions	5,271,842	5,644,241
	458,059,923	437,089,259
Administrative expenses	2,318,359	2,287,263
Consulting expenses	382,116	373,556
Total Deductions	460,760,398	439,750,078
Net Increase	237,239,611	89,027,331
Net assets held in trust for pension benefits		
Beginning of year	3,954,836,588	3,865,809,257
End of Year	$ 4,192,076,199	$ 3,954,836,588

See accompanying notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2006 AND 2005

1. **Plan Description:**

The Policemen's Annuity and Benefit Fund of Chicago (Fund) is the administrator of a defined benefit, single-employer pension plan with a defined contribution minimum for the purpose of providing benefits to the policemen of the City of Chicago (City), their widows and children. Any employee of the City employed under the provisions of the municipal personnel ordinance as police service is covered by the Fund. The defined benefits as well as the employer and employee contribution levels are mandated in Illinois Compiled Statutes (40 ILCS 5/5) and may be amended only by the Illinois State Legislature. The Fund is governed by an 8-member Board of Trustees (four appointed by the City, three elected by the policemen, and one elected by the annuitants) whose duties are to administer the Fund under the Illinois Pension Code.

The City of Chicago payrolls for employees covered by the Fund for the years ended December 31, 2006 and 2005 were $1,012,983,634 and $948,973,732, respectively. At December 31, 2006 and 2005, the Fund membership consisted of the following:

	2006	2005
Active Employees	13,749	13,462
Retirees and beneficiaries currently receiving benefits	12,026	11,999
Terminated employees entitled to benefits or a refund of contributions but not yet receiving them	595	587
	26,370	26,048

The Fund provides retirement benefits as well as death and disability benefits. Employees age 50 or more with at least 10 years of service are entitled to receive a money purchase annuity and partial City contributions if less than 20 years of service. Effective in 2003, the mandatory retirement age for a participant is 63. Employees age 50 or more with at least 20 years of service are entitled to receive a minimum formula annuity of 2.5% per year for the first 20 years of service plus 2.5% per year for each following year or fraction thereof times the final average salary (highest average annual salary for any 4 consecutive years within the last 10 years of service immediately preceding the date of retirement). The annuity shall not exceed 75% of the highest average annual salary.

The monthly annuity is increased by 3% of the original annuity at the first of the month following the later of age 55 or the first anniversary of retirement, and by 3% on each January 1st thereafter, if born before January 1, 1955.

If born after January 1, 1955, then the monthly annuity is increased by 1.5% of the original annuity at the first of the month following the later of age 60 or the first anniversary of retirement, and 1.5% on each January 1st thereafter, but not to exceed a total of 30%.

Covered employees are required to contribute 9.0% of their salary to the Fund. If an employee leaves covered employment without qualifying for an annuity, accumulated contributions are refunded with interest. The City is required by State statutes to contribute the remaining amounts necessary to finance the requirements of the Fund. It is required to levy a tax at a rate not more than an amount equal to the total amount of contributions by the employees to the Fund made in the calendar year two years prior to the year for which the annual applicable tax is levied, multiplied by 2.00 annually.

Health Insurance Supplement

The City offers group health benefits to annuitants and their eligible dependents through the City's health care plans. Premiums are set by the City with the City pays 50% of the claims or premiums, whichever are applicable, and the remaining amount to be paid by all annuitants participating in the plans. Currently, the Fund pays to the City on behalf of each of the annuitants who chooses to participate in any of the City's health care plans up to a maximum of $85 per month from July 1, 2003 through June 30, 2008 and $95 per month from July 1, 2008 through June 30, 2013 for each annuitant who is not qualified to receive Medicare benefits; and up to a maximum of $55 per month from July 1, 2003 through June 30, 2008, and $65 per month from July 1, 2008 through June 30, 2013 for each annuitant who is qualified to receive Medicare benefits.

The health insurance supplement is financed with current contributions on a pay-as-you-go basis. There is no separate healthcare account established by the Fund to pay the health insurance supplement.

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

(a) **Reporting Entity**

Accounting principles generally accepted in the United States of America as established by the Governmental Accounting Standards Board (GASB) define a financial reporting entity as consisting of the primary government and its component units for which the primary government is financially accountable. Financial accountability includes appointing a voting majority of a component unit's governing board, the ability of the primary government to impose its will on the component unit or a potential for the component unit to provide specific financial benefits to, or to impose specific financial burdens on the primary government. A primary government may also be financially accountable for its component units that are fiscally dependent on it.

Based on the above criteria, the Fund is considered to be a component unit of the City of Chicago. The Fund is part of the City's financial reporting entity and it is included in the City's pension trust funds' financial statements.

(b) **Basis of Accounting**

The Fund's financial statements are prepared on the accrual basis of accounting. Employee and employer contributions are recognized as additions in the period when due, pursuant to formal commitments from the City of Chicago, as well as statutory requirements established by Illinois State law, rather than in the period in which employee services are performed. Benefits and refunds are recognized as deductions when payable. Expenses are recorded when the corresponding liabilities are incurred, regardless of when payment is made.

(c) **Use of Estimates**

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results may differ from those estimates.

(d) **Investments**

The Fund is authorized by 40 ILCS 5/1-113 to invest in bonds, notes and other direct obligations of the United States Government and United States Government agencies; corporate bonds, debentures and notes; certain notes secured by mortgages, including pass through securities; common and preferred stocks; certain pooled funds and various types of investment securities. Investment made in accordance with the State Statutes shall be deemed to be prudent.

(e) **Method Used to Value Investments**

Investments are reported at fair value. 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. Fixed income securities are valued principally using quoted market prices provided by independent pricing services. For collective investments, the net asset value is determined and certified by the investment managers as of the reporting date. Real estate investments are valued by appraisals. Investments that do not have an established market are reported at estimated fair value.

(f) **Furniture and Office Equipment**

Furniture and office equipment are not capitalized as they are immaterial and are charged to expenses in the year of purchase.

(g) **Administrative Expenses**

Administrative expenses are budgeted and approved by the Board of Trustees of the Fund. Administrative expenses are funded by the employer contributions.

(h) **Securities Lending Transactions**

Cash received as collateral on securities lending transactions and investments made with that cash are reported as assets in the statements of plan net assets. Securities received as collateral are reported as assets only if the Fund has the ability to pledge or sell them without a borrower default. Liabilities resulting from these transactions are reported in the statements of plan net assets. The costs of securities lending transactions are reported as deductions in the statements of changes in plan net assets at gross amounts.

(i) **New Accounting Pronouncement**

In 2006, the Fund adopted the provisions of GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans.* This new standard establishes uniform financial reporting standards for other postemployment benefits (OPEB). Adoption of GASB Statement No. 43 had no effect on the plan net assets and changes in plan net assets.

(j) **Reclassifications**

Certain amounts in the 2005 notes to the financial statements have been reclassified to conform to the 2006 presentation. These reclassifications have no effect on previously reported net assets held in trust for pension benefits.

3. **Cash and Investment Risk Disclosure:**

(a) **Cash**

The bank balance and carrying amount of the Fund's deposits, excluding $250 of petty cash, at December 31, 2006 were $509,520 and $(614,732), respectively; and they were $1,041,296 and $(111,266) at December 31, 2005, respectively. The entire bank balance at December 31, 2006 and 2005 is on deposit with the City Treasurer and is insured or collateralized by securities held by the City Treasurer in the Fund's name.

(b) **Investment Policy**

The Fund's overall investment policy is based on the following principles established by the Trustees:

- Maintain a long-term investment horizon for the Fund
- Emphasize equity investment to enhance long-term return
- Diversify investments across several asset classes
- Avoid market timing strategies

In order to minimize the impact of large losses and to reduce annual variability of returns, the Fund's assets are allocated across major asset classes and diversified broadly within each asset class.

(c) **Investment Summary**

The following table presents a summary of the Fund's investments by type at December 31, 2006 and 2005:

	2006	2005
U.S. Government and Agency Fixed Income	$ 397,636,968	$ 163,798,316
U.S. Corporate Fixed Income	430,888,913	173,949,648
U.S. Fixed Income Funds	381,052,756	793,245,855
U.S. Equities	1,569,866,651	1,216,554,377
U.S. Stock Funds	410,476,372	572,475,843
Foreign Equities	548,499,467	684,478,951
Pooled Short-Term Investment Funds	68,623,813	44,361,231
Real Estate	27,579,058	1
Private Equity	164,262,438	138,079,627
U.S. Miscellaneous	763,000	7,165,000
Commercial Paper	6,190,266	1,454,526
U.S. Treasury Bills	8,498,370	-
SWAPS	-	14,599
Cash and Cash Equivalents	15,130,592	9,596,261
Total Investments at Fair Value	$ 4,029,468,664	$ 3,805,174,235

(d) **Investment Risks**

The Fund's investments are subject to certain types of risks, including interest rate risk, credit risk, custodial credit risk, concentration of credit risk, and foreign currency risk. The following describes those risks:

Interest Rate Risk – Interest rate risk is the risk that the fair value of debt securities decreases due to increases in the prevailing market interest rate. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. To manage interest rate risk, the Fund has employed a pool of fixed income managers directing diverse investments in both the Core and Core-plus sectors. Core funds are composed largely of domestic investment-grade bonds. Core-plus managers invest in emerging market and high-yield instruments as well as in Core-type securities. The Fund also manages its exposure to interest rate risk through managers purchasing a combination of shorter term and longer term investments and by timing cash flow from maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations. The following tables show the segmented time distribution of the Fund's investments into time periods of maturities based on the investments' cash flows.

At December 31, 2006, the Fund had the following investments and maturities:

Investment Type	Fair Value	Investment Maturities: Less than 1 Year	1 to 6 years	7 to 10 years	More Than 10 years
Asset backed securities	$ 51,880,789	$ 1,026,125	$ 23,584,831	$ 8,344,855	$ 18,924,978
Commercial mortgage backed securities	53,746,166	-	-	-	53,746,166
Corporate bonds	232,028,675	8,138,430	94,052,080	71,468,224	58,369,941
Government agency securities	51,442,296	670,193	24,125,549	24,653,757	1,992,797
Government bonds	118,142,805	4,427,677	76,636,288	4,667,006	32,411,834
Government mortgage backed securities	204,418,504	-	1,204,702	8,977,481	194,236,321
Municipal bonds	1,458,394	-	389,413	337,822	731,159
Non-government backed collateralized mortgage obligations	93,233,283	-	208,010	4,404,120	88,621,153
Other fixed income	22,174,969	-	-	22,174,969	-
Total	$ 828,525,881	$ 14,262,425	$ 220,200,873	$ 145,028,234	$ 449,034,349

At December 31, 2005, the Fund had the following investments and maturities:

Investment Type	Fair Value	Investment Maturities: Less than 1 Year	1 to 6 years	7 to 10 years	More Than 10 years
Asset backed securities	$ 39,264,126	$ -	$ 25,713,169	$ 3,121,238	$ 10,429,719
Commercial mortgage backed securities	21,636,353	-	-	774,622	20,861,731
Corporate bonds	100,018,103	1,944,465	38,094,884	33,574,343	26,404,411
Government agency securities	17,703,825	152,308	16,377,651	98,580	1,075,286
Government bonds	57,034,897	163,661	18,050,620	10,404,264	28,416,352
Government mortgage backed securities	88,267,805	-	1,230,406	4,087,768	82,949,631
Municipal bonds	791,788	-	-	-	791,788
Non-government backed collateralized mortgage obligations	13,031,067	-	1,435,252	-	11,595,815
Total	$ 337,747,964	$ 2,260,434	$ 100,901,982	$ 52,060,815	$ 182,524,733

Credit Risk – Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligations. This credit risk is measured by the credit quality ratings issued by national ratings agencies such as Moody's and Standard and Poor's. The Fund's investment policy limits its investments in corporate bonds to those that are rated Baa or better by nationally recognized rating agencies.

The following table provides information on the credit ratings associated with the Fund's investments in debt securities. It should be noted that U.S. Government debt securities are *explicitly* guaranteed by the U.S. Government whereas certain agency securities carry an *implicit* guarantee of the US Government. The following ratings were obtained from Standard and Poor's:

Quality Rating	**2006 Fair Value**	**2005 Fair Value**
AAA	$ 227,770,426	$ 134,019,296
AA	29,788,431	4,057,569
A	69,788,862	36,693,126
BBB	90,894,788	52,399,577
BB	11,219,049	5,353,972
B	26,358,496	653,036
Not Rated	82,339,282	2,133,925
Other	2,491,401	9,476,763
Total Credit Risk of Debt Securities	**540,650,735**	**244,787,264**
U.S. Government & Agencies	**287,875,146**	**92,960,700**
	$ 828,525,881	**$ 337,747,964**

Custodial Credit Risk – For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Fund will not be able to recover the value of its 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 the name of the Fund, and are held by either the counterparty or the counterparty's trust department or agent but not in the Fund's name. The Fund's master custodian holds all investments of the Fund in the Fund's name. As of December 31, 2006, deposits of $294,862 were exposed to custodial credit risk as uninsured and uncollaterized.

Concentration of Credit Risk – The Fund's investment policy limits the aggregate amount that can be invested in each asset class. Domestic equity, international equity, fixed income, private equity and short-term investments are limited to 49%, 15%, 32%, 3% and 1% of the market value of the aggregate portfolio, respectively.

The Fund has no significant investments in any organization that represent 5% or more of net assets held in trust for pension benefits.

Foreign Currency Risk – This is the risk that changes in exchange rates will adversely affect the fair value of an investment. International equity securities purchased by the Fund meet exchange listing requirements and all foreign equities held by the Fund are denominated in U.S. dollars.

The Fund does not have a formal investment policy governing foreign currency risk, but does manage its exposure to loss in the fair value of assets by requiring managers of foreign investments to maintain diversified portfolios in order to minimize foreign currency and security risk.

Currency	2006 Fair Value	2005 Fair Value
Argentine Peso	$ -	$ 178,311
Australian Dollar	19,731,453	10,525,138
Brazilian Real	2,214,143	2,818,819
British Pound Sterling	102,018,243	69,792,698
Canadian Dollar	24,828,052	23,883,091
Chilean Peso	-	195,063
Chinese Yuan	-	483,251
Colombian Peso	-	352,108
Danish Krone	1,869,082	660,667
Egyptian Pound	269,984	-
Euro Currency Unit	191,907,981	146,536,802
Hong Kong Dollar	31,110,448	15,632,225
Hungarian Forint	394,914	(198,071)
Iceland Krona	-	98,070
Indian Rupee	1,865,269	(99,567)
Indonesian Rupiah	2,463,402	102,501
Israeli Shekel	(1,379,615)	303,840
Japanese Yen	124,193,613	120,726,831
Malaysian Ringgit	770,105	428,612
Mexican Peso	6,458,144	3,796,868
New Zealand Dollar	(350,841)	-
Norwegian Krone	5,140,350	4,583,897
Philippine Peso	-	119,975
Russian Ruble	-	398,832
Singapore Dollar	15,407,784	3,983,594
Slovak Koruna	-	186,517
South African Rand	8,309,474	2,535,644
South Korean Won	14,481,959	10,876,096
Swedish Krona	17,703,268	6,495,488
Swiss Franc	60,076,552	45,486,536
Taiwan Dollar	12,918,301	5,052,369
Thai Baht	802,178	(97,413)
Turkish Lira	993,648	435,969
Uruguayan Peso	-	11,677
Total	**$ 644,197,891**	**$ 476,286,438**

(e) **Derivatives**

The Fund's investment managers may enter into derivative transactions as permitted by their guidelines for hedging or risk reduction, not for speculative purposes. A derivative financial instrument is an investment whose payoff depends upon the value of an underlying such as bond or stock prices, a market index, or commodity prices. Derivative financial instruments involve, to varying degrees, credit risk and market risk. The Fund held fixed income future contracts of $7,595,438 and $5,006,703 at December 31, 2006 and 2005, respectively.

4. **Securities Lending Program**

State statutes and Board of Trustees policies permit the Fund to lend its securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. The Fund's master custodian, Northern Trust Bank, lends securities of the type on loan at year-end for collateral in the form of cash, irrevocable letters of credit or other securities at 102 percent for U.S. securities. At year-end, the Fund has no credit risk exposure to borrowers because the amounts the Fund owes the borrowers exceed the amounts the borrowers owe the Fund. The contract with the Fund's master custodian requires it to indemnify the Fund if the borrowers fail to return the securities (and if the collateral is inadequate to replace the securities lent) or fail to pay the Fund for income distributions by the securities' issuers while the securities are on loan.

All securities loans can be terminated on demand by either the Fund or the borrower, although the average term of the loans is 99 days. Cash collateral is invested in the lending agent's short-term investment pool, which at year-end has a weighted-average maturity of 42 days. The relationship between the maturities of the investment pool and the Fund's loans is affected by the maturities of the securities loans made by other entities that use the agent's pool, which the Fund cannot determine. The Fund cannot pledge or sell collateral securities received unless the borrower defaults.

Loans outstanding as of December 31, 2006 and 2005 are as follows:

	2006	2005
Market value of securities loaned	$ 570,835,841	$ 333,417,325
Market value of cash collateral from borrowers	564,202,733	322,994,408
Market value of non-cash collateral from borrowers	23,170,427	20,906,187

5. **Contributions**:

The Fund's funding policy provides for an employer contribution which when added to the amounts contributed by the employees will be sufficient for the requirements of the Fund. This amount cannot be more than an amount equal to the total amount of contributions by the employees to the Fund made in the calendar year two years prior to the year of employer contribution multiplied by 2.00.

The total annual actuarial required contribution to the Fund (financed by the employees and the City) is equal to the normal cost plus interest only on the unfunded actuarial accrued liabilities determined using the entry age normal method. This actuarial cost method amortizes the costs of the participants' benefits over the entire career of each member as a level of percentage of compensation. The employer contribution required for interest only on the unfunded actuarial accrued liabilities results in a decreasing annual employer cost expressed as a percentage of payroll as future payrolls increase. Since the tax levy is expressed as a multiple of the total salary deductions made two years prior, the City is effectively contributing a level annual percentage of payrolls.

6. **Reserves:**

The Fund maintains several reserves as required by the Illinois Pension Code and Board policy. The following are brief descriptions of the reserves.

(a) **City Contribution Reserve**

	2006	2005
Balances at December 31	$ 1,812,623,964	$ 1,717,385,855

The City Contribution Reserve is maintained for the payment of the City's portion of future retirement benefits for active and inactive participants. Interest at 3% is credited to this reserve annually. When the amount of annuity for a policeman or widow is fixed, the City Contribution Reserve is charged with the amount of the present value of retirement benefit and the Annuity Payment Reserve is credited with such amount.

The City Contribution Reserve does not equal the present value of expected retirement benefits. The unfunded liability as calculated by the actuary was $3,941,570,358 in 2006 and $3,808,305,493 in 2005.

(b) **Salary Deduction Reserve**

	2006	2005
Balances at December 31	$ 1,000,682,920	$ 940,465,168

The Illinois Pension Code requires the Fund to maintain separate accounts for each policeman for the amounts of salary deductions with interest at 3% per year. When a policeman retires, the amount of his annuity is charged to the Salary Deduction Reserve and credited to the Annuity Payment Reserve. If a policeman takes a separation refund, his salary deductions are refunded to him and charged to the Salary Deduction Reserve. This reserve is fully funded.

(c) **Annuity Payment Reserve**

	2006	2005
Balances at December 31	$ 682,879,418	$ 724,108,049

When the amount of annuity has been fixed, the present value of expected benefit is transferred from the City Contribution Reserve and the Salary Deduction Reserve to the Annuity Payment Reserve for the payment of annuity. All age and service annuities, widow's annuities and refunds are charged to this reserve.

Annually, the actuary calculates the present value of all annuities. The Investment and Interest Reserve will transfer amounts to the Annuity Payment Reserve to ensure that the balance in the Annuity Payment Reserve equals the present value of annuities. This reserve is fully funded.

(d) **Prior Service Annuity Reserve**

	2006	2005
Balances at December 31	$ 1,091,780,544	$ 904,330,787

The Prior Service Annuity Reserve is increased by the City's contributions for policemen and widows' prior service annuities and all prior service annuities payable to policemen and widows are charged to this reserve.

(e) **Gift Reserve**

	2006	2005
Balances at December 31	$ 12,465,043	$ 11,507,544

The Gift Reserve is maintained for gifts, grants, bequests or other amounts received by the Fund. The Board of Trustees determines the use of these funds. Interest is credited to the Gift Reserve annually.

(f) **Investment and Interest Reserve**

All gains and losses from investments and investment earnings are recorded in the Investment and Interest Reserve. Interest due to the City Contribution Reserve, Salary Deduction Reserve, Prior Service Annuity Reserve, Gift Reserve and Supplementary Payment Reserve is transferred from the Investment and Interest Reserve to those reserves.

(g) **Ordinary Death Benefit Reserve**

	2006	2005
Balances at December 31	$ (10,522,052)	$ (8,739,621)

Amounts contributed by policemen and the City for death benefits are credited to the Ordinary Death Benefit Reserve. Death benefit payments are charged to this reserve. The Ordinary Death Benefit Reserve has a deficit of $10,522,052 and $8,739,621 at December 31, 2006 and 2005, respectively.

(h) **Automatic Increase Reserve**

	2006	2005
Balances at December 31	$ (398,281,040)	$ (334,668,596)

The Automatic Increase Reserve is credited with amounts deducted from the salaries of policemen and matching contributions by the City for automatic increase in annuity with interest thereon. Payments of increased annuities and salary deduction refunds for increase in annuity are charged to this reserve. At December 31, 2006 and 2005, the Automatic Increase Reserve has a deficit of $398,281,040 and $334,668,596, respectively.

(i) **Supplementary Payment Reserve**

	2006	2005
Balances at December 31	$ 447,402	$ 447,402

The Supplementary Payment Reserve receives amounts transferred from the Investment and Interest Reserve for supplemental increases in annuity for certain eligible retirees. This reserve is fully funded.

(j) **Child's Annuity Reserve**

Amounts contributed by the City for child's annuity are credited to the Child's Annuity Reserve and payments of child's annuity are charged to this reserve.

(k) **Duty Disability Reserve**

The Duty Disability Reserve is increased by the City's contributions for duty disability benefits, child's disability benefit and compensation annuity; and decreased by the payments of these benefits.

(l) **Ordinary Disability Reserve**

Amounts contributed by the City for ordinary disability benefits are credited to the Ordinary Disability Reserve. Payments of ordinary disability benefits are charged to this reserve.

(m) **Hospitalization Fund Reserve**

The health care premiums are paid from the tax levies and are credited to the reserve for Group Hospitalization Fund. Premium payments to the City are charged against this reserve.

(n) **Expense Reserve**

Amounts contributed toward the cost of administration are credited to the Expense Reserve while expenses of administration are charged to this reserve.

7. **Deferred Compensation Plan:**

The Fund offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all employees of the Fund, permits them to defer a portion of their salary until future years. Participation in the plan is optional. The deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency. The plan is managed by a third-party administrator.

The assets of the plan were placed in trust accounts with the plan administrator for the exclusive benefit of participants and their beneficiaries and are not considered assets of the Fund.

8. **Lease Agreement:**

The Fund leases its office facilities under a noncancellable agreement. The lease expired at the end of 2005 and was renewed for ten years until 2015. Office rental expense amounted to $110,786 and $139,919 for the years ended December 31, 2006 and 2005, respectively.

Future minimum rental payments under the office lease at December 31, 2006 are as follows:

Year	Amount
2007	$ 179,985
2008	225,355
2009	229,294
2010	233,234
2011	239,258
Thereafter	1,002,377
	$ 2,109,503

9. **Risk Management:**

The Fund is exposed to various risks of loss related to tort, theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Fund carries commercial insurance to reduce its exposure to risk of loss. There is no significant reduction in insurance coverage from year to year. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

POLICEMEN'S ANNUITY AND BENEFIT FUND OF CHICAGO

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF FUNDING PROGRESS – PENSION

YEARS ENDED DECEMBER 31, 2006 AND 2005

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
12/31/01	$4,183,796,025	$5,932,510,629	$1,748,714,604	70.52%	$763,352,475	229.08%
12/31/02	4,124,579,960	6,384,845,959	2,260,265,999	64.60	866,531,789	260.84
12/31/03	4,039,695,590	6,581,433,250	2,541,737,660	61.38	887,555,791	286.37
12/31/04	3,933,031,342	7,034,271,474	3,101,240,132	55.91	874,301,958	354.71
12/31/05	3,914,431,654	7,722,737,147	3,808,305,493	50.69	948,973,732	401.31
12/31/06	3,997,990,919	7,939,561,277	3,941,570,358	50.36	1,012,983,634	398.11

See notes to required supplementary information.

POLICEMEN'S ANNUITY AND BENEFIT FUND OF CHICAGO

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF EMPLOYER CONTRIBUTIONS – PENSION

YEARS ENDED DECEMBER 31, 2006 AND 2005

Year Ended December 31	Contributions Annual Required	Employee	Employer	Percentage Contributed
2001	$ 123,201,657	$ 71,146,651	$ 139,411,046	113.16%
2002	130,237,405	79,238,513	141,935,213	108.98
2003	181,545,562	79,816,332	140,734,767	77.52
2004	203,757,534	78,800,816	135,819,486	66.66
2005	238,423,459	89,109,811	177,910,607	74.62
2006	262,657,025	91,965,685	157,689,286	60.04

See notes to required supplementary information.

POLICEMEN'S ANNUITY AND BENEFIT FUND OF CHICAGO

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION – PENSION

YEARS ENDED DECEMBER 31, 2006 AND 2005

Valuation date	December 31, 2006
Actuarial cost method	Entry age
Amortization method	Level percent open
Remaining amortization period	30 years
Actuarial value of assets	5-year smoothed market
Post-retirement increase:	
A retiree born before January 1, 1955 with at least 20 years of service, receives an increase of 3% of the original annuity, starting on the first of the month following the first anniversary of his retirement or the first of the month following attainment of age 55, whichever is later.	3%
For retirees born after January 1, 1955, automatic increases are 1.5% of the original annuity, commencing at age 60, or the first anniversary of retirement, if later, to a maximum of 30%.	1.5%
Actuarial assumptions:	
Pension investment rate of return	8.0%
Projected salary increases	4.0% per year, plus additional percentage related to service
Cost of living allowance	3.0% (1.5% for retirees born after January 1, 1955)

POLICEMEN'S ANNUITY AND BENEFIT FUND OF CHICAGO

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF FUNDING PROGRESS – HEALTH INSURANCE

YEARS ENDED DECEMBER 31, 2006 AND 2005

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
12/31/05	-	$ 176,117,539	$176,117,539	0.00%	$ 948,973,732	18.56%
12/31/06	-	176,981,897	176,981,897	0.00	1,012,983,634	17.47

See notes to required supplementary information.

POLICEMEN'S ANNUITY AND BENEFIT FUND OF CHICAGO

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF EMPLOYER CONTRIBUTIONS – HEALTH INSURANCE

YEARS ENDED DECEMBER 31, 2006 AND 2005

Year Ended December 31	Contributions Annual Required	Employee	Employer	Percentage Contributed
2006	$ 11,076,022	$ -	$ 8,041,573	72.60%

See notes to required supplementary information.

POLICEMEN'S ANNUITY AND BENEFIT FUND OF CHICAGO

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

HEALTH INSURANCE

YEARS ENDED DECEMBER 31, 2006 AND 2005

Valuation date	December 31, 2006
Actuarial cost method	Entry age
Amortization method	Level percent open
Remaining amortization period	30 years
	Actuarial assumptions:
OPEB investment rate of return	4.5%
Projected salary increases	4.0% per year, plus additional percentage related to service
Cost of living allowance	3.0% (1.5% for retirees born after January 1, 1955)

POLICEMEN'S ANNUITY AND BENEFIT FUND OF CHICAGO

OTHER SUPPLEMENTARY INFORMATION

SCHEDULE OF ADMINISTRATIVE EXPENSES

YEARS ENDED DECEMBER 31, 2006 AND 2005

	2006	2005
Administrative Expenses:		
Personal services	$ 1,432,092	$ 1,397,879
Supplies	9,341	8,193
Fiduciary insurance	119,186	114,095
Occupancy and utilities	112,329	145,090
Postage	6,000	9,000
Equipment service and rent	44,404	83,122
Benefit disbursements	202,125	150,518
Miscellaneous	392,882	379,366
	$ 2,318,359	$ 2,287,263

See accompanying independent auditors' report.

POLICEMEN'S ANNUITY AND BENEFIT FUND OF CHICAGO

OTHER SUPPLEMENTARY INFORMATION

SCHEDULE OF CONSULTING EXPENSES

YEARS ENDED DECEMBER 31, 2006 AND 2005

	2006	2005
Payment to Consultants:		
External auditors	$ 34,750	$ 43,600
Medical consultant	87,999	76,080
Legal services	160,927	161,158
Actuary service	98,440	92,718
	$ 382,116	$ 373,556

See accompanying independent auditors' report.

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Investment Section

ENNISKNUPP

Investments
(Compiled by Ennis, Knupp & Associates, Investment Advisors to the Fund)

Investment Authority. Since December 16, 1987, the Policemen's Annuity & Benefit Fund of Chicago has operated in accordance with Public Act 85-964, which is the Prudent-Person rule for the Police Fund's investments. The Prudent-Person rule states that fiduciaries must discharge their duties with the care, skill, prudence, and diligence that a prudent person acting in a like capacity and familiar with such matters would use under the prevailing conditions. (A fiduciary is any person who has authority or control with respect to the management or administration of plan assets.)

Investment Policy. In 1983, the Trustees undertook a restructuring of the Fund's investment policy to improve the Fund's investment diversification. The revised policy allows for investment in additional asset classes (e.g., international stocks and bonds, real estate and private equity investments). As a result of the policy change, the Fund was restructured. The Trustees allocated monies among the new asset classes and added several new investment managers. The Trustees also allocated monies to passive investments (index funds), which provide a low-cost means of achieving market-like returns.

Distinction of Responsibilities. In order to clarify the roles and responsibilities of the Trustees and the various investment professionals engaged by the Trustees, the Trustees divided the responsibilities for the Fund as follows:

> The Trustees assume the responsibility for establishing the investment policy that is to guide the investment of the Fund. The investment policy describes the degree of investment risk that the Trustees deem appropriate.
>
> Investment managers are appointed to execute the policy and invest pension assets in accordance with the policy and applicable statutes, but apply their own judgments concerning relative investment values. In particular, investment managers are accorded full discretion, within policy limits, to (1) select individual investments, (2) make periodic adjustments to the proportions of equity and fixed income investments, and (3) diversify pension assets.

Ennis Knupp + Associates
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Chicago, Illinois 60606 3709

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Allocation of Assets. As of December 31, 2006, the Fund's asset allocation targets were as follows:

Asset Category	Target Allocation
Domestic Stocks	46%
International Stocks	15%
Private Equity	4%
Total Equity	65%
Fixed Income	34%
Real Estate	1%
TOTAL	100%

Diversification. The Fund's assets are diversified in several ways to minimize the potential for large losses in individual investments. Since 1984, the Trustees have expanded the number of asset classes available for investment to six (including large- and small-capitalization stocks) and have hired multiple managers. As of December 31, 2006, the Fund retained 33 investment managers for a total of 39 different accounts. During the year, the BNY Asset Management account was liquidated and Zenna was hired to manage an S&P 500 Index fund. On the fixed income side, the Holland Capital account was liquidated, and LM Capital and Taplin, Canida, & Habacht were hired to manage fixed income portfolios. Four new real estate managers, ABR Chesapeake, M.S. Prime Property, Quadrant R.E. Advisors, and UBS Realty, were funded.

Investment Objective. The return of the Total Fund is compared with the return of a "policy portfolio" comprising 50% of the Wilshire 5000 Stock Index, 15% of the Morgan Stanley Capital International (MSCI) All Country World ex-U.S. Index, 34% of the Lehman Brothers Aggregate Bond Index, and 1% of the NCREIF Net Property Index. The investment objective is to equal or exceed the policy portfolio rate of return after fees. The Total Fund's return is also compared with a universe of other public funds.

2006 Asset Allocation. As of December 31, 2006, the Fund's allocation to non-U.S. stocks was slightly above the allowable upper limit (18.0% of assets versus 17.0%). While the Fund was underweight to fixed income and U.S. equity, the allocations were within the allowable range. No new capital commitments were made to the private equity asset class during 2006; however, capital committed previously to private equity continued to be drawn down during the year and the allocation grew from 3.8% to 4.1%. There was an additional allocation made to real estate during the year. The funding of the four new managers brought the allocation to real estate to 0.7% at year end. The Fund's market value increased by approximately $250 million during the year as a result of investment gains of $461 million and net disbursements of $211 million. The Fund's asset allocation as of December 31, 2006 is shown in the table on the following page.

Asset Fair Value & Allocation

At December 31, 2006
($ in thousands)

	Domestic Stock	International Stock	Private Equity	Fixed Income	Real Estate	Cash Equiv.	Total	% of Total
Stock Accounts								
Ariel Capital Management	$51,977	-	-	-	-	$3,495	$55,472	1.4%
Channing Capital	22,689	-	-	-	-	606	23,295	0.6
Chicago Equity Partners	158,254	-	-	-	-	15,652	173,906	4.3
Cordillera	22,032	-	-	-	-	88	22,120	0.5
Denali Advisors	23,780	-	-	-	-	120	23,900	0.6
Great Lakers	231,390	-	-	-	-	22,049	253,439	6.3
Harris Investments	38,369	-	-	-	-	815	39,184	1.0
Holland U.S. Equity	51,801	$1,888	-	-	-	1,832	55,521	1.4
Montag	199,903	-	-	-	-	6,822	206,725	5.1
NT US MarketCap	410,476	-	-	-	-	-	410,476	10.2
Piedmont	22,997	-		-	-	422	23,419	0.6
Piedra	21,102	-	-	-	-	85	21,187	0.5
William Blair	209,236	-	-	-	-	8,718	217,954	5.4
UBS Global Management	215,225	-	-	-	-	-	215,225	5.3
Zenna	55,624	-	-	-	-	-	55,624	1.4
Artisan Partners	-	$72,815	-	-	-	$1,425	$74,240	1.8%
Capital Guardian	-	119,152	-	-	-	2,497	121,649	3.0
JP Morgan Fleming Asset Mgmt.	-	142,952	-	-	-	2,828	145,780	3.6
McKinley Capital Management	-	76,297	-	-	-	1,288	77,585	1.9
UBS Global Asset Management – Int'l	-	163,010	-	-	-	-	163,010	4.0
William Blair & Co.	-	137,854	-	-	-	5,000	142,854	3.5
Global Transition Account	-	11	-	-	-	-	11	0.0
Fixed-Income Accounts								
Dearborn (Baird)	-	-	-	$80,664	-	$487	$81,151	2.0%
LM Capital	-	-	-	25,626	-	792	26,418	0.7
Taplin, Canida & Habacht	-	-	-	48,525	-	3,708	52,233	1.3
NT Aggregate Bond Index Fund	-	-	-	394,353	-	-	394,353	9.8
UBS Global Asset Management – Bond	-	-	-	422,429	-	49	422,478	10.5
Wellington	-	-	-	169,500	-	5,423	174,923	4.3
Wells	-	-	-	151,714	-	11,874	163,588	4.1
Real Estate								
ABR Chesapeake III	-	-	-	-	$2,000	-	$2,000	0.0%
DV Urban	-	-	-	-	2,196	-	2,196	0.1
M.S. Prime Property	-	-	-	-	13,400	-	13,400	0.3
Quadrant R.E. Advisors	-	-	-	-	10,261	-	10,261	0.3
Private Equity								

	Domestic Stock	International Stock	Private Equity	Fixed Income	Real Estate	Cash Equiv.	Total	% of Total
Adams Street - Venture Capital	-	-	$79,970	-	-	-	$79,970	2.0%
Chancellor	-	-	1,194	-	-	-	1,194	0.0
Harbourvest Partners	-	-	63,079	-	-	-	63,079	1.6
Invesco Private Capital	-	-	14,990	-	-	-	14,990	0.4
Mesirow	-	-	2,665	-	-	-	2,665	0.1
Muller & Monroe	-	-	3,312	-	-	-	3,312	0.1
Zell/Chillmark	-	-	17	-	-	-	17	0.0
Cash Accounts								
Cash and Equivalents	-	-	-	-	-	$5,693	$5,693	0.1%
Total	$1,734,855	$713,979	$165,227	$1,292,811	$27,857	$101,768	$4,036,497	100%
Percent of Total	44.5%	18.0%	4.1%	32.6%	0.7%	0.1%	100%	
Policy	46	15	4	34	1	0	100	
Percent Passively Managed	26	0	0	30	0	0		

Summary of 2006 Investment Activity

Investment Manager Changes. Several changes were made to the investment manager line-up during the year. In domestic equity, index manager Zenna was hired in June to manage an S&P 500 index mandate. In the bond portfolio, two new managers were hired in May to replace Holland Capital. Bond managers LM Capital (Core-plus) and Taplin, Canida & Habacht (Core) received their initial funding on May 19th. Real estate manager ABR Chesapeake received initial funding during September. Other real estate managers M.S. Prime Property, Quadrant R.E. Advisors, and UBS Realty received their initial funding in December.

Market Environment. U.S. equity markets posted impressive gains in 2006, returning a strong absolute return of 15.8% for the year as measured by the DJ Wilshire 5000 Index. All market sectors advanced during the year with utilities and energy leading the way, gaining 28.0% and 21.7%, respectively. In addition, REITs posted robust returns within the financials sector and proved to be a common headwind for managers. A more favorable market environment that included lower inflation concerns, a moderation in commodity prices, and persistent earnings growth resulted in the Dow Jones Industrials Average closing at an all time record high at the end of the year.

From a style perspective, small cap stocks continued to outpace their large cap counterparts, and value bested growth during the year. Small cap value stocks led the year with a strong 23.5% return, driven primarily by gains in financials, particularly REITs, and utilities.

The non-U.S. stock market, as measured by the MSCI All Country World ex-U.S. Index, produced an impressive gain of 26.7% for the year on the strength of continued economic growth around the world. A weakening dollar also boosted foreign stock returns for U.S. based investors. Unlike 2005, the Japanese market was the lowest returning region with a return of

6.2%. Emerging markets gained a strong 26.6% during the past twelve months. Latin America was again the best regional performer, advancing 43.5% over the one-year period.

The fixed income market modestly advanced during 2006 with a 4.3% return as measured by the Lehman Brothers Aggregate Bond Index. The Federal Reserve Bank raised the Federal Funds Rate four times in the first half of the year to 5.25% and held rates steady for the rest of the year. Yields across the maturity spectrum increased over 2005; however, the yield curve remains inverted as rates at the short end increased by a higher margin than on the long end. While all sectors of the bond market advanced, high yield led the way with a robust 11.8% return in 2006.

Total Fund Performance. For 2006, the Total Fund generated a 12.1% return, which trailed the 13.3% return of the policy benchmark. The policy benchmark represents a hypothetical portfolio invested solely in passive index funds in the proportion of the Fund's allocation targets. Over the five-year period, the Fund's performance slightly trailed the policy portfolio and trailed the average public fund. For the trailing ten-year period, the Fund's return of 8.3% slightly outperformed the 8.2% return of the policy portfolio.

Asset Class Performance. The Fund's domestic stock component returned 12.2% versus the 15.8% return of the Index during the year. Great Lakes, Ariel, and William Blair were the largest detractors to this unfavorable result as each lagged their respective benchmarks during the year. The Fund's international stock component produced a strong absolute gain of 23.7% in 2006, yet this return fell short of the benchmark's return of 26.7%. The UBS international equity portfolio and the William Blair international equity portfolio both struggled during the year against their benchmarks. The three newly hired managers had mixed results. As expected, index manager Zenna approximated the benchmark's return while bond managers LM Capital outperformed and Taplin, Canida & Habacht lagged their benchmarks. The bond component posted a positive return of 4.6% and slightly outperformed the Bond Index during the year.

Longer-Term Performance. The table on the following page details the annual returns earned by the Fund over the past five calendar years, as well as the cumulative annualized returns for periods ending December 31, 2006. Also shown are the returns of the Fund's aggregate investments in each of the major asset classes, as well as those of the performance benchmarks.

ANNUAL INVESTMENT RETURNS[1]

Calculations were repaired using a time-weighted rate of return based on the market rate of return.

	2002	2003	2004	2005	2006	*Cumulative Annualized Returns* 3 Years	5 Years	10 Years
TOTAL FUND								
Police Fund	-9.6%	21.0%	10.8%	7.3%	12.1%	10.0%	7.8%	8.3%
Policy Portfolio[2]	-9.6	22.8	10.9	6.5	13.3	10.2	8.3	8.2
Russell/Mellon Public Fund Index	-9.4	22.9	12.0	8.4	13.8	11.4	9.0	8.6
Inflation	2.4	1.9	3.3	3.4	2.5	3.1	2.7	2.4
DOMESTIC STOCKS								
Police Fund	-20.4%	30.8%	13.2%	6.8%	12.2%	10.7%	7.1%	8.8%
Wilshire 5000 Stock Index	-20.9	31.7	12.5	6.4	15.8	11.5	7.6	8.7
Universe Median	-22.3	31.6	12.8	7.0	14.3	11.4	7.7	9.0
INTERNATIONAL STOCKS								
Police Fund	-15.6%	37.1%	15.7%	15.9%	23.7%	18.4%	13.9%	6.9%
Performance Benchmark[3]	-14.9	40.8	20.9	16.6	26.7	21.3	16.4	8.4
Universe Median	-15.1	37.0	19.4	15.4	25.1	19.9	15.6	9.0
FIXED INCOME								
Police Fund	9.7%	4.5%	4.4%	2.5%	4.6%	3.8%	5.1%	6.1%
Lehman Bros. Aggregate Bond Index[4]	10.3	4.1	4.3	2.4	4.3	3.7	5.1	6.2
Universe Median	8.2	5.3	4.8	2.5	4.4	3.9	5.3	6.2
REAL ESTATE								
Police Fund[5]	-1.1%	N/A	N/A	N/A	N/A	N/A	N/A	N/A
NCREIF Net Property Index	2.0	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Asset Allocation								
Domestic Stocks	46%	46%	48%	47%	45%			
International Stocks	13	13	18	18	18			
Private Equity	3	3	3	4	4			
Fixed Income	38	38	31	31	33			
Real Estate	<1	<1	<1	0	<1			

[1]*Returns are reported net of investment management fees.*

[2]*As of December 31, 2000, the performance benchmark has been composed of 50% of the Wilshire 5000 Stock Index, 15% of the Morgan Stanley Capital International (MSCI) All Country World ex-US Index, and 35% of the Lehman Brothers Aggregate Bond Index.*

[3]*As of October 1, 2000, the performance benchmark is the All Country World ex- U.S. Index. Before October of 2000, the benchmark was the MSCI EAFE-Free Index. Prior to 1993, a combination of the hedged and unhedged EAFE Index to reflect prior hedged and unhedged foreign equity investments.*

[4]*Prior to September 30, 1991, the benchmark was the Salomon Brothers Broad Investment-Grade Bond Index.*

[5] *As the Real Estate investments were in the final stages of liquidation during 2003, returns are not shown.*

List of Largest Assets Held

Largest Stock Holdings as of December 31, 2006

	Shares	Stocks	Fair Value
1	417,502	CITIGROUP INC COM	23,254,861
2	620,174	GENERAL ELEC CO COM	23,076,675
3	231,078	AMERN INTL GROUP INC COM	16,559,049
4	262,289	AMER EXPRESS CO COM	15,913,074
5	183,114	3M CO COM	14,270,074
6	186,788	BURL NORTHERN SANTA FE CORP COM	13,786,822
7	363,617	MICROSOFT CORP COM	10,857,604
8	168,258	PROCTER & GAMBLE CO COM	10,831,295
9	125,687	ALTRIA GROUP INC COM	10,786,458
10	146,095	CONOCO-PHILLIPS COM	10,511,535

Largest Bond Holdings as of December 31, 2006

	Par	Bonds	Fair Value
1	28,220,000	US TREAS NOTES DTD 08/31/2006	28,217,799
2	19,700,000	US TREAS NOTES DTD 10/31/2006	19,709,239
3	14,938,393	FNMA POOL #256526 6.0% DUE 12/01/2036	15,297,960
4	12,118,999	FNMA POOL #735926 4.5% DUE 10/01/2020	11,692,410
5	10,465,000	US TREAS NOTES DTD 04/17/2006	10,279,054
6	9,833,436	WELLS FARGO MTGE-BACKED 2006-20 TR	9,766,608
7	9,852,274	FNMA POOL #735407 5.0% DUE 4/01/2020	9,696,243
8	9,810,000	US TREAS NOTES DTD 02/15/2003	9,388,857
9	8,000,000	BANC AMER COML MTG TR 2006-6	8,018,408
10	7,984,773	WAMU MTGE-PASS THRU CERTS SER 2006	7,950,503

A complete list of portfolio holdings is available upon request.

Investment Activity Expenses
Paid in 2006 and 2005

Investment Managers	2006	2005
Ariel Capital Management	342,245	-
Artisan Partners	502,295	308,661
BNY Asset Management	186,593	702,034
Capital Guardian Trust Co.	1,092,381	1,050,490
Channing Capital	176,656	-
Chicago Equity Partners	567,387	494,672
Cordillera Asset Management	204,059	-
Dearborn Partners	134,149	102,795
Denali Advisors	122,819	10,027
Driehaus Capital Management	-	113,944
Great Lakes Advisors	435,844	589,740
Harris Investment Management	212,294	390,201
Holland Capital Management	257,452	147,962
Invesco Capital Management	479,134	296,810
JP Morgan Fleming Asset Management	786,318	331,438
LM Capital Group	42,917	-
McKinley Capital Management	421,978	254,470
Montag & Caldwell	662,382	623,631
Northern Trust Global Investments - Index Funds	181,064	247,843
Piedmont Investment Advisors	119,381	9,275
Piedra Capital Ltd.	146,721	-
T. Rowe Price International	-	170,644
Taplin, Canida, & Habacht	71,798	-
UBS Global Asset Management, Inc.	2,848,808	2,983,308
Wellington Management Company	403,243	351,978
Wells Capital Management	334,906	220,995
William Blair & Company	1,727,765	993,463
Zenna Financial Services	16,683	-
Investment Management Fees	**12,477,272**	**10,394,381**
Ennis Knupp & Associates	320,913	195,588
Courtland Partners, Ltd.	58,164	-
Investment Consulting Fees	**379,077**	**195,588**
The Northern Trust Company	521,115	452,210
Custodial Fees	**521,115**	**452,210**
Total Investment Actvity Expenses	**13,377,464**	**11,042,179**

Commissions Paid by Investment Managers in 2006

Manager	Total Number of Trades	Total Number of Shares	Total Commissions
Ariel Capital Management	842	1,290,200	41,434
Artisan Partners	2,516	9,401,129	136,288
BNY Asset Management	393	3,010,507	104,785
Capital Guardian Trust Co.	1,893	66,146,374	140,068
Channing Capital	144	530,718	17,175
Chicago Equity Partners	2,049	8,755,265	245,369
Cordillera Asset Management	1,861	5,211,700	224,526
Denali Advisors	488	1,096,074	21,344
Great Lakes Advisors	33	379,679	16,855
Harris Investment Management	2,154	2,844,808	90,976
Holland Capital Management	59	404,246	14,615
JP Morgan Fleming Asset Mgmt.	279	3,451,454	80,203
McKinley Capital Management	415	5,058,659	126,401
Montag & Caldwell	370	4,092,730	163,749
Piedmont Investment	205	1,149,654	40,155
Piedra Capital	127	1,010,221	43,653
UBS Global Asset Management	2,798	18,099,456	232,983
William Blair & Company	2,765	30,554,442	696,499
Zenna Capital	318	52,762	710
Transition Account	5	1,000	29
	19,714	**162,541,078**	**2,437,817**

Commissions Paid to Brokers in 2006

Broker	Total Number of Shares	Total Commissions
Merrill Lynch	10,134,242	145,114
Pershing	4,856,840	118,398
Instinet	4,270,012	109,271
Gardner Rich & Co	2,854,371	106,387
Morgan Stanley	16,442,269	100,805
Investment Technology Group	5,643,402	100,090
Bear Stearns	3,853,002	95,956
Mr Beal & Company	2,375,299	82,323
Melvin Securities	2,199,657	80,752
Cabrera Capital Markets	2,209,030	79,570
Citigroup	3,040,268	76,311
Weeden & Company	6,624,413	73,173
Lehman Brothers	2,367,540	71,844
Liquidnet Inc	2,562,173	65,808
CFSB	6,461,137	63,248
Union Bank of Switzerland	4,437,717	59,266
JP Morgan Securities Inc.	3,497,738	57,752
Williams Capital	1,531,925	55,825
Cheevers & Company	1,339,274	53,063
Goldman Sachs	1,467,595	52,842
Loop Capital	816,784	30,001
Deutsche Bank	1,539,873	29,034
Credit Suisse First Boston	995,228	27,163
Credit Lyonnais	2,825,983	26,239
Macquarie Securities, Inc.	1,251,309	26,117
Banc America	611,430	24,865
Jefferies & Company	549,106	24,040
Nomura Securities	216,029	16,178
BNY ESI Securities	350,899	15,331
Dresdner	1,628,850	15,229
Robert W Baird & Company	372,281	14,886
B Trade Services	726,168	14,294
ABN Amro	1,313,003	13,403
Bernstein Sanford & Co	331,550	13,090
Prudential Equity Group	299,479	13,045
Societe Generale	406,109	12,949
Cantor Fitzgerald	317,800	12,201
Cheuvreux De Virieu Paris	97,321	11,566
Knight Securities	428,105	11,119
Donaldson Lufkin & Jenrette	244,790	11,065
Daiwa Securities	182,616	10,699

Guzman & Company	312,125	10,322
William Blair & Co.	208,015	9,287
Morgan Keegan & Associated	244,410	8,898
Raymond James	208,100	8,843
Suntrust Robinson	217,700	8,726
Magna Scurities	285,557	8,647
Keefe, Bruyette, and Woods	214,660	8,423
Hong Kong Shanghai Banking Corp	344,523	8,031
Piper Jaffray Inc	206,020	7,997
SBK Brooks Investment Corp	221,100	7,767
RBC Capital Markets	188,650	7,387
BNP Prime Securities	1,009,105	7,321
Brokers with less than $7,000 in commissions	55,208,496	315,856
Totals	**162,541,078**	**2,437,817**

Investment Summary
as of 12/31/06

Investment Type	Fair Value	Percent of Total Fair Value
Fixed Income		
Government Bonds	384,336,968	9.5%
Corporate Bonds	430,888,913	10.7%
Total Bonds:	815,225,881	20.3%
Pooled Bond Index Fund	394,352,756	9.8%
Total Fixed Income:	1,209,578,637	30.1%
Equities		
U.S. Equities	1,569,866,651	39.0%
International Equities	548,499,467	13.6%
Stock Index Funds	410,476,372	10.2%
Total Equities:	2,528,842,490	62.8%
Other Investments		
Real Estate	27,579,058	0.7%
Venture Capital	164,262,438	4.1%
Total Other:	191,841,496	4.8%
Short-term funds and Cash:	94,667,517	2.4%
Total Assets at Fair Value:	4,024,930,140	100.0%

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Actuarial Section

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April 10, 2007

Board of Trustees
Policemen's Annuity and Benefit Fund
City of Chicago
221 North LaSalle Street, Suite 1626
Chicago, IL 60601

Subject: Actuarial Valuation Report for the Year Ending December 31, 2006

Dear Members of the Board:

At your request, we have performed an actuarial valuation for the Policemen's Annuity and Benefit Fund of Chicago ("the Fund") as of December 31, 2006. This valuation has been performed to measure the funded status of the Fund and determine the contribution levels for 2007. In addition, it includes disclosure information required under GASB Statement No. 25, Statement No. 27, and Statement No. 43. These actuarial valuations of the Fund are performed annually.

We have prepared the supporting schedules for the actuarial section of the comprehensive annual financial report, including:

- Summary of Actuarial Valuation Methods and Assumptions
- Schedule of Active Member Data
- Retirements and Beneficiaries Added to and Removed from Rolls
- Solvency (Termination) Test
- Development of Annual Required Contributions under GASB Statements No. 25 and No. 43
- Development of Actuarial Gains and Losses
- Summary of Basic Actuarial Values

We have also provided the following schedules for the following trend data schedules in the financial section of the report.

- Schedule of Funding Progress
- Schedule of Employer Contributions
- Notes to Required Supplementary Information

This valuation is based upon:

Data relative to the members of the Fund — Data for active members and persons receiving benefits from the Fund was provided by the Fund's staff. We have tested this data for reasonableness.

Asset Values — The value of assets of the Fund was provided by the Fund's staff. Book values of assets are used to develop actuarial results for the state reporting basis. Actuarial value of assets are used for financial reporting under GASB Statement No. 25 and Statement No. 27.

Actuarial Method — The actuarial method utilized by the Fund is the Entry-Age Actuarial Cost Method. The objective of this method is to amortize the costs of Fund benefits over the entire career of each member as a level of percentage of compensation. Any Unfunded Actuarial Accrued Liability (UAAL) under this method is separately financed. All actuarial gains and losses under this method are reflected in the UAAL.

Actuarial Assumptions — All actuarial assumptions remain unchanged from the prior valuation. The assumptions used are set forth in Appendix 4: Actuarial Methods and Assumptions of the Valuation Report.

The funding objective is to provide employer and employee contributions sufficient to provide the benefits of the Fund when due. The provision of State Law establishing the Fund constrains employer contributions to be twice the employee contribution level in the second prior fiscal year. Thus, with an administrative lag, the employer contribution is designed to match the employee contribution in a 2:1 relationship. The most recent actuarial valuation of the Fund on the State reporting basis shows that a ratio of 4.95:1 is needed to adequately finance the Fund.

The valuation results set forth in this report are based on the data and actuarial techniques described above, and upon the provision of the Fund as of the valuation date. Based on these items, we certify these results to be true and correct.

Respectfully yours,

Alex Rivera, FSA	Michael R. Kivi, FSA	Larry Langer, ASA
Senior Consultant	Senior Consultant	Senior Consultant

AR: ap

I. ACTUARIAL COST METHOD

An Actuarial Cost Method is a set of techniques used by the actuary to develop contribution levels under a retirement plan. The Actuarial Cost Method used in this valuation for all purposes is the Entry Age Actuarial Cost Method.

Under the Entry Age Normal Actuarial Cost Method, each participant's benefits are assumed to be funded by annual installments, equal to a level percentage of compensation, payable from date of participation to assumed retirement. The total "Normal Cost" is the sum of the current year's annual installments determined for all active participants. The "Actuarial Accrued Liability" is the excess of the value of projected benefits for all participants (both active and retired) over the discounted value of Normal Costs determined for future years of service.

To the extent that current assets and future Normal Costs do not support participants' expected future benefits, an Unfunded Actuarial Accrued Liability ("UAAL") develops. The UAAL is generally amortized over a fixed period of time (e.g. 30 years) from the date incurred. At a minimum, interest on UAAL should be funded. The total contribution developed under this method is the sum of the Normal Cost and the payment toward the UAAL. The Minimum Actuarially Determined Contribution contains only an interest payment on the UAAL.

II. CURRENT ACTUARIAL ASSUMPTIONS

The current actuarial assumptions were adopted and became effective December 31, 2003, and were based on an experience study for the period January 1, 1998, to December 31, 2002.

A. Demographic Assumptions

Mortality: 1983 Group Annuity Mortality Table.

Disabled Mortality: 1992 Railroad Retirement Board Disability Mortality Table.

Rate of Disability: Rates at which members are assumed to become disabled under the provisions of the Fund. Sample rates assumed are as follows:

Attained Age	Rate
22	.0005
27	.0096
32	.0023
37	.0025
42	.0025
47	.0045
52	.0060
57	.0075
62	.0075

The distribution of disability types is assumed to be as follows:

Duty Disability	35%
Occupational Disease Disability	35%
Ordinary Disability	30%

Rate of Retirement: Rates at which members are assumed to retire under the provisions of the Fund. The rates assumed are as follows:

Attained Age	Rate
49	.040
50	.120
51	.120
52	.120
53	.120
54	.160
55	.160
56	.160
57	.160
58	.160
59	.160
60	.250
61	.250
62	.400
63	1.000

Turnover Rates: The following sample rates exemplify the table:

Years of Service	Rate
0	.040
1	.020
5-9	.012
10+	.008

B. Economic Assumptions

Investment Return Rate: 8.00% per annum for pensions and 4.50% for OPEB. OPEB rate effective as of December 31, 2005.

Future Salary Increases: Assumed rates of individual salary increase at 4.0% per year, plus an additional percentage based on the following service scale:

Service	Scale
0	0.1700
1	0.0600
2	0.0500
3	0.0500
4	0.0500
5-9	0.0000
10	0.0350
11-14	0.0000
15	0.0350
16-19	0.0000
20	0.0350
21-24	0.0000
25	0.0350
26-29	0.0000
30	0.0250
Over 30	0.0000

Asset Value: For State reporting, bonds are at amortized value and stocks are at cost.

For GASB #25 and #27, the actuarial value of assets is smoothed by recognizing each year's difference between actual and expected investment return at the rate of 20 percent per year over a five-year period.

C. Other Assumptions

Marital Status: It is assumed that 85% of members have an eligible spouse. The male spouse is assumed to be three years older than the female spouse. No assumption is made about other dependents.

Group Health Insurance: It is assumed for valuation purposes that the current health insurance supplement will continue for life for all employee annuitants (and their future widows). The amount of the Fund-paid health insurance from July 1, 2003, until June 30, 2008 is $85.00 per month for each annuitant (employees and widows) not qualified to receive Medicare benefits and $55.00 if qualified. After June 30, 2008, the amounts will be $95.00 and $65.00, respectively. It is assumed that all annuitants age 65 and over will be eligible for Medicare and all annuitants less than age 65 will not be eligible for Medicare. Future widows of retirees are assumed to be eligible for Medicare, as well as widow annuitants that are currently receiving a health insurance supplement.

Required Ultimate Multiple:	The actuarially determined contribution (adjusted for tax levy loss) less expected employee contributions divided by the actual employee contributions made in the second prior year.
Loss in Tax Levy:	4% overall loss on tax levy is assumed.

History of Average Annual Salaries

Year End	Members in Service	Increase	Current Year Salary	Increase	Average Salary	Increase	Actuarial Assumptions	CPI Chicago
1968	12,427	6.8	$108,057,504	11.2	$8,895	6.5	3.50	4.3
1969	12,595	1.4	136,846,000	26.6	10,865	22.1	3.50	5.4
1970	12,948	2.8	160,682,780	17.4	12,410	4.2	3.50	5.6
1971	13,296	2.7	178,077,405	10.8	13,393	7.9	5.00	3.9
1972	13,318	0.2	185,841,384	4.4	13,954	4.2	5.00	2.9
1973	13,692	2.8	196,404,600	5.7	14,344	2.8	5.00	6.2
1974	13,291	(2.9)	205,212,984	4.5	15,440	7.6	5.00	10.7
1975	13,163	(1.0)	226,348,320	10.3	17,196	11.4	5.00	7.9
1976	13,353	1.4	244,004,592	7.8	18,273	6.3	5.00	4.8
1977	13,446	0.7	259,475,784	6.3	19,298	5.6	5.00	6.4
1978	13,107	(2.5)	270,132,744	4.1	20,610	6.8	5.00	8.6
1979	12,635	(3.6)	277,077,160	2.5	21,924	6.4	5.00	12.5
1980	12,587	(0.4)	292,438,368	5.5	23,233	6.0	5.00	14.4
1981	12,465	(1.0)	310,153,128	6.1	24,882	7.1	5.00	9.6
1982	12,810	2.8	348,850,944	12.5	27,233	9.4	6.00	6.8
1983	12,557	(2.0)	381,553,344	9.4	30,386	11.6	6.00	4.0
1984 [1]	12,110	(3.6)	379,686,648	(2.8)	30,610	0.7	6.00	3.8
1985	12,096	(0.1)	395,295,432	6.6	32,680	6.8	6.00	3.8
1986	12,578	4.0	431,883,240	9.3	34,336	5.1	6.00	2.0
1987	12,602	0.2	443,122,728	2.6	35,163	2.4	6.00	4.1
1988 [2]	12,495	(0.8)	443,669,520	0.1	35,508	1.0	6.00	3.9
1989	12,060	(3.5)	437,121,504	(1.5)	36,246	2.1	6.00	5.1
1990	12,039	(0.2)	471,544,173	7.9	39,168	8.1	6.00	5.5
1991	12,513	3.9	520,015,930	10.3	41,558	6.1	6.00	3.0
1992	12,570	0.5	538,404,098	3.5	42,832	3.1	5.80	3.3
1993	12,591	0.2	561,156,282	4.2	44,568	4.1	5.80	2.3
1994	13,095	4.0	599,073,276	6.8	45,748	2.6	5.80	2.9
1995	13,437	2.6	622,413,737	3.9	46,321	1.3	5.80	2.2
1996	13,475	0.3	654,149,310	5.1	48,545	4.8	5.80	3.8
1997	13,435	(0.3)	675,515,532	3.7	50,280	3.6	5.80	1.7
1998 [3]	13,586	1.1	736,401,756	9.0	54,203	7.8	5.50	1.5
1999	13,829	1.8	755,303,667	2.6	54,617	0.8	5.50	2.6
2000	13,858	0.2	759,343,026	0.5	54,795	0.3	5.50	4.0
2001	13,889	0.2	763,352,475	0.5	54,961	0.3	5.50	0.8
2002	13,720	(1.2)	866,531,789	13.5	63,158	14.9	5.50	2.5
2003	13,746	0.2	887,555,791	2.4	64,568	2.2	5.50	1.7
2004	13,569	(1.3)	874,301,958	(1.5)	64,434	(0.2)	5.50	2.2
2005	13,462	(0.8)	948,973,732	8.5	70,493	9.4	5.50 [4]	3.6
2006	13,749	2.1	1,012,983,635	6.7	73,677	4.5	5.50 [4]	0.7
Average Increase (Decrease) for the last 5 years:		**(0.2)%**		**5.9 %**		**6.2 %**		**2.1 %**

1 Members in service does not include those age 63 and over who are still working.
2 Figures do not include retroactive raise.
3 Pay definition changed to include duty availability pay. Of the $1,012,983,635 current year salary, $38,482,680 is duty availability pay.
4 See Appendix 4 for a complete description of the current assumptions.

SUMMARY OF CHANGES IN ACTIVE PARTICIPANTS FOR FISCAL YEAR ENDING DECEMBER 31, 2006

	Male	Female	Total
Number of Participants at Beginning of Fiscal Year	10,234	3,228	13,462
Increases:			
Participants Added During Year	535	170	705
Participants Returning From Inactive or Disability Status	40	10	50
Totals	10,809	3,408	14,217
Decreases:			
Terminations During Year	365	103	468
Number of Participants at End of Fiscal Year	10,444	3,305	13,749
Total Inactive Participants			595
Terminations			
Withdrawal (With Refunds)[1]	32	6	38
Withdrawal (Without Refunds)	69	20	89
Ordinary Disability Benefit	7	6	13
Occupational Disease Disability Benefit	4	0	4
Duty Disability Benefit	4	5	9
Retirements	223	64	287
Deaths (Occupational)	0	0	0
Deaths (Non-occupational)	26	2	28
Totals	**365**	**103**	**468**

1. This total differs from the total of 76 shown in Exhibit D due to the fact that only 38 of the refunds were paid to participants who were considered to be active as of December 31, 2005.

SUMMARY OF CHANGES IN ANNUITANTS AND BENEFICIARIES FOR FISCAL YEAR ENDING DECEMBER 31, 2006

	Number at Beginning of Year	Additions During Year	Terminations During Year	Number at End of Year
Service Retirement Annuities	8,026	328	271	8,083
Widow Annuities	3,107	158	172	3,093
Children's Annuities	247	24	16	255
Ordinary Disability Benefit (Non-Occupational)	35	13	9	39
Occupational Disease Disability Benefit	82	4	17	69
Duty Disability Benefit (Occupational)	298	11	18	291
Children's Disability Benefit	139	4	11	132
Widows' Compensation Annuities (Service Connected Death)	65	0	1	64
Totals	11,999	542	515	12,026

TOTAL ANNUITANTS AND BENEFICIARIES (LAST SIX YEARS)

	Annual Allowances Beginning of Year	Annual Allowances Added to Rolls	Annual Allowances Removed from Rolls	Annual Allowances at Year-end	% Increase in Annual Allowances	Average Annual Allowances
2001	10,867	846	538	11,175	2.8%	11,021
2002	11,175	744	561	11,358	1.6%	11,267
2003	11,358	669	586	11,441	0.7%	11,400
2004	11,441	858	491	11,808	3.2%	11,625
2005	11,808	676	485	11,999	1.6%	11,904
2006	11,999	542	515	12,026	0.2%	12,013

ACTUARIAL ACCRUED LIABILITY
PRIORITIZED SOLVENCY TEST

Valuation Date 12/31	(Col. A) Active and Inactive Member Contributions	(Col. B) Retirees and Beneficiaries	(Col. C) Active and Inactive Members (ER Financed Portion)	(Col. D) Actuarial Value of Assets	Portion (%) of Present Value Covered By Assets (1)	(2)	(3)
1996	$717,890,959	$2,150,952,000	$1,498,186,586	$2,599,760,692	100%	87.49%	0%
1997	750,341,108	2,333,523,000	1,525,303,810	2,896,754,452	100%	91.98%	0%
1998	777,205,937	2,690,216,494	1,690,773,788	3,249,729,847	100%	91.91%	0%
1999	763,729,532	2,939,332,536	1,691,810,150	3,685,681,671	100%	99.41%	0%
2000	818,382,556	3,228,954,418	1,604,693,684	4,019,467,561	100%	99.14%	0%
2001	803,453,930	3,463,944,097	1,665,112,602	4,183,796,025	100%	97.59%	0%
2002	846,622,627	3,769,125,439	1,769,097,893	4,124,579,960	100%	86.97%	0%
2003	893,425,839	3,856,262,804	1,831,744,607	4,039,695,590	100%	81.59%	0%
2004	910,480,098	4,313,531,046	1,810,260,330	3,933,031,342	100%	70.07%	0%
2005	950,764,942	4,677,632,909	2,094,339,296	3,914,431,654	100%	63.36%	0%
2006	1,016,217,810	4,858,554,051	2,241,771,313	3,997,990,919	100%	61.37%	0%

(1) Percentage equals lesser of 100% or (Col. D / Col. A)

(2) Percentage equals lesser of 100% or [(Col. D - Col. A) / Col. B]

Development of Annual Required Contribution under GASB No. 25 and GASB No. 43 for 2007 [1]

	Pension	Health Ins. Supplement	Total
(1) Normal Cost (see Table 2)	$ 174,835,081	$ 4,647,841	$ 179,482,922
(2) Actuarial Accrued Liability (AAL)	$ 7,939,561,277	$ 176,981,897	$ 8,116,543,174
(3) Unfunded AAL (UAAL)			
(a) Actuarial Value of Assets	$ 3,997,990,919	$ 0	$ 3,997,990,919
(b) UAAL (2-3(a))	3,941,570,358	176,981,897	4,118,552,255
(4) Amortization Payable at Beginning of Year [2]	$ 215,417,496	$ 6,318,824	$ 221,736,320
(5) Estimated Member Contributions	$ 93,386,490	$ 0	$ 93,386,490
(6) Annual Required Contribution (ARC)			
(a) Interest Adjustment for Semimonthly Payment	15,860,521	253,416	16,113,937
(b) Annual Required Contribution (1 + 4 - 5 + 6(a))	$ 312,726,608	$ 11,220,081	$ 323,946,689
(c) Annual Required Contribution (Percent of Pay)	30.87%	1.11%	31.98%
(7) Estimated City Contribution	$ 167,122,184	$ 11,097,816 [3]	$ 178,220,000
(8) Deficiency/(Excess)			
(a) in Dollars (6(b)-7)	$ 145,604,424	$ 122,265	$ 145,726,689
(b) as a Percentage of Pay	14.37%	0.01%	14.39%

[1] Pension liabilities were discounted at 8.0% per year, and OPEB liabilities discounted at 4.5% per year.
[2] Amortization is over a 30-year period as a level percent of pay.
[3] Represents expected health insurance supplemental benefits for fiscal year 2007.

SUMMARY OF BASIC ACTUARIAL VALUES

UNFUNDED ACTUARIAL ACCRUED LIABILITY - BEGINNING OF 2006		
(1)	Actuarial Accrued Liability - 12/31/2005	$7,722,737,147
(2)	Assets at Book Value - 12/31/2005	3,555,381,191
(3)	Unfunded Accrued Actuarial Liability - 12/31/2005	$4,167,355,956

EXPECTED UNFUNDED ACTUARIAL ACCRUED LIABILITY - END OF 2006		
(4)	Normal Cost for 2006	$ 168,333,565
(5)	Total Contributions for 2006	250,724,962
(6)	Interest on (3), (4), & (5) at Valuation Rate	330,696,160
(7)	Expected Unfunded Actuarial Accrued Liability - 12/31/2006 ((3)+(4)-(5)+(6))	$4,415,660,718

DEVIATIONS FROM EXPECTED		
(8)	(Gain)/Loss on Investment Return (Book Value)	$ (137,457,331)
(9)	(Gain)/Loss from Salary Changes	57,033,310
(10)	(Gain)/Loss from Retirement	(29,313,504)
(11)	(Gain)/Loss from Turnover	1,792,874
(12)	(Gain)/Loss from Mortality	20,310,642
(13)	(Gain)/Loss from Disability	(9,018,453)
(14)	(Gain)/Loss from Data Changes	23,521,604 (1)
(15)	(Gain)/Loss from New Entrants	7,212,198
(16)	(Gain)/Loss from All Other Sources	6,422,991
(17)	Composite Actuarial (Gain)/Loss	($59,495,669)

UNFUNDED ACTUARIAL ACCRUED LIABILITY - END OF 2006		
(18)	Unfunded Accrued Actuarial Liability - 12/31/2006 ((7)+(17))	$4,356,165,050

[1] The main components of the data loss are: $9.8 million for benefit increases greater than expected for members in payment status, $5.4 million for new members in payment status without a prior record, $5.0 million for changes in benefits for members that changed payment status during the year, $2.8 million for unexpected refund payments, and $0.5 million for data changes to active members.

SUMMARY OF BASIC ACTUARIAL VALUES

	APV of Projected Benefits	Actuarial Accrued Liability (AAL)
(1) Values for Active Members		
(a) Retirement	$4,481,191,164	$3,057,295,795
(b) Termination	91,873,398	24,228,421
(c) Disability	394,389,420	146,039,278
(d) Death	93,189,310	30,425,629
Total for Actives	$5,060,643,292	$3,257,989,123
(2) Values for Inactive Members		
(a) Retired	4,127,833,108	4,127,833,108
(b) Survivor	452,927,303	452,927,303
(c) Disability	243,063,598	243,063,598
(d) Inactive (Deferred Vested)	22,595,942	22,595,942
(e) Children	12,134,100	12,134,100
Total for Inactives	4,858,554,051	4,858,554,051
(3) Grand Totals	$9,919,197,343	$8,116,543,174
(4) Normal Cost for Active Members	$ 179,482,922	
(5) Actuarial Present Value of Future Compensation	$10,610,890,190	

SUMMARY OF PRINCIPAL ELIGIBILITY AND BENEFIT PROVISIONS

AS OF DECEMBER 31, 2006

PARTICIPANTS	An employee in the police department of the City of Chicago appointed and sworn or designated by law as a peace officer with the title of policeman, policewoman, chief surgeon, police surgeon, police dog catcher, police kennelman, police matron and members of the police force of the police department.
SERVICE	In computing service rendered by a police officer, the following periods shall be counted, in addition to all periods during which he performed the duties of his position, as periods of service for annuity purposes only: All periods of (a) vacation; (b) leave of absence with pay; (c) military service; (d) disability for which the police officer receives disability benefit. The calculation of service is based on a day-to-day basis for most purposes. For the purpose of calculating benefits under the Dominant Formula, one-year of Service is credited for a year in any portion of which a police officer is compensated.

RETIREMENT

Eligibility	Attainment of age 50 with at least 10 years of service.
Mandatory	Effective in plan year 2003, retirement is mandatory for a participant who has attained age 63.
Accumulation Annuity	At age 50 or more, with 10 or more years of service, the employee is entitled to an annuity based on the sums accumulated for age and service annuity plus 1/10 of the sum accumulated from the contributions by the City for the age and service annuity for each completed year of service after the first 10 years. At age 50 or more with 20 or more years, the employee is entitled to an annuity based on all sums accumulated.
Formula Minimum Annuity	While there are several alternative formulas available with 20 or more years of service, the Dominant Formula is 50% of highest average salary (including duty availability pay) in 48 consecutive months within the last 10 years of service plus 2.5% for each year or fraction of service over 20 years, limited to 75% of average salary.

Mandatory Retirement Minimum Annuity	A police officer who is required to withdraw from service due to attainment of mandatory retirement age who has less than 20 years of service credit may elect to receive an annuity equal to 30% of average salary for the first 10 years of service, plus 2% of average salary for each completed year of service in excess of 10, to a maximum of 48% of average salary. This benefit qualifies for post retirement increases.
Post-Retirement Increase	A retiree born before January 1, 1955, with at least 20 years of service, receives an increase of 3% of the original annuity, starting on the first of the month following the first anniversary of his retirement or the first of the month following attainment of age 55, whichever is later, and shall not be subject to a 30% maximum increase. For retirees born after January 1, 1955, automatic increases are 1.5% of the original annuity, commencing at age 60, or the first anniversary of retirement, if later, to a maximum of 30%.
Minimum Annuity	The benefit of any retiree who retired from the service before January 1, 1986, at age 50 or over with at least 20 years of service, or due to termination of disability is not less than $1,050 per month.
Reversionary Annuity	A member, prior to retirement, may elect to reduce his own annuity, and provide a reversionary annuity, to begin upon the officer's death, for the officer's spouse.

SURVIVOR INCOME BENEFITS PAYABLE ON DEATH

Death in Service (Non-Duty):	Generally, a money purchased benefit is provided, based on total salary deductions and City contributions. However, if a policeman dies in service after December 31, 1985, with at least 1.5 years of service, the widow's annuity is the greater of (a) 30% of the annual maximum salary attached to the classified civil service position of a first class patrolman at the time of his death (without dollar limit) or (b) 50% of the benefit accrued by the policeman at date of death. The lifetime benefit is payable until death or remarriage if remarriage occurs before age 60.
Death in Service (Duty Related)	
Compensation Annuity	75% of the member's salary attached to the civil service position that would ordinarily have been paid to such member as though in active discharge of his duties at the time of death payable until the date the policeman would have attained age 63.

Supplemental Annuity	Payable for life and is equal to the difference between the money purchase annuity for the spouse and an amount equal to 75% of the annual salary (including all salary increases and longevity raises) the police officer would have been receiving when he attained age 63 if the police officer had continued in service at the same rank last held in the department.
Death after Retirement	If a police officer retires on or after January 1, 1986, and subsequently dies, the widow's annuity is 40% before 1988 and 50% on and after January 1, 1988 of the retired policeman's annuity at the time of death (without dollar limit).
Maximum Annuity	$500 a month (after discount for age difference) under both the accumulation method and the old formula method. There is no dollar limit on the 30%, 40% or 50% benefit.
Minimum Annuity	Any spouse is entitled to a minimum annuity of $1,000 a month.

CHILDREN'S ANNUITIES

Eligibility	Payable at death of the policeman to all unmarried children less than 18 years of age. Children must have been born or legally adopted with proceedings initiated at least 6 months before the date of the policeman's withdrawal or death (waived for duty death).
Benefit	10% of the annual maximum salary of a first class patrolman during widow (widower) life, 15% otherwise.
Payable Until	Age 18. If the child is disabled, benefit is payable for life or as long as such disablement exists.
Family Maximum	60% (non-duty death) or 100% (duty death) of the salary that would ordinarily been paid to the policeman, if he had been in the active discharge of his duties.
Parent's Annuities	
Eligibility	Payable to a dependent parent at the death of a policeman who is in either active service, or receiving a disability benefit, or on leave of absence, or in receipt of an annuity granted after 20 years of service, or waiting to start receiving an annuity granted for 20 years of service. The benefit is only payable if there are no surviving spouses or children eligible for benefits.

Benefit	18% of the current salary attached to the rank at separation from service.
Payable until	Death of the dependent parent.

DUTY DISABILITY BENEFIT

Eligibility	Disabling condition incurred in the performance of duty.
Benefit	75% of salary at the time the disability is allowed plus $100.00 per month for each unmarried child less than age 18, (total amount of child's benefits shall not exceed 25% of salary). Beginning January 1, 2000, after 7 years of payment, the benefit shall not be less than 60% of the current salary attached to the rank held by the policemen at the time of disability. Payable to employee's age 63 or by operation of law, whichever is later. Salary deductions are contributed by the City.

OCCUPATIONAL DISEASE DISABILITY BENEFIT

Eligibility	Heart attack or any disability heart disease after 10 years of service.
Benefit	65% of salary attached to the rank held by the police officer at the time of his or her removal from the police department payroll with a minimum after 10 years of 50% of the current salary attached to the rank. Each natural or legally adopted unmarried child of the officer under the age of 18 is entitled to a benefit of $100 per month. This benefit is not terminated at age 18 if the child is then dependent by reason of physical or mental disability.

ORDINARY DISABILITY BENEFIT

Eligibility	Disabling condition other than duty related.
Benefit	50% of salary at the time of injury, payable for a period not more than 25% of service (excluding any previous disability time) rendered prior to injury, nor more than 5 years. Disability shall cease at age 63. Salary deductions are contributed by the City.

DEATH BENEFIT

Eligibility

Payable upon the death of a police officer whose death occurs while in active service; on authorized leave of absence; within 60 days of receipt of salary; while receiving duty or ordinary disability benefit; occurring within 60 days of termination of such benefit; or occurring on retirement while in receipt of annuity and separation was effective after 20 years of service. This benefit is payable to beneficiaries or, if none, to estate.

Benefit

Death in Service:

Age at Death	Benefit
49 and under	$12,000
50-62	$12,000 less $400 for each year by which age at death exceeds 49.
63 and Over	$6,000

Death after Retirement:

Age at Death	Benefit
50 and over	$6,000

If death results from injury incurred in performance of duty before retirement on annuity, the benefit payable is $12,000 regardless of the attained age.

GROUP HEALTH HOSPITAL AND SURGICAL INSURANCE PROGRAM

The pension fund shall provide payments in the amount of $85 per month for non-Medicare eligible city annuitants and $55 per month for Medicare eligible city annuitants from July 1, 2003, through June 30, 2008. Thereafter, the pension fund shall provide payments in the amount of $95 per month for non-Medicare eligible city annuitants and $65 per month for Medicare eligible city annuitants from July 1, 2008, through June 30, 2013.

REFUNDS

Policemen

Without regard to service and under age 50, or with less than 10 years of service and under age 57 at withdrawal: a refund of all salary deductions together with 1.5% simple interest until the date of withdrawal.

For Spouse's Annuity	Upon retirement an unmarried policeman will receive a refund of contributions for spouse's annuity, accumulated at 3% (4% for those commencing membership prior to January 1, 1954) compounded annually.
Of Remaining Amounts	If at death of a retired policeman the total member contributions paid while active exceed the total retirement benefits paid to date of death, the difference is payable.

CONTRIBUTIONS

Salary Deductions	Employee	7 %	
	Spouse	1½%	
	Annuity Increase	½%	
		9 %	
City Contributions [1]	Employee	9-5/7%	
	Spouse	2 %	
	Annuity Increase	½%	Unallocated
		12-3/14%	

[1] Credited to Participant's Accumulation Annuity and Widow's Annuity Account

In addition to the above contributions, a contribution is made to support the Death Benefit. Policemen contribute $2.50 per month. City contributes a total of $224,000 for all policemen.
The total City contribution is generated by a tax equal to double the contributions by the policemen to the Fund two years prior to the year of the tax levy.

"PICK UP" OF EMPLOYEE SALARY DEDUCTIONS	Beginning January 1, 1982, the employee contributions were "picked up" by the employer. The W-2 salary is therefore reduced by the amount of contribution. For pension purposes the salary remains unchanged. Income tax will be paid when a refund or annuity is received. For the purpose of benefits, refunds or contributions, these contributions will be treated as employee contributions.

Statistical Section

SUPPLEMENTAL INFORMATION

The following section contains special schedules designed to supplement benefit payment data contained elsewhere in this Comprehensive Annual Financial Report.

- **Revenues by Source and Expenses by Type** details the specific sources and uses of funds: Employee contributions obtained from participants through payroll deductions, employer contributions from the City of Chicago's real estate tax levy (Calculated using a 2.0 multiplier that matches employee contributions on a two year lag basis) and finally, investment income derived from the Fund's portfolio of assets. On the expense side, the largest component is benefit payments to participants, followed by refunds of contributions to participants and finally, the Fund's own administrative expenses.

- **Schedule of Benefit Expenses by Type (Last 10 Years)** further details the total annual benefit expense by breaking it down into payments to annuitants, survivors, disability payments, death benefits, and health insurance supplements.

- **Average Employee Retirement Benefits Payable** provides some key demographics of the annuitant population including average annual benefit paid, average current age, average age at retirement, and average years of service prior to retirement.

- **Retirees and Beneficiaries by Type of Benefit** provides totals for each type of benefit payment including those to annuitants and their survivors as well as to employees receiving disability benefits from the Fund.

REVENUES BY SOURCE AND EXPENSES BY TYPE

Year	Employee Contributions(1)	Employer Contributions(2)	Investment Income (3)	Total	Employer Cont. as a percent of Current Year Payroll
1997	63,315,812	109,361,629	506,339,581	679,017,022	17.09%
1998	69,890,008	118,867,416	467,101,444	655,858,868	16.19%
1999	70,185,289	125,281,970	475,716,575	671,183,834	16.14%
2000	71,261,412	139,481,871	31,299,210	242,042,493	16.58%
2001	71,146,651	139,675,766	(214,033,382)	(3,210,965)	18.37%
2002	79,238,513	141,989,025	(335,936,484)	(114,708,946)	18.30%
2003	79,816,332	140,807,354	627,291,033	847,914,719	15.86%
2004	78,800,816	135,744,173	367,908,110	582,453,099	15.53%
2005	89,109,811	178,278,371	261,389,227	528,777,409	18.79%
2006	91,965,685	158,759,277	447,275,047	698,000,009	15.67%

Year	Benefits Expenses	Administrative Expenses	Refunds	Total	Income Less Payouts
1997	227,827,254	1,932,357	2,966,400	232,726,011	446,291,011
1998	251,231,727	1,923,882	4,288,642	257,444,251	398,414,617
1999	274,572,115	2,104,158	4,627,583	281,303,856	389,879,978
2000	297,506,761	2,201,877	4,642,278	304,350,916	(62,308,423)
2001	324,836,320	2,451,822	5,664,009	332,952,151	(336,163,116)
2002	350,413,759	2,544,860	5,238,860	358,197,479	(472,906,425)
2003	370,696,206	3,166,145	4,806,372	378,668,723	469,245,996
2004	401,519,101	2,626,056	5,781,659	409,926,816	172,526,283
2005	431,445,018	2,660,819	5,644,241	439,750,078	89,027,331
2006	452,788,081	2,700,475	5,271,842	460,760,398	237,239,611

(1) Includes deductions in lieu for disability
(2) Net tax levy and miscellaneous income
(3) Includes realized net gain or loss on sale and exchange of assets, and net of investment expense

SCHEDULE OF BENEFIT EXPENSES BY TYPE (LAST 10 YEARS)

Year	Employee	Spouse	Dependent	Ordinary, Duty and Children Disability	Death	Hospitalization	Total
1997	173,965,490	33,775,938	917,778	12,677,645	1,629,500	4,860,903	227,827,254
1998	194,708,964	34,599,872	908,620	13,989,343	1,833,790	5,191,138	251,231,727
1999	212,421,576	38,208,300	993,831	15,677,024	1,938,352	5,333,033	274,572,116
2000	233,114,183	39,163,934	1,177,881	16,711,644	1,818,700	5,520,420	297,506,762
2001	257,540,559	40,169,959	1,189,323	18,536,460	1,736,900	5,663,121	324,836,322
2002	278,369,295	42,773,551	1,197,537	20,563,408	1,610,800	5,899,168	350,413,759
2003	297,127,105	43,938,085	1,178,671	19,938,927	1,783,627	6,720,792	370,687,207
2004	322,926,347	47,527,540	1,230,130	20,250,689	1,837,006	7,747,390	401,519,102
2005	347,272,478	51,283,810	1,228,497	22,184,105	1,500,000	7,976,128	431,445,018
2006	366,275,912	53,432,655	1,368,446	21,783,830	1,886,443	8,040,795	452,788,081

AVERAGE EMPLOYEE RETIREMENT BENEFITS PAYABLE

Years Ended	Average Annual Benefit	Average Current Age of Retirees	Average Age at Retirement Current Year	Average Years of Service at Retirement Current Year
1979	7,920	68	57.3	28.1
1980	8,573	68	57.6	28.2
1981	9,292	68	58.4	28.6
1982	10,020	68	59.1	29.2
1983	10,770	68	59.4	29.3
1984	11,782	68	58.6	29.9
1985	13,070	68	58.7	30.2
1986	15,033	67	57.7	30.0
1987	16,257	67	58.1	30.1
1988	17,855	67	58.8	30.9
1989	19,315	67	58.6	30.7
1990	21,120	68	58.9	30.2
1991	21,782	68	58.4	30.8
1992	23,128	68	57.7	30.3
1993	24,724	68	56.9	29.6
1994	25,636	68	55.7	29.5
1995	26,996	67	55.3	29.2
1996	28,412	67	55.5	29.8
1997	29,867	67	55.0	29.3
1998	31,682	66	54.6	30.0
1999	33,220	66	54.8	29.9
2000	34,880	66	56.3	31.6
2001	36,428	66	56.4	29.8
2002	38,199	66	55.6	29.4
2003	38,998	66	57.1	30.2
2004	41,914	66	57.5	30.4
2005	43,930	67	57.3	30.6
2006	45,680	67	58.0	29.6

RETIREES AND BENEFICIARIES BY TYPE OF BENEFIT

Years	ANNUITANTS			DISABILITY				Widow	Total
	Employee	Spouse[1]	Child	Ordinary	Duty	Occup.	Child[2]	Comp.	
1979	3,458	3,140	558	145	47			64	7,412
1980	3,546	3,154	511	163	57			66	7,497
1981	3,657	3,170	475	142	72			71	7,587
1982	3,666	3,175	462	125	75			70	7,573
1983	3,642	3,202	446	104	86			70	7,550
1984	3,723	3,152	435	87	113			74	7,584
1985	3,861	3,234	406	95	126			70	7,792
1986	4,212	3,145	380	78	144			69	8,028
1987	4,467	3,100	354	66	156			75	8,218
1988	4,595	3,184	350	63	167			78	8,437
1989	4,772	3,202	335	58	179			71	8,617
1990	4,936	3,214	335	51	187			66	8,789
1991	5,033	3,137	329	75	192			68	8,834
1992	5,109	3,129	310	83	204			66	8,901
1993	5,195	3,151	294	59	211		160	66	9,136
1994	5,309	3,123	281	51	221		159	64	9,208
1995	5,510	3,133	254	51	231	1	144	60	9,384
1996	5,714	3,120	252	67	256	12	158	59	9,638
1997	5,945	3,104	240	59	270	36	130	59	9,843
1998	6,241	3,093	228	56	279	57	150	57	10,161
1999	6,520	3,118	249	57	291	76	150	58	10,519
2000	6,876	3,107	267	48	274	87	149	59	10,867
2001	7,192	3,114	255	52	265	95	143	59	11,175
2002	7,392	3,092	235	38	289	103	150	59	11,358
2003	7,498	3,083	247	29	285	97	139	63	11,441
2004	7,815	3,133	249	44	287	85	130	65	11,808
2005	8,026	3,107	247	35	298	82	139	65	11,999
2006	8,083	3,093	255	39	291	69	132	64	12,026

1) Includes reversionary.

2) New benefit classification enacted by law in 1995.