NEW YORK STATE AND LOCAL RETIREMENT SYSTEM

Financial Statements and Supplementary Information

Fiscal Year Ended March 31, 2012

(With Independent Auditors' Report Thereon)

NEW YORK STATE AND LOCAL RETIREMENT SYSTEM

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KPMG LLP
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Albany, NY 12207-2974

Independent Auditors' Report

The Trustee
New York State and Local Retirement System:

We have audited the accompanying statement of plan net assets of the New York State and Local Retirement System (the System) as of March 31, 2012, and the related statement of changes in plan 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 audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. 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 also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 present fairly, in all material respects, the plan net assets of the New York State and Local Retirement System as of March 31, 2012, and changes in its plan net assets for the year then ended, in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued a report dated July 13, 2012, on our consideration of the System's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance, and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

U.S. generally accepted accounting principles require that the management's discussion and analysis and required supplementary information as listed in the accompanying table of contents be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements.

We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements of the System. The accompanying additional supplementary information as listed in the accompanying table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The additional supplementary information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the additional supplementary information is fairly stated in all material respects in relation to the basic financial statements as a whole.

KPMG LLP

July 13, 2012

The following overview of the financial activity of the New York State and Local Retirement System (the System) for the fiscal year ended March 31, 2012 is intended to provide the reader with an analysis of the System's overall financial position. This management's discussion and analysis should be read in conjunction with the basic financial statements of the System, which follow.

Financial Highlights

- The net assets of the System held in trust to pay pension benefits were $153.394 billion as of March 31, 2012. This amount reflects an increase of $3.846 billion from the prior fiscal year. This change is primarily the result of the net appreciation of the fair value of the investment portfolio. Investment appreciation for the fiscal years ended March 31, 2012 and 2011 is $4.959 billion and $16.741 billion, respectively.
- The System's funding objective is to meet long-term benefit obligations through member and employer contributions and investment earnings. The funded ratio is the ratio of actuarially determined assets against actuarial liabilities. The funded ratio for April 1, 2011 is: Employees' Retirement System (ERS) 90.2 percent, Police and Fire Retirement System (PFRS) 91.9 percent.
- Retirement and death benefits paid this year totaled $8.863 billion to 403,174 annuitants as compared to $8.465 billion to 385,031 annuitants for last year. The increase is due to the number of new retirees.
- Contributions from employers increased from $4.165 billion last year to $4.585 billion this year.
- The System's investments reported a total positive return of 5.96 percent for the current year and a positive return of 14.57 percent for last year.

Overview of the Financial Statements

The financial statements consist of the statement of plan net assets, statement of changes in plan net assets, and the notes to the financial statements. The required supplementary information that appears after the notes to the financial statements is not a required part of the financial statements, but is supplementary information required by the Governmental Accounting Standards Board. The additional supplementary information following the required supplementary information is also not required, but management has chosen to include such information.

The statement of plan net assets reflects the resources available to pay members, retirees, and beneficiaries at the close of the System's fiscal year. This statement also provides information about the fair value and composition of net assets.

The statement of changes in plan net assets presents the changes to the System's net assets for the fiscal year, including net investment income, net appreciation or depreciation in fair value of the investment portfolio, and contributions from members and employers. Benefits and administrative expenses paid by the System are included under the deductions section of the statement.

The notes to the financial statements are an integral part of the basic financial statements and provide additional information about the plans of the System. Notes include a plan description, significant accounting policies, funding status and funding progress, System reserves, deposit and investment risk disclosure, derivatives, securities lending program, federal income tax status, commitments, and contingencies.

(Continued)

The required supplementary schedules include information about funding progress using the entry age normal funding method to approximate the funding status of the System. The aggregate actuarial funding method, which does not identify or separately amortize unfunded actuarial liabilities, is utilized by the System for funding purposes. In addition, employer contributions for the current year and the previous five years are reported.

The additional supplementary information includes schedules of administrative expenses, investment expenses, and consulting fees.

Analysis of Overall Financial Position of the System

The purpose of the System's investments is to provide for long-term growth, while also ensuring a reliable cash flow that meets the funding requirements of the near-term pension obligation. To achieve these goals, the investments are allocated to a variety of asset types and strategies in order to meet the current funding needs and future growth requirements of the pension liability. Equity-related investments are included for their long-term return and growth characteristics, while fixed income and debt-related investments are included in the allocation for their ability to control investment risk and provide for a reliable cash flow that meets the funding requirements of the pension payments. It is important to note that the change from year to year is due not only to changes in fair values, but also to purchases, sales, and redemptions. Tables 1, 2, and 3 summarize and compare financial data for the current and prior years.

Table 1

Summary schedule of plan net assets as of March 31, 2012, as compared to March 31, 2011, follows:

	2012	2011	Dollar change	Percentage change
		(In Thousands)		
Assets:				
Investments	$ 150,658,883	$ 147,237,006	$ 3,421,877	2.3%
Securities lending collateral – invested	4,895,247	7,498,089	(2,602,842)	(34.7)
Receivables and other assets	4,037,749	4,179,904	(142,155)	(3.4)
Total assets	159,591,879	158,914,999	676,880	0.4
Liabilities:				
Securities lending obligations	5,077,571	7,678,952	(2,601,381)	(33.9)
Payables and other liabilities	1,119,874	1,687,496	(567,622)	(33.6)
Total liabilities	6,197,445	9,366,448	(3,169,003)	(33.8)
Net assets held in trust for pension benefits	$ 153,394,434	$ 149,548,551	$ 3,845,883	2.6%

The plan net assets of the System totaled $153.394 billion as of March 31, 2012, an increase of $3.846 billion from the prior fiscal year.

(Continued)

Table 2

Schedule of invested assets as of March 31, 2012, as compared to March 31, 2011, follows:

	2012	2011		Dollar change	Percentage change
		(In Thousands)			
Short-term investments	$ 7,397,691	$ 8,360,235		$ (962,544)	(11.5)%
Government bonds	23,419,191	21,417,207		2,001,984	9.3
Corporate bonds	10,021,324	9,620,648		400,676	4.2
Domestic equity	55,888,530	55,720,380		168,150	0.3
International equity	23,170,630	24,224,573		(1,053,943)	(4.4)
Private equity	14,925,933	14,620,463	*	305,470	2.1
Absolute return strategy investments	5,165,712	4,215,569	*	950,143	22.5
Opportunistic funds	527,440	575,652	*	(48,212)	(8.4)
Real estate and mortgage loans	10,142,432	8,482,279		1,660,153	19.6
Total investments	$ 150,658,883	$ 147,237,006		$ 3,421,877	2.3%

The largest percentage increases to the invested assets were in absolute return strategy investments and real estate and mortgage loans, which represent 3.4 percent and 6.7 percent of the portfolio, respectively. During the fiscal year, the Common Retirement Fund (the Fund) allocated $200 million to an emerging managers program for the absolute return strategies portfolio. The recovery in the real estate market fundamentals was driven by the availability of debt financing, but at lower amounts than in the past, along with the willingness of lenders to restructure debt and the increase in property values across all the property types.

* Private equity, absolute return strategy investments, and opportunistic funds have been reclassified for March 31, 2011 to identify opportunistic funds separately consistent with the March 31, 2012 reporting.

Table 3

Summary schedule of changes in plan net assets for the year ended March 31, 2012, as compared to the year ended March 31, 2011, follows:

	2012	2011	Dollar change	Percentage change
		(In Thousands)		
Additions:				
Net investment income	$ 7,868,313	$ 19,339,896	$ (11,471,583)	(59.3)%
Total contributions	5,016,050	4,578,479	437,571	9.6
Total additions	12,884,363	23,918,375	(11,034,012)	(46.1)
Deductions:				
Total benefits paid	(8,937,831)	(8,520,223)	(417,608)	4.9
Administrative expenses	(100,649)	(101,333)	684	(0.7)
Total deductions	(9,038,480)	(8,621,556)	(416,924)	4.8
Net increase	3,845,883	15,296,819	(11,450,936)	(74.9)
Net assets held in trust for pension benefits – beginning of year	149,548,551	134,251,732	15,296,819	11.4
Net assets held in trust for pension benefits – end of year	$ 153,394,434	$ 149,548,551	$ 3,845,883	2.6%

The change in net investment income is primarily attributable to the decrease in the net appreciation in fair value of investments from 2011 to 2012. This is reflected in the change in net gain from 14.57 percent in 2011 to 5.96 percent in 2012. The increase in total contributions is attributable to the change in employer billing rates and costs associated with retirement incentives.

Economic Factors and Rates of Return

The Fund posted a strong investment performance for the fiscal year ended March 31, 2012, with a net gain of 5.96 percent, reflecting a continued recovery in the global financial markets during that time. This was the third year of positive performance for the Fund following the fiscal crisis of 2008.

While the Fund benefited from mostly favorable markets last year, market volatility continued and concerns about the global economy continued to exist – including the debt crisis within Europe, the pace of domestic jobs and housing recoveries, uncertainty regarding additional financial reforms and escalating political unrest in the Middle East.

(Continued)

Requests for Information

This financial report is designed to provide a general overview of the System's finances for all interested parties. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the New York State and Local Retirement System, 110 State Street, Albany, New York 12244-0001. The report can also be accessed on the Comptroller's website at **www.osc.state.ny.us/pension/cafr.htm.**

NEW YORK STATE AND LOCAL RETIREMENT SYSTEM

Statement of Plan Net Assets

March 31, 2012

(In Thousands)

	Employees' Retirement System	Police and Fire Retirement System	Total
Assets:			
Investments (notes 2, 5 and 6):			
Short-term investments	$ 6,282,165	$ 1,115,526	$ 7,397,691
Government bonds	19,887,722	3,531,469	23,419,191
Corporate bonds	8,510,170	1,511,154	10,021,324
Domestic equity	47,460,885	8,427,645	55,888,530
International equity	19,676,642	3,493,988	23,170,630
Private equity	12,675,195	2,250,738	14,925,933
Absolute return strategy investments	4,386,755	778,957	5,165,712
Opportunistic funds	447,905	79,535	527,440
Real estate and mortgage loans	8,613,016	1,529,416	10,142,432
Total investments	127,940,455	22,718,428	150,658,883
Securities lending collateral – invested (note 7)	4,157,074	738,173	4,895,247
Forward foreign exchange contracts (note 6)	417,748	74,180	491,928
Receivables:			
Employers' contributions	1,548,410	163,554	1,711,964
Members' contributions	5,552	63	5,615
Member loans	1,078,928	1,918	1,080,846
Accrued interest and dividends	364,449	64,715	429,164
Investment sales	90,116	16,002	106,118
Other (note 2)	136,636	41,221	177,857
Total receivables	3,224,091	287,473	3,511,564
Capital assets, at cost, net of accumulated depreciation	29,091	5,166	34,257
Total assets	135,768,459	23,823,420	159,591,879
Liabilities:			
Securities lending obligations (note 7)	4,311,905	765,666	5,077,571
Forward foreign exchange contracts (note 6)	418,103	74,243	492,346
Accounts payable – investments	223,219	39,637	262,856
Accounts payable – benefits	153,074	33,913	186,987
Other liabilities (note 2)	156,118	21,567	177,685
Total liabilities	5,262,419	935,026	6,197,445
Net assets held in trust for pension benefits	$ 130,506,040	$ 22,888,394	$ 153,394,434

See accompanying notes to financial statements.

NEW YORK STATE AND LOCAL RETIREMENT SYSTEM

Statement of Changes in Plan Net Assets

Year ended March 31, 2012

(In Thousands)

	Employees' Retirement System	Police and Fire Retirement System	Total
Additions:			
Income from investing activities:			
Net appreciation in fair value of investments	$ 4,211,014	$ 747,913	$ 4,958,927
Interest income	1,171,377	208,046	1,379,423
Dividend income	1,193,835	212,035	1,405,870
Other income	439,560	78,070	517,630
Less investment expenses	(359,651)	(63,877)	(423,528)
Total income from investing activities	6,656,135	1,182,187	7,838,322
Income from securities lending activities:			
Securities lending income	15,794	2,805	18,599
Securities lending rebates	12,503	2,221	14,724
Less securities lending management fees	(2,829)	(503)	(3,332)
Total income from securities lending activities	25,468	4,523	29,991
Total net investment income	6,681,603	1,186,710	7,868,313
Contributions:			
Employers	3,878,717	706,461	4,585,178
Members	268,545	4,702	273,247
Interest on accounts receivable	62,222	9,862	72,084
Other	72,599	12,942	85,541
Total contributions	4,282,083	733,967	5,016,050
Total additions	10,963,686	1,920,677	12,884,363
Deductions:			
Benefits paid:			
Retirement benefits	(7,316,153)	(1,361,669)	(8,677,822)
Death benefits	(172,340)	(12,620)	(184,960)
Other, net	(73,815)	(1,234)	(75,049)
Total benefits paid	(7,562,308)	(1,375,523)	(8,937,831)
Administrative expenses	(87,232)	(13,417)	(100,649)
Total deductions	(7,649,540)	(1,388,940)	(9,038,480)
Net increase	3,314,146	531,737	3,845,883
Net assets held in trust for pension benefits – beginning of year	127,191,894	22,356,657	149,548,551
Net assets held in trust for pension benefits – end of year	$ 130,506,040	$ 22,888,394	$ 153,394,434

See accompanying notes to financial statements.

(1) Description of Plans

The Comptroller of the State of New York serves as sole trustee of the New York State Common Retirement Fund (the Fund) and administrative head of the New York State and Local Employees' Retirement System (ERS), the New York State and Local Police and Fire Retirement System (PFRS), and the Public Employees' Group Life Insurance Plan (GLIP). GLIP provides death benefits in the form of life insurance. These entities are collectively referred to as the New York State and Local Retirement System (the System). All net assets of the System are held in the Fund, which was established to hold all net assets and record changes in plan net assets allocated to the System. In these statements, GLIP amounts are apportioned to and included in ERS and PFRS.

System benefits are established under the provisions of the New York State Retirement and Social Security Law (RSSL) and are guaranteed by the New York State Constitution. Once a public employer elects to participate in the System, the election is irrevocable. The System cannot be terminated, and plan benefits cannot be diminished or impaired. Benefits can be reduced for future members only by an act of the State Legislature.

Generally, members of the System are employees of the State and its municipalities, other than New York City.

ERS and PFRS are cost-sharing, multiple-employer defined benefit pension plans. The System is included in the State's financial report as a pension trust fund.

As of March 31, 2012 and 2011, the number of participating employers for ERS and PFRS consisted of the following:

	2012 ERS	2011 ERS	2012 PFRS	2011 PFRS
State	1	1	1	1
Counties	57	57	4	4
Cities	61	61	61	61
Towns	912	911	206	205
Villages	491	492	376	376
School Districts	699	700	—	—
Miscellaneous	795	794	34	34
Total	3,016	3,016	682	681

As of March 31, 2012 and 2011, the System membership for ERS and PFRS consisted of the following:

	2012 ERS	2011 ERS	2012 PFRS	2011 PFRS
Retirees and beneficiaries currently receiving benefits	371,468	353,940	31,706	31,091
Active members	505,575	513,092	31,024	31,659
Inactive members	116,532	124,829	3,093	3,143
Total members and benefit recipients	993,575	991,861	65,823	65,893

(a) Membership Tiers

Pension legislation enacted in 1973, 1976, 1983, 2009 and 2012 established distinct classes of membership. For convenience, the System uses a tier concept to distinguish these groups, generally:

ERS

Tier 1 Those persons who last became members before July 1, 1973.

Tier 2 Those persons who last became members on or after July 1, 1973, but before July 27, 1976.

Tier 3 Generally, those persons who are State correction officers who last became members on or after July 27, 1976, but before January 1, 2010, and all others who last became members on or after July 27, 1976, but before September 1, 1983.

Tier 4 Generally, except for correction officers, those persons who last became members on or after September 1, 1983, but before January 1, 2010.

Tier 5 Those persons who last became members on or after January 1, 2010, but before April 1, 2012.

Tier 6 Those persons who first became members on or after April 1, 2012.

PFRS

Tier 1 Those persons who last became members before July 31, 1973.

Tier 2 Those persons who last became members on or after July 31, 1973, but before July 1, 2009.

Tier 3 Those persons who last became members on or after July 1, 2009, but before January 9, 2010.

Tier 4 N/A

Tier 5 Those persons who last became members on or after January 9, 2010, but before April 1, 2012, or who were previously PFRS Tier 3 members who elected to become Tier 5.

Tier 6 Those persons who first became members on or after April 1, 2012.

Vesting

Members who joined the System prior to January 1, 2010 need five years of service to be 100 percent vested. Members who joined on or after January 1, 2010 (ERS) or January 9, 2010 (PFRS) require 10 years of service credit to be 100 percent vested.

(b) Benefits

Tiers 1 and 2

Eligibility: Tier 1 members, with the exception of those retiring under special retirement plans, must be at least age 55 to be eligible to collect a retirement benefit. There is no minimum service requirement for Tier 1 members. Tier 2 members, with the exception of those retiring under special retirement plans, must have five years of service and be at least age 55 to be eligible to collect a retirement benefit. The age at which full benefits may be collected for Tier 1 is 55, and the full benefit age for Tier 2 is 62.

Benefit Calculation: Generally, the benefit is 1.67 percent of final average salary for each year of service if the member retires with less than 20 years. If the member retires with more than 20 years of service, the benefit is 2 percent of final average salary for each year of service. Tier 2 members with five or more years of service can retire as early as age 55 with reduced benefits. Tier 2 members age 55 or older with 30 or more years of service can retire with no reduction in benefits. As a result of Article 19 of the RSSL, Tier 1 and Tier 2 members who worked continuously from April 1, 1999 through October 1, 2000 received an additional month of service credit for each year of credited service they have at retirement, up to a maximum of 24 additional months.

Tiers 3, 4, and 5

Eligibility: Tier 3 and 4 members, with the exception of those retiring under special retirement plans, must have five years of service and be at least age 55 to be eligible to collect a retirement benefit. Tier 5 members, with the exception of those retiring under special retirement plans, must have 10 years of service and be at least age 55 to be eligible to collect a retirement benefit. The full benefit age for Tiers 3, 4 and 5 is 62.

Benefit Calculation: Generally, the benefit is 1.67 percent of final average salary for each year of service if the member retires with less than 20 years. If a member retires with between 20 and 30 years of service, the benefit is 2 percent of final average salary for each year of service. If a member retires with more than 30 years of service, an additional benefit of 1.5 percent of final average salary is applied for each year of service over 30 years. Tier 3 and 4 members with five or more years of service and Tier 5 members with 10 or more years of service can retire as early as age 55 with reduced benefits. Tier 3 and 4 members age 55 or older with 30 or more years of service can retire with no reduction in benefits.

Tier 6

Eligibility: Tier 6 members, with the exception of those retiring under special retirement plans, must have 10 years of service and be at least age 55 to be eligible to collect a retirement benefit. The full benefit age for Tier 6 is 63 for ERS members and 62 for PFRS members.

Benefit Calculation: Generally, the benefit is 1.67 percent of final average salary for each year of service if the member retires with less than 20 years. If a member retires with 20 years of service, the benefit is 1.75 percent of final average salary for each year of service. If a member retires with more than 20 years of service, an additional benefit of 2 percent of final average salary is applied for each year of service over 20 years. Tier 6 members with 10 or more years of service can retire as early as age 55 with reduced benefits.

Special Plans

The 25-Year Plans allow a retirement after 25 years of service with a benefit of one-half of final average salary, and the 20-Year Plans allow a retirement after 20 years of service with a benefit of one-half of final average salary. These plans are available to certain PFRS members, sheriffs, and correction officers.

Ordinary Disability Benefits

Generally, ordinary disability benefits, usually one-third of salary, are provided after ten years of service; in some cases, they are provided after five years of service.

Accidental Disability Benefits

For all eligible Tier 1 members and Tier 2 ERS members, the accidental disability benefit is a pension of 75 percent of final average salary, with an offset for any workers' compensation benefits received. For Tier 1 and Tier 2 PFRS members, the benefit is a pension of 75 percent of final average salary with an offset for any workers' compensation benefits received. The benefit for Tier 3, 4, 5 and 6 members is the ordinary benefit with the years-of-service eligibility requirement dropped.

Ordinary Death Benefits

Death benefits are payable upon the death, before retirement, of a member who meets eligibility requirements as set forth by law. The first $50,000 of an ordinary death benefit is paid in the form of group term life insurance. The benefit is generally three times the member's annual salary. For most members, there is also a reduced post-retirement ordinary death benefit.

Post-retirement Benefit Increases

A cost-of-living adjustment is provided to: (i) all pensioners who have attained age 62 and have been retired for five years; (ii) all pensioners who have attained age 55 and have been retired for ten years; (iii) all disability pensioners, regardless of age, who have been retired for five years; and (iv) ERS recipients of an accidental death benefit, regardless of age, who have been receiving such benefit for five years. This cost-of-living adjustment is a percentage of the annual retirement benefit of the eligible member as computed on a base benefit amount not to exceed $18,000 of the annual retirement benefit. The cost-of-living percentage shall be 50 percent of the annual Consumer Price

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Index as published by the U.S. Bureau of Labor, but cannot be less than 1 percent or exceed 3 percent.

(2) Summary of Significant Accounting Policies

(a) Basis of Accounting

The accompanying financial statements are prepared using the accrual basis of accounting. Revenue is recognized when earned, and liabilities are recognized when incurred. Employer contributions are recognized when due, pursuant to statutory requirements and formal commitments. Member contributions are based on when member salaries are earned and are recognized when due. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan. Investment sales and purchases are recorded on a trade-date basis. The amounts shown on the financial statements are allocated between ERS and PFRS based on each system's monthly average equity in the Fund.

(b) Method Used to Value Investments

Investments are reported at fair value. Fair value is defined as the amount that a plan can reasonably expect to receive for an investment in a current sale between a willing buyer and a willing seller. Due to the nature of investments, it is reasonable that changes in the value of investments will occur in the near future and changes could materially affect the amounts reported.

Equity securities traded on a national or international exchange are reported at current quoted market values.

Bonds are primarily reported at fair values obtained from independent pricing services.

Mortgages are valued on the basis of future principal and interest payments and are discounted at prevailing interest rates for similar instruments.

Direct investments in real estate are valued based on independent appraisals made every three years or according to the fund agreement.

Real estate partnerships are reported at values provided by general partners. These values are based on discounted cash flows, comparative sales, capitalization rates applied to net operating income, or cost, if none of the preceding fit a property's attributes and strategy.

Private equity, opportunistic funds and absolute return strategy investments are reported at fair value as determined by the investment manager. Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 820, *Fair Value Measurements and Disclosures*, requires private equity investment managers to value nonpublicly traded assets at current fair value, taking into consideration the financial performance of the issuer, cash flow analysis, recent sales prices, market comparable transactions, a new round of financing, a change in economic conditions, and other pertinent information. Fair value is determined using the best information available for a hypothetical transaction at the measurement date, not using forced sale or fire-sale pricing.

The Fund trades in foreign exchange contracts in the normal course of its investing activities in order to manage exposure to market risks. Such contracts, which are generally for a period of less than one year, are used to purchase and sell foreign currency at a guaranteed future price. These contracts are recorded at market value using foreign currency exchange rates.

(c) Member Loan Programs

Members are entitled to participate in a loan program that allows them to borrow up to 75 percent of their member contributions. Repayment of outstanding amounts is generally made through payroll deductions within five years. The interest rate charged for member loans is fixed at 1 percent below the actuarial interest rate at the time the loan is granted. The loan rate for loans issued during the fiscal year ended March 31, 2012 was 6.5 percent.

(d) Benefits Payable

Benefits payable represent payments due on account of death and retirement on or before March 31, 2012, for which final calculations had not been completed and paid as of that date.

(e) Other Receivables

Included in other receivables at March 31, 2012 are redemption receivables totaling $135.47 million due from absolute return strategy funds.

(f) Other Liabilities

Other liabilities include a cash managed balance, which represents disbursements issued on previous business days, which are funded when presented for payment at the issuing bank. Other liabilities total $177.68 million, of which $80.54 million represents outstanding checks. In addition, tax withholding payments due to the Internal Revenue Service total $71.21 million.

(g) Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingencies. These estimates are subject to a certain amount of uncertainty in the near term, which could result in changes in the values reported for those assets in the statement of plan net assets. Because of the inherent uncertainty in privately held securities, the fair value may differ from the values that would have been used if a ready market for such securities existed, and the difference can be material. Estimates also affect the reported amounts of income/additions and expenses/deductions during the reporting period. Actual results could differ from these estimates.

(h) Other Income

Included in other income is $16.4 million, which represents amounts received from settlements by the Attorney General of the State of New York pursuant to the Martin Act. There may be future settlements; however, amounts are unknown and management of the System believes there will be no material effect on the basic financial statements.

(i) Capital Assets

Capital assets are capitalized at cost and depreciated on a straight-line basis over the related assets' estimated useful lives.

During the fiscal year ended March 31, 2011, the System began capitalizing outlays associated with its data imaging, filing, and storage system. As of March 31, 2012, capitalized outlays for the project total $9.7 million. This project is currently ongoing and is expected to be completed in the fiscal year ending 2017, at which time amortization of the capitalized costs will begin.

(j) Contributions Required

Participating employers are required under RSSL to contribute annually to the System. Annual bills for employer contributions accrue interest at the actuarial interest rate applicable during the year. For the fiscal year ended March 31, 2012, the applicable interest rate was 7.5 percent.

(k) System Expenses

The System receives an allocation from employer contributions, which are designated by law to cover all non-investment related operating expenses. Investment expenses are offset directly by investment income.

(l) Required Contribution Rates

Tier 3, 4, and 5 members must contribute 3 percent of their salary. As a result of RSSL Article 19, eligible Tier 3 and 4 employees, with a membership date on or after July 27, 1976, who have ten or more years of membership or credited service with the System, are not required to contribute. Less than 1 percent of other members are contributory. Members cannot be required to begin making contributions or to make increased contributions beyond what was required when membership began. For Tier 6 members, the contribution rate varies from 3 percent to 6 percent depending on salary. Tier 6 members are required to contribute for all years of service.

(m) Contributions Receivable

Employers' contributions receivable are presented net of withdrawals, refunds, advance employer payments, and credits due employers. Receivable amounts from participating employers include $154.81 million for amortization of retirement incentives, new plan adoptions, and retroactive membership. Receivable amounts from the State for other amortizations total $165.20 million.

RSSL Chapter 260 of the Laws of 2004 authorized employers to amortize over ten years, at 5 percent interest, the portion of their annual bill for the fiscal year ended 2005 that exceeded 7 percent of payroll. The amortized amount receivable from the State as of March 31, 2012 is $176.92 million and from participating employers is $37.52 million.

RSSL Chapter 260 of the Laws of 2004 authorized employers to amortize over ten years, at 5 percent interest, the portion of their annual bill for the fiscal year ended 2006 that exceeded 9.5 percent of payroll. The amortized amount receivable from the State as of March 31, 2012 is $72.10 million and from participating employers is $14.18 million.

RSSL Chapter 260 of the Laws of 2004 authorized local employers to amortize over ten years, at 5 percent interest, the portion of their annual bill for the fiscal year ended 2007 that exceeded 10.5 percent of payroll. The amortized amount receivable from participating employers as of March 31, 2012 is $13.64 million.

RSSL Chapter 57 of the Laws of 2010 authorized the State and local employers to amortize a portion of their annual pension costs during periods when actuarial contribution rates exceed thresholds established by the statute. Amortized amounts will be paid in equal annual installments over a ten-year period including a rate of interest set by the Comptroller annually. Employers may prepay these amounts at any time without penalty. The first payment will be due in the fiscal year following the decision to amortize. Chapter 57 further provides that when contribution rates fall below legally specified levels and all outstanding amortizations have been paid, employers that elected to amortize will be required to pay additional moneys into reserve funds, specific to each employer, which will be used to offset their contributions in the future. These reserve funds will be invested separately from pension assets.

For the annual bill for the fiscal year ended 2011, the statutory amortization threshold is 9.5 percent of payroll for ERS and 17.5 percent for PFRS. The Comptroller has set an interest rate of 5 percent. The amortized amount receivable from the State as of March 31, 2012 is $230.67 million and from participating employers is $40.39 million.

For the annual bill for the fiscal year ended 2012, the statutory amortization threshold is 10.5 percent of payroll for ERS and 18.5 percent for PFRS. The Comptroller has set an interest rate of 3.75 percent. The amortized amount receivable from the State as of March 31, 2012 is $585.78 million and from participating employers is $216.33 million.

(3) Funded Status and Funding Progress

Funding Policy

Funding of the System is accomplished through member and employer contributions and the investment earnings on these contributions, according to the RSSL. The System uses the aggregate actuarial funding method, which does not identify or separately amortize unfunded actuarial accrued liabilities. As required under GASB Statement No. 50, *Pension Disclosures (an amendment of GASB No. 25 and No. 27)*, the following is a schedule of funding progress using the entry age normal funding method to approximate the funding status of the System as of the most recent actuarial valuation date. This actuarial valuation for the fiscal year ended 2012, performed on April 1, 2011, determined employer contributions for the year ended March 31, 2013.

The funded status of the System as of April 1, 2011, the most recent valuation date, is as follows (dollars in millions):

	ERS					
Actuarial Valuation Date	**Actuarial Assets**	**Actuarial Accrued Liability**	**Unfunded Actuarial Accrued Liability**	**Funded Ratio**	**Covered Payroll**	**Unfunded Actuarial Accrued Liability as a Percentage of Covered Payroll**
April 1, 2011	$ 126,395	$ 140,087	$ 13,692	90.2%	$ 24,389	56.1%

	PFRS					
Actuarial Valuation Date	Actuarial Assets	Actuarial Accrued Liability	Unfunded Actuarial Accrued Liability	Funded Ratio	Covered Payroll	Unfunded Actuarial Accrued Liability as a Percentage of Covered Payroll
April 1, 2011	$ 22,205	$ 24,169	$ 1,964	91.9%	$ 3,146	62.4%

The required schedule of funding progress immediately following the notes to the financial statements 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.

Significant actuarial assumptions used in the April 1, 2011 valuation to determine employer contributions for the year ending March 31, 2013 were as follows:

Interest rate	7.5%
Salary scale	
ERS	4.9
PFRS	6.0
Decrement tables	April 1, 2005 – March 31, 2010 System's experience
Inflation rate	2.7%

The actuarial asset value for domestic bonds and mortgages is amortized value. Short-term investments are at market value. Normally, all other investments use a five-year moving average of market values method assuming a 7 percent rate of expected appreciation. This method immediately recognizes regular investment income (interest and dividends) while phasing in unexpected appreciation/depreciation over a five-year period. It treats realized or unrealized gains (or losses) in the same manner.

Generally, participating employers that have adopted the same benefit plans contribute at the same rate of payroll. The total employer contribution rate as a percentage of salary includes rates for administrative expenses, GLIP, and supplemental benefits. GLIP is a one-year term insurance plan. Consequently, the GLIP rates are determined so as to pay for the current year's GLIP costs. Similarly, the administrative rates are determined so as to pay the current year's administrative expenses. Employers may make other contributions due to legislation, such as retirement incentives; the ten-year amortization of part of their bills for the fiscal years ended 2005, 2006, and 2007; and deficiency payments, which an employer may incur when joining the System and are payable for up to 25 years. The following average employer contribution rates exclude certain contributions such as the ten-year amortization. The average contribution rate for ERS for the fiscal year ended March 31, 2012, was approximately 16.3 percent of payroll. The average employer contribution rate for PFRS for the fiscal year ended March 31, 2012, was approximately 21.6 percent of payroll.

(4) System Reserves

The legally required reserves, as covered by provisions of RSSL, are maintained by the System, are fully funded as of March 31, 2012, and are described below:

- *Annuity Savings Funds* – Funds in which contributions of Tier 1 and Tier 2 members are accumulated.
- *Annuity Reserve Funds* – Funds from which member contribution annuities are paid.
- *Pension Accumulation Funds* – Funds in which employer contributions and income from the investments of the System are accumulated.
- *Pension Reserve Funds* – Funds from which pensions are paid.
- *Designated Annuitant Funds* – Funds from which beneficiary annuities are paid.
- *Loan Insurance Funds* – Funds that provide loan insurance coverage for members with existing non-default loan balances at time of death.
- *Group Life Insurance Plan Reserve* – Reserves that provide group term death benefits not to exceed $50,000, payable upon the death of eligible members.
- *Coescalation (COESC) Contribution Funds* – Funds in which contributions are accumulated. These funds are transferred to the Pension Accumulation Fund at retirement.

As of March 31, 2012, the System reserves for ERS and PFRS consisted of the following:

	ERS 2012	PFRS 2012
	(In Millions)	
Annuity savings	$ 9.50	$ 31.00
Annuity reserve	108.31	10.41
Pension accumulation	54,415.10	10,170.43
Pension reserve	67,651.60	12,653.27
Designated annuitant	57.86	18.63
Loan insurance	1.82	0.10
Group Life Insurance Plan reserve	93.88	2.32
COESC contributions	8,167.97	2.23
Total	$ 130,506.04	$ 22,888.39

(5) Deposit and Investment Risk Disclosure

(a) Custodial Credit Risk for Investments

Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the Fund, or are held either by the counterparty or the counterparty's trust department or agent, but not in the name of the Fund.

Equity and fixed income investments owned directly by the Fund, which trade in the United States (U.S.) markets, are held at the Fund's custodian, in separate accounts, in the name of the Comptroller of the State of New York in Trust for the Fund. These securities are typically held in electronic form through the Federal Book Entry System and by the Depository Trust Company (DTC) and its subsidiaries acting as an agent of the Fund's custodian bank. Securities held directly by the Fund, which trade in markets outside the U.S., are held by a subsidiary of the Fund's custodian bank in the local market, a bank performing custodial services in the local market acting as an agent for the Fund's custodian bank, and in some foreign markets, the securities are held in electronic form by a DTC subsidiary or an organization similar to DTC. Directly held investments include short-term and long-term fixed income and domestic and international equity separately managed accounts. The aforementioned investments have the lowest custodial risk.

Equity investments held indirectly by the Fund via limited partnerships, commingled investment funds, joint ventures, and other similar vehicles are held in custody by an organization contracted by the general partner and/or the investment management firm responsible for the management of each investment organization.

Title to real estate invested in by the Fund is held either by a real estate holding company or a real estate investment fund. Ownership of mortgage assets is documented by the Fund's holding of original mortgage and note documents by the Office of the State Comptroller's Division of Pension Investment and Cash Management.

(b) Custodial Credit Risk for Deposits

Deposits are exposed to custodial credit risk if the deposits are not covered by depository insurance or deposits are uncollateralized, collateralized with securities held by the pledging financial institution, or collateralized with securities held by the pledging institution's trust department or agent, but not in the name of the Fund.

In accordance with existing policies and procedures, the Division of Pension Investment and Cash Management in the Office of the State Comptroller monitors deposit balances for the purpose of determining collateralization levels. Collateral sufficient to cover all uninsured deposits is held at the State's custodial bank.

(c) Interest Rate Risk

The System has interest rate risk, which is the risk that changes in market interest rates will adversely affect the fair value of the Fund's fixed income securities.

The price volatility of the Fund's fixed income holdings is measured by duration. Macaulay duration is a measure of a debt security's exposure to fair value changes arising from changing interest rates. It uses the present value of cash flows, weighted for those cash flows as a percentage of the security's full price.

As of March 31, 2012, the duration of the fixed income portfolio is as follows:

Bond Category		Fair Value	Percentage of Bond Portfolio	Macaulay Duration
		(In Thousands)		(In Years)
Treasury	$	3,772,335	11.3%	7.62
Federal agency		1,878,713	5.6	3.94
Mortgage-backed		8,324,682	24.9	3.12
Corporate		8,190,585	24.5	5.05
Treasury Inflation Protected Securities (TIPS)		11,274,200	33.7	10.50
Total	$	33,440,515	100.0%	

(d) Credit Risk of Debt Securities

State statutes and the System's investment policies require that corporate fixed income obligations must be investment grade at the time of their acquisition. A bond is considered investment grade if its credit rating is Baa by Moody's or BBB– by Standard & Poor's. Long-term bond ratings as of March 31, 2012, are as follows (dollars in thousands):

Quality Rating		Fair Value	Percentage of Fair Value
AAA	$	24,855,930	74.33%
AA		2,169,278	6.49
A		4,456,715	13.33
BAA		1,819,601	5.44
BA		20,629	0.06
BBB		95,240	0.28
BB		12,294	0.04
B		10,828	0.03
Total	$	33,440,515	100.00%

(e) Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of the Fund's investment in a single issuer.

As of March 31, 2012, the System did not hold any investments in any one issuer that would represent 5 percent or more of total investments. Investments issued or explicitly guaranteed by the U.S. government and pooled investments are excluded from the regulation in the following paragraph.

Issuer limits for investments held by the Fund are established for each investment area by RSSL Article 2, Section 13 and Article 4A, Sections 176, 177, and 313, and policy guidelines adopted by the Division of Pension Investment and Cash Management.

Short-term fixed income investments are generally limited to the following investment types maturing in one year or less:

- Obligations for which the full faith and credit of the U.S. is pledged to provide payment of interest and principal.
- Obligations issued by any Federal Home Loan Bank or obligations fully guaranteed as to principal and interest by the Federal National Mortgage Association or Federal Home Loan Mortgage Corporation.
- Commercial paper that has the highest rating by two nationally recognized rating services. A maximum of $500 million of the short-term portfolio may be invested in any one commercial paper issuer.
- Simultaneous purchase and sale of U.S. Treasury obligations may be executed with Primary Government Dealers. A maximum of $200 million may be invested with any one Primary Government Dealer.

Fixed income investments are generally limited to the following investment types with maturities longer than one year:

- Obligations for which the full faith and credit of the U.S. is pledged to provide payment of principal and interest.
- Obligations payable in U.S. dollars issued by any department, agency, or political subdivision of the U.S. government or issued by any corporation, company, or other issuer of any kind or description created or existing under the laws of the U.S., any state of the U.S., District of Columbia, or Commonwealth of Puerto Rico, and obligations of Canada or any province or city of Canada, provided each obligation shall be rated investment grade by two nationally recognized rating services. The aggregate investment by the Fund in the obligations of any one issuer shall not exceed 2 percent of the assets of the Fund or 5 percent of the direct liabilities of the issuer.
- Interest-bearing obligations are payable in U.S. funds at the time the investments are rated in one of the four highest rating grades by each rating service, which has rated such obligations. The aggregate amount invested in the obligations of any single issuer may not exceed 1 percent of the assets of the Fund.
- Bonds issued or guaranteed by the State of Israel payable in U.S. dollars, not to exceed 5 percent of the assets of the Fund.
- Obligations issued or guaranteed by the International Bank for Reconstruction and Development, Inter-American Development Bank, Asian Development Bank, or the African Development Bank.

(f) Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. The Fund has exposure through direct investments in international equities, international equity commingled funds, international real estate investments, international absolute return strategies, international private equity investments, and international opportunistic funds. The Fund's asset allocation and investment policies allow for active and passive investments in international securities. The Fund permits the managers of direct investments in international equities to use forward currency contracts to manage their exposure to foreign currencies relative to the U.S. dollar. Where the Fund participates in commingled funds, limited partnerships, or other investment arrangements, the decision whether or not to use forward currency contracts to manage their foreign currency exposure is left up to the individual investment managers.

Foreign investments included in the statement of plan net assets as of March 31, 2012 are as follows (in thousands of U.S. dollars):

	Equity	Cash	Real Estate	Private Equity, Opportunistic and Absolute Return Strategy Funds	Total
Algerian Dollar	$ —	$ —	$ 182	$ 1,521	$ 1,703
Argentine Peso	—	—	634	27,726	28,360
Australian Dollar	511,187	2,858	94,993	56,134	665,172
Bahamian Dollar	—	—	714	4,466	5,180
Bahraini Dinar	—	—	—	84	84
Barbadian Dollar	—	—	261	—	261
Bermuda Dollar	—	—	1,804	542,907	544,711
Botswana Pula	—	—	—	1,834	1,834
Brazilian Real	194,026	49	52,439	34,736	281,250
British Pound Sterling	1,947,062	12,908	368,328	454,194	2,782,492
Bulgarian Leva	—	—	132	10,637	10,769
Canadian Dollar	253,929	324	23,042	250,471	527,766
Cayman Islands Dollar	—	—	—	2,127,327	2,127,327
Central African CFA Franc	—	—	146	11	157
Chilean Peso	13,321	(1)	—	203	13,523
Chinese Renminbi	—	—	297,060	322,351	619,411
Columbian Peso	13,863	—	452	(8)	14,307
Congolese Franc	—	—	—	259	259
Costa Rica Colon	—	—	266	—	266
Croatian Kuna	—	—	91	133	224
Czech Koruna	3,094	469	13,210	5,651	22,424
Danish Krone	151,141	271	46,813	82,569	280,794
Dominican Peso	—	—	156	542	698
Egyptian Pound	3,360	8	6,075	(113)	9,330
Estonian Kroon	—	—	—	144	144
Ethiopian Birr	—	—	866	—	866
Euro	2,515,045	48,934	1,012,052	2,067,837	5,643,868
Fijian Dollar	—	—	97	—	97
Gibraltar Pound	—	—	—	1,199	1,199
Hong Kong Dollar	572,888	447	11,798	41,840	626,973
Hungarian Forint	1,659	30	2,254	234	4,177
Iceland Krona	—	—	55	5,054	5,109
Indian Rupee	98,631	246	25,108	168,475	292,460
Indonesian Rupiah	43,079	156	365	38,152	81,752
Israeli Shekel	3,113	194	5,569	136,669	145,545
Jamaica Dollar	—	—	84	—	84
Japanese Yen	1,819,990	2,171	175,287	71,421	2,068,869
Kazakhstani Tenge	—	—	—	1,706	1,706
Kenyan Shilling	—	—	761	—	761
Kuwaiti Dinar	—	—	373	—	373

	Equity	Cash	Real Estate	Private Equity, Opportunistic and Absolute Return Strategy Funds	Total
Latvian Lats	$ —	$ —	$ 338	$ 4,717	$ 5,055
Libyan Dinar	—	—	—	92	92
Lithuanian Litas	—	—	—	83	83
Malaysian Ringgit	40,631	173	583	5,798	47,185
Maldivian Rufiyaa	—	—	1,900	—	1,900
Mauritian Rupee	—	—	195	8,606	8,801
Mexican Peso	46,246	942	27,880	7,072	82,140
Mongolian Tugrik	—	—	—	215	215
Moroccan Dirhan	536	—	—	—	536
New Taiwan Dollar	180,303	993	50	3,571	184,917
New Zealand Dollar	322	71	111	829	1,333
Nigerian Naira	—	—	1,210	(16)	1,194
Norwegian Krone	94,021	455	17	45,057	139,550
Panamanian Balboa	—	—	109	2	111
Peruvian Nouveau Sol	—	1	43	7,587	7,631
Philippine Peso	25,964	17	46	4,379	30,406
Polish Zloty	50,564	360	31,293	6,960	89,177
Qatar Rial	6,137	—	35	182	6,354
Romania Leu	—	—	3,381	(416)	2,965
Russian Ruble	—	—	20,703	64,241	84,944
Saudi Riyal	—	—	4,537	(1)	4,536
Singapore Dollar	182,135	394	9,685	35,569	227,783
South African Rand	97,072	35	1,309	82,584	181,000
South Korean Won	309,181	110	3,141	23,855	336,287
Sri Lanka Rupee	—	—	240	—	240
Swedish Krona	302,252	476	139,059	76,644	518,431
Swiss Franc	713,165	1,459	16,190	81,587	812,401
Thailand Baht	78,975	22	1,868	350	81,215
Trinidad and Tobago Dollar	—	—	256	—	256
Turkish Lira New	34,034	39	13,450	20,235	67,758
Ukraine Hryvane	—	—	4,878	6,499	11,377
United Arab Emirates Dirham	—	—	4,787	2,394	7,181
Uruaguay Peso	—	—	—	324	324
Venezuelan Bolivar	—	—	1,251	4,968	6,219
Vietnamese Dong	—	—	122	2,531	2,653
Other	—	—	195	21	216
Total subject to foreign currency risk	$ 10,306,926	$ 74,611	$ 2,430,329	$ 6,952,885	$ 19,764,751
Commingled international equity in U.S. Dollars	11,033,257	—	—	—	11,033,257
Foreign investments in U.S. Dollars	1,830,447	—	7,780	2,190,652	4,028,879
Total foreign investments	$ 23,170,630	$ 74,611	$ 2,438,109	$ 9,143,537	$ 34,826,887

(6) Derivatives

A derivative is generally defined as an investment contract or security with a value that depends on, or is derived from, the value of an underlying asset, reference rate, or financial index. The System has classified the following as derivatives:

Forward Currency Contracts

The System may enter into forward currency contracts to manage exposure to fluctuations in foreign currency exchange rates on portfolio holdings. The System also enters into forward exchange contracts to settle future obligations. A forward exchange contract is a commitment to purchase or sell a foreign currency at a future date at a negotiated forward rate. A contract is classified as a forward contract when the settlement date is more than two days after the trade date. Risk associated with such contracts includes movement in the value of a foreign currency relative to the U.S. dollar. The contracts are valued at forward exchange rates and include net appreciation/depreciation in the statement of plan net assets. Realized gain or loss on forward currency contracts is the difference between the original contract and the closing value of such contract and is included in the statement of changes in plan net assets.

The table below summarizes the fair value of foreign currency contracts, asset (liability), as of March 31, 2012 (in thousands of U.S. dollars):

Currency	Forward Currency Contracts	Spot Currency Contracts	Totals
Australian Dollar	$ (51,294)	$ (404)	$ (51,698)
Brazilian Real	(3,715)	—	(3,715)
British Pound Sterling	(25,223)	(9,207)	(34,430)
Canadian Dollar	(11,941)	(196)	(12,137)
Euro	70,586	2,847	73,433
Hong Kong Dollar	(38,438)	661	(37,777)
Japanese Yen	(61,434)	(578)	(62,012)
Swedish Krona	—	88	88
Swiss Franc	13,902	262	14,164
U.S. Dollar	107,139	6,482	113,621
Total	$ (418)	$ (45)	$ (463)

(7) Securities Lending Program

RSSL Section 177-d authorizes the Fund to enter into security loan agreements with broker/dealers and state or national banks. The Fund has designated its master custodian bank (the custodian) to manage a securities lending program. This program is subject to a written contract between the Fund and the custodian who acts as security lending agent for the Fund. The custodian is authorized to lend securities within the borrower limits and guidelines established by the Fund. Types of collateral received from borrowers for securities loaned are cash, government securities, and obligations of federal agencies. The custodian is authorized to invest the cash collateral in short-term investments that are legal for the Fund. These include domestic corporate and bank notes, U.S. Treasury obligations, obligations of federal agencies, repurchase agreements, and specific asset-backed securities. All rights of ownership to securities pledged as collateral remain with the borrower except in the event of default. As of March 31, 2012, there were no violations of legal or contractual provisions. The Fund has not experienced any losses resulting from the default of a borrower or lending agent during the year ended March 31, 2012 or in the history of the program.

The Fund lends fixed income, domestic equity, and international equity securities to approved broker/dealers. Collateral for securities loaned equals 102 percent of fair market value for domestic securities and 105 percent for international securities. Credit risk associated with the investment of cash collateral pledged by borrowers is mitigated by the maturity restrictions, percentage limitations, and rating requirements for individual asset classes included in the Fund's reinvestment guidelines. The custodian acknowledges responsibility to reimburse the Fund for losses that might arise from managing the program in a manner inconsistent with the contract. The Fund manages its market risk by recording investments at market value daily and maintaining the value of the collateral held by the Fund in excess of the value of the securities loaned. As of March 31, 2012, the fair value of securities on loan was $10.678 billion. The associated collateral was $10.926 billion, of which $5.066 billion was cash collateral and $5.860 billion was securities. The cash collateral has been reinvested in other instruments, which had a fair value of $4.895 billion as of March 31, 2012. The securities lending obligations were $5.078 billion. The unrealized loss in invested cash collateral on March 31, 2012 was $182.325 million, which is reported in the statement of changes in plan net assets as part of "Net appreciation in fair value of investments."

All open security loans can be terminated on demand by either the Fund or the borrower. To provide sufficient liquidity, the policy of the Fund is to maintain a minimum of 10 percent collateral in overnight investments. While the Securities Lending Investment Guidelines allow investments up to a maximum of three years for U.S. Treasury and federal agency obligations and one year for all other investments, the average term of open security loans at March 31, 2012 was 25 days. All loans were open loans. There were no direct matching loans.

The collateral pool is valued at fair value obtained from independent pricing services.

(8) Federal Income Tax Status

Management believes that the System meets the definition of a governmental plan. In the System's communications with the Internal Revenue Service (IRS), it has been treated as a qualified plan and is, therefore, considered exempt from federal income taxes. In January 2011, the System filed an application with the IRS under "Cycle E" for recertification of its qualified plan status. The System is awaiting a response to its application and has no reason to believe it will not receive a favorable determination from the IRS.

(9) Commitments

As of March 31, 2012, the System had contractual commitments totaling $6.572 billion to fund future private equities and $2.790 billion to fund future real estate investments.

(10) Contingencies

The System is a defendant in litigation involving individual benefit payments, participant eligibility, and other issues arising from its normal activities. Management of the System believes there will be no material adverse effect on the basic financial statements as a result of the outcome of these matters.

REQUIRED SUPPLEMENTARY INFORMATION

Schedule 1

NEW YORK STATE AND LOCAL RETIREMENT SYSTEM

Required Supplementary Information – Schedule of Funding Progress

Year ended March 31, 2012

(Unaudited)

The System uses the aggregate funding method, which does not identify or separately amortize unfunded actuarial liabilities. The aggregate funding method sets the actuarial accrued liability equal to the actuarial value of assets so there is no unfunded actuarial accrued liability. All of the cost comes from the present value of future normal costs; there is no amortization of the unfunded actuarial accrued liability. With the actuarial accrued liability set equal to the actuarial value of assets, there is an implied funding ratio of 100 percent unless disclosed using another method. Therefore, we have provided below a schedule of funding progress using the entry age normal funding method to approximate the funding status of the System. Every April 1st, an actuarial valuation is performed, which determines employer contributions for the year ending the next succeeding March 31st. For example, the fiscal year ending 2012 actuarial valuation performed on April 1, 2011 determined employer contributions for the fiscal year ending March 31, 2013.

1. The average employer contribution rates for ERS for fiscal years ending 2012 and 2013 were approximately 16.3 percent of projected payroll and 18.9 percent of projected payroll, respectively.
2. The average employer contribution rates for PFRS for fiscal years ending 2012 and 2013 were approximately 21.6 percent of projected payroll and 25.8 percent of projected payroll, respectively.
3. These average employer contribution rates exclude certain contributions such as the 17-year amortization and the 10-year amortization available for the bills for fiscal years ended 2006, 2007, and 2008.

Employees' Retirement System
(Dollars In Millions)

Actuarial Valuation Date	Actuarial Assets	Actuarial Accrued Liability	Unfunded Actuarial Accrued Liability	Funded Ratio	Covered Payroll	Unfunded Actuarial Accrued Liability as a Percentage of Covered Payroll
April 1, 2006	$ 112,209	$ 107,785	$ (4,424)	104.1%	$ 20,919	(21.1)%
April 1, 2007	121,116	114,525	(6,591)	105.8	22,018	(29.9)
April 1, 2008	128,916	120,183	(8,733)	107.3	22,779	(38.3)
April 1, 2009	126,438	125,136	(1,302)	101.0	24,099	(5.4)
April 1, 2010	125,482	133,574	8,092	93.9	24,972	32.4
April 1, 2011	126,395	140,087	13,692	90.2	24,389	56.1

Schedule 1

NEW YORK STATE AND LOCAL RETIREMENT SYSTEM

Required Supplementary Information – Schedule of Funding Progress

Year ended March 31, 2012

(Unaudited)

Police and Fire Retirement System

(Dollars In Millions)

Actuarial Valuation Date	Actuarial Assets	Actuarial Accrued Liability	Unfunded Actuarial Accrued Liability	Funded Ratio	Covered Payroll	Unfunded Actuarial Accrued Liability as a Percentage of Covered Payroll
April 1, 2006	$ 19,827	$ 18,853	$ (974)	105.2%	$ 2,712	(35.9)%
April 1, 2007	21,379	20,074	(1,305)	106.5	2,825	(46.2)
April 1, 2008	22,767	21,072	(1,695)	108.0	2,926	(57.9)
April 1, 2009	22,423	21,597	(826)	103.8	2,970	(27.8)
April 1, 2010	22,230	22,998	768	96.7	3,113	24.7
April 1, 2011	22,205	24,169	1,964	91.9	3,146	62.4

See accompanying independent auditors' report.

Schedule 2

NEW YORK STATE AND LOCAL RETIREMENT SYSTEM

Schedule of Employer Contributions

Year ended March 31, 2012

(Unaudited)

(Dollars in Thousands)

Employees' Retirement System

	Annual Required Contributions			
Year ended March 31	**New York State**	**Local Employers**	**Total**	**Percentage Contribution**
2007	$ 878,920	$ 1,337,167	$ 2,216,087	100%
2008	892,480	1,242,474	2,134,954	100
2009	802,655	1,160,758	1,963,413	100
2010	808,129	1,071,080	1,879,209	100
2011	1,659,288	1,963,350	3,622,638	100
2012	1,649,528	2,229,189	3,878,717	100

Police and Fire Retirement System

	Annual required contributions			
Year ended March 31	**New York State**	**Local Employers**	**Total**	**Percentage Contribution**
2007	$ 109,333	$ 393,131	$ 502,464	100%
2008	115,294	398,200	513,494	100
2009	86,575	406,235	492,810	100
2010	89,335	375,678	465,013	100
2011	99,668	442,265	541,933	100
2012	136,064	570,396	706,460	100

The annual required contributions (ARC) include the employers' normal costs, the GLIP amounts, and other supplemental amounts amortized over the collection period. In addition, due to statutory contribution provisions, State contributions may vary from the ARC to allow for under/overpayment of amounts for a one-year period.

See accompanying independent auditors' report.

ADDITIONAL SUPPLEMENTARY INFORMATION

Schedule 3

NEW YORK STATE AND LOCAL RETIREMENT SYSTEM

Schedule of Administrative Expenses

Years ended March 31, 2012 and 2011

(In Thousands)

	2012	2011
Personnel services:		
Salaries	$ 51,695	$ 51,437
Overtime salaries	2,884	3,317
Fringe benefits	27,209	27,492
Total personnel services	81,788	82,246
Building occupancy expenses:		
Building, lease, and condominium fees	3,486	3,496
Utilities and municipal assessments	140	213
Office supplies and services	110	156
Telephone	768	581
Total building occupancy expenses	4,504	4,446
Computer expenses:		
IT hardware lease/purchases	1,043	228
IT supplies and maintenance/agency mainframe	7,174	7,469
IT consulting services	316	388
Total computer expenses	8,533	8,085
Personnel and operating expenses:		
Training	76	154
Travel and auto expenses – includes pre-retirement seminars	761	797
Postage – includes member and retiree communication	1,697	1,921
Printing – includes member and retiree communication	516	329
Subscriptions/memberships	227	122
Total personnel and operating expenses	3,277	3,323
Professional expenses:		
Medical/clinical services	1,473	1,627
Consulting services	1,074	1,606
Total professional expenses	2,547	3,233
Total	$ 100,649	$ 101,333

See accompanying independent auditors’ report.

Schedule 4

NEW YORK STATE AND LOCAL RETIREMENT SYSTEM

Schedule of Investment Expenses

Years ended March 31, 2012 and 2011

(In Thousands)

	2012	2011	
Investment expenses:			
Investment management and incentive fees:			
Private equity	$ 128,712	$ 109,183	*
Absolute return strategy funds	110,670	115,376	*
Real estate	69,747	81,959	
International equity	64,260	70,625	
Domestic equity	25,505	36,725	
Opportunistic funds	6,063	11,121	*
Total investment management and incentive fees	404,957	424,989	
Investment-related expenses:			
Legal fees	4,353	6,681	
Mortgage loan servicing fees	2,822	2,565	
Private equity consulting and monitoring	2,645	1,752	
EDP expenses/licenses	2,594	2,575	
Absolute return strategy consulting and monitoring	1,865	3,309	
Administrative expenses	1,390	2,353	
General consulting	753	350	
Real estate consulting and monitoring	661	607	
Fixed income consulting and monitoring	500	487	
Custodial fees	396	483	
Global equity consulting	330	477	
Auditor fees	200	175	
Domestic equity consulting and monitoring	62	60	
Total investment-related expenses	18,571	21,874	
Total investment expenses	$ 423,528	$ 446,863	

* Private equity, absolute return strategy investments, and opportunistic funds have been reclassified for March 31, 2011 to identify opportunistic funds separately consistent with the March 31, 2012 reporting.

See accompanying independent auditors' report.

Schedule 5

NEW YORK STATE AND LOCAL RETIREMENT SYSTEM

Schedule of Consulting Fees

Year ended March 31, 2012

(In Thousands)

Fees in excess of $25,000 paid to outside professionals other than investment advisors.

	Amount	Nature
Day Pitney, LLP	$ 1,463	Legal
Foster Pepper, PLLC	854	Legal
Morgan, Lewis & Bockius, LLP	466	Legal
Seward & Kissel	345	Legal
First Choice Evaluations	282	Medical Services
K&L Gates	235	Legal
Hunton & Williams	211	Legal
Garnet River, LLC	208	IT Consultant
KPMG LLP	197	Auditor
D & D Associates	183	Medical Services
Entwistle & Capucci, LLP	176	Legal
Honigman, Miller, Schwartz & Cohn	171	Legal
DeNovo Legal	161	Legal
Cox, Castle & Nicholson, LLP	121	Legal
Jeffrey Meyer MD	101	Medical Services
John S. Mazella MD, PC	92	Medical Services
Nixon Peabody, LLP	90	Legal
Louis Benton	83	Medical Services
Regional Orthopaedics, PLLC	55	Medical Services
Mary T. Babiarz Court Reporting Services, Inc.	51	Court Reporter
Garger Associates, LLP	39	Medical Services
Lexis Nexis Risk Data	35	Research Services
Leon Sultan MD	35	Medical Services
CEM Benchmarking, Inc.	35	Industry Measurement Survey
Groom Law Group	33	Tax Consultant
Michael J. Lynch MD, CM	30	Medical Services
Jack Economou	30	Hearing Officer
Jack W. Hunt & Assoc., Inc.	29	Medical Services
Summit Security Services, Inc.	28	Security Services

See accompanying independent auditors' report.

KPMG LLP
515 Broadway
Albany, NY 12207-2974

Report on Internal Control over
Financial Reporting and on Compliance and Other Matters
Based on an Audit of Financial Statements Performed in
Accordance with *Government Auditing Standards*

The Trustee
New York State and Local Retirement System:

We have audited the financial statements of the New York State and Local Retirement System (the System) as of and for the year ended March 31, 2012, and have issued our report thereon dated July 13, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

Management of the System is responsible for establishing and maintaining internal control over financial reporting. In planning and performing our audit, we considered the System's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the System's internal control over financial reporting.

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the System's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of the System in a separate letter dated July 13, 2012.

This report is intended solely for the information and use of the Trustee and management, and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

July 13, 2012