

**DEPARTMENT OF
THE TREASURY**

Andrew P. Sidamon-Eristoff
State Treasurer

**DIVISION OF PENSIONS
AND BENEFITS**

Florence J. Sheppard
Acting Director



State of New Jersey
DIVISION OF PENSIONS AND BENEFITS
PO Box 295 • Trenton, NJ 08625-0295

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

**BOARD OF TRUSTEES
as of June 30, 2011**

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TO THE HONORABLE
CHRIS CHRISTIE
GOVERNOR of the STATE OF NEW JERSEY

Dear Governor Christie:

The Board of Trustees of the

POLICE AND FIREMEN'S RETIREMENT SYSTEM

is pleased to present the Fiscal Year 2011 Annual Report in accordance with the provisions of N.J.S.A. 43:16A-13.

Respectfully submitted,

A handwritten signature in dark ink, appearing to read "J. Sierchio".
JOHN SIERCHIO
Chairperson

POLICE AND FIREMEN'S RETIREMENT SYSTEM

BOARD OF TRUSTEES



JOHN SIERCHIO
Chairperson



SUSANNE CULLITON
*State Treasurer's
Representative*



MARTY BARRETT



LAUREL BRENNAN



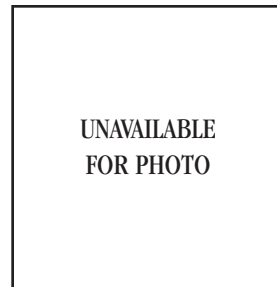
VINCENT FOTI



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KELLIE KIEFER-PUSHKO
Deputy Attorney General



WENDY JAMISON
Board Secretary



LISA POINTER
Administrative Assistant

SIGNIFICANT LEGISLATION

Chapter 52, P.L. 2011

Effective Date: This act takes effect on the 60th day following enactment (June 19, 2011), but the boards of trustees of the Public Employees' Retirement System, the Teachers' Pension and Annuity Fund, the Police and Firemen's Retirement System, and the State Police Retirement System, and the State House Commission, and the Division of Pensions and Benefits may take such anticipatory administrative action as may be necessary to implement the provisions of this act.

Description: This law provides that the boards of trustees of the Teachers' Pension and Annuity Fund, the Public Employees' Retirement System, the Police and Firemen's Retirement System, and the State Police Retirement System, and the State House Commission in the case of the Judicial Retirement System, will require a certifying officer to complete training on eligibility for enrollment in the pension fund or retirement system in accordance with the provisions of the rules or regulations and laws governing those funds or systems. "Certifying officer" is defined in the law to mean an officer or employee of the State or an employer other than State who is responsible for submitting to a pension fund or retirement system information, and for performing the duties relating to matters concerning the pension fund or retirement system with respect to each of the employees of the employer, as required of the employer by law, the board of trustees or commission, and the Division of Pensions and Benefits.

The law requires the division to develop, and the respective board or commission to approve, the form and content of the training. Each board or commission may require the training to include such additional pension fund or retirement system matters as it deems necessary to ensure compliance. The training will be provided through the Internet and accessible from the official Internet site of the State. A certifying officer required to complete the training will submit to the division an acknowledgement of such completion.

In addition, the law requires that each board of trustees or commission require a certifying officer and the officer's immediate supervisor to certify in writing or electronically, at the time of an enrollment of a member and annually for each member of the retirement system, that the person enrolled is eligible for enrollment in the pension fund or retirement system in accordance with the relevant rules or regulations and law. The certification will require the certifying officer and the officer's immediate supervisor to acknowledge that any person who knowingly makes a false statement, or falsifies or permits to be falsified any record, application, form, or report of a pension fund or retirement system, in an attempt to defraud the fund or system as a result of such act will be guilty of a crime of the fourth degree.

This law is based on the recommendations of the Office of the Inspector General as set forth in the report "Professional Services Provider Enrollment in the PERS," issued December 15, 2009.

Chapter 78, P.L. 2011

Effective Date: June 28, 2011. Sections 39 through 44 regarding employee health benefit contributions will expire four years after this law's effective date.

Description: This law makes various changes to pension and health care benefits for public employees.

I. Pension Plan Changes

This law makes various changes to the manner in which the Teachers' Pension and Annuity Fund (TPAF), the Judicial Retirement System (JRS), the Public Employees' Retirement System (PERS), the Police and Firemen's Retirement System (PFRS), and the State Police Retirement System (SPRS) operate and to the benefit provisions of those systems.

Sections 1 to 7: New Pension Committees Formed

Establishes new pension committees as follows:

- One 8-member committee for the TPAF and one for the SPRS;
- Two 8-member committees in the PERS, one for the State part of the PERS and one for the local part of the PERS; and
- Two 10-member committees in the PFRS, one for the State part of the PFRS and one for the local part of the PFRS.

Half of the members of each committee will be appointed by the Governor to represent public employers and half appointed by certain unions whose members are in the retirement system. When a target funded ratio for the system or part of the system is achieved, each committee will have the discretionary authority to modify the: member contribution rate; formula for calculation of final compensation or final salary; fraction used to calculate a retirement allowance; age at which a member may be eligible and the benefits

SIGNIFICANT LEGISLATION, *continued*

for service or early retirement; and benefits provided for disability retirement. A committee will not have authority to change the number of years required for vesting.

The committees of these systems will have the authority to reactivate the cost of living adjustment on pensions and modify the basis for the calculation of the cost of living adjustment and set the duration and extent of the activation. A committee must give priority consideration to the reactivation of the cost of living adjustment. No decision of the committee shall be implemented if the direct or indirect result of the decision will be that the system's funded ratio falls below the target funded ratio in any valuation period during the 30 years following the implementation of the decision.

The State House Commission will have the same authority with regard to JRS.

Each committee may also hire actuaries and consultants.

Sections 8 to 16: New Employee Pension Contribution Rates

This law provides for increases in the employee contribution rates: from 5.5% to 6.5% plus an additional 1% phased-in over 7 years beginning in the first year, meaning after 12 months, after the law's effective date for TPAF and PERS (including legislators, Law Enforcement Officer (LEO) members, and workers compensation judges); from 3% to 12% for JRS phased-in over seven years; from 8.5% to 10% for PFRS members and members of PERS Prosecutors Part; and from 7.5% to 9% for SPRS members.

Section 17 to 19 and Sections 37 and 38: Pension Plan Design Changes

New members of TPAF and PERS will need 30 years of creditable service and age 65 for receipt of the early retirement benefit without a reduction of 1/4 of 1% for each month that the member is under age 65. New members will be eligible for a service retirement benefit at age 65. A new PFRS member's special retirement benefit will be 60% of final compensation, plus 1% of final compensation multiplied by the number of years of creditable service over 25 but not over 30, instead of the current benefit of 65% of final compensation plus 1% for each year of service over 25 but not over 30.

Sections 15 and 20 to 23: Funding Changes

Changes the methodology for calculating the unfunded accrued liability payment portion of the employer's annual pension contribution to the PERS, TPAF, PFRS, SPRS and JRS. The unfunded actuarial accrued liability (UAAL) will be amortized for each plan over an open-ended 30 year period and paid in level dollars. Beginning with the July 1, 2019 actuarial valuation (July 1, 2018 for PFRS), the UAAL will be amortized over a closed 30 year period until the remaining period reaches 20, when the amortization period will revert to an open-ended 20 year period.

Section 24: Retirement Systems Actuary Selection Committee

Amends the statute pertaining to the Retirement Systems Actuary Selection Committee.

Section 25: COLA Suspension

Suspends the payment of automatic cost-of-living adjustment to current and future retirees and beneficiaries until reactivated as permitted by this law.

Section 26: Contractual Rights to Employer Pension Contributions

Provides that each member of the TPAF, JRS, Prison Officers' Pension Fund, PERS, Consolidated Police and Firemen's Pension Fund, PFRS, and SPRS will have a contractual right to the annual required contribution made by the employer or by any other public entity. The contractual right to the annual required contribution means that the employer or other public entity must make the annual required contribution on a timely basis to help ensure that the retirement system is securely funded and that the retirement benefits to which the members are entitled by statute and in consideration for their public service and in compensation for their work will be paid upon retirement. The failure of the State or any other public employer to make the annually required contribution will be deemed to be an impairment of the contractual right of each employee. The Superior Court, Law Division will have jurisdiction over any action brought by a member of any system or fund or any board of trustees to enforce the contractual right set forth in this law. The State and other public employers will submit to the jurisdiction of the Superior Court, Law Division and will not assert sovereign immunity in such an action. If a member or board prevails in litigation to enforce the contractual right set forth in this law, the court may award that party their reasonable attorney's fees.

This section also provides that the rights reserved to the State in current law to alter, modify, or amend such retirement systems and funds, or to create in any member a right in the corpus or management of a retirement system or pension fund, cannot diminish the contractual right of employees established by this law.

SIGNIFICANT LEGISLATION, *continued*

Section 27: Target Funded Ratio Defined

Defines the term “target funded ratio” to mean a ratio of the actuarial value of assets against the actuarially determined accrued liabilities expressed as a percentage that will be 75 percent in State fiscal year 2012, and increased annually by equal increments in each of the subsequent seven fiscal years, until the ratio reaches 80 percent at which it is to remain for all subsequent fiscal years.

Section 28 to 32: Investment Council

Increases the membership of the State Investment Council from 13 to 16 members. It eliminates one representative from the SPRS, but adds one member from the State Troopers Fraternal Association. Two additional members are appointed by the Governor with the advice and consent of the Senate, and one additional appointment is added to the current one by the Governor from persons nominated by Public Employee Committee of the New Jersey State AFL-CIO, specifying that one of the two will be a representative of a police officers’ or firefighters’ union. The law also provides that an elected member, as opposed to any member, of the boards of trustees for TPAF, PERS and PFRS will be eligible for designation to serve on the State Investment Council.

Section 33: Super Conciliator

Establishes a process using a super conciliator to resolve an impasse on a decision or matter regarding benefits before any of the newly established committees in the TPAF, PERS, PFRS, and SPRS.

Sections 34, 35 and 82: Retiring While Serving in Elected Office

The law repeals N.J.S.A. 43:15A-47.2 and 43:16A-5.1 which provide that a member of PERS or PFRS may retire while holding an elective public office covered by PERS or PFRS and continue to receive the full salary for that office, if the member’s PERS or PFRS retirement allowance is not based solely on service in the elected public office. PFRS or PERS retirees who were granted a retirement allowance under those sections prior to the law’s effective date and are currently in an elective office covered by either of those systems may continue to receive their pension benefit and salary for the elective office.

Sections 56 to 75: Pension Plan Compliance Provisions

Codifies in law various provisions necessary to maintain the qualified plan status of the retirement systems under the federal Internal Revenue Code; for compliance with Statements Nos. 43 and 45 of the Governmental Accounting Standards Board, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions (GASB 43/45); and to bring the defined contribution plans into compliance with U.S. Department of Treasury regulations affecting administration of plans administered under section 403(b) of the Internal Revenue Code. Modifications pertaining to the Supplemental Annuity Collective Trust are also being made by the law.

II. Health Care Benefit Changes

Sections 39 to 44: Required Active and Retired Employee Contributions towards Health Benefit Coverage This law requires all public employees and certain public retirees to contribute toward the cost of health care benefits coverage based upon a percentage of the cost of coverage.

All active public employees will pay a percentage of the cost of health care benefits coverage for themselves and any dependents. Lower compensated employees will pay a smaller percentage and more highly compensated employees will pay a higher percentage. In addition, the applicable percentage will vary based upon whether the employee has family, individual, or member with child or spouse coverage. The rates gradually increase based on an employee’s compensation, at intervals of \$5,000. These rates will be phased in over several years for employees employed on the contribution’s effective date who will pay $\frac{1}{4}$, $\frac{1}{2}$, and $\frac{3}{4}$ of the amount of the contribution rate during the first, second and third years, respectively, meaning during the three 12-month periods after the contribution rates become effective. The law establishes a “floor” for employee contributions so that no employee will pay an amount that is less than 1.5% of the employee’s compensation. Employees who pay for health care benefits coverage based upon a percentage of the cost of coverage will not also be required to pay the minimum contribution of 1.5% of compensation, as provided by other laws. The contribution will commence on the law’s effective date for certain public employees and upon the expiration of a collective negotiation agreement for others.

Similar provisions in this law apply to retirees of the State, employers other than the State, and units of local government who accrue 25 years of service after the law’s effective date, or on or after the expiration of an applicable collective bargaining agreement in effect on that date, and retire after that, who will be required to contribute a percentage of the cost of health care benefits coverage in retirement, but as based on their retirement benefit. These provisions will not apply to public employees who, on the effective date of the

SIGNIFICANT LEGISLATION, *continued*

law, have 20 or more year of service in one or more State or locally-administered retirement systems. A 1.5% “floor”, for those retirees to whom the 1.5% contribution in current law applies, will also be applicable to these retirees.

The law allows boards of education and units of local government, that do not participate in the SHBP or SEHBP, to enter into contracts for health care benefits coverage, as may be required to implement a collective negotiations agreement, and agree to different employee contribution rates if certain cost savings in the aggregate over the period of the agreement can be demonstrated. The savings must be certified to the Department of Education or the Department of Community Affairs, as appropriate. The departments are to approve or reject the certification, within 30 days of receipt. The certification is deemed approved if not rejected within that time. The agreement cannot be executed until that approval is received or the 30 day period has lapsed, whichever occurs first.

The provisions concerning contributions for health care benefits will expire four years after the effective date.

A public employee whose amount of contribution in retirement was determined in accordance with the expired sections of law will be required to contribute the amount so determined in retirement, notwithstanding that the law has expired, with the retirement allowance, and any future cost of living adjustment thereto, used to identify the percentage of the cost of coverage.

Sections 36 and 45 to 55: New SHBP and SEHBP Committees

Creates two new committees, one for the State Health Benefits Program and one for the School Employees’ Health Benefits Program and confers on the committees the responsibility for plan design. Half of the committee members will be appointed by the Governor to represent public employers and half by certain unions who represent public employees in the State. The law establishes a process using a super conciliator to resolve an impasse on a matter before a committee.

Requires the committees for both programs to set the amounts for maximums, co-pays, deductibles, and other such participant costs; provide employees with the option to select one level of at least three levels of coverage each for family, individual, individual and spouse, and individual and dependent, or equivalent categories, for each plan offered by the program differentiated by out of pocket costs to employees including with regard to co-payments and deductibles; and provide for a high deductible health plan that conforms to the Internal Revenue Code Section 223.

Requires the Division to complete a study regarding local employer participation in the SHBP/SEHBP within one year of this law’s effective date.

Requires local employers to establish an IRC Section 125 cafeteria plan for medical and dental plan participant costs.

Section 76: Coverage for Out-of-State Health Care Providers

Beginning January 1, 2012, limits coverage for certain medically necessary tertiary health care services performed by certain out of State health care providers. (NOTE: Section 76 of this law has been amended by S-2959, which will require health benefit plans provided to public employees to offer an option that covers out-of-state health care providers.)

Sections 77 to 79: Impact of Collectively Negotiated Agreements on Required Employee Health Benefit Contributions

A public employer and employees who are in negotiations for the next collective negotiations agreement to be executed after the employees in that unit have reached full implementation of the premium share set forth in this law must conduct negotiations concerning contributions for health care benefits as if the full premium share was included in the prior contract. The public employers and public employees will remain bound by the health care contribution provisions of the law, notwithstanding the expiration of those sections, until the full amount of the contribution has been implemented in accordance with the schedule set forth in this law.

Employees subject to any collective negotiations agreement in effect on the effective date of the law, that has an expiration date on or after the expiration of the health care contribution provisions of the law, will be subject to those provisions, upon expiration of that collective negotiations agreement, until the health care contribution schedule set forth in the law is fully implemented.

After full implementation, those contribution levels will become part of the parties’ collective negotiations and will then be subject to collective negotiations in a manner similar to other negotiable items between the parties.

Section 80: Increased Employee Pension and Health Benefit Contribution Begin Date

The increased employee contributions under this law for pension benefits and the contributions for health care benefits will begin upon the implementation of necessary administrative actions for collection and will not be applied retroactively to this law’s effective date.

SIGNIFICANT LEGISLATION, *continued*

III. Other Provisions

Section 81: Disclaimer

Provides that if any provision of this law or its application to any particular person or circumstance is held invalid, that provision or its application shall be severable and shall not affect the validity of other provisions or applications of this act.

Section 82: Repealed Statutes

This law repeals the following statutes:

- N.J.S.A. 52:14-17.28a: Provides that the State Health Benefits Commission must not enter into a contract for the benefits provided pursuant to the contract in effect on October 1, 1988, including, but not limited to, basic benefits, extended basic benefits, and major medical benefits unless the level of benefits provided under the contract entered into is equal to or exceeds the level of benefits provided for in the contract in effect on October 1, 1988, or unless the benefits in effect on October 1, 1988 are modified by an authorized collective bargaining agreement made on behalf of the State.
- N.J.S.A. 43:15A-47.2: Provides that a member of PERS may retire while holding an elective public office covered by PERS and continue to receive the full salary for that office, if the member's PERS retirement allowance is not based solely on service in the elected public office.
- N.J.S.A. 43:16A-5.1: Provides that a member of PFRS may retire while holding an elective public office covered by PFRS and continue to receive the full salary for that office, if the member's PFRS retirement allowance is not based solely on service in the elected public office.

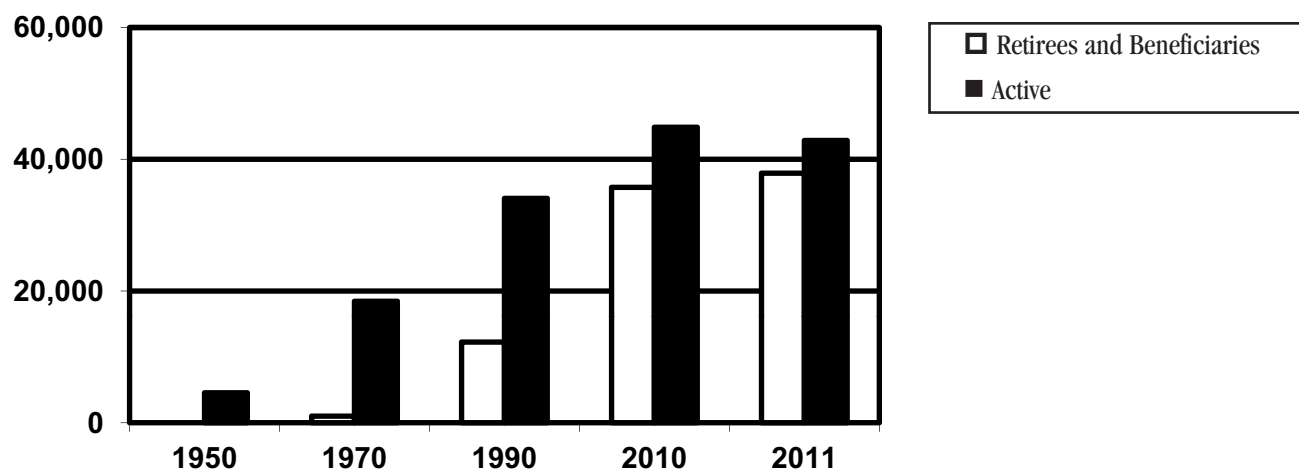
Section 83: Effective Date

This law is effective immediately. Sections 39 through 44 regarding employee health benefit contributions will expire four years after this law's effective date.

MEMBERSHIP

- As of June 30, 2011, the active membership of the system totaled 42,849. There were 37,882 retirees and beneficiaries receiving annual pensions totaling \$1,686,445,400*.
- Beneficiaries of deceased active and retired members received lump sum death benefits in the amount of \$35,107,319.
- The system's assets totaled \$21,673,746,646 at the close of the fiscal year 2011.

* Includes cost-of-living adjustments paid under the provisions of the Pension Adjustment Act.



MEMBERSHIP ACTIVITY

During fiscal year 2011, the following transactions were processed by the Division of Pensions and Benefits on behalf of the membership of the Police and Firemen's Retirement System of New Jersey.

- Loans - 17,090 loans were issued to members during fiscal year 2011 for \$182,257,430. The total loans receivable as of June 30, 2011 was \$401,765,399.
- Retirement - 2,365 members retired under the following retirement types:

<u>TYPE OF RETIREMENT</u>		<u>OPTIONS SELECTIONS</u>	
Service	44	Maximum	2,340
Ordinary Disability	98	Option 1	0
Accidental Disability	146	Option 2	0
Accidental Death	1	Option 3	0
Special Retirement	1,890	Option 4	0
Deferred	6	Option A	0
Active Death	25	Option B	0
Involuntary Retirement	22	Option C	0
Chapter 428	126	Option D	0
Other	7	Other	25
Total	2,365	Total	2,365

Independent Auditor's Report

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

We have audited the accompanying statement of fiduciary net assets of the State of New Jersey Police and Firemen's Retirement System (the System) as of June 30, 2011, and the related statement of changes in fiduciary net assets for the year 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. The financial statements of the System as of June 30, 2010 were audited by other auditors whose report dated October 27, 2010 expressed an unqualified opinion on those financial statements.

We conducted our audit 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 audit provides 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 State of New Jersey Police and Firemen's Retirement System as of June 30, 2011, and changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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 the accounting principles generally accepted in the United States of America. 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 audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The 2011 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 basic financial statements, and, in our opinion, is presented fairly, in all material respects, in relation to the basic financial statements taken as a whole.

Clifton Gundersen LLP

Mt. Laurel, New Jersey
November 1, 2011

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

Management's Discussion and Analysis

June 30, 2011 and 2010

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, 2011 and 2010. Please read it in conjunction with the basic financial statements and financial statement footnotes, which follow this discussion.

Financial Highlights

2011 - 2010

- Net assets held in trust for pension benefits increased by \$1,448,550,068 as a result of fiscal year 2011's operations from \$19,844,137,816 to \$21,292,687,884.
- Additions for the year are \$3,181,924,007, which are comprised of member and employer pension contributions of \$110,443,152 and net investment income of \$3,071,480,855.
- Deductions for the year are \$1,733,373,939, which are comprised of benefit and refund payments of \$1,729,258,463 and administrative expenses of \$4,115,476.

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.

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 of 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.

(Continued)

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

Management's Discussion and Analysis

June 30, 2011 and 2010

Financial Analysis

Summary of Fiduciary Net Assets

2011 – 2010

	<u>2011</u>	<u>2010</u>	<u>Increase</u>
Assets	\$ 21,673,746,646	19,987,241,043	1,686,505,603
Liabilities	381,058,762	143,103,227	237,955,535
Net assets	<u>\$ 21,292,687,884</u>	<u>19,844,137,816</u>	<u>1,448,550,068</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 2010 and 2011, total assets increased by \$1.7 billion or 8.4%. The total assets increased due to an increase in investments of \$2.6 billion, an increase in the securities lending collateral of \$225.2 million, offset by a decrease in receivables of \$1.1 billion. Employer contributions receivables include contribution receivables from local employers for appropriations and early retirement incentive programs due April 1, 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 increased by \$238.0 million or 166.3% due to an increase in the securities lending collateral and rebates payable of \$224.9 million and an increase in retirement benefits payable and other payables of \$13.1 million.

Net assets held in trust for pension benefits increased by \$1.4 billion or 7.3%.

Summary of Fiduciary Net Assets

2010 – 2009

	<u>2010</u>	<u>2009</u>	<u>Increase (decrease)</u>
Assets	\$ 19,987,241,043	19,323,903,680	663,337,363
Liabilities	143,103,227	1,234,974,065	(1,091,870,838)
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.

(Continued)

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

Management's Discussion and Analysis

June 30, 2011 and 2010

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 Changes to Fiduciary Net Assets

2011 – 2010

	<u>2011</u>	<u>2010</u>	<u>Increase (decrease)</u>
Additions:			
Member contributions	\$ 327,357,244	330,951,798	(3,594,554)
Employer contributions	(216,914,092)	1,001,223,223	(1,218,137,315)
Net investment income	3,071,480,855	2,008,239,281	1,063,241,574
Total additions	<u>3,181,924,007</u>	<u>3,340,414,302</u>	<u>(158,490,295)</u>
Deductions:			
Benefits	1,721,552,719	1,573,510,855	148,041,864
Refunds of contributions	7,705,744	5,615,160	2,090,584
Administrative and miscellaneous expenses	4,115,476	6,080,086	(1,964,610)
Total deductions	<u>1,733,373,939</u>	<u>1,585,206,101</u>	<u>148,167,838</u>
Changes in net assets	<u>\$ 1,448,550,068</u>	<u>1,755,208,201</u>	<u>(306,658,133)</u>

Additions primarily consist of member and employer contributions and earnings from investment activities. Member contributions decreased by \$3.6 million or 1.1% due to a decrease in active membership.

Employer contributions decreased by \$1.2 billion or 121.7%. In fiscal year 2011, employer contributions include accrued appropriations due April 1, 2012 and early retirement incentive benefits billed to local employers. The State did not make a pension contribution for fiscal year 2011 but did make a contribution of \$7.6 million for Non-contributory Group Insurance (NCGI) death benefits. Also included in the employer contributions is 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. The amount accrued in fiscal year 2010 and due April 1, 2012 was originally \$950.7 million. In fiscal year 2011 the State made a decision to reduce the PFRS lag period between the valuation year and the contribution year from three years to two years which will bring the System in line with the other pension trust funds. This change results in a revised accrual for the bills due April 1, 2012 in the amount of \$736.1 million resulting in a reduction of \$214.6 million.

Net investment income increased by \$1.1 billion or 52.9% due to appreciation of investments.

(Continued)

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

Management's Discussion and Analysis

June 30, 2011 and 2010

The total investment return for all pension funds was estimated to be an 18.03% gain compared to a 13.4% gain in the prior year.

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 \$148.0 million or 9.4% primarily due to an increase in number of retirees receiving benefits. The amount of refunds processed increased by \$2.1 million or 37.2%. Administrative expenses decreased by \$2.0 million or 32.3% due to a change in the method of calculating the amount reimbursed to the State of New Jersey general fund between fiscal years 2010 and 2011.

Summary of Changes to Fiduciary Net Assets

2010 – 2009

	<u>2010</u>	<u>2009</u>	<u>Increase (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 a 13.4% gain compared to a 15.5% loss in the prior year.

(Continued)

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

Management's Discussion and Analysis

June 30, 2011 and 2010

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%.

Retirement System as a Whole

The overall funded ratios of 80.2% for fiscal year 2011 and 70.8% for fiscal year 2010 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, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Assets:		
Cash	\$ 3,530,486	5,763,447
Securities lending collateral	229,475,294	4,292,198
Investments, at fair value:		
Cash Management Fund	834,258,381	858,161,248
Common Pension Fund A	5,224,187,934	4,455,622,370
Common Pension Fund B	5,000,893,229	5,041,808,272
Common Pension Fund D	4,148,349,248	3,252,936,018
Common Pension Fund E	3,532,122,612	2,401,803,179
Mortgages	1,166,665,018	1,338,985,275
Total investments	<u>19,906,476,422</u>	<u>17,349,316,362</u>
Receivables:		
Contributions:		
Members	42,193,912	45,062,645
Employers	976,737,845	2,085,862,363
Accrued interest and dividends	99,127,632	92,153,743
Members' loans	401,765,399	388,256,691
Securities sold in transit	9,561,663	12,166,417
Other	4,877,993	4,367,177
Total receivables	<u>1,534,264,444</u>	<u>2,627,869,036</u>
Total assets	<u>21,673,746,646</u>	<u>19,987,241,043</u>
Liabilities:		
Accounts payable and accrued expenses	3,585,173	3,130,086
Retirement benefits payable	145,797,941	133,450,778
Non-contributory group insurance premiums payable	2,497,728	2,269,382
Securities lending collateral and rebates payable	229,177,920	4,252,981
Total liabilities	<u>381,058,762</u>	<u>143,103,227</u>
Net assets:		
Held in trust for pension benefits	<u>\$ 21,292,687,884</u>	<u>19,844,137,816</u>

See schedule of funding progress on pages 38-39.
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, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Additions:		
Contributions:		
Members	\$ 327,357,244	330,951,798
Employers	(216,914,092)	1,001,223,223
Total contributions	<u>110,443,152</u>	<u>1,332,175,021</u>
Investment income:		
Net appreciation in fair value of investments	2,533,138,436	1,466,339,195
Interest	440,253,971	450,487,844
Dividends	99,455,410	92,716,111
	<u>3,072,847,817</u>	<u>2,009,543,150</u>
Less investment expense	<u>1,366,962</u>	<u>1,303,869</u>
Net investment income	<u>3,071,480,855</u>	<u>2,008,239,281</u>
Total additions	<u>3,181,924,007</u>	<u>3,340,414,302</u>
Deductions:		
Benefits	1,721,552,719	1,573,510,855
Refunds of contributions	7,705,744	5,615,160
Administrative and miscellaneous expenses	4,115,476	6,080,086
Total deductions	<u>1,733,373,939</u>	<u>1,585,206,101</u>
Change in net assets	1,448,550,068	1,755,208,201
Net assets – beginning of year	<u>19,844,137,816</u>	<u>18,088,929,615</u>
Net assets – end of year	<u>\$ 21,292,687,884</u>	<u>19,844,137,816</u>

See accompanying notes to financial statements.

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

Notes to Financial Statements

June 30, 2011 and 2010

(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 July 1, 2010 and 2009, the dates of the most recent actuarial valuations, participating employers consisted of the following:

	<u>2010</u>	<u>2009</u>
State of New Jersey	1	1
Municipalities	588	588
Total	<u>589</u>	<u>589</u>

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. Pursuant to the provisions of Chapter 78, P.L. 2011, the annual benefit under special retirement for members enrolled after June 28, 2011 (Tier 3 members), is 60% 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 65% 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.

(Continued)

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

Notes to Financial Statements

June 30, 2011 and 2010

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

Eligible retirees receiving monthly benefits are entitled to cost-of-living (COLA) 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 COLA increases are funded by the retirement system and are included in the annual actuarial calculations of the required state and state-related employer contributions. Pursuant to the provisions of Chapter 78, P.L. 2011, COLA increases are suspended for all current and future retirees of all retirement systems. No further COLA increases will be granted. The law does not reduce any COLA increases that have already been added to retiree benefits.

Pursuant to Chapter 1, P.L. 2010, for new members of PFRS hired after May 21, 2010 (Tier 2 members), this law capped the maximum compensation that can be used to calculate a pension from these plans 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 July 1, 2010 and 2009, the dates of the most recent actuarial valuations:

	<u>2010</u>	<u>2009</u>
Retirees and beneficiaries currently receiving benefits and terminated employees entitled to benefits but not yet receiving them	35,973	34,364
Active members:		
Vested	29,552	29,400
Nonvested	14,652	15,750
Total active members	<u>44,204</u>	<u>45,150</u>
Total	<u><u>80,177</u></u>	<u><u>79,514</u></u>

(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,

(Continued)

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

Notes to Financial Statements

June 30, 2011 and 2010

and deductions are recorded at the time the liabilities are incurred. The financial statements of the System conform to the provisions of Governmental Accounting Standards Board (GASB) Statement No. 25, *Financial Reporting for Defined Benefit Plans and Note Disclosures for Defined Contributions Plans*. Employer contributions are recognized when payable to the System. Benefits and refunds are recognized when due and payable in accordance with the terms of the System.

Investments

The Division of Investment, Department of the Treasury, State of New Jersey (Division of Investment) manages and invests certain assets of seven of the defined benefit plans (PERS, TPAF, JRS, PFRS, CPFPPF, SPRS and POPF). The Division of Investment separately reports the assets, liabilities and net assets of the underlying investment portfolio of the seven defined benefit plans in its Pension Fund report. The Division of Investment accounts included in the Pension Fund report are: Common Fund A, Common Fund B, Common Fund D, Common Fund E, Police and Firemen's Mortgage Program accounts and other investments owned directly by the seven defined benefit pension plans. Common Fund A invests primarily in domestic equity securities. Common Fund B invests primarily in domestic fixed income securities. Common Fund D invests primarily in foreign equity and fixed income securities. Common Fund E invests primarily in alternative investments which includes private equity, real assets, 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, Sovereign and Corporate obligations – prices quoted by a major dealer in such securities.
- Domestic and Foreign Equity Securities, Exchanged Traded Funds, Forward Foreign Exchange Contracts – closing prices as reported on the primary market or exchange on which they trade.
- Money Market Instruments – amortized cost which approximates fair value.
- Cash Management Fund – closing bid price on the last day of trading during the period as determined by the Transfer Agent.
- 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

(Continued)

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

Notes to Financial Statements

June 30, 2011 and 2010

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.

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 values of Common Funds A, B, D and E (Common Funds) are 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. Collateral is marked to market daily and adjusted as needed to maintain the required minimum level. Effective December 2010, for loans of U.S. government securities or sovereign debt issued by non-U.S. governments, in the event that the market value of the collateral falls below 100% of the market value of the outstanding loaned securities to an individual borrower, or the market value of the collateral of all loans of such securities falls below the collateral requirement, 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 together with collateral previously delivered meets the collateral requirements. For loans of all other types of securities, in the event that the market value of the collateral falls below the collateral requirement of either 102% or 105% (depending on whether the securities are denominated in U.S. dollars or a foreign currency, respectively) of the market value of the outstanding loaned securities to an individual borrower, additional collateral shall be transferred in an amount that will increase the aggregate of the borrower's collateral to meet the collateral requirements. As of June 30, 2011 and 2010, the Common Funds have no aggregate credit risk exposure to borrowers 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 and provides that collateral securities may be sold in the event of a borrower default. The Common Funds are also indemnified for any loss of principal or interest on collateral invested in repurchase agreements. The Common Funds cannot

(Continued)

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

Notes to Financial Statements

June 30, 2011 and 2010

participate in any dividend reinvestment program or vote with respect to any securities that are on loan on the applicable record date. The securities loans can be terminated by notification by either the borrower or the Common Funds. The term to maturity of the securities loans is generally matched with the term to maturity of the investment of the cash collateral.

Derivatives

The Division of Investment, from time to time, utilizes forward foreign currency contracts, derivative securities, 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.

The fair values of foreign forward currency contracts held directly by the Common Funds as of June 30, 2011 and 2010 were as follows:

	2011	2010
Forward currency receivable	\$ 1,285,366,143	1,950,687,029
Forward currency payable	1,310,308,414	1,964,107,355
Net unrealized loss	(24,942,271)	(13,420,326)

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 System had written call options on 5,375,000 shares, and these options had a fair value of \$3,822,200 at June 30, 2011. The System owned 11,650 put option contracts with a fair value of \$5,505,500 at June 30, 2011. The Common Funds did not have any written call or put option contracts as of June 30, 2010.

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

Members' Loans

Members who have at least three years of service in the System may borrow up to 50% of their accumulated member contributions. Repayment of loan balances is deducted from payroll checks and bears

(Continued)

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

Notes to Financial Statements

June 30, 2011 and 2010

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.

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 pension loan interest rate became 3.25% per year for year 2010 and 5.25% for year 2011.

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, 2011, the Common Funds had unfunded commitments totaling approximately \$4.8 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.

(Continued)

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

Notes to Financial Statements

June 30, 2011 and 2010

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 July 1, 2010 and 2009 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 July 1, 2010 and 2009.

	State		Local	
Actuarial valuation date	July 1, 2010	July 1, 2009	July 1, 2010	July 1, 2009
Actuarial value of assets	\$ 2,190,654,958	\$ 2,254,766,935	\$ 20,367,865,987	\$ 20,724,453,343
Actuarial accrued liability	3,672,361,258	3,993,259,480	25,601,998,126	28,448,841,765
Unfunded actuarial accrued liability	1,481,706,300	1,738,492,545	5,234,132,139	7,724,388,422
Funded ratio	59.7%	56.5%	79.6%	72.8%
Covered payroll	\$ 530,747,536	\$ 525,862,047	\$ 3,189,786,833	\$ 3,147,812,476
Unfunded actuarial accrued liability as a percentage of covered payroll	279.2%	330.6%	164.1%	245.4%
Actuarial cost method	Projected unit credit	Projected unit credit	Projected unit credit	Projected unit credit
Asset valuation method	5 year average of market value	5 year average of market value	5 year average of market value	5 year average of market value
Amortization method	Level dollar, open	Level percent, open	Level dollar, open	Level percent, open
Remaining amortization 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	0.00%	1.80%	0.00%	1.80%

(Continued)

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

Notes to Financial Statements

June 30, 2011 and 2010

(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 27.2%, 22.5%, 27.0%, 26.2%, and 95.0%, respectively, of each investment total of the pension fund as of June 30, 2011.

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

	<u>2011</u>	<u>2010</u>
Domestic equities	\$ 18,794,883,830	15,432,119,968
International equities	14,710,800,731	12,622,731,135
Domestic fixed income	18,023,341,944	19,933,985,342
International fixed income*	2,066,705,578	2,502,077,223
Bank loan funds	1,174,078,860	1,071,419,455
Police and Fireman's mortgages	1,140,494,077	1,305,728,863
Private equity funds	5,381,612,092	4,219,334,445
Real estate funds	2,731,205,959	1,875,718,683
Absolute return strategy funds	3,902,428,308	3,377,238,284
Real assets	1,191,374,306	997,115,205
Put Options	5,505,500	—
	<u>\$ 69,122,431,185</u>	<u>63,337,468,603</u>

*US dollar denominated securities

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 the role of the Council is to formulate investment policies. The Council issues regulations which establish guidelines for permissible investments which include domestic and international equities and exchange traded funds, covered call and put options, equity futures contracts, obligations of the U.S. Treasury, government agencies, corporations, 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 Cash Management Fund (CMF). The CMF is a short-term cash fund and is open to state and certain non-state participants.

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.

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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.

(Continued)

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

Notes to Financial Statements

June 30, 2011 and 2010

These credit ratings and limits are as follows:

Category	Minimum rating (1)			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
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; 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	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

(Continued)

**STATE OF NEW JERSEY
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June 30, 2011 and 2010

Category	Minimum rating (1)			Limitation of issuer's outstanding debt	Limitation of issue	Other limitations
	Moody's	S&P	Fitch			
Interest rate swap transactions	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 (2)	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	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	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 October 19, 2009, this was restricted to NJ State & Municipal obligations.

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.

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For securities in the fixed income portfolio, the following tables disclose aggregate market value, by major credit quality rating category as of June 30, 2011. The first table for 2011 includes fixed income securities rated by Moody's. The second table for 2011 discloses S&P and Fitch ratings for fixed income securities not rated by Moody's.

		June 30, 2011							
		Moody's rating (1)							
(In thousands)		Aaa	Aa	A	Baa	Ba	B	Ca	Caa
Corporate obligations	\$	579,318	1,240,698	3,767,728	3,703,489	291,148	262,447	3,200	119,424
United States treasury TIPS		2,728,503	—	—	—	—	—	—	—
United States treasury bonds		1,739,541	—	—	—	—	—	—	—
Foreign government obligations		183,511	916,049	26,762	—	125	—	—	—
International corporate obligations		—	109,077	456,420	284,861	9,170	16,450	714	6,399
Mortgages (FHLMC/FNMA/GNMA)		630,629	—	—	—	—	—	—	—
United States government strips		568,556	—	—	—	—	—	—	—
Federal agency obligations		362,867	—	—	—	—	—	—	—
SBA pass through certificates		152,640	—	—	—	—	—	—	—
Asset backed obligations		—	16,786	25,189	43,759	1,519	—	—	623
Other		97,477	854,064	249,972	—	—	—	—	—
	\$	7,043,042	3,136,674	4,526,071	4,032,109	301,962	278,897	3,914	126,446

(1) Subsequent to the June 30, 2011, Standard & Poor's downgraded the United States credit rating to AA+ from its top rank of AAA, for the first time in history.

		June 30, 2011							
		Standard & Poor's & Fitch ratings							
(In thousands)		Standard & Poor's						Fitch	Totals
		A	AA	AAA	B	BB	BBB	CCC	BBB
Corporate obligations	\$	97,733	69,219	—	11,032	3,981	94,199	5,131	13,234
International corporate obligations		—	—	—	2,943	618	—	—	—
Other		50,139	65,320	34,625	—	—	—	—	—
	\$	147,872	134,539	34,625	13,975	4,599	94,199	5,131	13,234

The 2011 tables do not include certain domestic and international corporate obligations including certain exchange traded funds (ETFs) totaling \$172,869,190, 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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**STATE OF NEW JERSEY
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June 30, 2011 and 2010

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. 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.

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

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

The 2010 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.

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 agreement must mature within 30 days. The investment in guaranteed income contracts and funding agreements is limited to a term of 10 years or less.

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**STATE OF NEW JERSEY
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June 30, 2011 and 2010

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, 2011 and 2010:

(In thousands)	June 30, 2011				
	Maturities in years				
	Less than 1	1-5	6-10	More than 10	Total fair value
Corporate obligations	\$ 2,470	788,190	3,826,864	5,683,875	10,301,399
United States treasury inflation index notes	—	—	2,296,801	431,702	2,728,503
United States treasury bonds	—	—	—	1,739,541	1,739,541
Foreign government obligations	—	122,643	447,719	598,498	1,168,860
Police and firemen's mortgage program	1	330	4,726	1,135,437	1,140,494
International corporate obligations	—	131,075	299,110	467,661	897,846
Mortgages (FHLMC/FNMA/GNMA)	—	4,608	6	626,015	630,629
United States government strips	—	—	—	568,556	568,556
Federal agency obligations	—	11,202	211,747	139,918	362,867
Asset backed obligations	—	1,347	17,409	148,962	167,718
SBA pass through certificates	—	—	152,640	—	152,640
Other	—	—	—	1,351,599	1,351,599
	<u>\$ 2,471</u>	<u>1,059,395</u>	<u>7,257,022</u>	<u>12,891,764</u>	<u>21,210,652</u>

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

The pension funds invest in global markets. Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. 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

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**STATE OF NEW JERSEY
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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 \$1.28 billion and payables totaling approximately \$1.31 billion (with a \$24.9 million net exposure) as of June 30, 2011. 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. At June 30, 2011, the credit ratings of the counterparties to the forward currency contracts had credit ratings of no less than A3 using Moody's rating scale.

The pension funds had the following foreign currency exposure as of June 30, 2011 and 2010 (expressed in U.S. dollars):

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(In thousands)		June 30, 2011		
Currency		Equities	Alternative Investments	Total fair value
Australian dollar	\$	539,940	—	539,940
Brazilian real		234,906	—	234,906
Canadian dollar		1,424,080	—	1,424,080
Chilean peso		3,700	—	3,700
Czech koruna		16,889	—	16,889
Danish krone		148,033	—	148,033
Egyptian pound		28,329	—	28,329
Euro		2,645,346	325,883	2,971,229
Hong Kong dollar		658,318	—	658,318
Hungarian forint		19,799	—	19,799
Indonesian rupiah		80,706	—	80,706
Israeli shekel		7,614	—	7,614
Japanese yen		2,008,900	—	2,008,900
Malaysian ringgit		52,994	—	52,994
Mexican peso		39,165	—	39,165
New Taiwan dollar		15,699	—	15,699
Norwegian krone		115,985	—	115,985
Pakistan rupee		8,043	—	8,043
Philippine peso		17,252	—	17,252
Polish zloty		24,996	—	24,996
Pound sterling (U.K.)		1,864,042	11,399	1,875,441
Singapore dollar		260,687	—	260,687
South African rand		152,337	—	152,337
South Korean won		321,936	—	321,936
Swedish krona		584,331	—	584,331
Swiss franc		781,942	—	781,942
Thailand baht		48,799	—	48,799
Turkish lira		57,784	—	57,784
	\$	<u>12,162,552</u>	<u>337,282</u>	<u>12,499,834</u>

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**STATE OF NEW JERSEY
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June 30, 2011 and 2010

(In thousands)		June 30, 2010		
Currency		Equities	Alternative Investments	Total fair value
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		2,622,791	213,678	2,836,469
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
Philippine 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
Thailand baht		32,703	—	32,703
Turkish lira		52,262	—	52,262
U.K. Sterling		1,196,105	12,445	1,208,550
	\$	<u>11,216,718</u>	<u>226,123</u>	<u>11,442,841</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 April 18, 2011, Council regulations provide that not more than 38% of the market value of the pension funds can be invested in alternative investments, with limits on the individual investment categories of real estate (9%), real assets (7%), private equity (12%) and absolute return strategy (15%). Prior to that, the overall limitation was 28% with a 7% limit on each of the individual categories. 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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**STATE OF NEW JERSEY
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(4) Securities Lending Collateral

The System's share in the securities lending program is 26.8% and 25.7% of the total market value of the collateral as of June 30, 2011 and 2010, respectively.

The securities lending collateral is subject to various risks. Among these risks are custodial credit risk, credit risk, concentration of credit risk, and interest rate risk. Prior to July 1, 2010, the 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, consistent with Council regulations and internal policies for funds managed by the Division of Investment. The pension funds did not lend securities from July through December 2010. As of December 2010, securities lending collateral is invested in repurchase agreements the maturities of which cannot exceed 30 days. 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 consistent with internal policies for funds managed by the Division of Investment.

For securities exposed to credit risk in the collateral portfolio, the following table discloses aggregate fair value, by major credit quality rating category as of June 30, 2011 and 2010.

		June 30, 2011		
		Rating		
		Aaa/AAA	Not rated	Totals
(In thousands)				
Repurchase agreements	\$	847,919	—	847,919
Cash		—	5,686	5,686
Totals	\$	847,919	5,686	853,605

Custodial credit risk for investments is the risk that in the failure of the counterparty to the transaction the pension funds will not recover the value of the investments that are in the possession of an outside party. The repurchase agreement's underlying securities are held in the pension funds' name.

As of June 30, 2011, the pension funds had outstanding loaned investment securities with an aggregate market value of \$831,618,717. 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.

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

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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.

(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. The full normal employee contribution rate will be increased from 8.5% to 10%, based on Chapter 78, P.L. 2011 in October 2011.

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.

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 did not make a pension contribution for fiscal year 2011 but did make a contribution of \$7.6 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 to the System. The amount accrued in fiscal year 2010 and due April 1, 2012 was originally \$950.7 million. In fiscal year 2011 the State made a decision to reduce the PFRS lag period between the valuation year and the contribution year from three years to two years which will bring the System in line with the other pension trust funds. This change results in a revised accrual for the bills due April 1, 2012 in the amount of \$736.1 million resulting in a reduction of \$214.6 million.

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 ERI contributions for those who participate in the various ERI programs and other miscellaneous items that were due to the System.

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**STATE OF NEW JERSEY
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June 30, 2011 and 2010

(6) Funds

PFRS maintains the following legally required funds as follows:

Members' Annuity Savings Fund (2011 – \$3,091,655,674; 2010 – \$3,075,484,919)

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

Retirement Reserve Fund (2011 – \$17,555,267,794; 2010 – \$18,599,167,672)

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 2011 and 2010) is credited to the Retirement Reserve Fund.

Special Reserve Fund (2011 – \$0; 2010 – \$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 (2011 – \$640,920,013; 2010 – \$-1,870,288,894)

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 administrative and miscellaneous expenses are made from this Fund.

Non-Contributory Group Insurance Premium Fund – Local (2011 – \$4,844,403; 2010 – \$39,774,119)

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.

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

Required Supplementary Information

Schedule of Funding Progress

(Unaudited – See accompanying independent auditor's report)

Actuarial valuation date	Actuarial value of assets (a)	Actuarial accrued liability (b)	Unfunded (overfunded) actuarial accrued liability (b – a)	Funded ratio (a / b)	Covered payroll (c)	Unfunded (overfunded) actuarial accrued liability as a percentage of covered payroll ((b – a) / c)
State:						
July 1, 2005	\$ 2,005,752,079	2,815,620,221	809,868,142	71.2%	\$ 482,460,402	167.9%
July 1, 2006	2,082,930,162	3,082,176,677	999,246,515	67.6	506,084,434	197.4
July 1, 2007	2,215,697,407	3,426,631,813	1,210,934,406	64.7	527,556,519	229.5
July 1, 2008	2,316,017,361	3,749,118,910	1,433,101,549	61.8	527,495,741	271.7
July 1, 2009	2,254,766,935	3,993,259,480	1,738,492,545	56.5	525,862,047	330.6
July 1, 2010	2,190,654,958	3,672,361,258	1,481,706,300	59.7	530,747,536	279.2
Local:						
July 1, 2005	\$ 17,372,138,294	21,388,972,326	4,016,834,032	81.2%	\$ 2,619,347,468	153.4%
July 1, 2006	18,281,315,556	22,907,522,660	4,626,207,104	79.8	2,772,915,465	166.8
July 1, 2007	19,500,229,156	24,562,195,443	5,061,966,287	79.4	2,932,283,180	172.6
July 1, 2008	20,437,541,909	26,871,106,532	6,433,564,623	76.1	3,068,758,436	209.6
July 1, 2009	20,724,453,343	28,448,841,765	7,724,388,422	72.8	3,147,812,476	245.4
July 1, 2010	20,367,865,987	25,601,998,126	5,234,132,139	79.6	3,189,786,833	164.1

(Continued)

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

Required Supplementary Information

Schedule of Funding Progress – Additional Actuarial Information

(Unaudited – See accompanying independent auditor's report)

Significant actuarial methods and assumptions used in the most recent 2010 and 2009 actuarial valuations include the following:

	<u>July 1, 2010</u>	<u>July 1, 2009</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 dollar, open	Level percent, open
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%

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**

Required Supplementary Information

Schedule of Employer Contributions

(Unaudited – See accompanying independent auditor's report)

Year ended June 30,		Annual required contribution	Employer contributions⁽¹⁾⁽³⁾	Percentage contributed
State:				
2006	\$	200,902,193	73,541,000	36.6%
2007		216,570,332	128,167,965	59.2
2008		252,836,330	133,510,475 ⁽⁴⁾	52.8
2009		275,205,347	20,014,342 ⁽⁴⁾	7.3
2010		343,091,276	7,326,383 ⁽⁴⁾	2.1
2011		377,153,530	7,736,000	2.1
Local:				
2006	\$	475,872,193	260,986,583 ⁽²⁾	54.8%
2007		584,645,679	422,743,218 ⁽²⁾	72.3
2008		708,019,933	647,288,920 ⁽⁵⁾	91.4
2009		773,029,316	696,476,702	90.1
2010		818,672,171	751,395,802	91.8
2011		960,271,326	892,167,113	92.9

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 2010 actuarial valuations and the actual amounts received in fiscal year 2011. 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 2011. The financial statements and footnotes reflect the actual amounts received in 2011.
- (4) For State, the fiscal year 2008, 2009, and 2010 contributions have been reduced in accordance with the provisions of the Appropriation Act for fiscal year 2008, 2009, and 2010, respectively.
- (5) For local, the fiscal year 2008 contribution has been reduced in accordance with Chapter 108, P.L. 2003.

STATE OF NEW JERSEY
POLICE AND FIREMEN'S RETIREMENT SYSTEM

Schedule of Changes in Fiduciary Net Assets by Fund

Year ended June 30, 2011

	Members' Annuity savings Fund	Pension Accumulation Fund	Retirement Reserve Fund	Special Reserve Fund	Non-Contributory Group Insurance Premium Fund	Total
Additions:						
Contributions:						
Members	\$ 327,357,244	—	—	—	—	327,357,244
Employers	—	(213,810,330)	—	—	(3,103,762)	(216,914,092)
Total contributions	327,357,244	(213,810,330)	—	—	(3,103,762)	110,443,152
Distribution of net investment income	—	1,732,228,353	1,335,971,137	—	3,281,365	3,071,480,855
Total additions	327,357,244	1,518,418,023	1,335,971,137	—	177,603	3,181,924,007
Deductions:						
Benefits	—	—	1,686,445,400	—	35,107,319	1,721,552,719
Refunds of contributions	7,680,275	25,469	—	—	—	7,705,744
Administrative and miscellaneous expenses	—	4,115,476	—	—	—	4,115,476
Total deductions	7,680,275	4,140,945	1,686,445,400	—	35,107,319	1,733,373,939
Net increase (decrease) before transfers among reserves	319,676,969	1,514,277,078	(350,474,263)	—	(34,929,716)	1,448,550,068
Transfers among reserves:						
Retirements	(303,960,292)	(1,411,284,365)	1,715,244,657	—	—	—
Other	454,078	2,408,216,194	(2,408,670,272)	—	—	—
Net increase (decrease)	16,170,755	2,511,208,907	(1,043,899,878)	—	(34,929,716)	1,448,550,068
Net assets held in trust for pension benefits:						
Beginning of year	3,075,484,919	(1,870,288,894)	18,599,167,672	—	39,774,119	19,844,137,816
End of year	\$ 3,091,655,674	640,920,013	17,555,267,794	—	4,844,403	21,292,687,884