



**STATE OF NEW JERSEY
POLICE AND FIREMEN'S RETIREMENT SYSTEM**

Financial Statements and Schedules

June 30, 2007 and 2006

(With Independent Auditors' Report Thereon)



KPMG LLP
Suite 402
301 Carnegie Center
Princeton, NJ 08540-6227

Independent Auditors' Report

The Board of Trustees
State of New Jersey
Police and Firemen's Retirement System:

We have audited the accompanying statements of fiduciary net assets of the State of New Jersey Police and Firemen's Retirement System (the System) as of June 30, 2007 and 2006, and the related statements of changes in fiduciary net assets for the years then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control over financial reporting. Accordingly, we express no such opinion. An audit 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 financial position of the State of New Jersey Police and Firemen's Retirement System as of June 30, 2007 and 2006, and the changes in its financial position for the years then ended in conformity with U.S. generally accepted accounting principles.

Management's Discussion and Analysis and the supplementary information included in the schedule of funding progress and schedule of employer contributions (schedules 1 and 2) are not a required part of the basic financial statements but are supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.



Our audits were conducted for the purpose of forming an opinion on the financial statements that collectively comprise the System's basic financial statements. The 2007 schedule of changes in fiduciary net assets by fund (schedule 3) is presented for purposes of additional analysis and is not a required part of the basic financial statements of the System. Such information has been subjected to the auditing procedures applied in the audit of the 2007 basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the 2007 basic financial statements taken as a whole.

KPMG LLP

February 29, 2008

STATE OF NEW JERSEY
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Management's Discussion and Analysis

June 30, 2007 and 2006

Our discussion and analysis of the financial performance of the Police and Firemen's Retirement System (the System or PFRS) provides an overview of the System's financial activities for the fiscal years ended June 30, 2007 and 2006. Please read it in conjunction with the basic financial statements and financial statement footnotes, which follow this discussion.

Financial Highlights

2007 - 2006

- Net assets held in trust for pension benefits increased by \$2,644,797,048 as a result of fiscal year 2007's operations from \$18,925,186,657 to \$21,569,983,705.
- Additions for the year are \$3,910,181,533, which are comprised of member and employer pension contributions of \$1,133,022,837 and net investment income of \$2,777,158,696.
- Deductions for the year are \$1,265,384,485, which are comprised of benefit and refund payments of \$1,259,425,550 and administrative expenses of \$5,958,935.

2006 - 2005

- Net assets held in trust for pension benefits increased by \$1,515,207,306 as a result of fiscal year 2006's operations from \$17,409,979,351 to \$18,925,186,657.
- Additions for the year were \$2,680,273,651, which are comprised of member and employer pension contributions of \$1,004,892,715 and net investment income of \$1,675,380,936.
- Deductions for the year were \$1,165,066,345, which are comprised of benefit and refund payments of \$1,160,135,537 and administrative expenses of \$4,930,808.

The Statements of Fiduciary Net Assets and the Statements of Changes in Fiduciary Net Assets

This annual report consists of two financial statements: *The Statements of Fiduciary Net Assets* and *The Statements of Changes in Fiduciary Net Assets*. These financial statements report information about the System and about its activities to help you assess whether the System, as a whole, has improved or declined as a result of the year's activities. The financial statements were prepared using the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized in the period they are earned and expenses are recorded in the year they are incurred, regardless of when cash is received or paid.

The Statements of Fiduciary Net Assets show the balances in all of the assets and liabilities of the System at the end of the fiscal year. The difference between assets and liabilities represents the System's fiduciary net assets. Over time, increases or decreases in the System's fiduciary net assets provide one indication of whether the financial health of the System is improving or declining. *The Statements of Changes in Fiduciary Net Assets* show the results of financial operations for the year. The statements provide an explanation for the change in the System's fiduciary net assets since the prior year. These two financial statements should be reviewed along with the information contained in the financial statement footnotes, including the required supplementary schedules, to determine whether the System is becoming financially stronger or weaker.

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Financial Analysis

Summary of Fiduciary Net Assets

2007 – 2006

	<u>2007</u>	<u>2006</u>	<u>Increase</u>
Assets	\$ 25,491,729,441	21,964,507,424	3,527,222,017
Liabilities	<u>3,921,745,736</u>	<u>3,039,320,767</u>	<u>882,424,969</u>
Net assets	<u>\$ 21,569,983,705</u>	<u>18,925,186,657</u>	<u>2,644,797,048</u>

The System's assets mainly consist of cash, securities lending collateral, investments, and contributions due from members and participating employers. Between fiscal years 2006 and 2007, total assets increased by \$3.5 billion or 16.1%. The total assets increased due to an increase in contributions receivable from employers, an overall increase in the fair value of investments, and an increase in securities lending collateral. Employer contributions receivables include contribution receivables from local employers for appropriations due April 1, 2008 and 2009 and for early retirement incentive benefits to local employees.

Liabilities consist of pension payments owed to members and beneficiaries, noncontributory group insurance premiums owed to the System's insurance provider, securities lending collateral rebates payable, and other payables. Total liabilities increased by \$882.4 million or 29.0% over last year. This is mainly due to an increase in securities lending collateral, rebates payable and in benefits payable to retirees and beneficiaries.

Net assets held in trust for pension benefits increased by \$2.6 billion or 14.0%.

2006 – 2005

	<u>2006</u>	<u>2005</u>	<u>Increase</u>
Assets	\$ 21,964,507,424	20,082,541,678	1,881,965,746
Liabilities	<u>3,039,320,767</u>	<u>2,672,562,327</u>	<u>366,758,440</u>
Net assets	<u>\$ 18,925,186,657</u>	<u>17,409,979,351</u>	<u>1,515,207,306</u>

The System's assets mainly consist of cash, securities lending collateral, investments, and contributions due from members and participating employers. Between fiscal years 2005 and 2006, total assets increased by \$1.9 billion or 9.4%. The total assets increased due to an increase in contributions receivable from employers, an overall increase in the fair value of investments, and an increase in securities lending collateral. Employer contributions receivables include contribution receivables from local employers for appropriations due April 1, 2007 and 2008 based on Chapter 108, P.L. 2003 and for early retirement incentive benefits to local employees based on Chapter 130, P.L. 2003.

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Liabilities consist of pension payments owed to members and beneficiaries, noncontributory group insurance premiums owed to the System's insurance provider, securities lending collateral rebates payable, and other payables. Total liabilities increased by \$366.8 million or 13.7% over last year. This is due to an increase in retirement benefits payable due to an increased number of retirees and also an increase in securities lending collateral and rebates payable

Net assets held in trust for pension benefits increased by \$1.5 billion or 8.7%.

Summary of Additions to Fiduciary Net Assets

2007 – 2006

	<u>2007</u>	<u>2006</u>	<u>Increase</u>
Member contributions	\$ 307,335,360	290,681,716	16,653,644
Employer contributions	825,687,477	714,210,999	111,476,478
Net investment income	<u>2,777,158,696</u>	<u>1,675,380,936</u>	<u>1,101,777,760</u>
Totals	<u>\$ 3,910,181,533</u>	<u>2,680,273,651</u>	<u>1,229,907,882</u>

Additions primarily consist of member and employer contributions and earnings from investment activities. Member contributions increased by \$16.7 million or 5.7% due to increased membership.

Employer contributions increased by \$111.5 million or 15.6%. In fiscal year 2007, employer contributions include accrued appropriations due April 1, 2008 and 2009 and early retirement incentive benefits billed to local employers.

The State made a contribution of \$121.36 million for fiscal year 2007, the first significant contribution to the System since fiscal year 1997. The amount contributed in fiscal year 2007 was equal to approximately 57.5% of the actuarially determined amount.

Net investment income increased by \$1.1 billion or 65.8% due to an increase in the net appreciation in fair value of investments.

The total investment return for all pension funds was estimated to be 17.1% compared to 9.7% in the prior year.

2006 – 2005

	<u>2006</u>	<u>2005</u>	<u>Increase</u>
Member contributions	\$ 290,681,716	276,195,076	14,486,640
Employer contributions	714,210,999	473,227,921	240,983,078
Investment and other	<u>1,675,380,936</u>	<u>1,383,396,386</u>	<u>291,984,550</u>
Totals	<u>\$ 2,680,273,651</u>	<u>2,132,819,383</u>	<u>547,454,268</u>

Additions primarily consist of member and employer contributions and earnings from investment activities. Member contributions increased by \$14.5 million or 5.2% due to increased membership.

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Employer contributions increased by \$241.0 million or 50.9%. In fiscal year 2006, employer contributions include accrued appropriations due April 1, 2007 and 2008, based on Chapter 108, P.L. 2003.

The Chapter 108, effective July 1, 2003, provided that local employer PFRS normal and accrued liability contributions will be 80% and 100% of the amount certified by the PFRS for payments due in State fiscal year 2007 and 2008, respectively.

The State made a contribution of \$73.5 million for fiscal year 2006 pension obligation. According to the Appropriation Act of 2003 related to fiscal year 2006, the State is paying pension obligations through a five-year phase-in.

Net investment income increased by \$292.0 million or 21.1% due to increase in the net appreciation in fair value of investments and a higher rate of return on investments.

The total investment return for all pension funds was estimated to be 9.7% compared to 8.7% in the prior year.

Summary of Deductions from Fiduciary Net Assets

2007 – 2006

	<u>2007</u>	<u>2006</u>	<u>Increase (decrease)</u>
Benefits	\$ 1,253,343,568	1,153,490,795	99,852,773
Refunds of contributions	6,081,982	6,644,742	(562,760)
Administrative expenses	5,958,935	4,930,808	1,028,127
Totals	<u>\$ 1,265,384,485</u>	<u>1,165,066,345</u>	<u>100,318,140</u>

Deductions are mainly comprised of pension benefit payments to retirees and beneficiaries, refunds of contributions to former members, and administrative costs incurred by the System. Benefit payments increased \$99.9 million or 8.7% primarily due to an increase in number of retirees receiving benefits. The number of refunds processed decreased by \$0.6 million or 8.5%. Administrative expenses increased by \$1.0 million or 20.9%.

2006 – 2005

	<u>2006</u>	<u>2005</u>	<u>Increase (decrease)</u>
Benefits	\$ 1,153,490,795	1,064,463,253	89,027,542
Refunds of contributions	6,644,742	5,609,036	1,035,706
Administrative expenses	4,930,808	5,964,075	(1,033,267)
Totals	<u>\$ 1,165,066,345</u>	<u>1,076,036,364</u>	<u>89,029,981</u>

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Deductions are mainly comprised of pension benefit payments to retirees and beneficiaries, refunds of contributions to former members, and administrative costs incurred by the System. Benefit payments increased by \$89.0 million or 8.4% primarily due to an increase in number of retirees receiving benefits. The number of refunds processed increased by \$1.0 million or 18.5%. Administrative expenses decreased by \$1.0 million or 17.3%. Fiscal year 2005 administrative expense was higher due to the reimbursement to the State General Fund of the Special Project Fund Appropriation utilized for the system reengineering project.

Retirement System as a Whole

The overall funded ratios of 78.4% for fiscal year 2007 and 80.1% for fiscal year 2006 indicate that the System is reasonably funded.

Contacting System Financial Management

The financial report is designed to provide our members, beneficiaries, investors and other interested parties with a general overview of the System's finances and to show the System's accountability for the money it receives. If you have any questions about this report or need additional financial information, contact the Division of Pensions and Benefits, P.O. Box 295, Trenton, NJ 08625-0295.

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Statements of Fiduciary Net Assets

June 30, 2007 and 2006

	2007	2006
Assets:		
Cash	\$ 143,305	2,131,532
Securities lending collateral	3,887,547,737	3,004,838,828
Investments, at fair value:		
Cash Management Fund	870,697,795	433,773,534
Bonds	—	945,271
Common Pension Fund A	7,734,741,833	8,534,696,154
Common Pension Fund B	4,166,503,153	3,584,064,503
Common Pension Fund D	4,137,994,344	3,371,942,503
Common Pension Fund E	1,552,048,426	284,423,836
Mortgage backed securities	1,166,343,866	1,033,780,638
Total investments	19,628,329,417	17,243,626,439
Receivables:		
Contributions:		
Members	53,598,187	49,697,767
Employers	1,367,331,659	1,092,948,923
Accrued interest and dividends	117,119,971	112,786,319
Members' loans	424,055,800	443,360,063
Other	13,603,365	15,117,553
Total receivables	1,975,708,982	1,713,910,625
Total assets	25,491,729,441	21,964,507,424
Liabilities:		
Accounts payable and accrued expenses	1,886,718	1,336,028
Retirement benefits payable	30,318,907	29,515,041
Noncontributory group insurance premiums payable	1,992,374	3,630,870
Securities lending collateral and rebates payable	3,887,547,737	3,004,838,828
Total liabilities	3,921,745,736	3,039,320,767
Net assets:		
Held in trust for pension benefits	\$ 21,569,983,705	18,925,186,657

See schedule of funding progress on pages 32-33.

See accompanying notes to financial statements.

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Statements of Changes in Fiduciary Net Assets

Years ended June 30, 2007 and 2006

	2007	2006
Additions:		
Contributions:		
Members	\$ 307,335,360	290,681,716
Employers	825,687,477	714,210,999
Total contributions	1,133,022,837	1,004,892,715
Investment income:		
Net appreciation in fair value of investments	2,204,650,600	1,059,993,931
Interest	411,094,785	439,352,270
Dividends	162,505,272	176,460,595
	2,778,250,657	1,675,806,796
Less investment expense	1,091,961	425,860
Net investment income	2,777,158,696	1,675,380,936
Total additions	3,910,181,533	2,680,273,651
Deductions:		
Benefits	1,253,343,568	1,153,490,795
Refunds of contributions	6,081,982	6,644,742
Administrative expenses	5,958,935	4,930,808
Total deductions	1,265,384,485	1,165,066,345
Change in net assets	2,644,797,048	1,515,207,306
Net assets – beginning of year	18,925,186,657	17,409,979,351
Net assets – end of year	\$ 21,569,983,705	18,925,186,657

See accompanying notes to financial statements.

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Notes to Financial Statements

June 30, 2007 and 2006

(1) Description of the System

State of New Jersey Police and Firemen's Retirement System (the System; PFRS) is a cost-sharing multiple-employer contributory defined benefit plan which was established as of July 1, 1944, under the provisions of N.J.S.A. 43:16A. The System is included along with other state-administered pension trust and agency funds in the basic financial statements of the State of New Jersey.

At June 30, 2006 and 2005, the dates of the most recent actuarial valuations, participating employers consisted of the following:

	2006	2005
State of New Jersey	\$ 1	1
Municipalities	587	584
Total	\$ 588	585

The System's designated purpose is to provide retirement, death and disability benefits to its members. Membership in the System is mandatory for substantially all full-time county and municipal police or firemen, and state firemen or officer employees with police powers appointed after June 30, 1944. The System's board of trustees is primarily responsible for its administration.

According to State of New Jersey Administrative Code, all obligations of the System will be assumed by the State of New Jersey should the System terminate.

Vesting and Benefit Provisions

The vesting and benefit provisions are set by N.J.S.A. 43:16A and 43:3B. The System provides retirement as well as death and disability benefits. All benefits vest after ten years of service except disability benefits which vest after four years of service. Retirement benefits for age and service are available at age 55 and are generally determined to be 2% of final compensation for each year of creditable service, as defined, up to 30 years plus 1% for each year of service in excess of 30 years. Final compensation equals the compensation for the final year of service prior to retirement. Members may seek special retirement after achieving 25 years of creditable service or they may elect deferred retirement after achieving ten years of service, in which case benefits would begin at age 55 equal to 2% of final compensation for each year of service. The annual benefit under special retirement is 65% of the member's final compensation plus 1% for each year of creditable service over 25 years but not to exceed 30 years. The maximum allowance is therefore 70% of final compensation.

Widow/widowers of members retired since December 18, 1967 receive 50% of the retiree's final compensation. The minimum annual widow/widower's benefits of an accidental disability retiree prior to December 18, 1967 and of all retirees since December 18, 1967 is \$4,500.

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Members are always fully vested for their own contributions. In the case of death before retirement, members' beneficiaries are entitled to full payment of members' contributions providing no survivor death benefits are payable.

Eligible retirees receiving monthly benefits are entitled to cost-of-living increases equal to 60% of the change in the average consumer price index for the calendar year in which the pensioner retired as compared to the average consumer price index for a 12-month period ending with each August 31st immediately preceding the year in which the adjustment becomes payable. The regular retirement allowance is multiplied by the 60% factor as developed and results in the dollar amount of the adjustment payable. Retired members become eligible for pension adjustment benefits after 24 months of retirement. The cost-of-living increases are funded by the retirement system and are included in the annual actuarial calculations of the required state and state-related employer contributions.

Chapter 4, P.L. 2001 provided increased benefits to certain members who retired prior to December 29, 1989 with at least 25 years of creditable service. The maximum amount of the increase was 5% of the retiree's final compensation. For those with 30 or more years of service, the total pension benefit would increase from 65% to 70% of final compensation.

Significant Legislation

Chapter 92, P.L. 2007 implements certain recommendations contained in the December 1, 2006 report of the Joint Legislative Committee on Public Employee Benefits Reform. One recommendation eliminates the 4% fixed rate of interest for loans from the defined benefit plans and provides that the rate of interest will be set by the State Treasurer at a commercially reasonable rate as required by the Internal Revenue Code and permits that an administrative processing fee may be charged for such loans. As such, effective January 1, 2008, the new pension loan interest rate will be 4.69% per year, and an \$8.00 processing fee per loan will be charged. Another recommendation removes language from existing law that permits the State Treasurer to reduce employer pension contributions needed to fund the system when excess assets are available.

Chapter 108 (P.L. 2003), effective July 1, 2003, provided that local employer PFRS normal and accrued liability contributions will be 20% of the amount certified by the PFRS for payments due in State fiscal year 2004 and thereafter a percentage of the amount certified by the System as the State Treasurer will determine, but not more than 40% in fiscal year 2005, not more than 60% in fiscal year 2006, and not more than 80% in fiscal year 2007.

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Membership

Membership in the System consisted of the following at June 30, 2006 and 2005, the dates of the most recent actuarial valuations:

	2006	2005
Retirees and beneficiaries currently receiving benefits and terminated employees entitled to benefits but not yet receiving them	30,487	29,321
Active members:		
Vested	28,236	27,894
Nonvested	16,589	16,317
Total active members	44,825	44,211
Total	75,312	73,532

(2) Summary of Significant Accounting Policies

Measurement Focus and Basis of Accounting

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. The System is accounted for using an economic resources measurement focus.

The accrual basis of accounting is used for measuring financial position and changes in fiduciary net assets of the System. Under this method, revenues are recorded in the accounting period in which they are earned, and deductions are recorded at the time the liabilities are incurred. The financial statements of the System conform to the provisions of Governmental Accounting Standards Board (GASB) Statement No. 25, *Financial Reporting for Defined Benefit Plans and note Disclosures for Defined Contributions Plans*. Employer contributions are recognized when payable to the System. Benefits and refunds are recognized when due and payable in accordance with the terms of the System.

Investments

The Division of Investment, Department of the Treasury, State of New Jersey (Division of Investment) manages and invests certain assets of seven of the defined benefit plans (PERS, TPAF, JRS, PFRS, CPFPPF, SPRS and POPF). The Division of Investment separately reports the assets, liabilities and net assets of the underlying investment portfolio of the seven defined benefit plans in its Pension Fund report. The Division of Investment accounts included in the Pension Fund report are: Common Fund A, Common Fund B, Common Fund D, Common Fund E, Police and Firemen's Mortgage Program accounts and other investments owned directly by the seven defined benefit pension plans. Common Fund A invests primarily in domestic equity securities. Common Fund B invests primarily in domestic fixed income securities. Common Fund D invests primarily in foreign equity and fixed income securities. Common Fund E invests primarily in alternative investments which includes private equity, real assets and absolute return strategy investments. The Police and Firemen's Retirement System includes a mortgage loan program administered by the New Jersey Housing and Mortgage Finance Agency that provides participants with mortgages from the program at rates which are fixed by formula. The law establishing the program provides that the Fund may not sell the mortgages, and no independent market exists for them.

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Valuation of Investments

Investments are reported at fair value as follows:

- U.S. Government and Agency, Foreign and Corporate obligations – prices quoted by a major dealer in such securities.
- Common Stock and Equity Funds, Foreign Equity Securities, Forward Foreign Exchange Contracts – closing prices as reported on the primary market or exchange on which they trade.
- Money Market Instruments – amortized cost which approximates fair value.
- Cash Management Fund – closing bid price on the last day of trading during the period as determined by the Transfer Agent.
- Alternative investments (private equity, real assets and absolute return strategy funds) – estimated fair value provided by the investment manager and reviewed by management. Because alternative investments are not readily marketable, their estimated value is subject to uncertainty and therefore may differ significantly from the value that would be used if a ready market for such investments existed. Accordingly, the realized value received upon the sale of the asset may differ from the fair value.

Investment Transactions

Investment transactions are accounted for on a trade date basis. Gains and losses from investment transactions are determined by the average cost method. Interest and dividend income is recorded on the accrual basis, with dividends accruing on the ex-dividend date.

Unit Transactions

The net asset value of Common Funds A, B, D and E (Common Funds) is determined as of the close of the last day of business of each month. Purchases and redemptions of participants' units are transacted each month within fifteen days subsequent to that time and at such net asset value.

Dividends and interest earned per unit are calculated monthly and distributed quarterly for Common Fund A and B. Dividends and interest earned per unit are calculated monthly for Common Fund D, and the income earned on Common Fund D units is reinvested. Income earned per unit is calculated monthly for Common Fund E, and the income earned on Common Fund E units is reinvested.

Securities Lending

Common Funds A, B and D and several of the directly held pension plan portfolios participate in securities lending programs, whereby securities are loaned to brokers or to other borrowers and, in return, the Pension Fund has rights to the collateral received. All of the securities held in Common Funds A, B and D, and certain securities held directly by the pension plans, are eligible for the securities lending program. Collateral received may consist of cash, letters of credit, or government securities having a market value equal to or exceeding 102% (U.S. dollar denominated) or 105% (non-U.S. dollar denominated) of the value of the loaned securities at the time the loan is made. For Common Funds A and B, in the event that the market value of the collateral falls below 101% of the market value of all the outstanding loaned

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securities to an individual borrower, additional collateral shall be transferred by the borrower to the respective funds no later than the close of the next business day so that the market value of such additional collateral, when added to the market value of the other collateral, shall equal 102% of the market value of the loaned securities. For Common Fund D, in the event that the market value of the collateral falls below the collateral requirement of either 102% or 105% (depending on whether the securities are denominated in U.S. dollars or a foreign currency, respectively) of the market value of the outstanding loaned securities to an individual borrower, additional collateral shall be transferred in an amount that will increase the aggregate of the borrower's collateral to meet the collateral requirements. As of June 30, 2007, the Common Funds have no aggregate credit risk exposure to brokers because the collateral amount held by the Common Funds exceeded the market value of the securities on loan.

The contracts with the Common Funds' custodian banks require them to indemnify the Common Funds if the brokers or other borrowers fail to return the securities or fail to pay the Common Funds for income distributions on the securities while they are on loan. The custodian bank for Common Fund D also indemnifies the Common Funds for any loss of principal or interest on the invested collateral. For any losses on the investment collateral in Common Funds A or B or other pension plan portfolios, the lending fee paid to the lending agent shall be reduced by 25% of the amount of such loss, up to an amount not to exceed 75% of the previous six months' securities lending fees. The securities loans can be terminated by notification by either the borrower or the Common Funds. The term to maturity of the securities loans is generally matched with the term to maturity of the investment of the cash collateral.

Derivatives

The Common Funds' international portfolio managers utilize forward foreign currency contracts, a derivative security, as a means to hedge against the currency risk in the Common Funds' foreign stock and fixed income portfolios. A derivative security is an investment whose payoff depends upon the value of other assets such as bond and stock prices, a market index, or commodity prices. Derivative transactions involve, to varying degrees, credit risk and market risk. Credit risk is the possibility that a loss may occur because a party to a transaction fails to perform according to terms. Market risk is the possibility that a change in market prices or currency rates will cause the value of a financial instrument to decrease or become more costly to settle.

Forward foreign currency contracts are agreements to buy or sell a specific amount of a foreign currency at a specified delivery or maturity date for an agreed upon price. Forward foreign currency contracts are used to hedge against the currency risk in the Common Funds' foreign stock and fixed income portfolios.

There were no foreign forward currency contracts at June 30, 2007. The fair value of foreign forward currency contracts held directly by the Common Funds as of June 30, 2006 was as follows:

Forward currency receivable	\$ 1,887,515,323
Forward currency payable	<u>1,902,654,117</u>
Net unrealized loss (gain)	<u>\$ 15,138,794</u>

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The Common Funds utilize covered call and put options in an effort to add value to or reduce the risk level in the portfolio. Covered options are agreements that give the owner of the option the right, but not obligation, to buy (in the case of a call option) or to sell (in the case of a put option) a specific amount of an asset for a specific price (called the strike price) on or before a specified expiration date. The writer of call options receives a premium at the outset of the agreement and bears the risk of an unfavorable change (i.e., an increase) in the price of the instrument underlying the option. The common Funds had written call options on 182,000 shares with a fair value of \$470,032 at June 30, 2006 which are reflected as contra-assets to the fair value of the portfolio. The Common Funds owned 53,208 contracts on indexed put options with a fair value of \$169,137,647 at June 30, 2007 and put options on 6,990,800 shares with a fair value of \$1,631,358 at June 30, 2006, which are included in the fair value of the portfolio.

Certain alternative investment funds and partnerships may use derivative instruments to hedge against market risk and to enhance investment returns. At any point during the year, the Common Funds may have additional exposure to derivatives primarily through limited liability vehicles such as limited partnerships and commingled investment funds.

Members' Loans

Members who have at least three years of service in the System may borrow up to 50% of their accumulated member contributions. Repayment of loan balances is deducted from payroll checks and bears an interest rate of 4%. Members who retire with an outstanding loan have the option of paying the loan in full prior to receiving any benefits or continuing their monthly loan payment schedule into retirement.

Under the Internal Revenue Service regulations effective January 1, 2004, the Division changed its pension loan repayment policy: Members who take multiple loans must repay the outstanding balance of the original loan, and all subsequent loans taken before the original loan is completely paid off, within a period not to exceed 5 years from the issuance of the first loan taken after January 1, 2004. Failure to repay the loan within the five-year period will result in the unpaid balance being declared a taxable distribution.

Administrative Expenses

The System is administered by the State of New Jersey Division of Pensions and Benefits. Administrative expenses are paid by the System to the State of New Jersey, Department of the Treasury and are included in the accompanying statements of changes in fiduciary net assets.

(3) Investments

The System is invested in Common Fund A, Common Fund B, Common Fund D, Common Fund E, and other investments, including mortgage backed securities, which represent 23.27%, 19.90%, 23.36%, 25.57%, and 89.14%, respectively, of each investment total of the Pension Fund as of June 30, 2007.

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The System is invested in Common Fund A, Common Fund B, Common Fund D, Common Fund E, and other investments, including bonds and mortgage backed securities, which represent 23.48%, 19.55%, 23.48%, 25.55%, and 77.37%, respectively, of each investment total of the Pension Fund as of June 30, 2006.

The Pension Fund investments as of June 30 are as follows:

	2007	2006
Domestic equities	\$ 31,474,841,997	36,206,866,148
International equities	17,174,769,178	12,953,297,531
Domestic fixed income	19,648,980,451	17,027,737,435
International fixed income	996,400,682	1,187,184,887
Commodity linked notes	502,393,611	—
Police and Fireman's mortgages	1,109,584,450	965,008,210
Private equity	1,159,903,960	236,208,692
Real estate	1,003,932,926	81,345,789
Absolute return strategy funds	2,340,519,278	260,707,666
Net forward foreign exchange contracts	—	(15,138,794)
	\$ 75,411,326,533	68,903,217,564

New Jersey state statute provides for a State Investment Council (Council) and a Director. Investment authority is vested in the Director of the Division and the role of the Council is to formulate investment policies. The Council issues regulations which establish guidelines for permissible investments which include domestic and international equities and exchange traded funds, covered call and put options, equity futures contracts, obligations of the U.S. Treasury, government agencies, corporations, finance companies and banks, obligations of international corporations, governments and agencies, interest rate swap transactions, fixed income exchange traded funds, U.S. Treasury futures contracts, New Jersey State and Municipal general obligations, public authority revenue obligations, collateralized notes and mortgages, commercial paper, certificates of deposit, repurchase agreements, bankers acceptances, guaranteed income contracts, funding agreements, money market funds, private equity, real estate, other real assets and absolute return strategy funds.

The Pension Fund investments are subject to various risks. Among these risks are credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. Each one of these risks is discussed in more detail below.

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The credit risk of a debt instrument is evaluated by nationally recognized statistical rating agencies such as Moody's Investors Service, Inc. (Moody's), Standard & Poor's Corporation (S&P), and Fitch Ratings (Fitch). Concentration of credit risk is the risk of loss attributed to the magnitude of an investment in a single issuer. There are no restrictions in the amount that can be invested in United States treasury and government agency obligations. Council regulations require minimum credit ratings for certain categories

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of fixed income obligations held directly by the Pension Fund and limit the amount that can be invested in any one issuer or issue. These limits for the period July 1, 2006 through September 4, 2006 were as follows:

Category	Minimum rating		Limitation of issuer's outstanding debt	Limitation of issue	Other limitations
	Moody's	S&P			
Corporate obligations	Baa	BBB	25%	25%	—
U.S. finance company debt, bank debentures and NJ state and municipal obligations	A	A	10%	10%	—
Canadian obligations	A	A	10%	10%	Purchase cannot exceed greater of 10% of issue or \$10 million; not more than 2% of fund assets can be invested in any one issuer
International government and agency obligations	Aa	AA	2%	10%	Not more than 1% of fund assets can be invested in any one issuer
Public authority revenue obligations	A	A	—	10%	Not more than 2% of fund assets can be invested in any one public authority
Collateralized notes and mortgages	Baa	BBB	—	33.3%	Not more than 2% of fund assets can be invested in any one issuer
Commercial paper	P-1	A-1	—	—	—
Certificates of deposit and Banker's acceptances (rating applies to international)	Aa/P-1	—	—	—	Uncollateralized certificates of deposit and banker's acceptances cannot exceed 10% of issuer's primary capital
Guaranteed income contracts	P-1	—	—	—	A+ rating from A.M. Best for insurance companies
Money market funds	—	—	—	—	Not more than 10% of fund assets can be invested in money market funds; limited to 5% of shares or units outstanding

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Effective September 5, 2006, the following limits became effective:

Category	Minimum rating			Limitation of issuer's outstanding debt	Limitation of issue	Other limitations
	Moody's	S&P	Fitch			
Corporate obligations	Baa3	BBB-	BBB-	10%	25%	Not more than 5% of fund assets can be invested in one corporation
U.S. finance company debt and bank debentures	Baa3	BBB-	BBB-	10%	25%	Not more than 5% of fund assets can be invested in one corporation
International corporate obligations	Baa3	BBB-	BBB-	10%	25%	Not more than 5% of fund assets can be invested in any one issuer with maturities exceeding 12 months; not more than 10% of fund assets can be invested in this category
International government and agency obligations	Aa3	AA-	AA-	25%	Greater of 25% or \$10 million	Not more than 1% of fund assets can be invested in any one issuer
Collateralized notes and mortgages	Baa3	BBB-	BBB-	—	25%	Not more than 5% of fund assets can be invested in any one issue; not more than 10% of fund assets (or 20% of Fund B assets) can be invested in this category
Commercial paper	P-1	A-1	F1	—	—	—
Certificates of deposit and Banker's acceptances:						Certificates of deposit and banker's acceptances cannot exceed 10% of issuer's primary capital
Domestic	A3/P-1	A-/A-1	A-/F1	—	—	
International	Aa/P-1	AA-/A-1	AA-/F1	—	—	
Guaranteed income contracts and funding agreements	A3	A-	A-	—	—	—
Money market funds	—	—	—	—	—	Not more than 10% of fund assets can be invested in money market funds; limited to 5% of shares or units outstanding

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Category	Minimum rating			Limitation of issuer's outstanding debt	Limitation of issue	Other limitations
	Moody's	S&P	Fitch			
Interest rate swap transactions	A3	A-	A-	—	—	Notional value of net exposure to any one counterparty shall not exceed 10% of fund assets
Repurchase agreements	Aa3	AA-	AA-	—	—	—
NJ state & municipal obligations	A3	A-	A-	10%	10%	Not more than 10% of fund assets can be invested in debt of any one political entity maturing more than 12 months from purchase
Public authority revenue obligations	A3	A-	A-	—	10%	Not more than 2% of fund assets can be invested in any one public authority
Mortgage backed passthrough securities	A3	A-	A-	—	—	Not more than 5% of fund assets can be invested in any one issue
Mortgage backed senior debt securities	—	—	—	—	25%	Not more than 5% of fund assets can be invested in any one issue

Up to 5% of the market value of Common Fund B may be invested in corporate obligations, finance company debt, bank debentures, international corporate obligations, collateralized notes, and mortgages and mortgage backed pass-through securities that do not meet the minimum credit rating requirements set forth above.

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For securities in the fixed income portfolio, the following tables disclose aggregate market value, by major credit quality rating category at June 30, 2007 and 2006:

(In thousands)	June 30, 2007			
	Moody's rating			
	Aaa	Aa	A	Baa
United States Treasury Notes	\$ 2,038,229	—	—	—
United States Treasury TIPS	1,875,022	—	—	—
United States Treasury Bonds	5,187,546	—	—	—
United States Treasury Strips	39,649	—	—	—
Title XI Merchant Marine Notes	2,786	—	—	—
Federal Agricultural Mortgage Corp. Notes	95,295	—	—	—
Federal Farm Credit Bank Bonds	50,227	—	—	—
Federal Home Loan Bank Bonds	289,167	—	—	—
Federal Home Loan Bank Discounted Notes	96,345	—	—	—
Federal National Mortgage Association Notes	96,355	—	—	—
Resolution Funding Corp. Obligations	6,466	—	—	—
Tennessee Valley Authority Strips	72,610	—	—	—
Floating Rate Notes	9,999	20,038	—	—
Domestic Corporate Obligations	427,646	760,349	2,093,792	2,020,011
International Corporate Obligations	—	—	47,912	35,330
Real Estate Investment Trust Obligations	—	—	—	34,025
Finance Company Debt	293,489	296,882	498,203	9,240
International Bonds and Notes	404,960	64,583	48,200	—
Foreign Government Obligations	302,900	92,516	—	—
Remic/FHLMC	952,817	—	—	—
Remic/FNMA	66,490	—	—	—
Remic/GNMA	17,969	—	—	—
GNMA Mortgage Backed Certificates	64,206	—	—	—
FHLM Mortgage Backed Certificates	939,992	—	—	—
FNMA Mortgage Backed Certificates	839,452	—	—	—
SBA Passthrough Certificates	9,700	—	—	—
Asset Backed Obligations	310,611	—	—	—
Private Export Obligations	56,771	—	—	—
Exchange Traded Securities	—	—	52,290	—
	\$ 14,546,699	1,234,368	2,740,397	2,098,606

The table does not include certain corporate obligations totaling \$25,310,000 which have an S&P rating of A and do not have a Moody's rating. The Police and Firemen's Mortgages and the Cash Management Fund are unrated.

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(In thousands)	June 30, 2006				
	Moody's rating				
	Aaa	Aa	A	Baa	Ba
United States Treasury Notes	\$ 3,516,004	—	—	—	—
United States Treasury Bills	389,716	—	—	—	—
United States Treasury TIPS	790,555	—	—	—	—
United States Treasury Bonds	1,984,003	—	—	—	—
United States Treasury Strips	37,219	—	—	—	—
Title XI Merchant Marine Notes	3,615	—	—	—	—
Federal Agricultural Mortgage Corp. Notes	95,763	—	—	—	—
Federal Farm Credit Bank Bonds	50,270	—	—	—	—
Federal Home Loan Bank Bonds	466,312	—	—	—	—
Federal Home Loan Bank Discounted Notes	89,894	—	—	—	—
Federal Home Loan Mortgage Corp. Notes	341,897	—	—	—	—
Federal National Mortgage Association Notes	226,193	—	—	—	—
Resolution Funding Corp. Obligations	6,397	—	—	—	—
Floating Rate Notes	25,023	20,020	9,999	22,841	—
Corporate Obligations	509,357	674,474	2,172,927	1,545,710	—
Real Estate Investment Trust Obligations	—	—	—	93,436	—
Finance Company Debt	217,653	623,016	626,864	9,097	55,587
Supranational Obligations	75,512	—	—	—	—
International Bonds and Notes	208,740	99,215	19,539	—	—
Foreign Government Obligations	470,461	313,716	—	—	—
Remic/FHLMC	731,131	—	—	—	—
Remic/FNMA	67,108	—	—	—	—
Remic/GNMA	17,650	—	—	—	—
GNMA Mortgage Backed Certificates	78,051	—	—	—	—
FHLM Mortgage Backed Certificates	598,915	—	—	—	—
FNMA Mortgage Backed Certificates	620,790	—	—	—	—
Asset Backed Obligations	178,119	—	—	—	—
Private Export Obligations	55,971	—	—	—	—
Exchange Traded Securities	—	—	51,735	—	—
	<u>\$ 11,852,319</u>	<u>1,730,441</u>	<u>2,881,064</u>	<u>1,671,084</u>	<u>55,587</u>

The table does not include certain corporate obligations totaling \$24,426,500 which have an S&P rating of A and do not have a Moody's rating. The Police and Firemen's Mortgages and the Cash Management Fund are unrated.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Commercial paper must mature within 270 days. Certificates of deposits and bankers acceptances are limited to a term of one year or less. The maturity requirement for repurchase agreements was 15 days through September 4, 2006; this was revised to 30 days effective September 5, 2006. The investment in guaranteed income contracts and funding agreements is limited to a term of 10 years or less.

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The following table summarizes the maturities (or, in the case of Remics, Police and Firemen's Mortgages and mortgage-backed securities, the expected average life) of the fixed income portfolio at June 30, 2007 and 2006:

(In thousands)	June 30, 2007				
	Total market value	Maturities in years			
		Less than 1	1-5	6-10	More than 10
United States Treasury Notes	\$ 2,038,229	148,736	447,759	1,441,734	—
United States Treasury Tips	1,875,022	—	185,141	762,104	927,777
United States Treasury Bonds	5,187,546	—	—	86,215	5,101,331
United States Treasury Strips	39,649	—	—	—	39,649
Title XI Merchant Marine Notes	2,786	—	—	—	2,786
Federal Agricultural Mortgage Corp. Notes	95,295	—	95,295	—	—
Federal Farm Credit Bank Bonds	50,227	20,114	30,113	—	—
Federal Home Loan Bank Bonds	289,167	18,107	250,170	20,890	—
Federal Home Loan Bank Discounted Notes	96,345	—	—	—	96,345
Federal National Mortgage Association Notes	96,355	—	96,355	—	—
Resolution Funding Corp. Obligations	6,466	—	—	—	6,466
Floating Rate Notes	30,037	—	20,038	9,999	—
Tennessee Valley Authority Strips	72,610	—	—	—	72,610
Domestic Corporate Obligations	5,327,108	127,673	850,539	959,663	3,389,233
International Corporate Obligations	83,242	—	—	—	83,242
Real Estate Investment Trust Obligations	34,025	—	19,574	14,451	—
Finance Company Debt	1,097,814	59,175	552,626	243,679	242,334
Foreign Government Obligations	395,416	64,184	244,266	67,973	18,993
International Bonds and Notes	517,743	69,410	128,538	110,541	209,254
Remic/FHLMC	952,817	—	—	39,882	912,935
Remic/FNMA	66,490	—	—	18,036	48,454
Remic/GNMA	17,969	—	—	—	17,969
SBA Passthrough Certificates	9,700	—	—	9,700	—
Police and Firemen's Mortgages	1,109,585	425	839	9,292	1,099,029
GNMA Mortgage Backed Certificates	64,206	131	36	—	64,039
FHLM Mortgage Backed Certificates	939,992	—	68	2,644	937,280
FNMA Mortgage Backed Certificates	839,452	171	5,284	16,137	817,860
Asset Backed Obligations	310,611	—	59,947	59,978	190,686
Private Export Obligations	56,771	—	32,490	24,281	—
	<u>\$ 21,702,675</u>	<u>508,126</u>	<u>3,019,078</u>	<u>3,897,199</u>	<u>14,278,272</u>

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(In thousands)	June 30, 2006				
	Fixed income investment type	Total market value	Maturities in years		
Less than 1			1-5	6-10	
United States Treasury Notes	\$ 3,516,004	747,277	796,007	1,972,720	—
United States Treasury Bills	389,716	389,716	—	—	—
United States Treasury TIPS	790,555	—	60,532	580,319	149,704
United States Treasury Bonds	1,984,003	—	—	215,305	1,768,698
United States Treasury Strips	37,219	—	—	—	37,219
Title XI Merchant Marine Notes	3,615	—	—	—	3,615
Federal Agricultural Mortgage Corp. Notes	95,763	—	95,763	—	—
Federal Farm Credit Bank Bonds	50,270	—	50,270	—	—
Federal Home Loan Bank Bonds	466,312	175,074	268,104	23,134	—
Federal Home Loan Bank Discounted Notes	89,894	—	—	—	89,894
Federal Home Loan Mortgage Corp. Notes	341,897	322,470	—	19,427	—
Federal National Mortgage Association Notes	226,193	129,785	96,408	—	—
Resolution Funding Corp. Obligations	6,397	—	—	—	6,397
Floating Rate Notes	77,883	35,021	32,863	9,999	—
Corporate Obligations	4,926,894	712,831	1,267,070	1,126,601	1,820,392
Real Estate Investment Trust Obligations	93,436	—	42,914	50,522	—
Finance Company Debt	1,532,217	380,558	741,111	273,382	137,166
Supranational Obligations	75,512	—	—	—	75,512
International Bonds and Notes	327,494	124,499	145,353	18,137	39,505
Foreign Government Obligations	784,177	22,393	459,160	193,953	108,671
Remic/FHLMC	731,131	3,383	—	39,299	688,449
Remic/FNMA	67,108	1,321	—	17,827	47,960
Remic/GNMA	17,650	—	—	—	17,650
Police and Fireman's Mortgages	965,008	—	—	—	965,008
GNMA Mortgage Backed Certificates	78,051	12	637	—	77,402
FHLM Mortgage Backed Certificates	598,915	—	148	3,698	595,069
FNMA Mortgage Backed Certificates	620,790	149	9,291	21,177	590,173
Asset Backed Obligations	178,119	—	118,906	59,213	—
Private Export Obligations	55,971	—	11,887	44,084	—
	<u>\$ 19,128,194</u>	<u>3,044,489</u>	<u>4,196,424</u>	<u>4,668,797</u>	<u>7,218,484</u>

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Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. The Pension Fund invests in global markets. The market value of international preferred and common stocks and issues convertible into common stocks, when combined with the market value of international government and agency obligations, previously could not exceed 22% of the market value of the Pension Fund. Effective September 5, 2006, the market value of emerging market securities cannot exceed more than 1.5 times the percentage derived by dividing the total market capitalization of companies included in the Morgan Stanley Capital International (MSCI) Emerging Market Index by the total market capitalization of the companies included in the MSCI All-Country World Ex-United States Index of the total market value of the assets held by Common Fund D. Prior to September 5, 2006, not more than 5% of the value of the assets held by Common Fund D can be invested in companies incorporated in emerging market countries. Not more than 5% of the market value of the emerging market securities can be invested in any one corporation. Council regulations permit the Pension Fund to enter into foreign exchange contracts for the purpose of hedging the international portfolio. The Pension Fund held forward contracts totaling approximately \$1.9 billion (with a \$14 million net exposure) at June 30, 2006. The Pension Fund had the following foreign currency exposure (expressed in U.S. dollars and in thousands):

June 30, 2007				
Currency	Total market value	Equities	Foreign government obligations	Alternative Investments
Australian dollar	\$ 472,778	472,778	—	—
Canadian dollar	700,076	700,076	—	—
Danish krone	236,914	236,914	—	—
Euro	5,777,859	5,466,997	278,743	32,119
Hong Kong dollar	187,292	187,292	—	—
Japanese yen	4,377,681	4,377,681	—	—
Mexican peso	74,710	74,710	—	—
New Zealand dollar	26,505	26,505	—	—
Norwegian krone	426,080	426,080	—	—
Pound sterling	2,077,051	2,051,057	—	25,994
Singapore dollar	151,674	151,674	—	—
South Korean won	175,851	175,851	—	—
Swedish krona	897,683	897,683	—	—
Swiss franc	1,702,575	1,702,575	—	—
	\$ 17,284,729	16,947,873	278,743	58,113

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Currency	June 30, 2006		
	Total market value	Equities	Foreign government obligations
Australian dollar	\$ 387,324	387,324	—
Canadian dollar	635,640	635,640	—
Danish krone	198,388	198,388	—
Euro	4,789,852	4,286,765	503,087
Hong Kong dollar	130,126	130,126	—
Japanese yen	3,039,675	3,039,675	—
Mexican peso	46,306	46,306	—
New Zealand dollar	18,426	18,426	—
Norwegian krone	269,692	269,692	—
Pound sterling	1,712,822	1,637,310	75,512
Singapore dollar	98,276	98,276	—
South Korean won	121,267	121,267	—
Swedish krona	760,561	682,104	78,457
Swiss franc	1,263,174	1,263,174	—
	\$ 13,471,529	12,814,473	657,056

The Cash Management Fund is not evidenced by securities that exist in physical or book entry form held by the Pension Fund.

The Pension Fund's interests in alternative investments may contain elements of credit, currency and market risk. Such risks include, but are not limited to, limited liquidity, absence of regulatory oversight, dependence upon key individuals, emphasis on speculative investments (both derivatives and non-marketable investments), and nondisclosure of portfolio composition. Effective September 5, 2006, Council regulations require that not more than 18% of the market value of the Pension Fund can be invested in alternative investments, with the individual categories of real estate, real assets, private equity and absolute return strategy investments limited to 7%. Not more than 5% of the market value of Common Fund E, plus outstanding commitments, may be committed to any one partnership or investment, without the prior written approval of the Council. The investments in Common Fund E cannot comprise more than 20% of any one investment manager's total assets.

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(4) Securities Lending Collateral

The System's share in the securities lending program is 21.03% and 21.19% of the total market value of the collateral as of June 30, 2007 and 2006, respectively.

The securities lending collateral is subject to various risks. Among these risks are credit risk, concentration of credit risk, and interest rate risk. Agreements with the lending agents require minimum credit ratings for certain categories of fixed income obligations and limit the amount that can be invested in any one issuer or issue. These limits are consistent with Council regulations and internal policies for funds managed by the Division. These limits for the period July 1, 2006 through September 4, 2006 were as follows:

Category	Minimum rating		Limitation of issuer's outstanding debt	Limitation of issue	Other limitations
	Moody's	S&P			
Corporate obligations	A3	A-	25%	25%	—
U.S. finance company debt and bank debentures	A2	A	10%	10%	—
Collateralized notes and mortgages	Aaa	AAA	—	33.3%	Limited to not more than 10% of the assets of the collateral portfolio
Commercial paper	P-1	A-1	—	—	Dollar limits by issuer
Certificates of deposit/ Banker's acceptances (rating applies to international)	Aa3/P-1	—	—	—	Uncollateralized certificates of deposit and banker's acceptances cannot exceed 10% of issuer's primary capital; dollar limits by issuer
Guaranteed income contracts	P-1	—	—	—	Limited to 5% of the assets of the collateral portfolio; A+ rating from A.M. Best for insurance companies
Money market funds	—	—	—	—	Limited to 10% of the assets of the collateral portfolio; limited to approved money market funds

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Effective September 5, 2006, the following limits became effective:

<u>Category</u>	<u>Minimum rating</u>			<u>Limitation of issuer's outstanding debt</u>	<u>Limitation of issue</u>	<u>Other limitations</u>
	<u>Moody's</u>	<u>S&P</u>	<u>Fitch</u>			
Corporate obligations	Baa3	BBB-	BBB-	10%	25%	—
U.S. finance company debt and bank debentures	Baa3	BBB-	BBB-	10%	25%	—
Collateralized notes and mortgages	Baa3	BBB-	BBB-	—	25%	Limited to not more than 10% of the assets of the collateral portfolio
Commercial paper	P-1	A-1	F1	—	—	Dollar limits by issuer
Certificates of deposit/ Banker's acceptances:						Certificates of deposit and banker's acceptances' cannot exceed 10% of issuer's primary capital; dollar limits by issuer
Domestic	A3/P-1	A-/A-1	A-/F1	—	—	
International	Aa3/P-1	AA-/A-1	AA-/F1	—	—	
Guaranteed income contracts and funding agreements	A3	A-	A-	—	—	Limited to 5% of the assets of the collateral portfolio
Money market funds	—	—	—	—	—	Limited to 10% of the assets of the collateral portfolio; limited to approved money market funds

Maturities of corporate obligations, U.S. finance company debt, bank debentures, collateralized notes and mortgages, guaranteed income contracts, and funding agreements must be less than 25 months. Commercial paper maturities cannot exceed 270 days. Repurchase agreement maturities cannot exceed 30 days. Certificates of deposit and banker's acceptances must mature in one year or less.

The collateral for repurchase agreements is limited to obligations of the U.S. Government or certain U.S. Government agencies, collateralized notes and mortgages and corporate obligations meeting certain minimum rating criteria.

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Notes to Financial Statements

June 30, 2007 and 2006

Total exposure to any individual issuer is limited, except for U.S. Treasury and Government Agency Obligations. For money market funds, the total amount of shares or units purchased or acquired of any money market fund shall not exceed 5% of the shares or units outstanding of said money market fund. For Collateralized Notes and Mortgages, not more than 2% and 5% of the assets of the collateral portfolio shall be invested in the obligations of any one issuer and issue, respectively. For Guaranteed Income Contracts and Funding Agreements, the total investment in any one issuer shall be limited to 2.5% of the collateral portfolio. The Division sets individual issuer limits for Commercial Paper and Certificate of Deposits. For Corporate Obligations, U.S. Finance Company Debt, Bank Debentures and Bankers Acceptances, exposure to any one issuer shall be limited to the following percentages of the collateral portfolio in accordance with the issuer's rating from Moody's: Aaa (4%), Aa (3%), A (2%), and Baa (1%).

For securities exposed to credit risk in the collateral portfolio, the following table discloses aggregate market value, by major credit quality rating category at June 30, 2007 and 2006. In those cases where an issuer and/or security have both a long-term and short-term rating, the short-term rating is presented.

(In thousands)	June 30, 2007					
	Rating					
	Aaa/AAA	Aa/AA	A/A	Baa/BBB	P1	Not rated
Corporate obligations	\$ 1,142,643	3,199,254	2,712,377	217,479	713,321	—
Commercial paper	—	—	—	—	3,536,172	—
Certificates of deposit	—	99,985	—	—	1,032,601	—
Repurchase agreements	—	—	—	—	—	1,765,830
Funding agreements	—	—	—	—	700,000	—
Money market funds	7,224	1,730,000	500,000	—	—	285,283
Collateralized notes	150,200	2,002	—	—	618,881	—
Cash	—	—	—	—	—	65
	\$ 1,300,067	5,031,241	3,212,377	217,479	6,600,975	2,051,178

(In thousands)	June 30, 2006				
	Moody's rating				
	Aaa	Aa	A	P1	Not rated
Corporate obligations	\$ 699,376	3,602,027	1,611,461	—	—
Commercial paper	—	—	—	3,683,532	—
Certificates of deposit	1,957,748	—	—	—	—
Repurchase agreements	—	—	—	—	1,609,375
Guaranteed investment contracts	—	450,000	—	—	—
Money market funds	253,861	—	—	—	101,392
Collateralized notes	—	135,924	—	—	—
Cash	—	—	—	—	147
	\$ 2,910,985	4,187,951	1,611,461	3,683,532	1,710,914

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Notes to Financial Statements

June 30, 2007 and 2006

The following tables summarize the maturities of the collateral portfolio at June 30, 2007 and 2006:

(In thousands)	June 30, 2007		
	Total market value	Maturities	
		Less than one year	One year to 25 months
Corporate obligations	\$ 7,985,074	4,144,639	3,840,435
Commercial paper	3,536,172	3,536,172	—
Certificates of deposit	1,132,586	1,132,586	—
Repurchase agreements	1,765,830	1,765,830	—
Funding agreements	700,000	700,000	—
Money market funds	2,522,507	2,522,507	—
Collateralized notes	771,083	769,081	2,002
	<u>\$ 18,413,252</u>	<u>14,570,815</u>	<u>3,842,437</u>

(In thousands)	June 30, 2006		
	Total market value	Maturities	
		Less than one year	One year to 25 months
Corporate obligations	\$ 5,912,864	2,301,117	3,611,747
Commercial paper	3,683,531	3,683,531	—
Certificates of deposit	1,957,748	1,957,748	—
Repurchase agreements	1,609,375	1,609,375	—
Guaranteed investment contracts	450,000	350,000	100,000
Money market funds	355,253	355,253	—
Collateralized notes	135,924	—	135,924
	<u>\$ 14,104,695</u>	<u>10,257,024</u>	<u>3,847,671</u>

As of June 30, 2007, the Pension Fund had outstanding loaned investment securities with an aggregate market value of \$18,034,823,201 and received cash collateral of \$18,423,399,432 and non-cash collateral of \$4,471,761. As of June 30, 2006, the Pension Fund had outstanding loaned investment securities with an aggregate market value of \$13,824,349,093 and received cash collateral of \$14,115,678,308 and non-cash collateral of \$1,670,223. In accordance with GASB accounting standards, the non-cash collateral is not reflected in the accompanying financial statements.

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Notes to Financial Statements

June 30, 2007 and 2006

(5) Contributions

The contribution policy is set by N.J.S.A. 43:16A and requires contributions by active members and contributing employers. Plan member and employer contributions may be amended by State of New Jersey legislation. Employers are required to contribute at an actuarially determined rate. The annual employer contributions include funding for basic retirement allowances, cost-of-living adjustments, and noncontributory death benefits. Members contribute at a uniform rate of 8.5% of base salary.

Chapter 108, P.L. 2003, effective July 1, 2003, provided that local employer PFRS normal and accrued liability contributions will be 20% of the amount certified by the PFRS for payments due in State fiscal year 2004 and thereafter a percentage of the amount certified by the System as the State Treasurer will determine, but not more than 60% in fiscal year 2006, not more than 80% in fiscal year 2007.

The State made a contribution of \$121.36 million for fiscal year 2007, the first significant contribution to the System since fiscal year 1997. The amount contributed in fiscal year 2007 was equal to approximately 57.5% of the actuarially determined amount. The State contributed \$73.54 million for fiscal year 2006.

(6) Funds

This System maintains the following legally required funds:

Members' Annuity Savings Fund (2007-\$2,691,572,376; 2006-\$2,548,345,093)

The Members' Annuity Savings Fund (ASF) is credited with all contributions made by active members of the System. Member withdrawals are paid out of this Fund.

Retirement Reserve Fund (2007-\$9,315,156,079; 2006-\$8,869,250,998)

The Retirement Reserve Fund is the account from which retirement benefits including cost-of-living adjustments are paid. Upon retirement of a member, accumulated contributions are transferred to the Retirement Reserve Fund from the Members' ASF. Any additional reserves needed to fund the balance of the retirement benefit are transferred from the Pension Accumulation Fund. Annually, interest as determined by the State Treasurer (8.25% since fiscal year 2006) is credited to the Retirement Reserve Fund.

Special Reserve Fund (2007-\$196,283,294; 2006-\$172,436,265)

The Special Reserve Fund is a fund to which any excess earnings and gains from sales and maturities of investments are transferred and against which any losses from the sales of securities are applied. The maximum limit on the accumulation of this account is 1% of the market value of the investments of the System. Amounts in excess of 1% are credited to the Pension Accumulation Fund.

Pension Accumulation Fund (2007-\$9,365,000,072; 2006-\$7,335,154,301)

The Pension Accumulation Fund is credited with the contributions of the State of New Jersey and other employers. Interest earnings, after crediting the ASF and the Retirement Reserve Fund, as required, are credited to this account. Additionally, payments for life insurance premiums and administrative expenses are made from this Fund.

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Notes to Financial Statements

June 30, 2007 and 2006

Non-Contributory Group Insurance Premium Fund-Local (2007-\$1,971,884; 2006-\$0)

The Non-Contributory Group Insurance Premium Fund represents the accumulation of employer group insurance contributions in excess of premiums disbursed to the insurance carrier since the inception of the non-contributory death benefit program plus reserves held by the insurance carrier. Members are eligible by statute for the non-contributory group insurance plan in the first year of membership.

(7) Income Tax Status

Based on a 1986 declaration of the Attorney General of the State of New Jersey, the System is a qualified plan as described in Section 401(a) of the Internal Revenue Code.

**STATE OF NEW JERSEY
POLICE AND FIREMEN'S RETIREMENT SYSTEM**

Required Supplementary Information

Schedule of Funding Progress

(Unaudited)

Actuarial valuation date	Actuarial value of assets (a)	Actuarial accrued liability (b)	Unfunded (overfunded) actuarial accrued liability (b - a)	Funded ratio (a / b)	Covered payroll (c)	Unfunded (overfunded) actuarial accrued liability as a percentage of covered payroll ((b - a) / c)
State:						
June 30, 1998	\$ 1,559,131,933	1,377,734,455	(181,397,478) ⁽¹⁾	113.2%	\$ 346,079,078	(52.4)%
June 30, 1999	1,717,248,151	1,534,470,501	(182,777,650) ⁽¹⁾	111.9	362,949,950	(50.4)
June 30, 2000	1,884,870,936	1,666,842,906	(218,028,030)	113.1	363,360,250	(60.0)
June 30, 2001	1,991,299,968	1,866,140,391	(125,159,577)	106.7	398,118,379	(31.4)
June 30, 2002	2,032,977,241	2,046,820,189	13,842,948	99.3	418,849,259	3.3
June 30, 2003	1,907,752,767	2,330,909,918	423,157,151	81.8	447,470,022	94.6
June 30, 2004	1,940,936,459	2,509,192,584	568,256,125	77.4	450,406,301	126.2
June 30, 2005	2,005,752,079	2,815,620,221	809,868,142	71.2	482,460,402	167.9
June 30, 2006	2,082,930,162	3,082,176,677	999,246,515	67.6	506,084,434	197.4
Local:						
June 30, 1998	\$ 13,169,957,658	12,881,842,367	(288,115,291) ⁽¹⁾	102.2%	\$ 1,870,322,787	(15.4)%
June 30, 1999	14,536,570,357	13,894,951,617	(641,618,740) ⁽¹⁾	104.6	1,971,087,124	(32.6)
June 30, 2000	15,644,750,281	14,924,699,712	(720,050,569)	104.8	2,055,781,766	(35.0)
June 30, 2001	16,083,153,842	16,056,446,646	(26,707,196) ⁽²⁾	100.2	2,163,590,060	(1.2)
June 30, 2002	16,392,195,411	17,181,142,310	788,946,899	95.4	2,275,130,620	34.7
June 30, 2003	16,447,380,691	18,422,073,072	1,974,692,381 ⁽³⁾	89.3	2,393,467,444	82.5
June 30, 2004	16,762,453,668	19,769,046,766	3,006,593,098	84.8	2,524,859,162	119.1
June 30, 2005	17,372,138,294	21,388,972,326	4,016,834,032	81.2	2,619,347,468	153.4
June 30, 2006	18,281,315,556	22,907,522,660	4,626,207,104	79.8	2,772,915,465	166.8

Notes to schedule:

- (1) Adjusted to reflect the impact of legislation passed in fiscal year 2002 which retroactively affected the June 30, 1999 and 1998 valuations. Chapter 4, P.L. 2001 provides benefit enhancements for certain eligible members who retired prior to December 29, 1989. The unfunded accrued liability attributable to the increased benefits was exactly offset by the recognition of an additional amount of market value of assets in the determination of the actuarial value of assets for the July 1, 1999 valuation.
- (2) Chapter 44, P.L. 2001, referred to in note 5, reduced the contribution of local employers by \$150 million.
- (3) The original June 30, 2003 valuation was revised due to the change in economic assumptions which would affect the fiscal year 2006 employer contributions, and due to the impact of the Appropriation Act for fiscal year 2005 which reduced the State contribution rate from the original 40% to 30% of the statutory required contribution.

**STATE OF NEW JERSEY
POLICE AND FIREMEN'S RETIREMENT SYSTEM**

Required Supplementary Information

Schedule of Funding Progress – Additional Actuarial Information

(Unaudited)

Significant actuarial methods and assumptions used in the most recent June 30, 2006 and 2005 actuarial valuations include the following:

	<u>June 30, 2006</u>	<u>June 30, 2005</u>
Actuarial cost method	Projected unit credit	Projected unit credit
Asset valuation method	5 year average of market value	5 year average of market value
Amortization method	Level percent, open	Level percent, closed
Remaining amortization period	30 years	30 years
Actuarial assumptions:		
Interest rate	8.25%	8.25%
Salary range	7.20%	7.20%
Cost-of-living adjustments	1.80%	1.80%

The actuarial assumptions used in the June 30, 2006 and 2005 valuations reflect the actuarial assumptions developed from the three year experience investigation for the period ending June 30, 2004.

Annual covered payroll is an estimate based upon annualizing one quarter's actual payroll.

**STATE OF NEW JERSEY
POLICE AND FIREMEN'S RETIREMENT SYSTEM**

Schedule of Employer Contributions

(Unaudited)

Year ended June 30,	Annual required contribution	Employer contributions⁽¹⁾	Percentage contributed
State:			
1998	\$ 84,167,834	73,587,848 ⁽²⁾	87.4%
1999	93,920,617	23,730,087 ⁽²⁾	25.3
2000	98,974,449	60,521,749 ⁽²⁾	61.1
2001	95,883,272	—	—
2002	103,580,989	—	—
2003	104,998,547	—	—
2004	118,297,232	22,215,429 ⁽²⁾⁽³⁾	18.8
2005	161,455,508	49,326,846 ⁽³⁾	30.6
2006	200,902,193	73,541,000 ⁽³⁾	36.6
2007	216,570,332	127,404,777 ⁽³⁾	58.8
Local			
1998	\$ 238,002,765	223,491,008	93.9%
1999	273,210,113	256,551,862	93.9
2000	275,790,739	214,164,848	77.7
2001	249,746,232	75,670,018	30.3
2002	248,754,078	185,415 ⁽²⁾	0.1
2003	259,969,532	364,850 ⁽²⁾	0.1
2004	316,272,883	53,396,685 ⁽⁴⁾	16.9
2005	355,229,715	132,740,650 ⁽⁴⁾	37.4
2006	475,872,193	260,986,583 ⁽⁴⁾	54.8
2007	584,645,679	422,743,218 ⁽⁴⁾	72.3

Notes to schedule:

- (1) Local employer contributions include contributions made by the State to provide funding for certain benefits payable to local participants.
- (2) In accordance with Chapter 115, P.L. 1997, all or a portion of the required contribution was funded by available excess valuation assets.
- (3) In accordance with the provisions of the Appropriation Act for fiscal years 2004 through 2007, the State statutory required contributions have been reduced.
- (4) In accordance with Chapter 108, P.L. 2003, the local statutory required contributions for fiscal years 2004 through 2007 have been reduced.

**STATE OF NEW JERSEY
POLICE AND FIREMEN'S RETIREMENT SYSTEM**

Schedule of Changes in Fiduciary Net Assets by Fund

Year ended June 30, 2007

	<u>Members' Annuity savings Fund</u>	<u>Pension Accumulation Fund</u>	<u>Retirement Reserve Fund</u>	<u>Special Reserve Fund</u>	<u>Non-Contributory Group Insurance Premium Fund</u>	<u>Total</u>
Additions:						
Contributions:						
Members	\$ 307,335,360	—	—	—	—	307,335,360
Employers	—	791,072,541	—	—	34,614,936	825,687,477
Total contributions	307,335,360	791,072,541	—	—	34,614,936	1,133,022,837
Distribution of net investment income	—	2,021,598,460	731,713,207	23,847,029	—	2,777,158,696
Total additions	307,335,360	2,812,671,001	731,713,207	23,847,029	34,614,936	3,910,181,533
Deductions:						
Benefits	—	—	1,220,700,516	—	32,643,052	1,253,343,568
Refunds of contributions	6,063,977	18,005	—	—	—	6,081,982
Administrative expenses	—	5,958,935	—	—	—	5,958,935
Total deductions	6,063,977	5,976,940	1,220,700,516	—	32,643,052	1,265,384,485
Net increase (decrease) before transfers among reserves	301,271,383	2,806,694,061	(488,987,309)	23,847,029	1,971,884	2,644,797,048
Transfers among reserves:						
Retirements	(158,044,100)	(776,848,290)	934,892,390	—	—	—
Net increase	143,227,283	2,029,845,771	445,905,081	23,847,029	1,971,884	2,644,797,048
Net assets held in trust for pension benefits:						
Beginning of year	2,548,345,093	7,335,154,301	8,869,250,998	172,436,265	—	18,925,186,657
End of year	\$ 2,691,572,376	9,365,000,072	9,315,156,079	196,283,294	1,971,884	21,569,983,705