



**STATE OF NEW JERSEY  
TEACHERS' PENSION AND ANNUITY FUND**

Financial Statements and Schedules

June 30, 2010 and 2009

(With Independent Auditors' Report Thereon)



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

## **Independent Auditors' Report**

The Board of Trustees  
State of New Jersey  
Teachers' Pension and Annuity Fund:

We have audited the accompanying statements of fiduciary net assets of the State of New Jersey Teachers' Pension and Annuity Fund (the Fund) as of June 30, 2010 and 2009, and the related statements of changes in fiduciary net assets for the years then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 Fund's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the State of New Jersey Teachers' Pension and Annuity Fund as of June 30, 2010 and 2009, and the changes in its financial position for the years then ended in conformity with U.S. generally accepted accounting principles.

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



Our audits were conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Fund's basic financial statements. The 2010 schedule of changes in fiduciary net assets by fund (schedule 3) is presented for purposes of additional analysis and is not a required part of the basic financial statements of the Fund. Such information has been subjected to the auditing procedures applied in the audit of the 2010 basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the 2010 basic financial statements taken as a whole.

KPMG LLP

October 27, 2010

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Management's Discussion and Analysis

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Our discussion and analysis of the financial performance of the Teachers' Pension and Annuity Fund (the Fund; TPAF) financial performance provides an overview of the Fund's financial activities for the fiscal years ended June 30, 2010 and 2009. Please read it in conjunction with the basic financial statements and financial statement footnotes which follow this discussion.

**Financial Highlights**

**2010 – 2009**

- Net assets held in trust for pension benefits increased by \$853,675,005 as a result of fiscal year 2010 operations from \$25,038,820,828 to \$25,892,495,833.
- Additions for the year are \$3,936,137,470, which are comprised of member and employer pension contributions of \$658,713,005 and net investment income of \$3,277,424,465.
- Deductions for the year are \$3,082,462,465, which are comprised of benefit and refund payments of \$3,070,138,656 and administrative expenses of \$12,323,809.

**2009 – 2008**

- Net assets held in trust for pension benefits decreased by \$7,276,663,249 as a result of fiscal year 2009 operations from \$32,315,484,077 to \$25,038,820,828.
- Additions for the year are negative \$4,353,153,615, which are comprised of member and employer pension contributions of \$718,695,104 and an investment loss of \$5,071,848,719.
- Deductions for the year are \$2,923,509,634, which are comprised of benefit and refund payments of \$2,910,762,884 and administrative expenses of \$12,746,750.

**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 Fund and about its activities to help you assess whether the Fund, as a whole, has improved or declined as a result of the year's activities. The financial statements were prepared using the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized in the period they are earned, and expenses are recorded in the year they are incurred, regardless of when cash is received or paid.

*The Statements of Fiduciary Net Assets* show the balances in all of the assets and liabilities of the Fund at the end of the fiscal year. The difference between assets and liabilities represents the Fund's fiduciary net assets. Over time, increases or decreases in the Fund's fiduciary net assets provide one indication of

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whether the financial health of the Fund 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 Fund'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 Fund is becoming financially stronger or weaker.

**Financial analysis**

**Summary of Fiduciary Net Assets**

2010 – 2009

	<u>2010</u>	<u>2009</u>	<u>Increase (decrease)</u>
Assets	\$ 26,192,726,225	27,225,491,484	(1,032,765,259)
Liabilities	<u>300,230,392</u>	<u>2,186,670,656</u>	<u>(1,886,440,264)</u>
Net assets	<u>\$ 25,892,495,833</u>	<u>25,038,820,828</u>	<u>853,675,005</u>

The Fund'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 2009, total assets decreased by a net \$1.0 billion or 3.8% due to a decrease of \$1.9 billion in the securities lending collateral, a decrease of \$0.1 billion in cash and receivables, offset by an increase of \$1.0 billion in the fair value of investments.

Liabilities consist of retirement benefits payable to retirees and beneficiaries, contributory and non-contributory group insurance premiums payable to the Fund's insurance provider, securities lending collateral and rebates payable and, classified under accounts payable and accrued expenses, liabilities of TPAF 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 a net \$1.9 billion or 86.3% due to a decrease in the securities lending collateral and rebates payable of \$1.9 billion offset by an increase of \$9.4 million in retirement benefits payable and other payables.

Net assets held in trust for pension benefits increased by \$0.9 billion or 3.4%.

**Summary of Fiduciary Net Assets**

2009 – 2008

	<u>2009</u>	<u>2008</u>	<u>(Decrease)</u>
Assets	\$ 27,225,491,484	38,137,002,946	(10,911,511,462)
Liabilities	<u>2,186,670,656</u>	<u>5,821,518,869</u>	<u>(3,634,848,213)</u>
Net assets	<u>\$ 25,038,820,828</u>	<u>32,315,484,077</u>	<u>(7,276,663,249)</u>

The Fund's assets primarily consist of investments, securities lending collateral, contributions due from members and participating employers, accrued investment income and members loans receivable. Between

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fiscal years 2009 and 2008, total assets decreased by \$10.9 billion or 28.6%. This is mainly due to a decrease in the fair value of investments and the securities lending collateral.

Liabilities consist of retirement benefits payable to retirees and beneficiaries, contributory and non-contributory group insurance premiums payable to the Fund's insurance provider, securities lending collateral and rebates payable and, classified under accounts payable and accrued expenses, liabilities of TPAF 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 a net \$3.6 billion or 62.4% due to a decrease in the securities lending collateral and rebates payable of \$3.7 billion and an increase of \$28.0 million in retirement benefits payable and other payables.

Net assets held in trust for pension benefits decreased by \$7.3 billion or 22.5%.

**Summary of Changes to Fiduciary Net Assets**

2010 – 2009

	<u>2010</u>	<u>2009</u>	<u>Increase (decrease)</u>
<b>Additions:</b>			
Member contributions	\$ 615,862,621	616,222,799	(360,178)
Employer contributions	42,850,384	102,472,305	(59,621,921)
Net investment income (loss)	3,277,424,465	(5,071,848,719)	8,349,273,184
Total additions	<u>3,936,137,470</u>	<u>(4,353,153,615)</u>	<u>8,289,291,085</u>
<b>Deductions:</b>			
Benefits	3,028,193,433	2,869,565,540	158,627,893
Refunds of contributions	41,945,223	41,197,344	747,879
Administrative and miscellaneous expenses	12,323,809	12,746,750	(422,941)
Total deductions	<u>3,082,462,465</u>	<u>2,923,509,634</u>	<u>158,952,831</u>
Changes in net assets	<u>\$ 853,675,005</u>	<u>(7,276,663,249)</u>	<u>8,130,338,254</u>

Additions consist of member and employer contributions and earnings from investment activities. Member contributions decreased by \$0.4 million or 0.1% due to a decrease in active membership.

Employer contributions decreased by \$59.6 million or 58.2% over last year.

The State did not make a pension contribution for fiscal year 2010 but did make a contribution of \$33.2 million for Non-contributory Group Insurance (NCGI) death benefits. Also, included in the employer contributions are the annual billing to local employers who participate in the various early retirement incentive programs and other miscellaneous items that were due the fund.

Net investment income increased by \$8.3 billion or 164.6% due to appreciation of investments.

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

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Deductions are comprised of pension benefit payments to retirees and beneficiaries, refunds of contributions to former members, and administrative costs incurred by the Fund. Benefit payments increased by \$158.6 million or 5.5% partly due to an increase in the number of retirees. The amount of refunds processed increased by \$0.7 million or 1.8%. Administrative expenses decreased by \$0.4 million or 3.3%.

**Summary of Changes to Fiduciary Net Assets**

2009 – 2008

	<u>2009</u>	<u>2008</u>	<u>Increase (decrease)</u>
<b>Additions:</b>			
Member contributions	\$ 616,222,799	585,800,133	30,422,666
Employer contributions	102,472,305	701,584,600	(599,112,295)
Net investment loss	(5,071,848,719)	(766,377,094)	(4,305,471,625)
Total additions	<u>(4,353,153,615)</u>	<u>521,007,639</u>	<u>(4,874,161,254)</u>
<b>Deductions:</b>			
Benefits	2,869,565,540	2,677,682,713	191,882,827
Refunds of contributions	41,197,344	40,716,544	480,800
Administrative and miscellaneous expenses	12,746,750	13,787,440	(1,040,690)
Total deductions	<u>2,923,509,634</u>	<u>2,732,186,697</u>	<u>191,322,937</u>
Changes in net assets	<u>\$ (7,276,663,249)</u>	<u>(2,211,179,058)</u>	<u>(5,065,484,191)</u>

Additions consist of member and employer contributions and earnings from investment activities. Member contributions increased by \$30.4 million or 5.2% due to normal salary and membership increases.

Employer contributions decreased by \$599.1 million or 85.4% over last year.

The State made a contribution of \$64.4 million for fiscal year 2009, which was received in September 2009 after the close of the fiscal year. The amount contributed for fiscal year 2009 was equal to 4.8% of the actuarially determined statutory amount.

Net investment income decreased by \$4.3 billion or 561.8% due to depreciation of investments.

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

Deductions are comprised of pension benefit payments to retirees and beneficiaries, refunds of contributions to former members, and administrative costs incurred by the Fund. Benefit payments increased by \$191.9 million or 7.2% partly due to an increase in the number of retirees. The amount of refunds processed increased by \$0.5 million or 1.2%. Administrative expenses decreased by \$1.0 million or 7.5%.

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Management's Discussion and Analysis

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**Retirement System as a Whole**

The overall funded ratios are 63.8% for fiscal year 2010 and 70.8% for fiscal year 2009.

**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 Fund's finances and to show the Fund's accountability for the money it receives. If you have any questions about this report or need additional financial information, contact the Division of Pensions and Benefits, P.O. Box 295, Trenton, NJ 08625-0295.

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Statements of Fiduciary Net Assets

June 30, 2010 and 2009

	<b>2010</b>	<b>2009</b>
<b>Assets:</b>		
Cash	\$ 5,951,038	2,936,186
Securities lending collateral	6,259,402	1,892,972,399
<b>Investments, at fair value:</b>		
Cash Management Fund	631,830,152	685,734,480
Common Pension Fund A	5,465,008,139	6,514,571,407
Common Pension Fund B	9,619,507,449	8,656,407,224
Common Pension Fund D	5,128,988,578	4,739,918,199
Common Pension Fund E	4,769,959,289	3,981,648,973
Mortgages	41,075,421	51,882,265
Total investments	25,656,369,028	24,630,162,548
<b>Receivables:</b>		
<b>Contributions:</b>		
Members	78,257,903	83,068,268
Employers	74,494,876	137,600,439
Accrued interest and dividends	149,589,936	303,904,231
Members' loans	217,644,202	168,157,525
Other	4,159,840	6,689,888
Total receivables	524,146,757	699,420,351
Total assets	26,192,726,225	27,225,491,484
<b>Liabilities:</b>		
Accounts payable and accrued expenses	40,531,632	35,108,366
Retirement benefits payable	250,004,387	246,290,108
Non-contributory group insurance premiums payable	3,492,134	3,203,635
Securities lending collateral and rebates payable	6,202,239	1,902,068,547
Total liabilities	300,230,392	2,186,670,656
<b>Net assets:</b>		
Held in trust for pension benefits	\$ 25,892,495,833	25,038,820,828

See accompanying notes to financial statements.

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Statements of Changes in Fiduciary Net Assets

Years ended June 30, 2010 and 2009

	<b>2010</b>	<b>2009</b>
Additions:		
Contributions:		
Members	\$ 615,862,621	616,222,799
Employers	42,850,384	102,472,305
Total contributions	658,713,005	718,695,104
Investment income:		
Net appreciation (depreciation) in fair value of investments	2,478,871,675	(5,910,267,629)
Interest	675,474,508	615,308,504
Dividends	126,945,078	226,755,534
	3,281,291,261	(5,068,203,591)
Less investment expense	3,866,796	3,645,128
Net investment income (loss)	3,277,424,465	(5,071,848,719)
Total additions	3,936,137,470	(4,353,153,615)
Deductions:		
Benefits	3,028,193,433	2,869,565,540
Refunds of contributions	41,945,223	41,197,344
Administrative and miscellaneous expenses	12,323,809	12,746,750
Total deductions	3,082,462,465	2,923,509,634
Change in net assets	853,675,005	(7,276,663,249)
Net assets – beginning of year	25,038,820,828	32,315,484,077
Net assets – end of year	\$ 25,892,495,833	25,038,820,828

See accompanying notes to financial statements.

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**(1) Description of the Fund**

The State of New Jersey Teachers' Pension and Annuity Fund (the Fund; TPAF) is a cost-sharing contributory defined benefit plan with a special funding situation which was established as of January 1, 1955, under the provisions of N.J.S.A. 18A:66. The Fund is included along with other state-administered pension trust and agency funds in the basic financial statements of the State of New Jersey.

The Fund's designated purpose is to provide retirement benefits, death, disability and medical benefits to certain qualified members. Membership in the Fund is mandatory for substantially all teachers or members of the professional staff certified by the State Board of Examiners, and employees of the Department of Education who have titles that are unclassified, professional and certified. The Fund's Board of Trustees is primarily responsible for the administration of the Fund.

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

***Vesting and Benefit Provisions***

The vesting and benefit provisions are set by N.J.S.A. 18A:66. The TPAF provides retirement, death and disability benefits. All benefits vest after ten years of service, except for medical benefits, which vest after 25 years of service or under the disability provisions of the Fund. Retirement benefits for age and service are available at age 60 and are generally determined to be 1/55 of final average salary for each year of service credit, as defined. Final average salary equals the average salary for the final three years of service prior to retirement (or highest three years' compensation if other than the final three years). Members may seek early retirement after achieving 25 years service credit, as defined, or they may elect deferred retirement after achieving ten years of service credit, in which case benefits would begin the first day of the month after the member attains normal retirement age.

Members are always fully vested for their own contributions and, after three years of service credit, become vested for 2% of related interest earned on the contributions. In the case of death before retirement, members' beneficiaries are entitled to full interest credited to the members' accounts.

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

Chapter 103, P.L. 2007 amended the early retirement reduction formula for members hired on or after July 1, 2007 and retiring with 25 years of service to be reduced by 1% for every year between age 55 and 60, plus 3% for every year under age 55.

Chapter 89, P.L. 2008 increased the TPAF eligibility age for unreduced benefits from age 60 to age 62 for members hired on or after November 1, 2008; increased the minimum annual compensation required for

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membership eligibility for new members. Also, it amended the early retirement reduction formula for members hired on or after November 1, 2008 and retiring with 25 years of service to 1% for every year between age 55 and 62, plus 3% for every year under age 55.

Chapter 1, P.L. 2010, effective May 21, 2010, changed the membership eligibility criteria for new members of TPAF from the amount of annual compensation to the number of hours worked weekly. Also, it returned the benefit multiplier for new members of TPAF to 1/60 from 1/55, and it provided that new members of TPAF have the retirement allowance calculated using the average annual compensation for the last five years of service instead of the last three years of service. New members of TPAF will no longer receive pension service credit from more than one employer. Pension service credit will be earned for the highest paid position only. This law also requires the State to make its full pension contribution, defined as 1/7th of the required amount, beginning in fiscal year 2012.

Chapter 3, P.L. 2010, effective May 21, 2010, replaced the accidental and ordinary disability retirement for new members of TPAF with disability insurance coverage similar to that provided by the State to individuals enrolled in the State's Defined Contribution Retirement Program.

***Membership and Contributing Employers***

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

	<b>2009</b>	<b>2008</b>
Retirees and beneficiaries receiving benefits currently and terminated employees entitled to benefits but not yet receiving them	78,782	76,068
Active members:		
Vested	78,829	76,368
Nonvested	78,280	79,719
Total active members	157,109	156,087
Total	235,891	232,155
Contributing employers	35	38

**(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 Fund 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 Fund. Under this method, revenues are recorded in the accounting period in which they are earned, and deductions are recorded at the time the liabilities are incurred. The financial statements of the Fund conform to the provisions of Governmental Accounting Standards Board (GASB) Statement No. 25,

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*Financial Reporting for Defined Benefit Plans and Note Disclosures for Defined Contributions Plans.* Employer contributions are recognized when payable to the Fund. Benefits and refunds are recognized when due and payable in accordance with the terms of the Fund.

***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.

Investments are reported at fair value as follows:

- U.S. Government and Agency, Foreign and Corporate obligations – prices quoted by a major dealer in such securities.
- Common Stock and Equity Funds, Foreign Equity Securities, Forward Foreign Exchange Contracts – closing prices as reported on the primary market or exchange on which they trade.
- Money Market Instruments – amortized cost which approximates fair value.
- Cash Management Fund (CMF) – closing bid price on the last day of trading during the period as determined by the Transfer Agent.
- Mortgages – priced by a major dealer in such securities and reviewed by management for reasonableness.
- Alternative investments (private equity, real estate, real asset, and absolute return strategy funds) – Fair values for the individual funds are based upon the net asset values for the funds at the closest available reporting date, adjusted for subsequent contributions, distributions, management fees and reserves. The valuation techniques vary based upon investment type and involve a certain degree of expert judgment. The most significant input into the net asset value of an entity is the value of its investment holdings. The net asset value is provided by the general partner and/or investment manager and reviewed by management. The net asset values are audited annually. The strategy of private equity and real estate funds are long term and illiquid in nature which can prevent the investment from being readily marketable. Hedge funds may be subject to redemption restrictions which can limit distributions and restrict the ability of a limited partner to exit a partnership. For alternative investments, the realized value received upon the sale of these investments in the open market might be different than the fair value reported in the accompanying financial statements.

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

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

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

***Securities Lending***

The State Investment Council policies permit Common Funds A, B and D and several of the direct pension plan portfolios to participate in securities lending programs, whereby securities are loaned to brokers or other borrowers and, in return, the pension funds have rights to the collateral received. All of the securities held in Common Funds A, B and D, and certain securities held directly by the pension plans, are eligible for the securities lending program. Collateral received may consist of cash, letters of credit, or government securities having a market value equal to or exceeding 102% (U.S. dollar denominated) or 105% (non-U.S. dollar denominated) of the value of the loaned securities at the time the loan is made. For Common Funds A and B, in the event that the market value of the collateral falls below 101% of the market value of all the outstanding loaned securities to an individual borrower, additional collateral shall be transferred by the borrower to the respective funds no later than the close of the next business day so that the market value of such additional collateral, when added to the market value of the other collateral, shall equal 102% of the market value of the loaned securities. For Common Fund D, in the event that the market value of the collateral falls below the collateral requirement of either 102% or 105% (depending on whether the securities are denominated in U.S. dollars or a foreign currency, respectively) of the market value of the outstanding loaned securities to an individual borrower, additional collateral shall be transferred in an amount that will increase the aggregate of the borrower's collateral to meet the collateral requirements. The securities lending contracts do not allow the Common Funds to pledge or sell any collateral securities unless the borrower defaults. As of June 30, 2010 and 2009, the Common Funds have no aggregate credit risk exposure to brokers because the collateral amount held by the Common Funds exceeded the market value of the securities on loan.

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

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

***Derivatives***

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

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

This Statement addresses the recognition, measurement, and disclosure of information regarding derivative instruments entered into by state and local governments. Derivative instruments are often complex financial arrangements used by governments to manage specific risks or to make investments. A derivative security is an investment whose payoff depends upon the value of other assets such as bond and stock prices, a market index, or commodity prices. By entering into these arrangements, governments receive and make payments based on market prices without actually entering into the related financial or commodity transactions. Derivative instruments associated with changing financial and commodity prices result in changing cash flows and fair values that can often be used as effective risk management or investment tools. Derivative instruments, however, can also expose governments to significant risks and liabilities. Derivative transactions involve, to varying degrees, credit risk and market risk. Credit risk is the possibility that a loss may occur because a party to a transaction fails to perform according to terms. Market risk is the possibility that a change in market prices or currency rates will cause the value of a financial instrument to decrease or become more costly to settle. Common types of derivative instruments used by governments include interest rate and commodity swaps, interest rate locks, options (caps, floors, and collars), swaptions, forward foreign currency contracts, and futures contracts.

The Division of Investment, from time to time, utilizes forward foreign currency contracts, a derivative security, as a means to hedge against currency risks in the Common Funds' foreign equity and fixed income portfolios. Forward foreign currency contracts are agreements to buy or sell a specific amount of a foreign currency at a specified delivery or maturity date for an agreed upon price.

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

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

The Common Funds utilize covered call and put options in an effort to add value to or reduce the risk level in the portfolio. Options are agreements that give the owner of the option the right, but not obligation, to buy (in the case of a call option) or to sell (in the case of a put option) a specific amount of an asset for a specific price (called the strike price) on or before a specified expiration date. The Common Funds enter into covered calls when they write (or sell) call options on underlying stocks held by the Common Funds or stock indices. The Common Funds enter into covered put options when they purchase put options on underlying stocks held by the Common Funds or stock indices. The purchaser of put options pays a premium at the outset of the agreement and stands to gain from an unfavorable change (i.e., a decrease) in the price of the instrument underlying the option. The writer of call options receives a premium at the outset of the agreement and bears the risk of an unfavorable change (i.e., an increase) in the price of the instrument underlying the option. The Common Funds did not have any written call or put option contracts as of June 30, 2010. The Common Funds had written call options on 25,737,000 shares, and these options had a fair value of \$10,862,850 as of June 30, 2009. The Common Funds owned 102,950 put option contracts on the S&P 500 index with a fair value of \$22,717,250 as of June 30, 2009.

Certain alternative investment funds and partnerships may use derivative instruments to hedge against market risk and to enhance investment returns. At any point during the year, the Common Funds may have additional exposure to derivatives primarily through limited liability vehicles such as limited partnerships and commingled investment funds. The Common Funds recognize the fair value of all derivative instruments as either an asset or liability in the accompanying financial statements with the offsetting gains or losses recognized in earnings.

***Members' Loans***

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

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.

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Chapter 92, P.L. 2007 eliminated the 4% fixed rate of interest for loans from the defined benefit plans and provided that the rate of interest will be set by the State Treasurer at a commercially reasonable rate as required by the Internal Revenue Code and permitted that an administrative processing fee may be charged for such loans. As such, effective January 1, 2008, an \$8.00 processing fee per loan was charged, and the new pension loan interest rate became 3.33% per year for year 2009 and 3.25% for year 2010.

***Administrative Expenses***

The Fund is administered by the State of New Jersey Division of Pensions and Benefits. Administrative expenses are paid by the Fund to the State of New Jersey, Department of the Treasury, and are included in the accompanying financial statements.

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

***Commitments***

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

***Use of Estimates***

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

***Funded Status and Funding Progress***

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

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.

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***Actuarial Methods and Assumptions***

In the June 30, 2009 and 2008 actuarial valuations, the projected unit credit was used as the actuarial cost method, and the five year average of market value was used as the asset valuation method for the Fund. The actuarial assumptions included (a) 8.25% for investment rate of return and (b) 5.74% for projected salary increases as of June 30, 2009 and 2008.

Actuarial valuation date	June 30, 2009	June 30, 2008
Actuarial value of assets	\$ 34,838,211,259	\$ 36,664,627,629
Actuarial accrued liability	54,576,061,024	51,754,814,521
Unfunded actuarial accrued liability	19,737,849,765	15,090,186,892
Funded ratio	63.8%	70.8%
Covered payroll	\$ 9,747,020,000	\$ 9,419,083,203
Unfunded actuarial accrued liability as a percentage of covered payroll	202.5%	160.2%
Actuarial cost method	Projected unit credit	Projected unit credit
Asset valuation method	5 year average of market value	5 year average of market value
Amortization method	Level percent, open	Level percent, open
Payroll growth rate for amortization	4.00%	4.00%
Remaining amortization period	30 years	30 years
Actuarial assumptions:		
Interest rate	8.25%	8.25%
Salary range	5.74%	5.74%
Cost-of-living adjustments	1.80%	1.80%

**(3) Investments**

The Fund is invested in Common Fund A, Common Fund B, Common Fund D, Common Fund E, and other investments, including mortgage backed securities, which represent 35.1%, 41.0%, 39.9%, 43.9%, and 2.9%, respectively, of each investment total of the pension fund as of June 30, 2010.

The Fund is invested in Common Fund A, Common Fund B, Common Fund D, Common Fund E, and other investments, including mortgage backed securities, which represent 39.2%, 40.0%, 38.2%, 49.3%, and 3.4%, respectively, of each investment total of the pension fund as of June 30, 2009.

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

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

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

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

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

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

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

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These credit ratings and limits are as follows:

Category	Minimum rating <sup>(1)</sup>			Limitation of issuer's outstanding debt	Limitation of issue	Other limitations
	Moody's	S&P	Fitch			
Corporate obligations	Baa3	BBB-	BBB-	10%	25%	Not more than 5% of fund assets can be invested in debt and non-convertible preferred stock of one issuer (3)
International corporate obligations	Baa3	BBB-	BBB-	10%	25%	Not more than 5% of fund assets can be invested in debt and non-convertible preferred stock of any one issuer (2)(3); not more than 10% of fund assets can be invested in this category
International government and agency obligations	Baa3	BBB-	BBB-	25%	Greater of 25% or \$10 million	—
Collateralized notes and mortgages	Baa3	BBB-	BBB-	—	25%	Not more than 5% of fund assets can be invested in any one issue; not more than 10% of fund assets (or 20% of Common Fund B assets) can be invested in this category
Commercial paper	P-1	A-1	F1	—	—	—
Certificates of deposit and Banker's acceptances:						Certificates of deposit and banker's acceptances cannot exceed 10% of issuer's primary capital
Domestic	A3/P-1	A-/A-1	A-/F1	—	—	
International	Aa3/P-1	AA-/A-1	AA-/F1	—	—	
Credit default swap transactions (4)	A1	A+	A+	—	—	Nominal value of net exposure to any one counterparty shall not exceed 10% of fund assets
Guaranteed income contracts and funding agreements	A3	A-	A-	—	—	—
Money market funds	—	—	—	—	—	Not more than 10% of fund assets can be invested in money market funds; limited to 5% of shares or units outstanding

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Category	Minimum rating <sup>(1)</sup>			Limitation of issuer's outstanding debt	Limitation of issue	Other limitations
	Moody's	S&P	Fitch			
Interest rate swap transactions (5)	A1	A+	A+	—	—	Notional value of net exposure to any one counterparty shall not exceed 10% of fund assets
Repurchase agreements	Aa3	AA-	AA-	—	—	—
State & municipal obligations (6)	A3	A-	A-	10%	10%	Not more than 2% of fund assets can be invested in debt of any one political entity maturing more than 12 months from purchase
Public authority revenue obligations	A3	A-	A-	—	10%	Not more than 2% of fund assets can be invested in any one public authority
Mortgage backed pass-through securities	A3	A-	A-	—	—	Not more than 5% of fund assets can be invested in any one issue
Mortgage backed senior debt securities	—	—	—	—	25%	Not more than 5% of fund assets can be invested in any one issue
Non-convertible preferred stocks of US corporations (4)	Baa3	BBB-	BBB-	10%	25%	Not more than 5% of fund assets can be invested in debt and non-convertible stock of any one corporation
Bank loans (4)	Baa3	BBB-	BBB-	10%	—	Not more than 10% of fund assets can be invested in this category

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

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

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

(4) Effective December 15, 2008.

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

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

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

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

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

		June 30, 2010							
		Standard & Poor's & Fitch ratings							
(In thousands)		Standard & Poor's					Fitch	Totals	
		A	AA	B	BB	BBB	CCC	B	
International corporate obligations	\$	—	—	2,788	920	—	213	—	3,921
Foreign government obligations		26,970	109,006	—	—	—	—	—	135,976
Corporate obligations		28,098	83,426	27,782	22,410	135,629	4,034	—	301,379
SBA passthrough certificates		—	—	1,990	760	—	—	—	2,750
Asset backed obligations		—	203,810	—	—	—	—	—	203,810
Other		87,458	100,644	—	—	—	—	45,956	234,058
	\$	<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 above tables do not include certain domestic and international corporate obligations including certain exchange traded funds (ETFs) totaling \$321,336,486, which invest in an underlying portfolio of fixed income securities and do not have a Moody's, Standard & Poor's or Fitch rating. The Police and Firemen's Mortgages and the CMF are also unrated.

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

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

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

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The 2009 tables above do not include certain domestic and international corporate obligations including certain ETFs totaling \$239,029,550 which invest in an underlying portfolio of fixed income securities and do not have a Moody's, Standard & Poor's or Fitch rating. The Police and Firemen's Mortgages and the CMF are unrated.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Commercial paper must mature within 270 days. Certificates of deposits and bankers acceptances are limited to a term of one year or less. Repurchase agreements must mature within 30 days. The investment in guaranteed income contracts and funding agreements is limited to a term of 10 years or less.

The following tables summarize the maturities (or, in the case of Remics, Police and Firemen's Mortgages and mortgage-backed securities, the expected average life) of the fixed income portfolio as of June 30, 2010 and 2009:

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

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

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. The pension funds invest in global markets. The market value of international preferred and common stocks and issues convertible into common stocks, when combined with the market value of international government and agency obligations, cannot exceed 30% of the market value of the pension funds. The market value of emerging market securities cannot exceed more than 1.5 times the percentage derived by dividing the total market capitalization of companies included in the Morgan Stanley Capital International (MSCI) Emerging Market Index by the total market capitalization of the companies included in the MSCI All-Country World Ex-United States Index of the total market value of the assets held by Common Fund D. Not more than 10% of the market value of the emerging market securities can be invested in the common and preferred stock of any one corporation; the total amount of stock purchased of any one corporation cannot exceed 5% of its stock classes eligible to vote. Council regulations permit the pension funds to enter into foreign exchange contracts for the purpose of hedging the international portfolio. The pension funds held forward contract receivables totaling approximately \$1.95 billion and payables totaling approximately \$1.96 billion (with a \$13.0 million net exposure) as of June 30, 2010. The pension funds held forward contract receivables totaling approximately \$4.9 billion and payables totaling approximately \$4.7 billion (with a \$126 million net exposure) as of June 30, 2009.

**STATE OF NEW JERSEY  
TEACHERS' PENSION AND ANNUITY FUND**

Notes to Financial Statements

June 30, 2010 and 2009

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

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

**STATE OF NEW JERSEY  
TEACHERS' PENSION AND ANNUITY FUND**

Notes to Financial Statements

June 30, 2010 and 2009

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

The pension funds' interests in alternative investments may contain elements of credit, currency and market risk. Such risks include, but are not limited to, limited liquidity, absence of regulatory oversight, dependence upon key individuals, speculative investments (both derivatives and nonmarketable investments), and nondisclosure of portfolio composition. Effective August 18, 2008, Council regulations provide that not more than 28% of the market value of the pension funds can be invested in alternative investments, with the individual categories of real estate, real assets, private equity and absolute return strategy investments limited to 7%. Prior to that, the overall limitation was 18%. Not more than 5% of the market value of Common Fund E, plus outstanding commitments, may be committed to any one partnership or investment, without the prior written approval of the Council. The investments in Common Fund E cannot comprise more than 20% of any one investment manager's total assets.

**STATE OF NEW JERSEY  
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Notes to Financial Statements

June 30, 2010 and 2009

**(4) Securities Lending Collateral**

The Fund's share in the securities lending program is 37.5% and 39.5% of the total market value of the collateral as of June 30, 2010 and 2009, respectively.

The securities lending collateral is subject to various risks. Among these risks are credit risk, concentration of credit risk, and interest rate risk. Agreements with the lending agents require minimum credit ratings for certain categories of fixed income obligations and limit the amount that can be invested in any one issuer or issue. These limits are consistent with Council regulations and internal policies for funds managed by the Division of Investment; from time to time the Division of Investment may impose more stringent policies based on market conditions.

Effective December 15, 2008, the following limits became effective:

Category	Minimum rating			Limitation of issuer's outstanding debt	Limitation of issue	Other limitations
	Moody's	S&P	Fitch			
Corporate obligations	A2	A	A	10%	25%	—
Collateralized notes and mortgages	Aa	AA	AA	—	25%	Limited to not more than 10% of the assets of the collateral portfolio
Commercial paper	P-1	A-1	F1	—	—	Dollar limits by issuer
Certificates of deposit/ Banker's acceptances:						Certificates of deposit and banker's acceptances' cannot exceed 10% of issuer's primary capital; dollar limits by issuer
Domestic	A2/P-1	A/A-1	A/F1	—	—	
International	Aa3/P-1	AA-/A-1	AA-/F1	—	—	
Guaranteed income contracts and funding agreements	A2	A	A	—	—	Limited to 5% of the assets of the collateral portfolio
Money market funds	—	—	—	—	—	Limited to 10% of the assets of the collateral portfolio; limited to approved money market funds

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Notes to Financial Statements

June 30, 2010 and 2009

Through December 14, 2008, the following limits were effective:

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

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

Commercial paper maturities cannot exceed 270 days. Repurchase agreement maturities cannot exceed 30 days. Certificates of deposit and banker's acceptances must mature in one year or less.

**STATE OF NEW JERSEY  
TEACHERS' PENSION AND ANNUITY FUND**

Notes to Financial Statements

June 30, 2010 and 2009

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

Total exposure to any individual issuer is limited, except for U.S. Treasury and Government agency obligations. For money market funds, the total amount of shares or units purchased or acquired of any money market fund shall not exceed 5% of the shares or units outstanding of said money market fund. For Collateralized notes and mortgages, not more than 2% and 5% of the assets of the collateral portfolio shall be invested in the obligations of any one issuer and issue, respectively. For Guaranteed income contracts and funding agreements, the total investment in any one issuer shall be limited to 2.5% of the collateral portfolio. Prior to December 15, 2008, the Division of Investment set individual issuer limits for Commercial paper and Certificate of deposits; subsequently, the Division of Investment set issuer limits for all investments in the collateral portfolio.

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

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

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

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

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

**STATE OF NEW JERSEY  
TEACHERS' PENSION AND ANNUITY FUND**

Notes to Financial Statements

June 30, 2010 and 2009

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

**(5) Contributions**

The contribution policy is set by N.J.S.A. 18:66 and requires contributions by active members and contributing employers. Plan member and employer contributions may be amended by State of New Jersey legislation. The full normal employee contribution rate became 5.5% of annual compensation, effective July 1, 2007 based on Chapter 103, P.L. 2007. 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.

Chapter 103, P.L. 2007 also provided that for members hired on or after July 1, 2007, the amount of compensation used for employer and member contributions and benefits under the TPAF cannot exceed the annual maximum wage contribution base for Social Security, pursuant to the Federal Insurance Contributions Act.

The State did not make a pension contribution for fiscal year 2010 but did make a contribution of \$33.2 million for NCGI death benefits. Also, included in the employer contributions are the annual billing to local employers who participate in the various early retirement incentives (ERI) programs and other miscellaneous items that were due the fund. Chapter 1, P.L. 2010, effective May 21, 2010, requires the State to make its full pension contribution, defined as 1/7th of the required amount, beginning in fiscal year 2012.

The State made a contribution of \$64.4 million for fiscal year 2009, which was received in September 2009 after the close of the fiscal year, excluding the State's contribution of NCGI of \$31.5 million, ERI of \$1.6 million, and others of \$4.9 million. The amount contributed for fiscal year 2009 was equal to 4.8% of the actuarially determined statutory amount.

**(6) Funds**

TPAF maintains the following legally required funds as follows:

***Members' Annuity Savings and Accumulative Interest Fund (2010 – \$9,151,924,963; 2009 – \$8,516,171,923)***

The Members' Annuity Savings Fund (ASF) is credited with all contributions made by active members of the Fund. Interest earned on member contributions is credited to the Accumulative Interest Fund. Member withdrawals are paid out of this Fund.

**STATE OF NEW JERSEY  
TEACHERS' PENSION AND ANNUITY FUND**

Notes to Financial Statements

June 30, 2010 and 2009

***Contingent Reserve Fund (2010 – \$-14,689,465,856; 2009 – \$-12,874,495,068)***

The Contingent Reserve Fund is credited with the contributions of contributing employers. Interest earnings, after crediting the Accumulative Interest Fund, Retirement Reserve Fund, and Special Reserve Fund, as required, are credited to this account. Additionally, payments for life insurance premiums and administrative expenses are made from this Fund.

***Retirement Reserve Fund (2010 – \$31,300,925,627; 2009 – \$29,264,887,048)***

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 together with accumulated interest, are transferred to the Retirement Reserve Fund from the Members' ASF and Accumulative Interest Fund. Any additional reserves needed to fund the balance of the retirement benefit are transferred from the Contingent Reserve Fund. Annually, interest as determined by the State Treasurer (8.25% for fiscal years 2010 and 2009) is credited to the Retirement Reserve Fund.

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

The Special Reserve Fund is the fund to which 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 allocated to the Fund, excluding Cash Management Fund investments allocated to the Contributory Group Insurance Premium Fund which amounted to \$133.0 million and \$134.0 as of June 30, 2010 and 2009, respectively. Amounts in excess of 1% are credited to the Contingent Reserve Fund.

***Contributory Group Insurance Premium Fund (2010 – \$129,111,099; 2009 – \$132,256,925)***

The Contributory Group Insurance Premium Fund represents the accumulation of member group insurance contributions in excess of premiums disbursed to the insurance carrier since the inception of the contributory death benefit program plus reserves held by the insurance carrier. Members are required by statute to participate in the contributory group insurance plan in the first year of membership and may cancel the contributory coverage thereafter. The current contribution rate for active members is 0.4 of 1% of salary, as defined.

***Non-Contributory Group Insurance Premium Fund (2010 – \$0; 2009 – \$0)***

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

**(7) Income Tax Status**

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

**STATE OF NEW JERSEY  
TEACHERS' PENSION AND ANNUITY FUND**

Required Supplementary Information

Schedule of Funding Progress

(Unaudited - See accompanying independent auditors' 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)
June 30, 2004	\$ 34,633,790,549	40,447,690,339	5,813,899,790	85.6%	\$ 8,047,272,269	72.2%
June 30, 2005	34,789,389,875	43,967,927,299	9,178,537,424	79.1	8,454,072,109	108.6
June 30, 2006	35,531,294,790	46,539,868,653	11,008,573,863	76.3	8,748,623,186	125.8
June 30, 2007	36,714,578,745	49,161,247,363	12,446,668,618	74.7	9,077,628,813	137.1
June 30, 2008	36,664,627,629	51,754,814,521	15,090,186,892	70.8	9,419,083,203	160.2
June 30, 2009	34,838,211,259	54,576,061,024	19,737,849,765	63.8	9,747,020,060	202.5

**STATE OF NEW JERSEY  
TEACHERS' PENSION AND ANNUITY FUND**

Required Supplementary Information

Schedule of Funding Progress – Additional Actuarial Information

(Unaudited - See accompanying independent auditors' report)

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

	<u>June 30, 2009</u>	<u>June 30, 2008</u>
Actuarial cost method	Projected unit credit	Projected unit credit
Asset valuation method	5 year average of market value	5 year average of market value
Amortization method	Level percent, open	Level percent, open
Payroll growth rate for amortization	4.00%	4.00%
Remaining amortization period	30 years	30 years
Actuarial assumptions:		
Interest rate	8.25%	8.25%
Salary range	5.74%	5.74%
Cost-of-living adjustments	1.80%	1.80%

**STATE OF NEW JERSEY  
TEACHERS' PENSION AND ANNUITY FUND**

Required Supplementary Information

Schedule of Employer Contributions

(Unaudited - See accompanying independent auditors' report)

<b>Year ended June 30</b>	<b>Annual required contribution</b>	<b>Employer contributions<sup>(2)</sup></b>	<b>Percentage contributed</b>
2005	\$ 883,460,483	—	—
2006	1,177,674,055	94,226,363 <sup>(1)</sup>	8.0%
2007	1,407,249,580	690,794,259	49.1
2008	1,550,503,835	695,275,811	44.8
2009	1,601,478,508	95,863,972	6.0
2010	1,796,358,016	96,579,654	5.4

Notes to schedule:

- (1) As of June 30, 2005 actuarial valuation, the assets in the Benefit Enhancement Fund were fully depleted. In fiscal year 2006, the State started to make a contribution to the Fund to satisfy the actuarially accrued liability.
- (2) Differences between the amounts in the employer contribution column in this schedule and the amounts recorded in the financial statements and footnotes are attributed to timing differences between the 2009 actuarial valuations and the actual amounts received in fiscal year 2010. Employer contributions per this schedule represent anticipated contribution amounts determined at the time the actuarial valuations were prepared and finalized prior to the end of fiscal year 2010. The financial statements and footnotes reflect the actual amounts received in 2010.

**STATE OF NEW JERSEY  
TEACHERS' PENSION AND ANNUITY FUND**

Schedule of Changes in Fiduciary Net Assets by Fund

Year ended June 30, 2010

	<b>Members' annuity savings and accumulative interest fund</b>	<b>Contingent Reserve Fund</b>	<b>Retirement Reserve Fund</b>	<b>Special Reserve Fund</b>	<b>Contributory Group Insurance Premium Fund</b>	<b>Non-Contributory Group Insurance Premium Fund</b>	<b>Total</b>
Additions:							
Contributions:							
Members	\$ 576,110,459	—	—	—	39,752,162	—	615,862,621
Employers	—	9,650,729	—	—	—	33,199,655	42,850,384
Total contributions	576,110,459	9,650,729	—	—	39,752,162	33,199,655	658,713,005
Distribution of net investment income	658,332,483	126,200,618	2,492,291,101	—	600,263	—	3,277,424,465
Total additions	1,234,442,942	135,851,347	2,492,291,101	—	40,352,425	33,199,655	3,936,137,470
Deductions:							
Benefits	—	—	2,951,495,527	—	43,498,251	33,199,655	3,028,193,433
Refunds of contributions	41,593,994	351,229	—	—	—	—	41,945,223
Administrative and miscellaneous expenses	—	12,323,809	—	—	—	—	12,323,809
Total deductions	41,593,994	12,675,038	2,951,495,527	—	43,498,251	33,199,655	3,082,462,465
Net increase (decrease) before transfers among reserves	1,192,848,948	123,176,309	(459,204,426)	—	(3,145,826)	—	853,675,005
Transfers among reserves:							
Retirements	(559,231,652)	(997,656,013)	1,556,887,665	—	—	—	—
Other	2,135,744	(940,491,084)	938,355,340	—	—	—	—
Net increase (decrease)	635,753,040	(1,814,970,788)	2,036,038,579	—	(3,145,826)	—	853,675,005
Net assets held in trust for pension and post-retirement medical benefits:							
Beginning of year	8,516,171,923	(12,874,495,068)	29,264,887,048	—	132,256,925	—	25,038,820,828
End of year	\$ 9,151,924,963	(14,689,465,856)	31,300,925,627	—	129,111,099	—	25,892,495,833