KPMG

NEW YORK STATE AND LOCAL RETIREMENT SYSTEM

Financial Statements and Supplementary Information

March 31, 2013

(With Independent Auditors' Report Thereon)

NEW YORK STATE AND LOCAL RETIREMENT SYSTEM

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KPMG LLP
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Independent Auditors' Report

The Trustee
New York State and Local Retirement System:

We have audited the accompanying statements of plan net position of the New York State and Local Retirement System (the System) as of March 31, 2013, the related statement of changes in plan net position for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly in all material respects, the net position of the System as of March 31, 2013, and the changes in its net position for the year then ended, in accordance with U.S. generally accepted accounting principles.

Other Matters

Required Supplementary Information

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.

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the System's basic financial statements. 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. Such 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 basic 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.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated July 15, 2013 on our consideration of the System's internal control over financial reporting and on 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the System's internal control over financial reporting and compliance.

KPMG LLP

July 15, 2013

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, 2013 is intended to provide the reader with an analysis of the System's overall financial position. The System is comprised 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). 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 position of the System held in trust to pay pension benefits was $164.22 billion as of March 31, 2013. This amount reflects an increase of $10.83 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, 2013 and 2012 is $11.59 billion and $4.96 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, 2012 is: ERS 87.2 percent, PFRS 87.9 percent.
- Retirement and death benefits paid this year totaled $9.45 billion to 413,436 annuitants as compared to $8.86 billion to 403,174 annuitants for last year. The increase is due to the number of new retirees.
- Contributions from employers increased from $4.59 billion last year to $5.34 billion this year. The increase in contributions is attributable to higher billing rates.
- The System's investments reported a positive return of 10.38 percent for the current year and a positive return of 5.96 percent for last year.

Overview of the Financial Statements

The financial statements consist of the statement of plan net position, statement of changes in plan net position, 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 position 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 the System's net position.

The statement of changes in plan net position presents the changes to the System's net position 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. The financial statement notes include plan descriptions, significant accounting policies, funded status and funding progress, System reserves, deposit and investment risk disclosure, derivatives, securities lending program, federal income tax status, commitments, and contingencies.

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 position as of March 31, 2013, as compared to March 31, 2012, follows:

	2013	2012	Dollar Change	Percentage Change
		(In thousands)		
Assets:				
Investments	$ 160,660,829	150,658,883	10,001,946	6.6%
Securities lending collateral – invested	8,372,067	4,895,247	3,476,820	71.0
Receivables and other assets	5,704,399	4,037,749	1,666,650	41.3
Total assets	174,737,295	159,591,879	15,145,416	9.5
Liabilities:				
Securities lending obligations	8,385,115	5,077,571	3,307,544	65.1
Payables and other liabilities	2,130,348	1,119,874	1,010,474	90.2
Total liabilities	10,515,463	6,197,445	4,318,018	69.7
Net position, restricted for pension benefits	$ 164,221,832	153,394,434	10,827,398	7.1%

(Continued)

The plan net position of the System totaled $164.22 billion as of March 31, 2013, an increase of $10.83 billion from the prior fiscal year.

Table 2

Schedule of invested assets as of March 31, 2013, as compared to March 31, 2012, follows:

	2013	2012	Dollar Change	Percentage Change
		(In thousands)		
Short-term investments	$ 6,461,328	7,397,691	(936,363)	(12.7)%
Government bonds	27,131,218	23,419,191	3,712,027	15.9
Corporate bonds	10,990,780	10,021,324	969,456	9.7
Exchange-traded fixed income funds	437,474	—	437,474	100.0
Domestic equity	56,948,897	55,888,530	1,060,367	1.9
International equity	26,100,590	23,170,630	2,929,960	12.6
Private equity	14,072,639	14,925,933	(853,294)	(5.7)
Absolute return strategy investments	6,124,694	5,165,712	958,982	18.6
Opportunistic funds	385,081	527,440	(142,359)	(27.0)
Real estate and mortgage loans	12,008,128	10,142,432	1,865,696	18.4
Total investments	$ 160,660,829	150,658,883	10,001,946	6.6%

The largest percentage increases to the invested assets were in exchange-traded fixed income funds (ETFs), absolute return strategy investments and real estate and mortgage loans, which represent 0.3 percent, 3.8 percent and 7.5 percent of the portfolio, respectively. The Common Retirement Fund (the Fund) added two ETFs to the fixed income portfolio. The addition of these funds is within the strategic plan of the fixed income portfolio. The Fund also added capital to the absolute return strategy portfolio to fulfill the allocation and to capitalize on the dynamic opportunity set across global markets. The recovery of real estate market fundamentals has been driven by the availability of inexpensive debt capital, albeit at lower amounts than in the past. Lenders have also been willing to restructure debt as, generally speaking, property values across all the property types have risen. The Fund capitalized on this market momentum and structured investment transactions to enhance the performance of the portfolio in light of the improving market environment.

(Continued)

Table 3

Summary schedule of changes in plan net position for the year ended March 31, 2013, as compared to the year ended March 31, 2012, follows:

	2013	2012	Dollar Change	Percentage Change
		(In thousands)		
Additions:				
Net investment income	$ 14,717,622	7,868,313	6,849,309	87.0%
Total contributions	5,737,032	5,016,050	720,982	14.4
Total additions	20,454,654	12,884,363	7,570,291	58.8
Deductions:				
Total benefits paid	(9,521,536)	(8,937,831)	(583,705)	6.5
Administrative expenses	(105,720)	(100,649)	(5,071)	5.0
Total deductions	(9,627,256)	(9,038,480)	(588,776)	6.5
Net increase	10,827,398	3,845,883	6,981,515	181.5
Net position, restricted for pension benefits – beginning of year	153,394,434	149,548,551	3,845,883	2.6
Net position, restricted for pension benefits – end of year	$ 164,221,832	153,394,434	10,827,398	7.1%

The change in net investment income is primarily attributable to the increase in the net appreciation in fair value of investments from 2012 to 2013. The increase in total contributions is attributable to the change in employer billing rates.

Economic Factors and Rates of Return

The Fund posted a strong investment performance for the fiscal year ended March 31, 2013, with a net gain of 10.38 percent, reflecting the global growth momentum in the financial markets during that time. This was the fourth year of positive performance for the Fund following the fiscal crisis of 2008.

While the Fund benefited from strong growth in the global economy last year, market volatility and concerns about the global economy persist – including the pace of fiscal tightening across the global markets, the recovery of domestic jobs and housing, and credit conditions in Europe and the emerging markets.

(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 Position

As of March 31, 2013

(In thousands)

	Employees' Retirement System	Police and Fire Retirement System	Total
Assets:			
Investments (notes 2, 5 and 6):			
Short-term investments	$ 5,486,881	974,447	6,461,328
Government bonds	23,039,499	4,091,719	27,131,218
Corporate bonds	9,333,236	1,657,544	10,990,780
Exchange traded fixed income funds	371,498	65,976	437,474
Domestic equity	48,360,308	8,588,589	56,948,897
International equity	22,164,302	3,936,288	26,100,590
Private equity	11,950,313	2,122,326	14,072,639
Absolute return strategy investments	5,201,015	923,679	6,124,694
Opportunistic funds	327,006	58,075	385,081
Real estate and mortgage loans	10,197,156	1,810,972	12,008,128
Total investments	136,431,214	24,229,615	160,660,829
Securities lending collateral – invested (note 7)	7,109,457	1,262,610	8,372,067
Forward foreign exchange contracts (note 6)	1,082,928	192,324	1,275,252
Receivables:			
Employers' contributions	2,340,245	238,402	2,578,647
Members' contributions	5,234	48	5,282
Member loans	1,082,025	2,032	1,084,057
Investment income	354,757	63,003	417,760
Investment sales	175,663	31,197	206,860
Other	64,318	28,005	92,323
Total receivables	4,022,242	362,687	4,384,929
Capital assets, at cost, net of accumulated depreciation	37,549	6,669	44,218
Total assets	148,683,390	26,053,905	174,737,295
Liabilities:			
Securities lending obligations (note 7)	7,120,537	1,264,578	8,385,115
Forward foreign exchange contracts (note 6)	1,088,816	193,369	1,282,185
Accounts payable – investments	446,857	79,360	526,217
Accounts payable – benefits	156,160	25,055	181,215
Other liabilities (note 2)	124,028	16,703	140,731
Total liabilities	8,936,398	1,579,065	10,515,463
Net position, restricted for pension benefits	$ 139,746,992	24,474,840	164,221,832

See accompanying notes to financial statements.

NEW YORK STATE AND LOCAL RETIREMENT SYSTEM

Statement of Changes in Plan Net Position

Year Ended March 31, 2013

(In thousands)

	Employees' Retirement System	Police and Fire Retirement System	Total
Additions:			
Income from investing activities:			
Net appreciation in fair value of investments	$ 9,842,787	1,749,576	11,592,363
Interest income	1,183,991	210,451	1,394,442
Dividend income	1,284,578	228,330	1,512,908
Other income	558,953	99,352	658,305
Less investment expenses	(398,856)	(70,896)	(469,752)
Total income from investing activities	12,471,453	2,216,813	14,688,266
Income from securities lending activities:			
Securities lending income	13,884	2,468	16,352
Securities lending rebates	13,810	2,455	16,265
Less securities lending management fees	(2,769)	(492)	(3,261)
Total income from securities lending activities	24,925	4,431	29,356
Total net investment income	12,496,378	2,221,244	14,717,622
Contributions:			
Employers	4,524,395	811,650	5,336,045
Members	264,788	4,346	269,134
Interest on accounts receivable	50,970	7,060	58,030
Other	71,961	1,862	73,823
Total contributions	4,912,114	824,918	5,737,032
Total additions	17,408,492	3,046,162	20,454,654
Deductions:			
Benefits paid:			
Retirement benefits	(7,826,778)	(1,429,274)	(9,256,052)
Death benefits	(177,113)	(17,057)	(194,170)
Other, net	(71,515)	201	(71,314)
Total benefits paid	(8,075,406)	(1,446,130)	(9,521,536)
Administrative expenses	(92,134)	(13,586)	(105,720)
Total deductions	(8,167,540)	(1,459,716)	(9,627,256)
Net increase	9,240,952	1,586,446	10,827,398
Net position, restricted for pension benefits – beginning of year	130,506,040	22,888,394	153,394,434
Net position, restricted for pension benefits – end of year	$ 139,746,992	24,474,840	164,221,832

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). The net position of the System is held in the Fund, which was established to hold all net assets and record changes in plan net position 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 (the 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 changed 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, 2013 and 2012, the number of participating employers for ERS and PFRS consisted of the following:

	2013 ERS	**2012 ERS**	**2013 PFRS**	**2012 PFRS**
State	1	1	1	1
Counties	57	57	4	4
Cities	61	61	61	61
Towns	912	912	205	206
Villages	489	491	376	376
School districts	700	699	—	—
Miscellaneous	784	795	34	34
Total	3,004	3,016	681	682

As of March 31, 2013 and 2012, the System membership for ERS and PFRS consisted of the following:

	2013 ERS	2012 ERS	2013 PFRS	2012 PFRS
Retirees and beneficiaries currently receiving benefits	380,899	371,468	32,537	31,706
Active members	498,266	505,575	30,780	31,024
Inactive members	115,664	116,532	2,864	3,093
Total members and benefit recipients	994,829	993,575	66,181	65,823

(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 ten 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.

Final average salary is the average of the wages earned in the three highest consecutive years. For Tier 1 members who joined on or after June 17, 1971, each year of final average salary is limited to no more than 20 percent of the previous year. For Tier 2 members, each year of final average salary is limited to no more than 20 percent of the average of the previous two years.

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 ten 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 ten 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.

Final average salary is the average of the wages earned in the three highest consecutive years. For Tier 3, 4 and 5 members, each year of final average salary is limited to no more than 10 percent of the average of the previous two years.

Tier 6

Eligibility: Tier 6 members, with the exception of those retiring under special retirement plans, must have ten 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 ten or more years of service can retire as early as age 55 with reduced benefits.

Final average salary is the average of the wages earned in the five highest consecutive years. For Tier 6 members, each year of final average salary is limited to no more than 10 percent of the average of the previous four years.

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 and Tier 2 ERS and PFRS members, the accidental disability 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 annually 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 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 such 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. Private equity investment managers 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) 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 the 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 position. 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.

(d) Recent Accounting Pronouncements

In June 2012, the Governmental Accounting Standards Board (GASB) approved Statement of Governmental Accounting Standards No. 67, *Financial Reporting for Pension Plans – an amendment of GASB Statement No. 25*, and Statement of Governmental Accounting Standards No. 68, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27*. GASB Statement No. 67 addresses reporting by pension plans that administer benefits for governments, and will require the System to include more extensive note disclosures and required supplementary information, including information about pension plan governance, investment policies (asset allocation), and the annual money-weighted rates of return on pension plan investments. The System will be subject to the provisions of GASB Statement No. 67 beginning with the fiscal year ending March 31, 2015. GASB Statement No. 67 replaces the requirements of GASB Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and GASB Statement No. 50, *Pension Disclosures*, as they relate to pension plans that are administered through trusts or similar arrangements meeting certain criteria. GASB Statement No. 67 builds upon the existing framework for financial reports of defined benefit pension plans and enhances note disclosures and required supplementary information for both defined benefit and defined contribution pension plans.

GASB Statement No. 68, which primarily relates to reporting by governments that provide pensions to their employees, is effective for fiscal years beginning after June 15, 2014.

The System is evaluating the impact of the new GASB standards but expects that related communications with participating employers will require significant effort due to the complexity of the required reporting and disclosures.

(e) 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, 2013 was 6.5 percent.

(f) Benefits Payable

Benefits payable represent payments due on account of death and retirement on or before March 31, 2013, for which final calculations had not been completed and payments made as of that date.

(g) 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 \$140.73 million, of which \$75.33 million represents tax withholding payments due to the Internal Revenue Service.

(h) 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, 2013, capitalized outlays for the project total \$21.2 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.

(i) Contributions Required

Participating employers are required under the RSSL to contribute annually to the System. Delinquent annual bills for employer contributions accrue interest at the actuarial interest rate applicable during the year. For the fiscal year ended March 31, 2013, the applicable interest rate was 7.5 percent.

(j) System Expenses

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

(k) 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. 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.

(l) Contributions Receivable

Employers' contributions receivable are presented net of withdrawals, refunds, advance employer payments, and credits due employers. Receivable amounts from participating employers include $117.17 million for amortization of retirement incentives, new plan adoptions, and retroactive membership. Receivable amounts from the State for other amortizations total $123.15 million.

The Retirement and Social Security Law includes several provisions related to the amortization of employer contribution amounts. These include:

- 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, 2013 is $120.8 million and from participating employers is $25.5 million.
- 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, 2013 is $55.37 million and from participating employers is $10.88 million.
- 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, 2013 is $11.17 million.
- 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, 2013 is $209.75 million and from participating employers is $36.73 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, 2013 is $517.03 million and from participating employers is $194.15 million.

For the annual bill for the fiscal year ended 2013, the statutory amortization threshold is 11.5 percent of payroll for ERS and 19.5 percent for PFRS. The Comptroller has set an interest rate of 3.0 percent. The amortized amount receivable from the State as of March 31, 2013 is $780.43 million and from participating employers is $370.73 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 2013, performed on April 1, 2012, determined employer contributions for the year ended March 31, 2014.

The funded status of the System as of April 1, 2012, 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, 2012	$ 125,751	144,170	18,419	87.2%	$ 24,291	75.8%

	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, 2012	$ 22,058	25,096	3,038	87.9%	$ 3,191	95.2%

(Continued)

The required schedule of funding progress immediately following the notes to the financial statements presents multiyear 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, 2012 valuation to determine employer contributions for the year ending March 31, 2014 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, 2013 was approximately 18.9 percent of payroll. The average employer contribution rate for PFRS for the fiscal year ended March 31, 2013 was approximately 25.8 percent of payroll.

(4) System Reserves

The legally required reserves, as covered by provisions of the RSSL, are maintained by the System, are fully funded as of March 31, 2013, 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 nondefault 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, 2013, the System reserves for ERS and PFRS consisted of the following:

		ERS	PFRS
		(In thousands)	
Annuity savings	$	7,870	32,484
Annuity reserve		101,675	10,416
Pension accumulation		60,140,341	11,751,016
Pension reserve		71,015,098	12,653,266
Designated annuitant		55,663	18,633
Loan insurance		2,242	103
Group Life Insurance Plan reserve		95,959	3,846
COESC contributions		8,328,144	5,076
Total	$	139,746,992	24,474,840

(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 that 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 the 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. To address changing economic factors and their impact on various sectors of the economy, the Division's staff meets periodically to discuss the investment strategy for the Fixed Income portfolio. Several factors are taken into account when formulating this strategy, including sector weightings and the current duration of the portfolio.

The price volatility of the Fund's fixed income holdings is measured by duration. Modified duration is a measure of the price sensitivity of a bond to interest rate movements. Modified duration follows the concept that interest rates and bond prices move in opposite directions.

As of March 31, 2013, the duration of the fixed income portfolio is as follows:

Bond category		Fair value	Percentage of bond portfolio	Modified duration
		(In thousands)		(In years)
Treasury	$	5,368,292	13.9%	8.14
Federal agency		2,359,627	6.1	4.27
Mortgage-backed		9,356,431	24.3	3.11
Corporate		8,896,819	23.1	5.81
ETF fixed income		437,474	1.1	8.57
Core Portfolio Average Duration				5.23
Treasury Inflation-Protected Securities (TIPS)		12,140,829	31.5	9.99
Total	$	38,559,472	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, 2013, are as follows (dollars in thousands):

Quality rating		Fair value	Percentage of fair value
AAA	$	28,492,881	73.89%
AA		2,472,676	6.41
A		4,911,448	12.74
BAA		2,362,785	6.13
BBB		293,356	0.76
BB		13,392	0.03
B		12,934	0.03
Total	$	38,559,472	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, 2013, 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 payable in U.S. funds at the time the investments are rated in one of the four highest rating grades by each rating service that 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. To address the impact of changes in exchange rates, only forward foreign exchange contracts of one year or less are allowed when used to lessen portfolio volatility or hedge the portfolio's currency exposure.

Foreign investments included in the statement of plan net position as of March 31, 2013 are as follows (in thousands of U.S. dollars):

	Equity	Cash	Real Estate	Private Equity, Opportunistic and Absolute Return Strategy Funds	Total
Angolan Kwanza	$ —	—	—	2,301	2,301
Argentine Peso	—	—	526	95,604	96,130
Australian Dollar	512,290	2,746	121,848	104,003	740,887
Bahamian Dollar	—	—	950	5,393	6,343
Barbadian Dollar	—	—	90	—	90
Bermudian Dollar	—	—	1,807	407,905	409,712
Brazilian Real	180,745	342	63,610	73,768	318,465
British Pound Sterling	2,097,774	6,489	404,721	790,732	3,299,716
Bulgarian Lev	—	—	46	9,813	9,859
Canadian Dollar	187,781	289	22,904	293,702	504,676
Cayman Islands Dollar	—	—	—	1,955,249	1,955,249
Central African CFA Franc	—	—	51	79	130
Chilean Peso	9,981	—	—	(2,985)	6,996
Chinese Yuan	—	—	289,885	334,606	624,491
Columbian Peso	12,208	—	137	14,283	26,628
Congolese Franc	—	—	—	98	98
Costa Rican Colón	—	—	92	36	128
Croatian Kuna	—	—	31	139	170
Czech Koruna	2,064	—	14,919	12,540	29,523
Danish Krone	165,359	531	41,483	38,142	245,515
Egyptian Pound	2,817	33	1,690	179	4,719
Ethiopian Birr	—	—	300	—	300
Euro	2,865,793	75,249	1,019,776	2,366,113	6,326,931
Ghanaian Cedi	—	—	—	4,894	4,894
Hong Kong Dollar	634,155	507	30,781	73,273	738,716
Hungarian Forint	4,358	28	2,841	11,287	18,514

	Equity	Cash	Real Estate	Private Equity, Opportunistic and Absolute Return Strategy Funds	Total
Icelandic Króna	$ —	—	19	85,585	85,604
Indian Rupee	96,439	682	40,436	181,400	318,957
Indonesian Rupiah	46,637	147	336	80,639	127,759
Israeli Shekel	5,972	13	1,931	135,130	143,046
Japanese Yen	2,078,956	3,673	202,587	345,228	2,630,444
Kazakhstani Tenge	—	—	—	10,117	10,117
Kenyan Shilling	—	—	264	—	264
Kuwaiti Dinar	—	—	130	—	130
Latvian Lats	—	—	445	10,220	10,665
Libyan Dinar	—	—	—	102	102
Macanese Pataca	—	—	—	96	96
Malaysian Ringgit	39,304	7	226	13,660	53,197
Maldivian Rufiyaa	—	—	860	—	860
Mauritian Rupee	—	—	345	8,221	8,566
Mexican Peso	70,211	114	28,184	235,534	334,043
Mongolian Tögrög	—	—	—	157	157
New Taiwan Dollar	203,307	976	143	11,081	215,507
New Zealand Dollar	243	14	185	3,092	3,534
Nigerian Naira	—	—	420	14,312	14,732
Norwegian Krone	71,118	8	6	63,652	134,784
Pakistani Rupee	—	—	—	437	437
Panamanian Balboa	—	—	38	48,003	48,041
Peruvian Nuevo Sol	—	1	15	26,508	26,524
Philippine Peso	34,003	9	20	17,855	51,887
Polish Zloty	53,743	35	38,564	454	92,796
Romanian Leu	—	—	5,245	946	6,191
Russian Ruble	—	—	19,640	189,323	208,963
Saudi Riyal	—	—	3,158	327	3,485
Singapore Dollar	214,926	2,509	11,173	7,301	235,909
South African Rand	94,727	184	491	78,400	173,802
South Korean Won	313,505	51	2,592	65,601	381,749
Sri Lankan Rupee	—	—	83	9,375	9,458
Swedish Krona	408,747	1,294	149,283	72,044	631,368
Swiss Franc	938,535	841	17,372	57,231	1,013,979
Thai Baht	93,479	23	2,670	19,926	116,098
Trinidad and Tobago Dollar	—	—	89	—	89
Turkish Lira	70,682	92	12,235	119,189	202,198
Ukrainian Hryvnia	—	—	5,260	4,785	10,045
United Arab Emirates Dirham	—	—	4,317	3,699	8,016
Uruguayan Peso	—	—	—	9,745	9,745

		Equity	Cash	Real Estate	Private Equity, Opportunistic and Absolute Return Strategy Funds	Total
Venezuelan Bolívar	$	—	—	2,107	78,292	80,399
Vietnamese Đồng		—	—	98	3,248	3,346
Zamibian Kwacha		—	—	—	2,994	2,994
Other		—	—	286	85	371
Total subject to foreign currency risk		11,509,859	96,887	2,569,741	8,605,148	22,781,635
Commingled international equity in U.S. Dollars		12,360,117	—	—	—	12,360,117
Foreign investments in U.S. Dollars		2,230,614	—	1,221	3,822,634	6,054,469
Total foreign investments	$	26,100,590	96,887	2,570,962	12,427,782	41,196,221

(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 position. 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 position.

The table below summarizes the fair value of foreign currency contracts, asset (liability), as of March 31, 2013 (in thousands of U.S. dollars):

Currency		Forward Currency Contracts	Spot Currency Contracts	Totals
Australian Dollar	$	6,725	—	6,725
Brazilian Real		195	(648)	(453)
British Pound Sterling		(20,476)	—	(20,476)
Canadian Dollar		12,665	—	12,665
Danish Krone		(1,748)	—	(1,748)
Euro		23,400	—	23,400
Hong Kong Dollar		(47,983)	—	(47,983)
Indian Rupee		(1,093)	—	(1,093)
Indonesian Rupiah		—	(56)	(56)
Japanese Yen		(133,666)	(839)	(134,505)
Malaysian Ringgitt		—	946	946
Mexican Peso		(734)	—	(734)
Swedish Krona		(536)	—	(536)
Swiss Franc		23,466	—	23,466
U.S. Dollar		132,852	593	133,445
Total	$	(6,933)	(4)	(6,937)

(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 securities 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, 2013, 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, 2013, 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, 2013, the fair value of securities on loan was $14.87 billion. The associated collateral was $15.21 billion, of which $8.51 billion was cash collateral and $6.70 billion was securities. The cash collateral has been reinvested in other instruments, which had a fair value of $8.37 billion as of March 31, 2013. The securities lending obligations were $8.39 billion. The unrealized loss in invested cash collateral on March 31, 2013 was $13.05 million, which is reported in the statement of changes in plan net position 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, 2013 was 24 days. All loans were open loans. There were no direct matching loans.

On March 4, 2013 a securities lending collateral deficiency was realized in the amount of $127.14 million and agreed to be repaid to the lending agent through future earnings commencing with revenues earned effective April 1, 2013 and continuing in the future until the deficiency has been reimbursed in full. The securities lending collateral deficiency is due to a loss in the reinvestment of cash collateral. Investment guidelines have been strengthened to mitigate future losses.

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

(8) Federal Income Tax Status

ERS and PFRS are qualified defined benefit retirement plans under Section 401(a) of the Internal Revenue Code and are exempt from federal income taxes. ERS and PFRS last received favorable determination letters from the Internal Revenue Service dated July 19, 2012 stating that ERS and PFRS are in compliance with the applicable requirements of the Internal Revenue Code. Therefore, no provision for income taxes has been included in the System's financial statements.

(9) Commitments

As of March 31, 2013, the System had contractual commitments totaling $6.33 billion to fund future private equity investments and $1.88 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, 2013

(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 2013 actuarial valuation performed on April 1, 2012 determined employer contributions for the fiscal year ending March 31, 2014.

1. The average employer contribution rates for ERS for fiscal years ending 2013 and 2014 were approximately 18.9 percent of projected payroll and 20.9 percent of projected payroll, respectively.

2. The average employer contribution rates for PFRS for fiscal years ending 2013 and 2014 were approximately 25.8 percent of projected payroll and 28.9 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, 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
April 1, 2012	125,751	144,170	18,419	87.2	24,291	75.8

(Continued)

Schedule 1

NEW YORK STATE AND LOCAL RETIREMENT SYSTEM

Required Supplementary Information – Schedule of Funding Progress

Year Ended March 31, 2013

(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, 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
April 1, 2012		22,058	25,096	3,038	87.9		3,191	95.2

See accompanying independent auditors' report.

Schedule 2

NEW YORK STATE AND LOCAL RETIREMENT SYSTEM

Schedule of Employer Contributions

Year Ended March 31, 2013

(Unaudited)

(Dollars in thousands)

Employees' Retirement System

Year ended March 31		Annual Required Contributions: New York State	Local employers	Total	Percentage contribution
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
2013		1,798,608	2,725,787	4,524,395	100

Police and Fire Retirement System

Year ended March 31		Annual Required Contributions: New York State	Local employers	Total	Percentage contribution
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
2013		151,536	660,114	811,650	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, 2013 and 2012

(In thousands)

		2013	2012
Personal services:			
Salaries	$	52,717	51,695
Overtime salaries		2,523	2,884
Fringe benefits		30,646	27,209
Total personal services		85,886	81,788
Building occupancy expenses:			
Building, lease, and condominium fees		3,713	3,486
Utilities and municipal assessments		152	140
Office supplies and services		257	110
Telephone		662	768
Total building occupancy expenses		4,784	4,504
Computer expenses:			
IT hardware lease/purchases		628	1,043
IT supplies and maintenance/agency mainframe		7,797	7,174
IT consulting services		28	316
Total computer expenses		8,453	8,533
Personal and operating expenses:			
Training		114	76
Travel and auto expenses – includes pre-retirement seminars		942	761
Postage – includes member and retiree communication		1,996	1,697
Printing – includes member and retiree communication		494	516
Subscriptions/memberships		122	227
Total personal and operating expenses		3,668	3,277
Professional expenses:			
Medical/clinical services		1,673	1,473
Miscellaneous consulting services		1,256	1,074
Total professional expenses		2,929	2,547
Total	$	105,720	100,649

See accompanying independent auditors’ report.

Schedule 4

NEW YORK STATE AND LOCAL RETIREMENT SYSTEM

Schedule of Investment Expenses

Years Ended March 31, 2013 and 2012

(In thousands)

Investment expenses:	2013	2012
Investment management and incentive fees:		
Absolute return strategy funds	$ 163,248	110,670
Private equity	120,869	128,712
International equity	71,813	64,260
Real estate	62,351	69,747
Domestic equity	27,353	25,505
Opportunistic funds	8,423	6,063
Total investment management and incentive fees	454,057	404,957
Investment-related expenses:		
Mortgage loan servicing fees	2,914	2,822
EDP expenses/licenses	2,855	2,594
Private equity consulting and monitoring	2,120	2,645
Legal fees	1,915	4,353
Audit and audit related fees	1,051	200
Absolute return strategy consulting and monitoring	1,011	1,865
Administrative expenses	935	1,390
Custodial fees	645	396
Real estate consulting and monitoring	591	661
Global equity consulting	575	330
General consulting	520	753
Fixed income consulting and monitoring	500	500
Domestic equity consulting and monitoring	63	62
Total investment-related expenses	15,695	18,571
Total investment expenses	$ 469,752	423,528

"Audit and audit related fees" include expenses incurred for the System's fiduciary review. The report can be accessed on the Comptroller's website at www.osc.state.ny.us/pension/snapshot.htm.

See accompanying independent auditors' report.

Schedule 5

NEW YORK STATE AND LOCAL RETIREMENT SYSTEM

Schedule of Consulting Fees

Year Ended March 31, 2013

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

		Amount	Nature
Funston Advisory Services, LLC	$	878,000	Fiduciary Review Services
Day Pitney, LLP		507,353	Legal
First Choice Evaluations		371,440	Medical Services
Morgan, Lewis & Bockius, LLP		344,962	Legal
Department of Financial Services		322,484	Regulatory Oversight Services
Foster Pepper, PLLC		249,314	Legal
Garnet River, LLC		247,869	IT Services
IBM Corporation		232,530	IT Services
D & D Associates		218,385	Medical Services
Bernstein Litowitz Berger & Grossman, LLP		182,478	Legal
KPMG LLP		172,704	Auditor
Regional Orthopaedics, PLLC		131,175	Medical Services
K&L Gates		129,369	Legal
Herrick Feinstein, LLP		128,979	Legal
Hunton & Williams, LLP		96,247	Legal
John S. Mazella MD, PC		91,100	Medical Services
Groom Law Group		71,832	Tax Consultant
Jeffrey M. Meyer, MD		66,304	Medical Services
Avaya, Inc.		59,068	IT Services
Nixon Peabody, LLP		57,923	Legal
Louis Benton		53,950	Medical Services
DeNovo Legal		51,405	Legal
DALCO Reporting, Inc.		41,075	Court Reporting
Riverside Orthopaedic & Sports Medicine Assoc.		40,350	Medical Services
Steven Fayer MD		40,100	Medical Services
CEM Benchmarking, Inc.		40,000	Industry Measurement Survey
Seward & Kissel		30,896	Legal
Simaren Corp.		29,238	Security Services
Sanford Lewis, Attorney		27,978	Legal

See accompanying independent auditors' report.

KPMG LLP
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Independent Auditors' 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, in accordance with the 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, the financial statements of the New York State and Local Retirement System (the System), which comprise the statement of plan net position as of March 31, 2013, and the related statement of changes in plan net position for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated July 15, 2013.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the System's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of the System's internal control.

A deficiency in internal control 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, 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. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the System's financial statements are free from 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*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the System's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the System's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

July 15, 2013