



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

Financial Statements and Schedules

June 30, 2010 and 2009

(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, 2010 and 2009, 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, 2010 and 2009, 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 2010 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 2010 basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the 2010 basic financial statements taken as a whole.

**KPMG LLP**

October 27, 2010

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

Management's Discussion and Analysis

June 30, 2010 and 2009

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, 2010 and 2009. Please read it in conjunction with the basic financial statements and financial statement footnotes, which follow this discussion.

**Financial Highlights**

**2010 - 2009**

- Net assets held in trust for pension benefits increased by \$1,755,208,201 as a result of fiscal year 2010's operations from \$18,088,929,615 to \$19,844,137,816.
- Additions for the year are \$3,340,414,302, which are comprised of member and employer pension contributions of \$1,332,175,021 and net investment income of \$2,008,239,281.
- Deductions for the year are \$1,585,206,101, which are comprised of benefit and refund payments of \$1,579,126,015 and administrative expenses of \$6,080,086.

**2009 - 2008**

- Net assets held in trust for pension benefits decreased by \$2,972,288,240 as a result of fiscal year 2009's operations from \$21,061,217,855 to \$18,088,929,615.
- Additions for the year are negative \$1,496,041,362, which are comprised of member and employer pension contributions of \$1,239,793,077 and an investment loss of \$2,735,834,439.
- Deductions for the year are \$1,476,246,878, which are comprised of benefit and refund payments of \$1,469,720,368 and administrative expenses of \$6,526,510.

**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.

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

Management's Discussion and Analysis

June 30, 2010 and 2009

**Financial Analysis**

**Summary of Fiduciary Net Assets**

*2010 – 2009*

|             | <u>2010</u>              | <u>2009</u>           | <u>Increase<br/>(decrease)</u> |
|-------------|--------------------------|-----------------------|--------------------------------|
| Assets      | \$ 19,987,241,043        | 19,323,903,680        | 663,337,363                    |
| Liabilities | <u>143,103,227</u>       | <u>1,234,974,065</u>  | <u>(1,091,870,838)</u>         |
| Net assets  | <u>\$ 19,844,137,816</u> | <u>18,088,929,615</u> | <u>1,755,208,201</u>           |

The System's assets primarily consist of investments, securities lending collateral, contributions due from members and participating employers, accrued investment income and members' loans receivable. Between fiscal years 2009 and 2010, total assets increased by \$0.7 billion or 3.4%. The total assets increased due to an increase of \$1.5 billion in the fair value of investments, an increase of \$0.3 billion in the employer contribution receivables and other assets, offset by a decrease of \$1.1 billion in the securities lending collateral. Employer contributions receivables include contribution receivables from local employers for appropriations and early retirement incentive programs due April 1, 2011 and 2012.

Liabilities consist of retirement benefits payable to retirees and beneficiaries, non-contributory group insurance premiums payable to the System's insurance provider, securities lending collateral and rebates payable and, classified under accounts payable and accrued expenses, liabilities of PFRS for unclaimed member accounts and checks issued to members that have not been negotiated by the members but remain due and payable. Total liabilities decreased by \$1.1 billion or 88.4% due to a decrease in the securities lending collateral and rebates payable of \$1.1 billion, offset by an increase of \$9.9 million in retirement benefits payable and other payables.

Net assets held in trust for pension benefits increased by \$1.8 billion or 9.7%.

**Summary of Fiduciary Net Assets**

*2009 – 2008*

|             | <u>2009</u>              | <u>2008</u>           | <u>(Decrease)</u>      |
|-------------|--------------------------|-----------------------|------------------------|
| Assets      | \$ 19,323,903,680        | 23,750,977,522        | (4,427,073,842)        |
| Liabilities | <u>1,234,974,065</u>     | <u>2,689,759,667</u>  | <u>(1,454,785,602)</u> |
| Net assets  | <u>\$ 18,088,929,615</u> | <u>21,061,217,855</u> | <u>(2,972,288,240)</u> |

The System's assets primarily consist of investments, securities lending collateral, contributions due from members and participating employers, accrued investment income and members' loans receivable. Between fiscal years 2008 and 2009, total assets decreased by \$4.4 billion or 18.6%. The total assets decreased due to a decrease in the fair value of investments and the securities lending collateral of \$4.8 billion and an increase in local employer's contributions receivable of \$373.0 million. Employer contributions receivables include contribution receivables from local employers for appropriations and early retirement incentive programs due April 1, 2010 and 2011.

**STATE OF NEW JERSEY  
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June 30, 2010 and 2009

Liabilities consist of retirement benefits payable to retirees and beneficiaries, non-contributory group insurance premiums payable to the System's insurance provider, securities lending collateral and rebates payable and, classified under accounts payable and accrued expenses, liabilities of PFRS for unclaimed member accounts and checks issued to members that have not been negotiated by the members but remain due and payable. Total liabilities decreased by \$1.5 billion or 54.1% due to a decrease in the securities lending collateral and rebates payable of \$1.5 billion, offset by an increase of \$10.6 million in retirement benefits payable and other payables.

Net assets held in trust for pension benefits decreased by \$3.0 billion or 14.1%.

**Summary of Changes to Fiduciary Net Assets**

2010 – 2009

|   | <u>2010</u>             | <u>2009</u>            | <u>Increase<br/>(decrease)</u> |
|---|-------------------------|------------------------|--------------------------------|
| Additions:                                |                         |                        |                                |
| Member contributions                      | \$ 330,951,798          | 326,491,066            | 4,460,732                      |
| Employer contributions                    | 1,001,223,223           | 913,302,011            | 87,921,212                     |
| Net investment income (loss)              | 2,008,239,281           | (2,735,834,439)        | 4,744,073,720                  |
| Total additions                           | <u>3,340,414,302</u>    | <u>(1,496,041,362)</u> | <u>4,836,455,664</u>           |
| Deductions:                               |                         |                        |                                |
| Benefits                                  | 1,573,510,855           | 1,463,420,411          | 110,090,444                    |
| Refunds of contributions                  | 5,615,160               | 6,299,957              | (684,797)                      |
| Administrative and miscellaneous expenses | 6,080,086               | 6,526,510              | (446,424)                      |
| Total deductions                          | <u>1,585,206,101</u>    | <u>1,476,246,878</u>   | <u>108,959,223</u>             |
| Changes in net assets                     | <u>\$ 1,755,208,201</u> | <u>(2,972,288,240)</u> | <u>4,727,496,441</u>           |

Additions primarily consist of member and employer contributions and earnings from investment activities. Member contributions increased by \$4.5 million or 1.4% due to a normal salary increase.

Employer contributions increased by \$87.9 million or 9.6%. In fiscal year 2010, employer contributions include accrued appropriations due April 1, 2011 and 2012 and early retirement incentive benefits billed to local employers. The State did not make a pension contribution for fiscal year 2010 but did make a contribution of \$7.3 million for Non-contributory Group Insurance (NCGI) death benefits. Also included are miscellaneous items that were due the system from the State and the local employers.

Net investment income increased by \$4.7 billion or 173.4% due to appreciation of investments.

The total investment return for all pension funds was estimated to be 13.4% gain compared to 15.5% loss in the prior year.

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Management's Discussion and Analysis

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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 \$110.1 million or 7.5% primarily due to an increase in number of retirees receiving benefits. The amount of refunds processed decreased by \$0.7 million or 10.9%. Administrative expenses decreased by \$0.4 million or 6.8%.

**Summary of Changes to Fiduciary Net Assets**

2009 – 2008

|   | <u>2009</u>               | <u>2008</u>          | <u>Increase<br/>(decrease)</u> |
|---|---------------------------|----------------------|--------------------------------|
| Additions:                                |                           |                      |                                |
| Member contributions                      | \$ 326,491,066            | 310,259,367          | 16,231,699                     |
| Employer contributions                    | 913,302,011               | 886,871,720          | 26,430,291                     |
| Net investment loss                       | <u>(2,735,834,439)</u>    | <u>(339,212,149)</u> | <u>(2,396,622,290)</u>         |
| Total additions                           | <u>(1,496,041,362)</u>    | <u>857,918,938</u>   | <u>(2,353,960,300)</u>         |
| Deductions:                               |                           |                      |                                |
| Benefits                                  | 1,463,420,411             | 1,353,109,000        | 110,311,411                    |
| Refunds of contributions                  | 6,299,957                 | 7,294,112            | (994,155)                      |
| Administrative and miscellaneous expenses | <u>6,526,510</u>          | <u>6,281,676</u>     | <u>244,834</u>                 |
| Total deductions                          | <u>1,476,246,878</u>      | <u>1,366,684,788</u> | <u>109,562,090</u>             |
| Changes in net assets                     | <u>\$ (2,972,288,240)</u> | <u>(508,765,850)</u> | <u>(2,463,522,390)</u>         |

Additions primarily consist of member and employer contributions and earnings from investment activities. Member contributions increased by \$16.2 million or 5.2% due to normal salary and membership increases.

Employer contributions increased by \$26.4 million or 3.0%. In fiscal year 2009, employer contributions include accrued appropriations due April 1, 2010 and 2011 and early retirement incentive benefits billed to local employers.

The State made a contribution of \$13.0 million for fiscal year 2009, which was received in September 2009 after the close of the fiscal year. The amount contributed for fiscal year 2009 was equal to 4.8% of the actuarially determined statutory amount.

Net investment income decreased by \$2.4 billion or 706.5% due to depreciation of investments.

The total investment return for all pension funds was estimated to be 15.5% loss compared to 2.7% loss in the prior year.

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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 \$110.3 million or 8.2% primarily due to an increase in number of retirees receiving benefits. The amount of refunds processed decreased by \$1.0 million or 13.6%. Administrative expenses slightly increased by 3.9%.

**Retirement System as a Whole**

The overall funded ratios of 70.8% for fiscal year 2010 and 74.3% for fiscal year 2009 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.

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

Statements of Fiduciary Net Assets

June 30, 2010 and 2009

|   | <b>2010</b>       | <b>2009</b>    |
|---|-------------------|----------------|
| Assets:   |                   |                |
| Cash  | \$ 5,763,447      | 4,271,644      |
| Securities lending collateral                     | 4,292,198         | 1,101,108,256  |
| Investments, at fair value:                       |                   |                |
| Cash Management Fund                              | 858,161,248       | 689,671,122    |
| Common Pension Fund A                             | 4,455,622,370     | 4,273,366,567  |
| Common Pension Fund B                             | 5,041,808,272     | 4,639,053,398  |
| Common Pension Fund D                             | 3,252,936,018     | 3,255,377,803  |
| Common Pension Fund E                             | 2,401,803,179     | 1,569,263,833  |
| Mortgages   | 1,338,985,275     | 1,407,932,792  |
| Total investments                                 | 17,349,316,362    | 15,834,665,515 |
| Receivables:                                      |                   |                |
| Contributions:                                    |                   |                |
| Members   | 45,062,645        | 45,787,013     |
| Employers   | 2,085,862,363     | 1,859,724,151  |
| Accrued interest and dividends                    | 92,153,743        | 162,071,758    |
| Members' loans                                    | 388,256,691       | 289,175,976    |
| Securities sold in transit                        | 12,166,417        | 22,696,866     |
| Other   | 4,367,177         | 4,402,501      |
| Total receivables                                 | 2,627,869,036     | 2,383,858,265  |
| Total assets                                      | 19,987,241,043    | 19,323,903,680 |
| Liabilities:                                      |                   |                |
| Accounts payable and accrued expenses             | 3,130,086         | 2,322,702      |
| Retirement benefits payable                       | 133,450,778       | 123,653,004    |
| Non-contributory group insurance premiums payable | 2,269,382         | 2,933,552      |
| Securities lending collateral and rebates payable | 4,252,981         | 1,106,064,807  |
| Total liabilities                                 | 143,103,227       | 1,234,974,065  |
| Net assets:                                       |                   |                |
| Held in trust for pension benefits                | \$ 19,844,137,816 | 18,088,929,615 |

See accompanying notes to financial statements.

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

Statements of Changes in Fiduciary Net Assets

Years ended June 30, 2010 and 2009

|  | <u>2010</u>              | <u>2009</u>            |
|--|--------------------------|------------------------|
| Additions:   |                          |                        |
| Contributions:   |                          |                        |
| Members  | \$ 330,951,798           | 326,491,066            |
| Employers  | 1,001,223,223            | 913,302,011            |
| Total contributions  | <u>1,332,175,021</u>     | <u>1,239,793,077</u>   |
| Investment income:   |                          |                        |
| Net appreciation (depreciation) in fair value of investments | 1,466,339,195            | (3,272,278,029)        |
| Interest   | 450,487,844              | 410,740,336            |
| Dividends  | 92,716,111               | 126,940,074            |
|  | <u>2,009,543,150</u>     | <u>(2,734,597,619)</u> |
| Less investment expense                                      | 1,303,869                | 1,236,820              |
| Net investment income (loss)                                 | <u>2,008,239,281</u>     | <u>(2,735,834,439)</u> |
| Total additions  | <u>3,340,414,302</u>     | <u>(1,496,041,362)</u> |
| Deductions:  |                          |                        |
| Benefits   | 1,573,510,855            | 1,463,420,411          |
| Refunds of contributions                                     | 5,615,160                | 6,299,957              |
| Administrative and miscellaneous expenses                    | 6,080,086                | 6,526,510              |
| Total deductions   | <u>1,585,206,101</u>     | <u>1,476,246,878</u>   |
| Change in net assets   | 1,755,208,201            | (2,972,288,240)        |
| Net assets – beginning of year                               | <u>18,088,929,615</u>    | <u>21,061,217,855</u>  |
| Net assets – end of year                                     | <u>\$ 19,844,137,816</u> | <u>18,088,929,615</u>  |

See accompanying notes to financial statements.

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

Notes to Financial Statements

June 30, 2010 and 2009

**(1) Description of the System**

The 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, 2009 and 2008, the dates of the most recent actuarial valuations, participating employers consisted of the following:

|                     | <b>2009</b> | <b>2008</b> |
|---------------------|-------------|-------------|
| State of New Jersey | 1           | 1           |
| Municipalities      | 588         | 588         |
| Total               | 589         | 589         |

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 PFRS 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.

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

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.

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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 1, P.L. 2010, effective May 21, 2010, eliminated the provision in PFRS that would permit a member to retire, at any age after 25 years of service credit, on a special retirement allowance of 70% of final compensation after the retirement system reaches a funded level of 104%. Also, for new members of PFRS, the law capped the maximum compensation that can be used to calculate a pension from the plan at the annual wage contribution base for Social Security, and requires the pension to be calculated using a three year average annual compensation instead of the last year's salary.

***Membership***

Membership in the System consisted of the following at June 30, 2009 and 2008, the dates of the most recent actuarial valuations:

|  | <b>2009</b> | <b>2008</b> |
|--|-------------|-------------|
| Retirees and beneficiaries currently receiving benefits<br>and terminated employees entitled to benefits but<br>not yet receiving them | 34,364      | 33,151      |
| Active members:  |             |             |
| Vested   | 29,400      | 29,056      |
| Nonvested  | 15,750      | 16,410      |
| Total active members   | 45,150      | 45,466      |
| Total  | 79,514      | 78,617      |

**(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.

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

Notes to Financial Statements

June 30, 2010 and 2009

***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, real estate 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 System may not sell the mortgages, and no independent market exists for them.

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 (CMF) – closing bid price on the last day of trading during the period as determined by the Transfer Agent.
- Mortgages – all mortgages except for the Police and Firemen's mortgages are priced by a major dealer in such securities and reviewed by management for reasonableness. The Police and Firemen's mortgages are priced using another third-party administrator.
- Alternative investments (private equity, real estate, real asset, and absolute return strategy funds) – Fair values for the individual funds are based upon the net asset values for the funds at the closest available reporting date, adjusted for subsequent contributions, distributions, management fees and reserves. The valuation techniques vary based upon investment type and involve a certain degree of expert judgment. The most significant input into the net asset value of an entity is the value of its investment holdings. The net asset value is provided by the general partner and/or investment manager and reviewed by management. The net asset values are audited annually. The strategy of private equity and real estate funds are long term and illiquid in nature which can prevent the investment from being readily marketable. Hedge funds may be subject to redemption restrictions which can limit distributions and restrict the ability of a limited partner to exit a partnership. For alternative investments, the realized value received upon the sale of these investments in the open market might be different than the fair value reported in the accompanying financial statements.

**STATE OF NEW JERSEY**  
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Notes to Financial Statements

June 30, 2010 and 2009

Investment transactions are accounted for on a trade or investment 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.

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 are recorded at such net asset value.

Dividends and interest earned per unit are calculated monthly and distributed quarterly for Common Funds 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***

The State Investment Council policies permit Common Funds A, B and D and several of the direct pension plan portfolios to participate in securities lending programs, whereby securities are loaned to brokers or other borrowers and, in return, the pension funds have 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 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. The securities lending contracts do not allow the Common Funds to pledge or sell any collateral securities unless the borrower defaults. As of June 30, 2010 and 2009, 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' securities lending agent 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 Common Fund D securities lending agent 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

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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 (or, in the case of floating rate notes, to the next interest rate reset date) of the cash collateral. The current lending programs were terminated effective June 30, 2010.

***Derivatives***

Effective July 1, 2009, the Division of Investment adopted GASB Statement No. 53 ("GASB 53"), *Accounting and Financial Reporting for Derivative Instruments*, which was issued in June 2008. GASB No. 53, establishes accounting and reporting requirements for derivative instruments.

The implementation of GASB 53 had no impact on the Common Fund's financial statements for the years ended June 30, 2010 and 2009, as the change in the fair value of derivative instruments was recorded in the accompanying financial statements. The derivative instruments were recorded at fair value in the accompanying financial statements as of June 30, 2010 and 2009. Derivative instruments consisted of foreign forward currency contracts as of June 30, 2010 and 2009 and call and put options as of June 30, 2009. Derivative instruments within alternative investment funds and partnerships are discussed further in the notes.

This Statement addresses the recognition, measurement, and disclosure of information regarding derivative instruments entered into by state and local governments. Derivative instruments are often complex financial arrangements used by governments to manage specific risks or to make investments. 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. By entering into these arrangements, governments receive and make payments based on market prices without actually entering into the related financial or commodity transactions. Derivative instruments associated with changing financial and commodity prices result in changing cash flows and fair values that can often be used as effective risk management or investment tools. Derivative instruments, however, can also expose governments to significant risks and liabilities. 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. Common types of derivative instruments used by governments include interest rate and commodity swaps, interest rate locks, options (caps, floors, and collars), swaptions, forward foreign currency contracts, and futures contracts.

The Division of Investment, from time to time, utilizes forward foreign currency contracts, a derivative security, as a means to hedge against currency risks in the Common Funds' foreign equity and fixed income portfolios. 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.

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The fair value of foreign forward currency contracts held directly by the Common Funds as of June 30, 2010 and 2009 was as follows:

|                             | <u>2010</u>      | <u>2009</u>   |
|-----------------------------|------------------|---------------|
| Forward currency receivable | \$ 1,950,687,029 | 4,865,537,164 |
| Forward currency payable    | 1,964,107,355    | 4,739,424,464 |
| Net unrealized (loss) gain  | (13,420,326)     | 126,112,700   |

The Common Funds utilize covered call and put options in an effort to add value to or reduce the risk level in the portfolio. 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 Common Funds enter into covered calls when they write (or sell) call options on underlying stocks held by the Common Funds or stock indices. The Common Funds enter into covered put options when they purchase put options on underlying stocks held by the Common Funds or stock indices. The purchaser of put options pays a premium at the outset of the agreement and stands to gain from an unfavorable change (i.e., a decrease) in the price of the instrument underlying the option. 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 did not have any written call or put option contracts as of June 30, 2010. The Common Funds had written call options on 25,737,000 shares, and these options had a fair value of \$10,862,850 as of June 30, 2009. The Common Funds owned 102,950 put option contracts on the S&P 500 index with a fair value of \$22,717,250 as of June 30, 2009.

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. The Common Funds recognize the fair value of all derivative instruments as either an asset or liability in the accompanying financial statements with the offsetting gains or losses recognized in earnings.

***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 a commercially reasonable interest rate. 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.

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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.

Chapter 92, P.L. 2007 eliminated the 4% fixed rate of interest for loans from the defined benefit plans and provided 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 permitted that an administrative processing fee may be charged for such loans. As such, effective January 1, 2008, an \$8.00 processing fee per loan was charged, and the new pension loan interest rate became 3.33% per year for year 2009 and 3.25% for year 2010.

***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 financial statements.

Miscellaneous expenses and reimbursements from the System that comprise various adjustments to member and employer accounts are incorporated into the administrative expense amounts included in the accompanying financial statements.

***Commitments***

The Common Funds are obligated, under certain private equity, real estate and absolute return strategy alternative investment agreements to make additional capital contributions up to contractual levels over the investment period specified for each investment. As of June 30, 2010, the Common Funds had unfunded commitments totaling approximately \$5.6 billion.

***Use of Estimates***

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of income and expense during the reporting period. Actual results could differ from those estimates.

***Funded Status and Funding Progress***

The required supplementary information regarding the funded status and funding progress is based on actuarial valuations which involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. These amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the probability of future events.

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The required schedule of funding progress presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Actuarial calculations reflect a long-term perspective and are based on the benefits provided under State statutes in effect at the time of each valuation and also consider the pattern of the sharing of costs between the employer and members at that point in time. The projection of benefits for financial reporting purposes does not explicitly incorporate the potential effects of legal or contractual funding limitations on the pattern of cost sharing between the employer and members in the future.

***Actuarial Methods and Assumptions***

In the June 30, 2009 and 2008 actuarial valuations, the projected unit credit was used as the actuarial cost method, and the five year average of market value was used as the asset valuation method for the System. The actuarial assumptions included (a) 8.25% for investment rate of return and (b) 7.20% for projected salary increases as of June 30, 2009 and 2008.

|   | State                             |                                   | Local                             |                                   |
|---|-----------------------------------|-----------------------------------|-----------------------------------|-----------------------------------|
|   | June 30, 2009                     | June 30, 2008                     | June 30, 2009                     | June 30, 2008                     |
| Actuarial valuation date  |                                   |                                   |                                   |                                   |
| Actuarial value of assets   | \$ 2,254,766,935                  | \$ 2,316,017,361                  | \$ 20,724,453,343                 | \$ 20,437,541,909                 |
| Actuarial accrued liability   | 3,993,259,480                     | 3,749,118,910                     | 28,448,841,765                    | 26,871,106,532                    |
| Unfunded actuarial<br>accrued liability                                       | 1,738,492,545                     | 1,433,101,549                     | 7,724,388,422                     | 6,433,564,623                     |
| Funded ratio  | 56.5%                             | 61.8%                             | 72.8%                             | 76.1%                             |
| Covered payroll   | \$ 525,862,047                    | \$ 527,495,741                    | \$ 3,147,812,476                  | \$ 3,068,758,436                  |
| Unfunded actuarial accrued<br>liability as a percentage<br>of covered payroll | 330.6%                            | 271.7%                            | 245.4%                            | 209.6%                            |
| Actuarial cost method   | Projected unit credit             | Projected unit credit             | Projected unit credit             | Projected unit credit             |
| Asset valuation method  | 5 year average of<br>market value |
| Amortization method   | Level percent, open               | Level percent, open               | Level percent, open               | Level percent, open               |
| Payroll growth rate for<br>amortization                                       | 4.00%                             | 4.00%                             | 4.00%                             | 4.00%                             |
| Remaining amortization<br>period  | 30 years                          | 30 years                          | 30 years                          | 30 years                          |
| Actuarial assumptions:  |                                   |                                   |                                   |                                   |
| Interest rate   | 8.25%                             | 8.25%                             | 8.25%                             | 8.25%                             |
| Salary range  | 7.20%                             | 7.20%                             | 7.20%                             | 7.20%                             |
| Cost-of-living adjustments  | 1.80%                             | 1.80%                             | 1.80%                             | 1.80%                             |

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**(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 28.6%, 21.5%, 25.3%, 22.1%, and 94.4%, respectively, of each investment total of the pension fund as of June 30, 2010.

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 25.7%, 21.4%, 26.3%, 19.4%, and 93.4%, respectively, of each investment total of the pension fund as of June 30, 2009.

The pension funds' investments as of June 30 are as follows:

|                                | <u>2010</u>              | <u>2009</u>           |
|--------------------------------|--------------------------|-----------------------|
| Domestic equities              | \$ 15,432,119,968        | 16,372,011,087        |
| International equities         | 12,622,731,135           | 11,998,610,775        |
| Domestic fixed income          | 19,933,985,342           | 18,650,830,684        |
| International fixed income     | 2,502,077,223            | 2,074,639,196         |
| Bank loan funds                | 1,071,419,455            | 1,027,830,211         |
| Police and Fireman's mortgages | 1,305,728,863            | 1,367,881,305         |
| Private equity funds           | 4,219,334,445            | 2,982,420,463         |
| Real estate funds              | 1,875,718,683            | 1,588,971,807         |
| Absolute return strategy funds | 3,377,238,284            | 2,743,253,999         |
| Real asset funds               | 997,115,205              | 547,120,061           |
|                                | <u>\$ 63,337,468,603</u> | <u>59,353,569,588</u> |

New Jersey state statute provides for a State Investment Council (Council) and a Director. Investment authority is vested in the Director of the Division of Investment and a 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, international governments and agencies, bank loans, interest rate swap transactions, credit default swaps, fixed income exchange traded funds, U.S. Treasury futures contracts, 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 funds, real estate funds, other real assets, absolute return strategy funds, and the State of New Jersey CMF. The CMF is a short-term cash fund and is open to state and certain non-state participants.

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The pension funds' investment in the CMF is not evidenced by securities that exist in physical or book entry form held by the pension funds.

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

Custodial credit risk, as it relates to investments, is the risk that in the event of the failure of the custodian, the pension funds will not be able to recover the value of investments or collateral securities that are in the possession of the third party. The pension funds' investment securities are not exposed to custodial credit risk as they are held in segregated trust accounts in the name of the pension funds with the custodians.

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The credit risk of issuers and debt instruments 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 of fixed income obligations held directly by the pension funds and limit the amount that can be invested in any one issuer or issue.

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These credit ratings and limits are as follows:

| Category   | Minimum rating <sup>(1)</sup> |         |        | 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 debt and non-convertible preferred stock of one issuer (3)   |
| International corporate obligations                | Baa3                          | BBB-    | BBB-   | 10%                                     | 25%                            | Not more than 5% of fund assets can be invested in debt and non-convertible preferred stock of any one issuer (2)(3); not more than 10% of fund assets can be invested in this category |
| International government and agency obligations    | Baa3                          | BBB-    | BBB-   | 25%                                     | Greater of 25% or \$10 million | —   |
| 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 Common 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                                      | Aa3/P-1                       | AA-/A-1 | AA-/F1 | —                                       | —                              |   |
| Credit default swap transactions (4)               | A1                            | A+      | A+     | —                                       | —                              | Nominal value of net exposure to any one counterparty shall not exceed 10% of fund assets   |
| 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 <sup>(1)</sup> |      |       | Limitation<br>of issuer's<br>outstanding<br>debt | Limitation<br>of issue | Other limitations  |
|---|-------------------------------|------|-------|--|------------------------|--|
|   | Moody's                       | S&P  | Fitch |  |                        |  |
| Interest rate swap transactions (5)                     | A1                            | A+   | A+    | —  | —                      | Notional value of net exposure to any one counterparty shall not exceed 10% of fund assets                                     |
| Repurchase agreements                                   | Aa3                           | AA-  | AA-   | —  | —                      | —  |
| State & municipal obligations (6)                       | A3                            | A-   | A-    | 10%  | 10%                    | Not more than 2% 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 pass-through 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   |
| Non-convertible preferred stocks of US corporations (4) | Baa3                          | BBB- | BBB-  | 10%  | 25%                    | Not more than 5% of fund assets can be invested in debt and non-convertible stock of any one corporation                       |
| Bank loans (4)  | Baa3                          | BBB- | BBB-  | 10%  | —                      | Not more than 10% of fund assets can be invested in this category  |

(1) Short term ratings (e.g. P-1, A-1, F1) are used for commercial paper and certificates of deposit.

(2) Prior to December 15, 2008, this restriction only applied to maturities exceeding 12 months.

(3) Prior to December 15, 2008, this restriction applied to debt only.

(4) Effective December 15, 2008.

(5) Prior to December 15, 2008, the minimum rating requirements were A3 (Moody's) and A- (S&P and Fitch).

(6) Prior to October 19, 2009, this was restricted to NJ State & Municipal obligations.

Effective December 15, 2008, up to 5% of the market value of the combined assets of the pension and annuity funds may be invested in corporate obligations, international corporate obligations, collateralized notes and mortgages, bank loans, non-convertible preferred stock, and mortgage backed pass-through securities that do not meet the minimum credit rating requirements set forth above. Prior to that, the limitation excluded bank loans and non-convertible preferred stock.

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For securities in the fixed income portfolio, the following tables disclose aggregate fair value, by major credit quality rating category as of June 30, 2010 and 2009. The first table for 2010 is for bonds rated by Moody's. The second table for 2010 uses S&P and Fitch ratings for bonds not rated by Moody's.

|                                     |           | <b>June 30, 2010</b>  |                  |                  |                  |                |                |              |               |                   |
|-------------------------------------|-----------|-----------------------|------------------|------------------|------------------|----------------|----------------|--------------|---------------|-------------------|
|                                     |           | <b>Moody's rating</b> |                  |                  |                  |                |                |              |               |                   |
| (In thousands)                      |           | <b>Aaa</b>            | <b>Aa</b>        | <b>A</b>         | <b>Baa</b>       | <b>Ba</b>      | <b>B</b>       | <b>Ca</b>    | <b>Caa</b>    | <b>Totals</b>     |
| United States Treasury TIPS         | \$        | 3,624,618             | —                | —                | —                | —              | —              | —            | —             | 3,624,618         |
| United States Treasury bonds        |           | 1,907,850             | —                | —                | —                | —              | —              | —            | —             | 1,907,850         |
| United States government strips     |           | 867,809               | —                | —                | —                | —              | —              | —            | —             | 867,809           |
| Federal agency obligations          |           | 581,474               | —                | 163,390          | —                | —              | —              | —            | —             | 744,864           |
| Mortgages (FHLMC/FNMA/GNMA)         |           | 658,973               | —                | —                | —                | —              | —              | —            | —             | 658,973           |
| International corporate obligations |           | —                     | 85,637           | 624,046          | 549,017          | 82,223         | 30,124         | 1,540        | 4,974         | 1,377,561         |
| International bonds and notes       |           | 83,516                | 143,872          | —                | —                | —              | —              | —            | —             | 227,388           |
| Foreign government obligations      |           | 163,396               | 554,284          | —                | —                | —              | —              | —            | —             | 717,680           |
| Corporate obligations               |           | 518,011               | 929,740          | 3,998,857        | 3,357,019        | 299,152        | 222,323        | 3,184        | 43,490        | 9,371,776         |
| SBA passthrough certificates        |           | 168,876               | —                | —                | —                | 1,919          | 57             | —            | —             | 170,852           |
| Other                               |           | 202,860               | 798,839          | 514,513          | —                | —              | —              | —            | 47,250        | 1,563,462         |
|                                     | <b>\$</b> | <b>8,777,383</b>      | <b>2,512,372</b> | <b>5,300,806</b> | <b>3,906,036</b> | <b>383,294</b> | <b>252,504</b> | <b>4,724</b> | <b>95,714</b> | <b>21,232,833</b> |

|                                     |           | <b>June 30, 2010</b>                             |                |               |               |                |              |               |                |
|-------------------------------------|-----------|--|----------------|---------------|---------------|----------------|--------------|---------------|----------------|
|                                     |           | <b>Standard &amp; Poor's &amp; Fitch ratings</b> |                |               |               |                |              |               |                |
| (In thousands)                      |           | <b>Standard &amp; Poor's</b>                     |                |               |               |                | <b>Fitch</b> | <b>Totals</b> |                |
|                                     |           | <b>A</b>   | <b>AA</b>      | <b>B</b>      | <b>BB</b>     | <b>BBB</b>     | <b>CCC</b>   | <b>B</b>      |                |
| International corporate obligations | \$        | —  | —              | 2,788         | 920           | —              | 213          | —             | 3,921          |
| Foreign government obligations      |           | 26,970   | 109,006        | —             | —             | —              | —            | —             | 135,976        |
| Corporate obligations               |           | 28,098   | 83,426         | 27,782        | 22,410        | 135,629        | 4,034        | —             | 301,379        |
| SBA passthrough certificates        |           | —  | —              | 1,990         | 760           | —              | —            | —             | 2,750          |
| Asset backed obligations            |           | —  | 203,810        | —             | —             | —              | —            | —             | 203,810        |
| Other                               |           | 87,458   | 100,644        | —             | —             | —              | —            | 45,956        | 234,058        |
|                                     | <b>\$</b> | <b>142,526</b>                                   | <b>496,886</b> | <b>32,560</b> | <b>24,090</b> | <b>135,629</b> | <b>4,247</b> | <b>45,956</b> | <b>881,894</b> |

The above tables do not include certain domestic and international corporate obligations including certain exchange traded funds (ETFs) totaling \$321,336,486, which invest in an underlying portfolio of fixed income securities and do not have a Moody's, Standard & Poor's or Fitch rating. The Police and Firemen's Mortgages and the CMF are also unrated.

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The first table for 2009 is for bonds rated by Moody's. The second table for 2009 uses S&P ratings not rated by Moody's.

| June 30, 2009                       |                     |                  |                  |                  |                |                |            |            |               |                |                   |
|-------------------------------------|---------------------|------------------|------------------|------------------|----------------|----------------|------------|------------|---------------|----------------|-------------------|
| Moody's rating                      |                     |                  |                  |                  |                |                |            |            |               |                |                   |
| (In thousands)                      | Aaa                 | Aa               | A                | Baa              | Ba             | B              | Bb         | C          | Ca            | Caa            | Totals            |
| United States Treasury TIPS         | \$ 3,317,891        | —                | —                | —                | —              | —              | —          | —          | —             | —              | 3,317,891         |
| United States Treasury bonds        | 2,238,574           | —                | —                | —                | —              | —              | —          | —          | —             | —              | 2,238,574         |
| United States Treasury strips       | 664,234             | —                | —                | —                | —              | —              | —          | —          | —             | —              | 664,234           |
| United States Treasury notes        | 49,612              | —                | —                | —                | —              | —              | —          | —          | —             | —              | 49,612            |
| Title XI Merchant Marine notes      | 1,828               | —                | —                | —                | —              | —              | —          | —          | —             | —              | 1,828             |
| Government agency obligations       | 200,236             | —                | —                | —                | —              | —              | —          | —          | —             | —              | 200,236           |
| Government agency strips            | 522,265             | —                | —                | —                | —              | —              | —          | —          | —             | —              | 522,265           |
| Floating rate notes                 | —                   | —                | 11,294           | 26,825           | 2,525          | 6,285          | —          | —          | —             | 2,450          | 49,379            |
| Corporate obligations               | 367,489             | 1,411,812        | 4,146,458        | 3,565,825        | 230,477        | 148,640        | 214        | 124        | 20,796        | 67,577         | 9,959,412         |
| Convertible bonds                   | —                   | —                | —                | 27,289           | 50             | 527            | —          | —          | —             | 801            | 28,667            |
| Federal farm credit/FHL bank bonds  | 74,151              | —                | —                | —                | —              | —              | —          | —          | —             | —              | 74,151            |
| Federal home loan discounted bonds  | 41,360              | —                | —                | —                | —              | —              | —          | —          | —             | —              | 41,360            |
| International corporate obligations | —                   | 129,361          | 705,097          | 648,390          | 16,264         | 28,180         | —          | 569        | —             | 2,615          | 1,530,476         |
| International bonds and notes       | 70,745              | 85,047           | —                | —                | —              | —              | —          | —          | —             | —              | 155,792           |
| International floating rate notes   | —                   | —                | —                | —                | —              | 1,540          | —          | —          | —             | —              | 1,540             |
| Foreign government obligations      | 29,885              | 303,592          | 24,817           | —                | —              | —              | —          | —          | —             | —              | 358,294           |
| Municipal bonds                     | —                   | 11,131           | 23,954           | 1,574            | —              | —              | —          | —          | —             | —              | 36,659            |
| Remic/FHLMC/FNMA                    | 618,437             | —                | —                | —                | —              | —              | —          | —          | —             | —              | 618,437           |
| Mortgages/FHLMC/FNMA/GNMA           | 139,418             | —                | —                | —                | —              | —              | —          | —          | —             | —              | 139,418           |
| Asset backed obligations            | 32,499              | 29,604           | 98               | 105,046          | —              | —              | —          | —          | —             | —              | 167,247           |
| SBA passthrough certificates        | 170,589             | —                | —                | 251              | —              | 238            | —          | —          | —             | —              | 171,078           |
| Private export obligations          | 24,985              | —                | —                | —                | —              | —              | —          | —          | —             | —              | 24,985            |
| High yield structured notes         | —                   | —                | —                | —                | —              | —              | —          | —          | —             | 79,076         | 79,076            |
|                                     | <u>\$ 8,564,198</u> | <u>1,970,547</u> | <u>4,911,718</u> | <u>4,375,200</u> | <u>249,316</u> | <u>185,410</u> | <u>214</u> | <u>693</u> | <u>20,796</u> | <u>152,519</u> | <u>20,430,611</u> |

| June 30, 2009                       |                  |               |            |              |              |              |              |              |               |
|-------------------------------------|------------------|---------------|------------|--------------|--------------|--------------|--------------|--------------|---------------|
| Standard & Poor's rating            |                  |               |            |              |              |              |              |              |               |
| (In thousands)                      | A                | AA            | B          | BB           | BBB          | CC           | CCC          | D            | Totals        |
| Corporate obligations               | \$ 26,627        | —             | —          | —            | 1,194        | 1,009        | 1,803        | 1,101        | 31,734        |
| Convertible bonds                   | —                | —             | —          | 1,376        | —            | —            | —            | —            | 1,376         |
| International corporate obligations | —                | —             | 570        | 923          | —            | —            | —            | 45           | 1,538         |
| Asset backed obligations            | —                | 21,181        | —          | —            | —            | —            | —            | —            | 21,181        |
|                                     | <u>\$ 26,627</u> | <u>21,181</u> | <u>570</u> | <u>2,299</u> | <u>1,194</u> | <u>1,009</u> | <u>1,803</u> | <u>1,146</u> | <u>55,829</u> |

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The 2009 tables above do not include certain domestic and international corporate obligations including certain ETFs totaling \$239,029,550 which invest in an underlying portfolio of fixed income securities and do not have a Moody's, Standard & Poor's or Fitch rating. The Police and Firemen's Mortgages and the CMF 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. Repurchase agreements must mature within 30 days. The investment in guaranteed income contracts and funding agreements is limited to a term of 10 years or less.

The following tables summarize 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 as of June 30, 2010 and 2009:

| (In thousands)                      | June 30, 2010        |                     |                |                  |                   |
|-------------------------------------|----------------------|---------------------|----------------|------------------|-------------------|
|                                     | Total<br>fair value  | Maturities in years |                |                  | More<br>than 10   |
|                                     |                      | Less than 1         | 1-5            | 6-10             |                   |
| <b>Fixed income investment type</b> |                      |                     |                |                  |                   |
| United States Treasury TIPS         | \$ 3,624,618         | —                   | —              | —                | 3,624,618         |
| United States Treasury bonds        | 1,907,850            | —                   | —              | —                | 1,907,850         |
| United States government strips     | 867,809              | —                   | —              | —                | 867,809           |
| Federal agency obligations          | 744,864              | —                   | —              | 87,325           | 657,539           |
| Mortgages/FHLMC/FNMA/GNMA           | 658,974              | 306                 | 25,982         | 2,150            | 630,536           |
| International corporate obligations | 1,382,008            | 43                  | 13,574         | 250,082          | 1,118,309         |
| International bonds and notes       | 246,341              | —                   | 77,905         | 168,436          | —                 |
| Foreign government obligations      | 873,729              | —                   | 126,917        | 274,742          | 472,070           |
| Corporate obligations               | 9,699,541            | 56,346              | 361,338        | 2,659,819        | 6,622,038         |
| Police & firemen's mortgages        | 1,305,728            | —                   | 1,870          | 89,053           | 1,214,805         |
| SBA passthrough certificates        | 173,602              | 57                  | 502            | 172,785          | 258               |
| Asset backed obligations            | 275,678              | —                   | —              | 16,966           | 258,712           |
| Other                               | 1,797,520            | —                   | 93,206         | 27,070           | 1,677,244         |
|                                     | <u>\$ 23,558,262</u> | <u>56,752</u>       | <u>701,294</u> | <u>3,748,428</u> | <u>19,051,788</u> |

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| (In thousands)                      | June 30, 2009        |                     |                |                  |                   |
|-------------------------------------|----------------------|---------------------|----------------|------------------|-------------------|
|                                     | Total<br>fair value  | Maturities in years |                |                  | More<br>than 10   |
|                                     |                      | Less than 1         | 1-5            | 6-10             |                   |
| Fixed income investment type        |                      |                     |                |                  |                   |
| United States Treasury TIPS         | \$ 3,317,891         | —                   | —              | —                | 3,317,891         |
| United States Treasury bonds        | 2,238,574            | —                   | —              | —                | 2,238,574         |
| United States Treasury strips       | 664,234              | —                   | —              | —                | 664,234           |
| United States Treasury notes        | 49,612               | —                   | —              | 49,612           | —                 |
| Title XI merchant marine notes      | 1,828                | —                   | —              | —                | 1,828             |
| Government agency obligations       | 200,236              | —                   | —              | —                | 200,236           |
| Government agency strips            | 522,266              | —                   | —              | —                | 522,266           |
| Floating rate notes                 | 49,379               | 13,216              | 6,023          | 3,440            | 26,700            |
| Corporate obligations               | 9,991,476            | 54,324              | 572,727        | 3,051,119        | 6,313,306         |
| Convertible bonds                   | 40,146               | 50                  | 2,246          | 1,281            | 36,569            |
| Federal farm credit/FHL bank bonds  | 74,151               | —                   | —              | 74,151           | —                 |
| Federal home loan discounted bonds  | 41,360               | —                   | —              | —                | 41,360            |
| International corporate obligations | 1,532,266            | 390                 | 14,444         | 308,715          | 1,208,717         |
| International bonds and notes       | 155,791              | —                   | —              | 155,791          | —                 |
| International floating rate notes   | 11,540               | —                   | 10,000         | 1,540            | —                 |
| Foreign government obligations      | 368,205              | 15,174              | 24,623         | 75,192           | 253,216           |
| Municipal bonds                     | 36,659               | —                   | —              | —                | 36,659            |
| Remic/FHLMC/FNMA                    | 618,437              | —                   | 20,344         | —                | 598,093           |
| Police & firemen's obligations      | 1,367,881            | —                   | —              | —                | 1,367,881         |
| Mortgages/FHLMC/FNMA/GNMA           | 139,419              | —                   | 7,340          | 4,224            | 127,855           |
| Asset backed obligations            | 233,536              | —                   | —              | 15,284           | 218,252           |
| SBA passthrough certificates        | 171,078              | —                   | 238            | 170,840          | —                 |
| Private export obligations          | 24,985               | —                   | —              | 24,985           | —                 |
| High yield structured notes         | 79,076               | —                   | 79,076         | —                | —                 |
|                                     | <u>\$ 21,930,026</u> | <u>83,154</u>       | <u>737,061</u> | <u>3,936,174</u> | <u>17,173,637</u> |

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. The pension funds invest 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, cannot exceed 30% of the market value of the pension funds. 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. Not more than 10% of the market value of the emerging market securities can be invested in the common and preferred stock of any one corporation; the total amount of stock purchased of any one corporation cannot exceed 5% of its stock classes eligible to vote. Council regulations permit the pension funds to enter into foreign exchange contracts for the purpose of hedging the international portfolio. The pension funds held forward contract receivables totaling approximately \$1.95 billion and payables totaling approximately \$1.96 billion (with a \$13.0 million net exposure) as of June 30, 2010. The pension funds held forward contract receivables totaling approximately \$4.9 billion and payables totaling approximately \$4.7 billion (with a \$126 million net exposure) as of June 30, 2009.

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The pension funds had the following foreign currency exposure as of June 30, 2010 and 2009 (expressed in U.S. dollars):

| (In thousands) | Currency           | June 30, 2010        |                   |                            |
|----------------|--------------------|----------------------|-------------------|----------------------------|
|                |                    | Total<br>fair value  | Equities          | Alternative<br>investments |
|                | Australian dollar  | \$ 686,886           | 686,886           | —                          |
|                | Brazilian real     | 166,664              | 166,664           | —                          |
|                | Canadian dollar    | 886,527              | 886,527           | —                          |
|                | Chilean peso       | 791                  | 791               | —                          |
|                | Czech koruna       | 2,983                | 2,983             | —                          |
|                | Danish krone       | 186,552              | 186,552           | —                          |
|                | Egyptian pound     | 30,844               | 30,844            | —                          |
|                | Euro               | 2,836,469            | 2,622,791         | 213,678                    |
|                | Hong Kong dollar   | 509,638              | 509,638           | —                          |
|                | Hungarian forint   | 11,599               | 11,599            | —                          |
|                | Indonesian rupiah  | 54,809               | 54,809            | —                          |
|                | Israeli shekel     | 3,561                | 3,561             | —                          |
|                | Japanese yen       | 3,002,843            | 3,002,843         | —                          |
|                | Malaysian ringgit  | 22,689               | 22,689            | —                          |
|                | Mexican peso       | 32,029               | 32,029            | —                          |
|                | Norwegian krone    | 84,594               | 84,594            | —                          |
|                | Pakistan rupee     | 5,392                | 5,392             | —                          |
|                | Philippines peso   | 6,377                | 6,377             | —                          |
|                | Polish zloty       | 16,167               | 16,167            | —                          |
|                | Russian ruble      | 54                   | 54                | —                          |
|                | Singapore dollar   | 219,767              | 219,767           | —                          |
|                | South African rand | 123,392              | 123,392           | —                          |
|                | South Korean won   | 181,570              | 181,570           | —                          |
|                | Swedish krona      | 289,725              | 289,725           | —                          |
|                | Swiss franc        | 776,100              | 776,100           | —                          |
|                | New Taiwan dollar  | 11,304               | 11,304            | —                          |
|                | Thai baht          | 32,703               | 32,703            | —                          |
|                | Turkish lira       | 52,262               | 52,262            | —                          |
|                | U.K. Sterling      | 1,208,550            | 1,196,105         | 12,445                     |
|                |                    | <u>\$ 11,442,841</u> | <u>11,216,718</u> | <u>226,123</u>             |

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| <b>June 30, 2009</b>   |                             |                   |  |                                    |
|------------------------|-----------------------------|-------------------|--|------------------------------------|
| (In thousands)         |                             |                   | <b>Foreign<br/>government/<br/>corporate<br/>obligations</b> | <b>Alternative<br/>investments</b> |
| <u>Currency</u>        | <u>Total<br/>fair value</u> | <u>Equities</u>   |  |                                    |
| Australian dollar      | \$ 656,680                  | 656,680           | —  | —                                  |
| Brazilian real         | 91,406                      | 91,406            | —  | —                                  |
| British pound sterling | 1,557,089                   | 1,542,240         | —  | 14,849                             |
| Canadian dollar        | 186,979                     | 186,979           | —  | —                                  |
| Chilean peso           | 3,407                       | 3,407             | —  | —                                  |
| Czech koruna           | 7,828                       | 7,828             | —  | —                                  |
| Danish krone           | 186,258                     | 186,258           | —  | —                                  |
| Euro                   | 3,706,589                   | 3,484,999         | 29,885   | 191,705                            |
| Egyptian pound         | 19,003                      | 19,003            | —  | —                                  |
| Hong Kong dollar       | 457,362                     | 457,362           | —  | —                                  |
| Hungarian forint       | 7,456                       | 7,456             | —  | —                                  |
| Indonesian rupiah      | 31,511                      | 31,511            | —  | —                                  |
| Israeli shekel         | 14,258                      | 14,258            | —  | —                                  |
| Japanese yen           | 1,944,838                   | 1,944,838         | —  | —                                  |
| Malaysian ringgit      | 12,409                      | 12,409            | —  | —                                  |
| Mexican peso           | 9,001                       | 9,001             | —  | —                                  |
| Norwegian krone        | 176,722                     | 176,722           | —  | —                                  |
| Pakistan rupee         | 2,378                       | 2,378             | —  | —                                  |
| Philippines peso       | 711                         | 711               | —  | —                                  |
| Polish zloty           | 7,104                       | 7,104             | —  | —                                  |
| Singapore dollar       | 172,635                     | 172,635           | —  | —                                  |
| South African rand     | 89,543                      | 89,543            | —  | —                                  |
| South Korean won       | 105,001                     | 105,001           | —  | —                                  |
| Swedish krona          | 165,297                     | 164,422           | 875  | —                                  |
| Swiss franc            | 879,433                     | 879,433           | —  | —                                  |
| New Taiwan dollar      | 10,823                      | 10,823            | —  | —                                  |
| Thai baht              | 25,597                      | 25,597            | —  | —                                  |
| Turkish lira           | 39,062                      | 39,062            | —  | —                                  |
|                        | <u>\$ 10,566,380</u>        | <u>10,329,066</u> | <u>30,760</u>  | <u>206,554</u>                     |

The pension funds' 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, speculative investments (both derivatives and nonmarketable investments), and nondisclosure of portfolio composition. Effective August 18, 2008, Council regulations provide that not more than 28% of the market value of the pension funds 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%. Prior to that, the overall limitation was 18%. 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 25.7% and 23.0% of the total market value of the collateral as of June 30, 2010 and 2009, 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 of Investment; from time to time the Division of Investment may impose more stringent policies based on market conditions.

Effective December 15, 2008, 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                              | A2             | A       | A      | 10%                                     | 25%                 | —  |
| Collateralized notes and mortgages                 | Aa             | AA      | AA     | —                                       | 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/<br>Banker's acceptances:  |                |         |        |   |                     | Certificates of deposit and banker's acceptances' cannot exceed 10% of issuer's primary capital; dollar limits by issuer |
| Domestic   | A2/P-1         | A/A-1   | A/F1   | —                                       | —                   |  |
| International                                      | Aa3/P-1        | AA-/A-1 | AA-/F1 | —                                       | —                   |  |
| Guaranteed income contracts and funding agreements | A2             | 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                         |

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Through December 14, 2008, the following limits were 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%                 | —  |
| 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/<br>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                         |

Prior to December 15, 2008, all investments in the collateral portfolio matured or were redeemed within one year, except that up to 25% of the portfolio could be invested in eligible securities which matured within 25 months; provided, however, that the average maturity of all investments did not exceed one year. Effective December 15, 2008, all investments in the collateral portfolio must mature or be redeemed within one year. Effective October 9, 2009 all investments in the collateral portfolio were limited to a final maturity term of 30 days from date of purchase.

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.

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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.

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. Prior to December 15, 2008, the Division of Investment set individual issuer limits for Commercial paper and Certificate of deposits; subsequently, the Division of Investment set issuer limits for all investments in the collateral portfolio.

For securities exposed to credit risk in the collateral portfolio, the following tables disclose aggregate fair value, by major credit quality rating category as of June 30, 2010 and 2009.

| (In thousands)        | <b>June 30, 2010</b> |                  |               |
|-----------------------|----------------------|------------------|---------------|
|                       | <b>Rating</b>        |                  |               |
|                       | <b>Aaa/AAA</b>       | <b>Not rated</b> | <b>Totals</b> |
| Repurchase agreements | \$ —                 | 16,669           | 16,669        |
| Money market funds    | 5                    | 5                | 10            |
| Cash                  | —                    | 5                | 5             |
| Totals                | <u>\$ 5</u>          | <u>16,679</u>    | <u>16,684</u> |

As of June 30, 2010, the System had outstanding loaned investment securities with an aggregate fair value of \$9,229,063. The program was terminated effective June 30, 2010 and all loaned securities and collateral were subsequently returned. In accordance with GASB accounting standards, the noncash collateral is not reflected in the accompanying financial statements. There were no borrower or lending agent default losses, and no recoveries or prior-period losses during the year.

| (In thousands)                  | <b>June 30, 2009</b> |               |                |               |                |                |                |                  |
|---------------------------------|----------------------|---------------|----------------|---------------|----------------|----------------|----------------|------------------|
|                                 | <b>Rating</b>        |               |                |               |                |                |                |                  |
|                                 | <b>Aaa/AAA</b>       | <b>Aa/AAA</b> | <b>Aa/AA</b>   | <b>a/AA</b>   | <b>Aa/A</b>    | <b>A/A</b>     | <b>A/AA</b>    | <b>Not rated</b> |
| Corporate obligations           | \$ —                 | 99,755        | 642,443        | 15,001        | 109,694        | 759,910        | 169,039        | 29,603           |
| Commercial paper                | —                    | —             | —              | —             | —              | —              | —              | 199,970          |
| Certificates of deposit         | —                    | —             | 100,000        | —             | 100,039        | —              | —              | 50,000           |
| Guaranteed investment contracts | —                    | —             | 100,000        | —             | —              | —              | 150,000        | —                |
| Repurchase agreements           | —                    | —             | —              | —             | —              | —              | —              | 1,726,824        |
| Money market funds              | 151,555              | —             | —              | —             | —              | —              | —              | 315,697          |
| United States agencies          | 70,020               | —             | —              | —             | —              | —              | —              | —                |
| Cash                            | —                    | —             | —              | —             | —              | —              | —              | 11               |
| Totals                          | <u>\$ 221,575</u>    | <u>99,755</u> | <u>842,443</u> | <u>15,001</u> | <u>209,733</u> | <u>759,910</u> | <u>319,039</u> | <u>2,322,105</u> |

As of June 30, 2009, all investments in the collateral portfolio will mature in less than one year.

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As of June 30, 2009, the pension funds had outstanding loaned investment securities with an aggregate fair value of \$4,666,568,972 and received cash collateral with an aggregate fair value of \$4,803,489,627 and noncash collateral of \$13,474,666. In accordance with GASB accounting standards, the noncash collateral is not reflected in the accompanying financial statements. There were no borrower or lending agent default losses, and no recoveries or prior-period losses during the year.

**(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 non-contributory death benefits. Members contribute at a uniform rate of 8.5% of base salary.

Chapter 19, P.L. 2009, effective March 17, 2009, provided an option for local employers to contribute 50% of the normal and accrued liability contribution amounts certified by PFRS for payments due in State fiscal year 2009. This law also provided that a local employer may pay 100% of the required contribution. Such an employer will be credited with the full payment and any such amounts will not be included in their unfunded liability. The actuaries for PFRS will determine the unfunded liability of those retirement systems, by employer, for the reduced normal and accrued liability contributions provided under this law. This unfunded liability will be paid by the employer in level annual payments over a period of 15 years beginning with the payments due in the State fiscal year ending June 30, 2012 and will be adjusted by the rate of return on the actuarial value of assets.

The State did not make a pension contribution for fiscal year 2010 but did make a contribution of \$7.3 million for NCGI death benefits. Also included in the employer contributions are the annual billing to local employers for their pension and NCGI contributions and Early Retirement Incentive (ERI) contributions for those who participate in the various ERI programs and other miscellaneous items that were due the System from the State and the local employers. Chapter 1, P.L. 2010, effective May 21, 2010, requires the State to make its full pension contribution, defined as 1/7th of the required amount, beginning in fiscal year 2012.

The State made a contribution of \$13.0 million for fiscal year 2009, which was received in September 2009 after the close of the fiscal year, excluding the State's contribution of NCGI of \$7.0 million and others of \$0.4 million. The amount contributed for fiscal year 2009 was equal to 4.8% of the actuarially determined statutory amount.

**(6) Funds**

PFRS maintains the following legally required funds as follows:

***Members' Annuity Savings Fund (2010 – \$3,075,484,919; 2009 – \$2,975,572,733)***

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.

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

Notes to Financial Statements

June 30, 2010 and 2009

***Retirement Reserve Fund (2010 – \$18,599,167,672; 2009 – \$16,897,010,406)***

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% for fiscal years 2010 and 2009) is credited to the Retirement Reserve Fund.

***Special Reserve Fund (2010 – \$0; 2009 – \$0)***

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 (2010 – \$-1,870,288,894; 2009 – \$-1,808,447,040)***

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

***Non-Contributory Group Insurance Premium Fund – Local (2010 – \$39,774,119; 2009 – \$24,793,516)***

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 May 2007 declaration of an outside tax council retained by the Attorney General of the State of New Jersey, the System complies with the qualification requirements of Section 401(a) of the Internal Revenue Code.

**(8) Contingencies**

The System is a party to various legal actions arising in the ordinary course of its operations. While it is not feasible to predict the ultimate outcome of these actions, it is the opinion of management that the resolution of these matters will not have a material adverse effect on the System's financial statements.

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

Required Supplementary Information

Schedule of Funding Progress

(Unaudited - See accompanying independent auditors' report)

| <u>Actuarial valuation date</u> | <u>Actuarial value of assets (a)</u> | <u>Actuarial accrued liability (b)</u> | <u>Unfunded (overfunded) actuarial liability (b - a)</u> | <u>Funded ratio (a / b)</u> | <u>Covered payroll (c)</u> | <u>Unfunded (overfunded) actuarial liability as a percentage of covered payroll ((b - a) / c)</u> |
|---------------------------------|--------------------------------------|--|--|-----------------------------|----------------------------|---|
| State:                          |                                      |  |  |                             |                            |   |
| 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   |
| June 30, 2007                   | 2,215,697,407                        | 3,426,631,813                          | 1,210,934,406  | 64.7                        | 527,556,519                | 229.5   |
| June 30, 2008                   | 2,316,017,361                        | 3,749,118,910                          | 1,433,101,549  | 61.8                        | 527,495,741                | 271.7   |
| June 30, 2009                   | 2,254,766,935                        | 3,993,259,480                          | 1,738,492,545  | 56.5                        | 525,862,047                | 330.6   |
| Local:                          |                                      |  |  |                             |                            |   |
| 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   |
| June 30, 2007                   | 19,500,229,156                       | 24,562,195,443                         | 5,061,966,287  | 79.4                        | 2,932,283,180              | 172.6   |
| June 30, 2008                   | 20,437,541,909                       | 26,871,106,532                         | 6,433,564,623  | 76.1                        | 3,068,758,436              | 209.6   |
| June 30, 2009                   | 20,724,453,343                       | 28,448,841,765                         | 7,724,388,422  | 72.8                        | 3,147,812,476              | 245.4   |

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

Required Supplementary Information

Schedule of Funding Progress – Additional Actuarial Information

(Unaudited - See accompanying independent auditors' report)

Significant actuarial methods and assumptions used in the most recent 2009 and 2008 actuarial valuations include the following:

|                                      | <u>June 30, 2009</u>           | <u>June 30, 2008</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, open            |
| Payroll growth rate for amortization | 4.00%                          | 4.00%                          |
| 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 valuations were prepared on the basis of the demographic assumptions that were determined from the July 1, 2004 to June 30, 2007 Experience Study.

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 - See accompanying independent auditors' report)

| <b>Year ended<br/>June 30,</b> | <b>Annual<br/>required<br/>contribution</b> | <b>Employer<br/>contributions<sup>(1)(3)</sup></b> | <b>Percentage<br/>contributed</b> |
|--------------------------------|---|--|-----------------------------------|
| State:                         |   |  |                                   |
| 2005                           | \$ 161,455,508                              | \$ 49,326,846                                      | 30.6%                             |
| 2006                           | 200,902,193                                 | 73,541,000   | 36.6                              |
| 2007                           | 216,570,332                                 | 127,404,777  | 58.8                              |
| 2008                           | 252,836,330                                 | 133,510,475 <sup>(4)</sup>                         | 52.8                              |
| 2009                           | 275,205,347                                 | 20,014,342 <sup>(4)</sup>                          | 7.3                               |
| 2010                           | 343,091,276                                 | 20,147,000   | 5.9                               |
| Local:                         |   |  |                                   |
| 2005                           | \$ 355,229,715                              | \$ 132,740,650 <sup>(2)</sup>                      | 37.4%                             |
| 2006                           | 475,872,193                                 | 260,986,583 <sup>(2)</sup>                         | 54.8                              |
| 2007                           | 584,645,679                                 | 422,743,218 <sup>(2)</sup>                         | 72.3                              |
| 2008                           | 708,019,933                                 | 647,288,920 <sup>(4)</sup>                         | 91.4                              |
| 2009                           | 773,029,316                                 | 696,476,702  | 90.1                              |
| 2010                           | 818,672,171                                 | 751,395,802  | 91.8                              |

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 108, P.L. 2003, the local statutory required contributions for fiscal years 2004 through 2007 have been reduced.
- (3) Differences between the amounts in the employer contribution column in this schedule and the amounts recorded in the financial statements and footnotes are attributed to timing differences between the 2009 actuarial valuations and the actual amounts received in fiscal year 2010. Employer contributions per this schedule represent anticipated contribution amounts determined at the time the actuarial valuations were prepared and finalized prior to the end of fiscal year 2010. The financial statements and footnotes reflect the actual amounts received in 2010.
- (4) 2008 and 2009 annual required contributions and employer contributions have been reduced in accordance with the provisions of the Appropriation Act for fiscal year 2008 and 2009, respectively for State contributions and Chapter 108, P.L. 2003 for local contributions.

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

Schedule of Changes in Fiduciary Net Assets by Fund  
Year ended June 30, 2010

|   | <u>Members'<br/>Annuity savings<br/>Fund</u> | <u>Pension<br/>Accumulation<br/>Fund</u> | <u>Retirement<br/>Reserve<br/>Fund</u> | <u>Special<br/>Reserve<br/>Fund</u> | <u>Non-Contributory<br/>Group Insurance<br/>Premium Fund</u> | <u>Total</u>   |
|---|--|--|--|-------------------------------------|--|----------------|
| Additions:  |  |  |  |                                     |  |                |
| Contributions:  |  |  |  |                                     |  |                |
| Members   | \$ 330,951,798                               | —  | —                                      | —                                   | —  | 330,951,798    |
| Employers   | —  | 956,038,559                              | —                                      | —                                   | 45,184,664   | 1,001,223,223  |
| Total contributions                                     | 330,951,798                                  | 956,038,559                              | —                                      | —                                   | 45,184,664   | 1,332,175,021  |
| Distribution of net investment income                   | —  | 569,904,589                              | 1,436,289,227                          | —                                   | 2,045,465  | 2,008,239,281  |
| Total additions   | 330,951,798                                  | 1,525,943,148                            | 1,436,289,227                          | —                                   | 47,230,129   | 3,340,414,302  |
| Deductions:   |  |  |  |                                     |  |                |
| Benefits  | —  | —  | 1,541,261,329                          | —                                   | 32,249,526   | 1,573,510,855  |
| Refunds of contributions                                | 5,422,025                                    | 193,135                                  | —                                      | —                                   | —  | 5,615,160      |
| Administrative and miscellaneous expenses               | —  | 6,080,086                                | —                                      | —                                   | —  | 6,080,086      |
| Total deductions  | 5,422,025                                    | 6,273,221                                | 1,541,261,329                          | —                                   | 32,249,526   | 1,585,206,101  |
| Net increase (decrease) before transfers among reserves | 325,529,773                                  | 1,519,669,927                            | (104,972,102)                          | —                                   | 14,980,603   | 1,755,208,201  |
| Transfers among reserves:                               |  |  |  |                                     |  |                |
| Retirements   | (226,079,011)                                | (1,070,931,165)                          | 1,297,010,176                          | —                                   | —  | —              |
| Other   | 461,424                                      | (510,580,616)                            | 510,119,192                            | —                                   | —  | —              |
| Net increase (decrease)                                 | 99,912,186                                   | (61,841,854)                             | 1,702,157,266                          | —                                   | 14,980,603   | 1,755,208,201  |
| Net assets held in trust for pension benefits:          |  |  |  |                                     |  |                |
| Beginning of year                                       | 2,975,572,733                                | (1,808,447,040)                          | 16,897,010,406                         | —                                   | 24,793,516   | 18,088,929,615 |
| End of year   | \$ 3,075,484,919                             | (1,870,288,894)                          | 18,599,167,672                         | —                                   | 39,774,119   | 19,844,137,816 |