PUERTO RICO SYSTEM OF ANNUITIES AND PENSIONS FOR TEACHERS
(A Component Unit of the Commonwealth of Puerto Rico)

Basic Financial Statements and Required
Supplementary Information

June 30, 2013

(With Independent Auditors' Report Thereon)

PUERTO RICO SYSTEM OF ANNUITIES AND PENSIONS FOR TEACHERS
(A Component Unit of the Commonwealth of Puerto Rico)

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Independent Auditors' Report

The Board of Trustees
Puerto Rico System of Annuities and
Pensions for Teachers:

We have audited the accompanying financial statements of the Puerto Rico System of Annuities and Pensions for Teachers (the System), which comprise the statement of plan net position as of June 30, 2013, the related statement of changes in plan net position for the year then ended, and the related notes to the financial statements, which collectively comprise the System's basic 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. 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 plan net position of the Puerto Rico System of Annuities and Pensions for Teachers as of June 30, 2013, and the changes in plan net position for the year then ended, in accordance with U.S. generally accepted accounting principles.

KPMG

Emphasis of a Matter

As discussed in note 1 to the basic financial statements, the System's unfunded actuarial accrued liability and funded ratio for pension benefits as of June 30, 2013 was approximately $10 billion and 15.6%, respectively. In the opinion of management, based on information prepared by consulting actuaries, the System's net position will be exhausted by the fiscal year 2020 if measures are not taken to reduce the unfunded actuarial accrued liability and increase the funded ratio of the System.

Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles require that the information in the Management's Discussion and Analysis, Schedule of Employers' Contributions, and Schedule of Funding Progress on pages 3-11 and 37-39 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.

KPMG LLP

San Juan, Puerto Rico
June 30, 2014

Stamp No. E125996 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report

Introduction

The Puerto Rico System of Annuities and Pensions for Teachers (the System) presents management's overview of the administrative and operational activities that had an impact on the System's net position for the fiscal year ended June 30, 2013. The System administers retirement and other participant benefits, such as personal, cultural and mortgage loans, occupational and nonoccupational disability annuities, and death benefits. The System also administers postemployment healthcare benefits provided by the Commonwealth of Puerto Rico to retired teachers of the Department of Education and retired employees of the System.

Overview of the Basic Financial Statements

This discussion and analysis is intended to serve as an introduction to the System's basic financial statements, which comprise the following: 1) Statement of Plan Net Position, 2) Statement of Changes in Plan Net Position, and 3) Notes to Basic Financial Statements. Required supplementary information is also presented to supplement the basic financial statements.

Statement of Plan Net Position and Statement of Changes in Plan Net Position

Both of these statements provide information about the overall financial status of the System. The Statement of Plan Net Position includes all of the System's assets and liabilities, with the difference reported as net position held in trust for pension benefits. The Statement of Changes in Plan Net Position discloses changes in the System's net position during the fiscal year.

Notes to Basic Financial Statements

The notes to the basic financial statements provide additional information that is essential for an understanding of the data provided in the Statements of Plan Net Position and Changes in Plan Net Position.

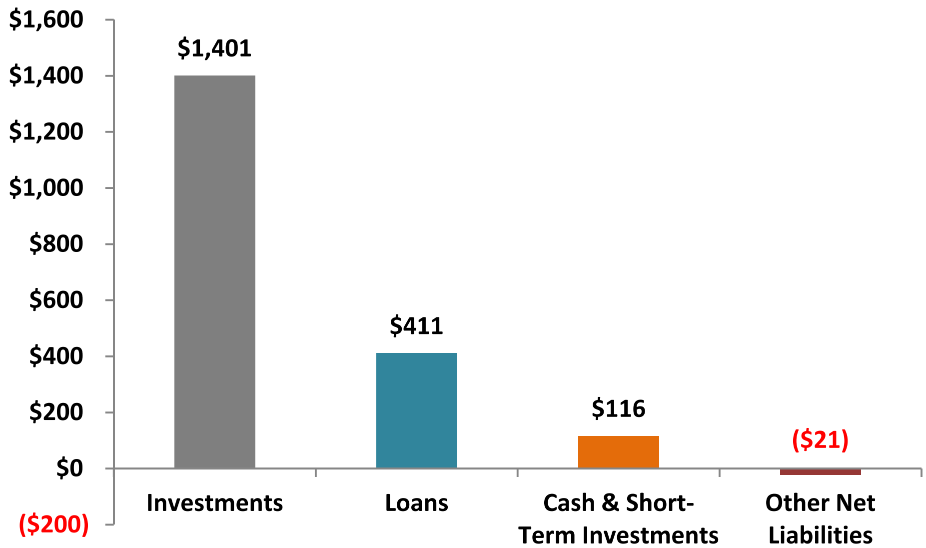
Required Supplementary Information

The required supplementary information consists of two schedules and related notes concerning the funded status of the benefits administered by the System.

Financial Highlights

- The System's net position decreased from approximately $2,099 million as of June 30, 2012 to $1,907 million as of June 30, 2013. The decrease was mainly attributable to the sale of investments to cover cash flow shortfall for purposes of paying the System's pension benefits, offset by a net appreciation in the fair value of investments. Net assets of $1,907 million as of June 30, 2013 consisted of the following:
    - $1,401 million in investments
    - $411 million in loans to plan members
    - $116 million in cash and short-term investments
    - $21 million in other net liabilities

The total plan net position is presented in the following chart (in millions):



- The fair value of the System's investments (excluding loans to participants) at June 30, 2013 amounted to $1,401 million, compared to $1,432 million at June 30, 2012.
- Contributions for the year ended June 30, 2013 amounted to $308 million, compared to $300 million for the year ended June 30, 2012.
- Investment income for the year ended June 30, 2013 amounted to $157 million, compared to $37 million for the year ended June 30, 2012.
- Benefits paid to participants for the year ended June 30, 2013 amounted to $636 million, compared to $602 million for the year ended June 30, 2012.
- Administrative expenses for the year ended June 30, 2013 amounted to $24 million, same as for the year ended June 30, 2012.
- The System's funded ratio of the actuarial accrued liability for pension benefits at June 30, 2013 was 15.6%, compared to 17% at June 30, 2012.
- The medical insurance plan contribution, which constitutes the other postemployment healthcare benefits, is financed by the Commonwealth on a pay-as-you-go basis and consequently is unfunded.

(Continued)

The following schedules present comparative summary of the System's net position and changes in net assets for fiscal years 2013 and 2012:

Comparative Summary of Plan Net Position – Pension Benefits

(Dollars in thousands)

	2013	2012	Amount of change	Percentage change
Assets:				
Cash and short-term investments	$ 116,097	358,383	(242,286)	(68)%
Investments and loans	1,812,075	1,835,728	(23,653)	(1)
Accounts receivable	31,318	80,750	(49,432)	(61)
Capital assets	19,312	20,885	(1,573)	(8)
Other assets	781	832	(51)	(6)
Total assets	1,979,583	2,296,578	(316,995)	(14)
Liabilities:				
Accounts payable and accrued expenses	16,860	16,237	623	4
Escrow funds of mortgage loans and guarantee insurance reserve for loans to plan members and liability for investments purchased	6,373	159,487	(153,114)	(96)
Securities lending obligations and other liabilities	49,468	21,638	27,830	129
Total liabilities	72,701	197,362	(124,661)	(63)
Net position held in trust for pension benefits	$ 1,906,882	2,099,216	(192,334)	(9)%

Comparative Summary of Plan Net Position Analysis – Pension Benefits

The decrease in cash and short-term investments is due to the transition out of cash reserves as part of the completion of the de-risking phase of the portfolio during the beginning of the 2013 fiscal year and the fluctuations in short-term investments, which represents the amount of short-term investments held by investment managers at a point in time. The decrease in accounts receivable is mainly attributable to a reduction in investment settlements pertaining to receivables for investments sold due to market conditions and investment managers' decisions as of fiscal year end.

The decrease in investments is primarily attributable to the sale of investments to cover the cash flow shortfall for purposes of paying the System's pension benefits, offset by a net appreciation in fair value. The System's total investments return experienced an increase from 2% in 2012 to 7.8% in 2013. Detailed information regarding the

(Continued)

investment portfolio is included in the Investment Portfolio and Capital Markets Overview section of this discussion and analysis.

The increase in accounts payable and accrued expenses is primarily due to the voluntary termination benefits program for the employees of the System implemented in fiscal year 2011, which resulted in an increase in liabilities of approximately $1 million for a total accumulated liability of $9 million as of fiscal year 2013. The decrease in escrow funds of mortgage loans and guarantee insurance reserve for loans to plan members and liability for investments purchased corresponds to a decrease in liabilities pertaining to investments purchased due to market conditions and investment managers' decisions as of fiscal year end. The increase in other liabilities is mainly due to payables to independent brokers under the securities lending program.

Comparative Summary of Changes in Plan Net Position – Pension Benefits

(Dollars in thousands)

	Years ended June 30		Amount	Percentage
	2013	**2012**	**of change**	**change**
Additions:				
Contributions	$ 308,286	300,268	8,018	3%
Investment income	157,494	37,153	120,341	324
Other income	1,432	1,374	58	4
Total additions	467,212	338,795	128,417	38
Deductions:				
Benefits paid to participants	635,940	601,667	34,273	6
Administrative expenses	23,606	23,775	(169)	(1)
Total deductions	659,546	625,442	34,104	5
Net (decrease) increase in net position held in trust for pension benefits	(192,334)	(286,647)	94,313	33
Net position held in trust for pension benefits:				
Beginning of year	2,099,216	2,385,863	(286,647)	(12)
End of year	$ 1,906,882	2,099,216	(192,334)	(9)%

Comparative Summary of Changes in Plan Net Position Analysis – Pension Benefits

During the fiscal year 2013, employers' contributions increased due to Act. No. 114 of July 5, 2011, which provides for annual employers' contribution increases of 1% of covered payroll in each of the five fiscal years following enactment and by 1.25% of covered payroll in each of the following five fiscal years. Contributions for special benefits increased by approximately $670,000 when compared to the prior fiscal year. The increase in

(Continued)

investment income that resulted in fiscal year 2013 is mainly attributable to a net appreciation in fair value of investments due to market conditions. The increase in benefits paid to participants is primarily due to an increase in annuities benefits paid as a result of an increase in the number of retirees from prior fiscal year.

Other Postemployment Healthcare Benefits

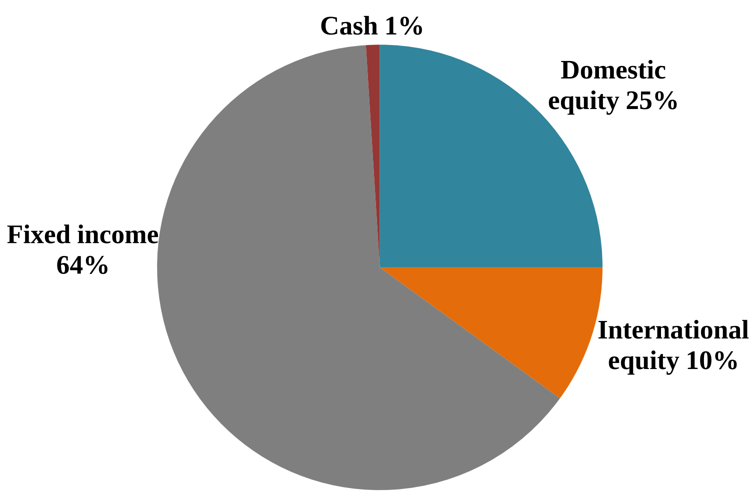
Other postemployment healthcare benefits paid during the fiscal year 2013 amounted to $34 million, compared to the $35 million paid during fiscal year 2012.

Financial Analysis of the System

The System provides retirement benefits mainly to teachers within the public education system of the Commonwealth of Puerto Rico. The System's net position held in trust for benefits at June 30, 2013, amounted to approximately $1,907 million, a decrease of approximately $192 million from approximately $2,099 million at June 30, 2012. Additions to the System's net position held in trust for benefits include employer and member contributions, as well as investment income. For fiscal year 2013, employer contributions increased by approximately $9 million, from approximately $124 million during fiscal year 2012 to approximately $133 million during fiscal year 2013. However, member contributions decreased by approximately $3 million, from approximately $122 million during fiscal year 2012 to approximately $119 million during fiscal year 2013. The System realized a net appreciation in the fair value of investments of approximately $87 million for fiscal year 2013.

Investment Portfolio and Capital Markets Overview

The System's asset allocation generated a return of 7.8% for the fiscal year ended June 30, 2013. The target asset allocation is as follows:



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Economy and Capital Markets Overview

The fiscal year 2013 started off strong due in large part to the deployment of monetary support from central banks across the globe. On the heels of a volatile spring and a steady flow of negative economic news, central banks took action. Notably, the Federal Reserve launched the much anticipated third round of quantitative easing (QE3) and the European Central Bank (ECB) initiated the Outright Monetary Transactions (OMT) program. The monetary stimulus drove global equity markets higher as relief set in that central bank support was present. However, the rally in the United States soon stalled as the positive sentiment gave way to concerns surrounding the United States presidential election and looming fiscal cliff. Meanwhile, international markets continued to rally into the second half of the fiscal year, as economic conditions improved and ECB President, Mario Draghi, committed to do "whatever it takes" to keep the Euro intact. In the United States, as the political uncertainty passed, equity markets surged to new all time highs, even amongst increased taxes and threat of the budget sequester. Overseas, despite disappointing elections in Italy, the Cyprus bailout and a credit downgrade in the United Kingdom, markets continued their modest upward trend. The Bank of Japan launched its own unprecedented monetary and fiscal stimulus, providing another boost to investor confidence. The fiscal year ended with a spike in volatility due to comments from Ben Bernanke suggesting an easing of monetary support if economic conditions continued to improve. Global equities quickly retreated and bond yields spiked before investors were somewhat calmed after the Federal Reserve clarified that interest rates would remain low for the foreseeable future.

As noted above, significant attention was paid to the comments from Ben Bernanke and the Federal Open Markets Committee (FOMC) throughout the year. The fiscal year began with the announcement of QE3, which authorized the Federal Reserve to purchase agency mortgage-backed securities at a pace of $40 billion per month. Together with Operation Twist, the programs increased the Federal Reserve holdings of longer dated securities by approximately $85 billion per month. Additionally, the FOMC maintained the Federal Funds Target Range at 0.00–0.25% throughout the year. However, in January, the Federal Reserve announced it would no longer provide calendar guidance on when they expect to raise rates. Instead, parameters consisting of unemployment below 6.5% or inflation reaching 2.5%, would initiate a rate hike. The fiscal year ended with reassurance that the Federal Reserve is committed to the economic recovery, but a broad understanding that tapering of the asset purchase program is on the horizon.

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With support from the Federal Reserve and mostly positive economic news, domestic equity markets trended upwards for the majority of the fiscal year, returning 21.5%. Developed international markets posted an 18.6% return, modestly trailing the U.S. equity markets. Emerging markets were a notable underperformer, returning 2.9% as export demand weakened and concerns surrounding China surfaced. The broad U.S. fixed income market declined a modest 0.7% over the year, with most of the adverse returns coming in the final months. The yield on the 10-year U.S. Treasury was mostly steady throughout the year, but spiked 85 basis points in the last two months due to fears of the Federal Reserve's tapering of the asset purchasing program. The table below shows the fiscal year and quarter returns of major indices:

Industry Indices Performance Overview

Indices	FY 2012-13	First quarter FY 2013	Second quarter FY 2013	Third quarter FY 2013	Fourth quarter FY 2013
Dow Jones U.S. Total Stock Market Index	21.5%	6.2%	0.2%	11.1%	2.8%
S&P 500	20.6	6.4	(0.4)	10.6	2.9
S&P/Citigroup Large Growth	16.8	6.4	(2.0)	9.3	2.5
S&P/Citigroup Large Value	25.0	6.3	1.6	12.0	3.4
Russell 3000	21.5	6.2	0.2	11.1	2.7
Russell 2000 Index	24.2	5.3	1.9	12.4	3.1
Russell 2000 Growth	23.7	4.8	0.4	13.2	3.7
Russell 2000 Value	24.8	5.7	3.2	11.6	2.5
MSCI EAFE	18.6	6.9	6.6	5.1	(1.0)
MSCI Emerging Markets	2.9	7.7	5.6	(1.6)	(8.1)
Barclays Aggregate Bond Index	(0.7)	1.6	0.2	(0.1)	(2.3)

Total System's Investment Portfolio Performance

The System's asset allocation generated a return of 7.8% during the fiscal year 2013 and outperformed its policy benchmark by 80 basis points. Outperformance was primarily a result of being overweight U.S. equities relative to the long-term target weight as equities overall outperformed fixed income. The overweight allocation to equities was a consequence of the System gradually de-risking its investment program (shifting from equities into bonds). This transition was concluded at the beginning of the 2013 fiscal year. The System's total investment portfolio, including loans as of June 30, 2013 totaled $1,877 million, composed of $1,812 million in total investments and loans, $57 million included in cash and cash equivalents and $8 million in accrued interest and dividends receivable and net due for investments purchased.

U.S. Equity Overview for the Fiscal Year 2013

U.S. stocks as measured by the Dow Jones U.S. Total Stock Market Index gained 21.5% during the fiscal year. All sectors produced positive returns during the fiscal year, as consumer discretionary and financials were the top performing sectors. From a style perspective, value stocks outpaced growth stocks across all market caps. On a size basis, small cap stocks outperformed their large cap counterparts.

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The System's domestic equity component generated a return of 21.5% during the fiscal year, performing in line with its' benchmark, the Russell 3000 Index. Approximately $88 million was transferred out of the domestic equity component as part of portfolio rebalancing and to meet the cash needs of the System. As of June 30, 2013, the System's domestic equity assets totaled $389 million and represented approximately 21% of the System's total investment portfolio, including loans.

International Equity Overview for the Fiscal Year 2013

International equity stocks, as measured by the MSCI EAFE Index, generated a return of 18.6%. The index provided positive performance for three consecutive quarters as monetary stimulus specifically from the ECB and The Bank of Japan provided support. The fourth quarter experienced a slight pullback as continued concerns regarding the strength of the economic recovery outside of the U.S. negatively impacted results. Europe ex-United Kingdom and Japan were the strongest performing regions over the fiscal year.

During the 2013 fiscal year, the System's international equity component generated a return of 18.3%, outperforming the component's benchmark by 510 basis points. The portfolio's only active international equity manager was the largest contributor to performance while the international commingled fund performed in line with its' benchmark. Approximately $65 million was redeemed from the component during the fiscal year as part of portfolio rebalancing and to meet the cash needs of the System. At the end of the fiscal year, the component had $137 million in assets, representing 7% of the System's total investment portfolio, including loans.

U.S. Fixed Income Overview for the Fiscal Year 2013

The U.S. fixed income market, as measured by the Barclays Aggregate Bond Index, produced positive results for the first two quarters of the period only to reverse gains in the second half resulting in a loss of 0.7% during the fiscal year. All underlying sectors generated negative returns during the period, with the exception of corporate, asset-backed, and commercial mortgage-backed securities. Long-term government bonds experienced the largest decline, while shorter-term bonds produced modest positive results.

The System's fixed income component generated a return of 1.1% during the one year ending June 30, 2013, outperforming the component's benchmark by 10 basis points. At the end of the fiscal year, fixed income assets totaled $920 million, consisting of approximately 49% of the System's total investment portfolio, including loans. Approximately $130 million was redeemed from the component during the 2013 fiscal year as part of portfolio rebalancing and to meet the cash needs of the System.

Other Investments

As of June 30, 2013, the System held approximately $411 million in loans to plan members, which represented 22% of the total investment portfolio. Loan balances as of June 30, 2013 were higher than the $404 million balance as of June 30, 2012. The loans portfolio component gained approximately 9% during the one year ending June 30, 2013.

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At the end of the fiscal year 2013, the System had some exposure to limited partnerships of private equity investments, which were valued at approximately $15 million and represented 1% of the System's total investment portfolio, including loans.

Funding Status

The System performs an actuarial valuation of its assets and obligations at least every other year. The most recent actuarial valuation was performed as of June 30, 2013. According to such valuation, the System's unfunded liability for pension benefits amounted to approximately $10,345 million, with a funding level of 15.6%. The unfunded liability for postemployment healthcare benefits amounted to approximately $793 million and was fully unfunded.

Act No. 91 of March 29, 2004 requires an actuarial study identifying the System's funding status prior to granting new benefits as a means to protect the System's financial health.

Recent Developments

Act No. 160 was enacted on December 24, 2013 (Act No. 160-2013) as new legislation for the System. The constitutionality of said Act was challenged in several lawsuits brought by participants of the System. On April 11, 2014 the Puerto Rico Supreme Court (the Supreme Court) declared certain sections of Act No. 160-2013 unconstitutional while maintaining the constitutionality of the following: (i) all changes made to the benefit structure apply to future participants that are hired after July 31, 2014; (ii) elimination of special laws benefits for participants that retire on or after August 1, 2014; and (iii) reduction of special laws benefits to current retirees as of July 31, 2014.

The Government of Puerto Rico, as well as the System's management, is currently evaluating and analyzing the effects of the Supreme Court's decision in order to determine the course of action to undertake.

Request for Information

The financial report is designed to provide a general overview of the System's financial status, comply with related laws and regulations, and demonstrate commitment to public accountability. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Puerto Rico Teachers Retirement System, Capital Center Building, #235 Arterial Hostos Ave., North Tower, 8th floor, Hato Rey, P.R. 00919-1879.

PUERTO RICO SYSTEM OF ANNUITIES AND PENSIONS FOR TEACHERS
(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Plan Net Position

June 30, 2013

(In thousands)

		Pension	Post employment healthcare benefits	Total
Assets:				
Cash and short-term investments:				
Cash and cash equivalents	$	59,183	—	59,183
Cash with fiscal agent		5,196	—	5,196
Cash deposited with Government Development Bank for Puerto Rico		3,298	—	3,298
Collateral from securities lending transactions		48,420	—	48,420
Total cash and short-term investments		116,097	—	116,097
Investments:				
Bonds and notes		742,146	—	742,146
Nonexchange commingled trust funds		546,775	—	546,775
Stocks		97,299	—	97,299
Investments in limited partnerships		14,823	—	14,823
Total investments		1,401,043	—	1,401,043
Loans to plan members:				
Mortgage		146,917	—	146,917
Personal		262,238	—	262,238
Cultural trips		1,877	—	1,877
Total loans to plan members		411,032	—	411,032
Total investments and loans		1,812,075	—	1,812,075
Accounts receivable:				
Investments sold		57	—	57
Accrued interest and dividends receivable		7,847	—	7,847
Other		23,414	—	23,414
Total accounts receivable		31,318	—	31,318
Capital assets – net		19,312	—	19,312
Other assets		781	—	781
Total assets		1,979,583	—	1,979,583
Liabilities:				
Investments purchased		65	—	65
Securities lending obligations		48,420	—	48,420
Accounts payable		1,906	—	1,906
Accrued expenses		14,954	—	14,954
Escrow funds of mortgage loans and guarantee insurance reserve for loans to plan members		6,308	—	6,308
Other liabilities		1,048	—	1,048
Total liabilities		72,701	—	72,701
Commitments and contingencies (note 10)				
Net position held in trust for pension benefits	$	1,906,882	—	1,906,882

See accompanying notes to basic financial statements.

PUERTO RICO SYSTEM OF ANNUITIES AND PENSIONS FOR TEACHERS
(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Changes in Plan Net Position

Year ended June 30, 2013

(In thousands)

		Pension	Post employment healthcare benefits	Total
Additions:				
Contributions:				
Employers:				
Basic benefits	$	133,369	—	133,369
Special benefits		54,075	34,239	88,314
Participating employees		119,162	—	119,162
Contributions transferred from other systems		1,680	—	1,680
Total contributions		308,286	34,239	342,525
Investment income:				
Interest income		71,457	—	71,457
Dividend income		2,693	—	2,693
Net appreciation in fair value of investments		86,573	—	86,573
Total investment income		160,723	—	160,723
Less investment expense		3,229	—	3,229
Net investment income		157,494	—	157,494
Other income – net		1,432	—	1,432
Total additions		467,212	34,239	501,451
Deductions:				
Benefits paid to participants:				
Annuities and death benefits		579,144	—	579,144
Special benefits		49,130	34,239	83,369
Refunds of contributions		7,666	—	7,666
General and administrative expenses		23,606	—	23,606
Total deductions		659,546	34,239	693,785
Net decrease in net position held in trust for pension benefits		(192,334)	—	(192,334)
Net position held in trust for pension benefits:				
Beginning of year		2,099,216	—	2,099,216
End of year	$	1,906,882	—	1,906,882

See accompanying notes to basic financial statements.

(1) Organization and Summary of Significant Accounting Policies

The Puerto Rico System of Annuities and Pensions for Teachers (the System) was created by Act No. 91 of March 29, 2004 (Act No. 91-2004), that superseded Act No. 218 of May 6, 1951. The System administers a cost-sharing, multi-employer defined benefit pension plan (the pension plan). The System also administers postemployment healthcare benefits provided by the Commonwealth of Puerto Rico (the Commonwealth) to retired teachers of the Department of Education and retired employees of the System (the Puerto Rico System of Annuities and Pensions for Teachers Medical Insurance Plan Contribution - TRS MIPC), an unfunded, cost-sharing, multi-employer defined benefit other postemployment benefit plan. The System is considered an integral part of the financial reporting of the Commonwealth and is included in the Commonwealth's basic financial statements. The System, as a governmental retirement plan, is excluded from the provisions of the Employee Retirement Income Security Act of 1974 (ERISA).

The responsibility for the proper operation and administration of the System is vested in a Board of Trustees (the Board). The Board is composed of nine members, as follows:

- Three ex-officio members, which are the Secretary of the Treasury, the Secretary of Education, and the President of the Government Development Bank for Puerto Rico (GDB), or their respective representatives.
- One member who is a representative of a teacher's organization designated by the Governor of the Commonwealth (the Governor).
- Three teachers of the System, one of which is a currently certified teacher in active service, and two who represent retired teachers. These three teachers are appointed by the Governor.
- One member who is a representative of the entity in accordance with Act No. 45 of February 25, 1998, as amended.
- One additional member, as representative of the public interest, with knowledge of and experience in the administration and operation of financial systems, appointed by the Governor.

As of June 30, 2013, the pension plan has an unfunded actuarial accrued liability (UAAL) for pension benefits of approximately $10,345 million, representing a 15.6% funding ratio. Certain measures have been taken to improve the funding status. However, in the opinion of management and based on information prepared by consulting actuaries, if additional measures are not taken soon to deal with this situation, the System's assets are estimated to be exhausted by the fiscal year 2020. The System's funding requirements, together with the funding requirements of the Employees' Retirement System of the Government of the Commonwealth of Puerto Rico and the Retirement System for the Judiciary of the Commonwealth of Puerto Rico, could have a direct negative effect on the Commonwealth's General Fund, since the Commonwealth is the plan sponsor and is obligated to make contributions to fund each of the systems.

The Commonwealth has been facing a number of fiscal and economic challenges in recent years due, among other factors, to continued budget deficits, a prolonged economic recession, high unemployment, population decline, and high levels of debt and pension obligations. In recent months, the widening of credit spreads for the Commonwealth's public sector debt and the recent downgrading of the Commonwealth's credit ratings and those of many of its instrumentalities to noninvestment grade have put further strain on the Commonwealth's liquidity and may affect its access to both the capital markets and private sources of financing, as well as the borrowing cost of any such funding.

The estimate of when the System's assets would be exhausted is based on significant assumptions, including the rate of return on investments, the amount and timing of collections from the Commonwealth for member and employers' contributions, as well as the estimated participant benefits and the System's administrative expenses to be paid each year. If the Commonwealth's financial condition does not improve as a result of fiscal and budgetary measures it is taking, its ability to repay its obligations, including its employer contributions to the System for the upcoming years may be adversely affected. Actual result could differ from this estimate.

The System and the Commonwealth, with the assistance of the System's external consulting actuaries, concluded that annual increases in the employers' contribution rate were required to assist in funding pension payments. As a result of such determination, the Commonwealth approved Act No. 114 on July 5, 2011 (Act No. 114-2011), which provides for an increase in employers' contributions to the System of 1% of covered payroll in each of the five fiscal years following enactment and by 1.25% of covered payroll in each of the following five fiscal years thereafter.

The following are significant accounting policies followed by the System in the preparation of its basic financial statements:

(a) Basis of Presentation

The accompanying basic financial statements have been prepared on the accrual basis of accounting in accordance with the provisions of Governmental Accounting Standards Board (GASB) Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, as amended by GASB Statement No. 50, *Pension Disclosures – an Amendment of GASB Statements No. 25 and No. 27*. Participating employee and employer contributions are recognized as revenues in the period in which the employee services are rendered. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

Healthcare benefits are reported in accordance with GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans.* GASB 43 establishes uniform financial reporting standards for Other Postemployment Benefit Plans (OPEB) and supersedes the interim guidance included in GASB Statement No. 26, *Financial Reporting for Postemployment Healthcare Plans Administered by Defined Benefit Pension Plans.* The approach followed by GASB 43 is generally consistent with the approach adopted in GASB 25, with modifications to reflect differences between pension and OPEB plans.

(b) Use of Estimates

The preparation of basic financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of net assets held in trust for pension benefits, the disclosure of contingent assets and liabilities at the date of the basic financial statements, and the reported amounts of additions and deductions to net assets held in trust for pension benefits during the reporting period. Actual results could differ from those estimates.

(c) Cash and Short-Term Investments

Cash and short-term investments consist of "overnight deposits" with the custodian bank, a commercial bank, and money market funds. Cash with fiscal agent represents a fund account the System has at the Department of Treasury for the payment of pensions, benefits, and payroll expenses.

(d) Investments

Investments are reported at fair value. The fair value of investments is based on quoted prices, if available. The System has investments in limited partnerships and nonexchange commingled trust funds valued at approximately $14.8 million and $546.8 million, respectively, as of June 30, 2013. Fair values of investments in limited partnerships have been estimated in the absence of readily determinable fair values, based on information provided by the underlying fund managers. Nonexchange commingled trust funds are reported at their net asset value (NAV). The NAV of each fund includes the market value of the securities in the fund plus any receivables, payables, and accrued fund expenses.

Securities transactions are accounted for on the trade date. Realized gains and losses on securities are determined by the average cost method and are included in the basic statement of changes in plan net position.

(e) Loans to Plan Members

Mortgages, personal, and cultural trip loans to plan members are stated at their outstanding principal balance. No allowance for uncollectible amounts has been established since loans to plan members are collected through payroll withholdings and secured by mortgage deeds, plan members' contributions, and any unrestricted amount remaining in the escrow funds. Maximum amounts that may be loaned to plan members for mortgage and cultural trip loans are $160,000 ($190,000 if the spouse is also a plan member) and $5,000, respectively. The maximum amount of personal loans to be granted to current participating employees is up to 90% of their accumulated contributions but not in excess of $20,000; and in the case of retirees currently receiving benefits is $5,000.

(f) Guarantee Insurance Reserve for Loans to Plan Members

Premiums collected and benefits claimed are recorded as additions and deductions of the guarantee insurance reserve for life insurance on loans to plan members, respectively.

(g) Capital Assets

Capital assets include building, building improvements, furniture and equipment, and projects in progress. The System defines capital assets as assets which have an initial individual cost of $500 or more at the date of acquisition and have a useful life of four or more years. Capital assets are recorded at historical cost or at estimated historical cost if actual historical cost is not available. Donated capital assets are recorded at their estimated fair value at the time of donation.

Capital assets are depreciated on the straight-line method over the assets' estimated useful lives. There is no depreciation recorded for projects in progress. The estimated useful lives of capital assets are as follows:

	Years
Buildings	40
Building improvements	10
Equipments, furniture, fixtures, and vehicles	4–10

(h) Future Adoption of Accounting Pronouncements

The GASB has issued the following Statements:

(a) GASB Statement No. 67, *Financial Reporting for Pension Plans – an Amendment of GASB Statement No. 25*, which is effective for periods beginning after June 15, 2013. The objective of this Statement is to improve financial reporting by state and local governmental pension plans. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for pensions with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency. This Statement replaces the requirements of Statements No. 25, Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans, and No. 50, Pension Disclosures, as they relate to pension plans that are administered through trusts or equivalent arrangements (hereafter jointly referred to as trusts) that meet certain criteria. The requirements of Statements 25 and 50 remain applicable to pension plans that are not administered through trusts covered by the scope of this Statement and to defined-contribution plans that provide postemployment benefits other than pensions.

(b) GASB Statement No. 68, *Accounting and Financial Reporting for Pension – an Amendment of GASB 27*, which is effective for periods beginning after June 15, 2014. The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for pensions. It also improves information provided by state and local governmental employers about financial support for pensions that is provided by other entities. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for pensions with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency. This Statement replaces the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, as well as the requirements of Statement No. 50, *Pension Disclosures*, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements (hereafter jointly referred to as trusts) that meet certain criteria. The requirements of Statements 27 and 50 remain applicable for pensions that are not covered by the scope of this Statement.

The impact that these Statements will have on the System's basic financial statements has not yet been determined.

(2) Plan Description

Pension Benefits

All active teachers of the Puerto Rico Department of Education and the employees of the System become plan members of the System at their date of employment. Licensed teachers working in private schools or other educational organizations have the option to become members of the System so long as the required employer and employee contributions are satisfied.

As of June 30, 2013, the membership consisted of the following:

Retirees and beneficiaries currently receiving benefits	38,367
Terminated vested participants	698
Current participating employees	41,553
Total membership	80,618

The plan members of the System are eligible for the benefits described below:

(a) Retirement Annuity

Plan members are eligible for monthly benefit payments determined by the application of stipulated benefit ratios to the plan member's average compensation. Average compensation is computed based on the highest 36 months of compensation recognized by the System. The annuity for which a plan member is eligible is limited to a minimum of $400 per month and a maximum of 75% of the average compensation.

The plan members are eligible for retirement annuity benefits upon complying with the following:

Age	Years of creditable services	Retirement annuity compensation
55	30 or more	75% of average compensation
50	30 or more	75% of average compensation (1)
Under 50	30 or more	65% of average compensation
50	At least 25, but less than 30	1.8% of average compensation times years of service
47, but less than 50	At least 25, but less than 30	95% of 1.8% of average compensation times years of service
60	At least 10, but less than 25	1.8% of average compensation times years of service

(1) Refer to section 2(g) under Plan Description.

(b) Deferred Retirement Annuity

A participating employee who terminates service before age 60, after having accumulated a minimum of 10 years of creditable services, qualifies for a deferred retirement annuity payable beginning at age 60. A participating employee who has completed 25 or more years of creditable services and is under the age of 47 at termination qualifies for a deferred retirement annuity payable beginning at age 47. The vested rights described above are provided if his or her contributions to the System are left within the System until the attainment of the respective retirement age.

(c) Occupational Disability Annuity

A participating employee, who as a direct result of the performance of his or her occupation becomes disabled, is eligible for an annuity of 1.8% of average compensation based on the highest 60 months or the number of months of creditable services, if less than 5 years, recognized by the System, times years of creditable services; but not less than $400 per month.

(d) Nonoccupational Disability Annuity

A participating employee disabled for causes not related to his or her occupation, and with at least five years of credited service, is eligible for an annuity of 1.8% of average compensation based on the highest 60 months recognized by the System, times years of service; but not less than $400 per month.

(e) Death Benefits

Preretirement – The beneficiaries receive the contributions made to the plan and 2% interest accumulated as of the date of death (after discounting debts with the System), plus an amount equal to the annual compensation of the member at the time of death.

Postretirement – The surviving spouse receives 50% of the retiree's pension and if there are children under 22 years of age or disabled (until disability ceases), they receive the other 50% of the pension. If there is no surviving spouse or children who qualify, the beneficiaries receive the excess, if any, of the accumulated contributions at the time of retirement over the total annuity benefits received before death, limited to a minimum of $1,000.

(f) Refunds

A participating employee who ceases his or her employment with the Commonwealth without the right to a retirement annuity has the right to a refund of the employee contributions paid to the System, plus any interest earned thereon.

(g) Early Retirement Program

On January 27, 2000, Act No. 44 was approved, which provided that effective March 9, 2000, plan members were eligible for early retirement upon attaining the age of 50 and 28 years of service in the first year of implementation and age 50 and 25 years of service in subsequent years. Those who selected early retirement under these conditions receive monthly benefits equal to 75% of their average compensation, which is computed based on the highest 36 months of compensation recognized by the System. Effective July 31, 2001, the option for early retirement was closed. On

January 27, 2001, Act No. 45 was approved, which established 50 years as the minimum age requirement to obtain a pension benefit equal to 75% of average compensation with 30 years of service. In these cases, the retiree will pay the participating employee contribution until attaining 55 years of age.

(h) Special Benefits

Special benefits include the following:

- Christmas Bonus – An annual bonus of $600 for each retiree and disabled member paid each December. The System pays $150 per retiree and disabled member and the remaining bonus is paid by the Commonwealth.
- Summer Bonus – An annual bonus of $100 for each retiree, beneficiary, and disabled member paid each July. This benefit is prorated if there are multiple beneficiaries and is funded by the Commonwealth.
- Medication Bonus – An annual bonus of $100 for each retiree, beneficiary, and disabled member paid each July to cover health costs. Evidence of coverage is not required. This benefit is funded by the Commonwealth.
- Cost-of-living Adjustments – Act No. 62 of September 4, 1992 provided, subject to the approval of the Legislature of the Commonwealth (the Legislature), for increases of 3% every three years in pensions to those plan members with three or more years of retirement. In years 1995, 1998, 2001, 2004, and 2007, the Legislature replicated the benefit granted per Act No. 62 of September 4, 1992. This benefit is funded by the Commonwealth.
- Other Pension Increase Acts – Act No. 128 of June 10, 1967, and Act No. 124 of June 8, 1973, provided a pension increase (from 2% to 10%) based on the monthly pension, and Act No. 47 of June 1, 1984, provided a pension increase based on credited service worked. This increase is funded by the Commonwealth.
- Cultural Loans – Act No. 22 of June 14, 1965, provides a 50% repayment of the interest that would be paid by the actives teachers and retirees. This benefit is funded by the Commonwealth.
- Death Benefit – Act No. 272 of March 29, 2004, increases the death benefit of $500 to $1,000. This $500 increase is funded by the Commonwealth.

Other Postemployment Benefits (OPEB) – Healthcare Benefits

TRS MIPC is a cost-sharing, multi-employer defined benefit other postemployment benefit plan sponsored by the Commonwealth. Its benefit covers a maximum of $100 per month per retiree. TRS MIPC covers all teachers of the Department of Education of the Commonwealth and employees of the System.

Plan members are eligible for benefits upon reaching the age of 47, with 25 years of service, or age 60 with 10 years of service.

As of June 30, 2013, the eligible membership consisted of the following:

Retirees and disabled	35,279
Terminated vested participants	698
Active	41,553
Total membership	77,530

(3) Funding Policy

Pension Benefits

Participating employees are required to contribute 9% of their compensation to the System, while the employers were required to contribute 10.5% of the applicable payroll for the year ended June 30, 2013. However, as discussed in note 1, Act No. 114-2011 provides for additional annual employers' contribution increases of 1% in each of the five fiscal years following enactment and by 1.25% in each of the following five fiscal years thereafter. Commonwealth contributions should ultimately cover any deficiency between the participating employees' contributions and the System's pension benefit obligations and administrative costs.

The special benefits contributions of approximately $54.1 million in 2013 represent contributions from the General Fund of the Commonwealth for the special benefits granted by special laws, as detailed in note 2. The funding of the special benefits is provided to the System through legislative appropriations each January 1 and July 1. The legislative appropriations are considered estimates of the payments to be made by the System for the special benefits. Deficiencies in legislative appropriations are covered by the System's own funds until recovered through future legislative appropriations. Any surplus of legislative appropriations collected over special benefits paid is combined with the assets held in trust for the payment of other pension benefits.

Calculations of the present value of benefits under the System were made by consulting actuaries as of June 30, 2013. The significant assumptions underlying the actuarial computations are presented in note 4.

The June 30, 2013 actuarial valuation reflects an increase in the assumed rate of return from 5.95% in 2012 to 6.25% in 2013, which resulted in a decrease of approximately $430 million in the actuarial accrued liability (AAL). This decrease was offset by other actuarial considerations, such as demographics, resulting in a reduction of $99 million in the AAL from $12,351 million in 2012 to $12,252 million in 2013.

OPEB

The contribution requirement of TRS MIPC is established by Act No. 95 approved on June 29, 1963. This OPEB plan is financed by the Commonwealth on a pay-as-you-go basis. There is no contribution requirement from the plan member during active employment. Retirees contribute the amount of the healthcare insurance premium not covered by the Commonwealth contribution. As a result, these OPEB are 100% unfunded. During the year ended June 30, 2013, OPEB contributions amounted to $34.2 million.

The funding of the OPEB is provided to the System through legislative appropriations each January 1 and July 1. The legislative appropriations are considered estimates of the payments to be made by the System for the healthcare benefits throughout the year. Deficiencies in legislative appropriations are covered by the System's own funds until recovered through future legislative appropriations. Any surplus of legislative appropriations collected over healthcare benefits paid is combined with the assets held in trust for the payment of other pension benefits.

(4) Funded Status and Funding Progress

The funded status of the System as of June 30, 2013, the most recent actuarial valuation date, is as follows (dollars in thousands):

	Actuarial value of plan assets	Actuarial Accrued Liability (AAL)	Unfunded Actuarial Accrued Liability (UAAL)	Funded ratio	Annual covered payroll	UAAL percentage of annual covered payroll
Pension	$ 1,906,882	$ 12,251,995	$ 10,345,113	15.6%	$ 1,248,674	828.5%
OPEB	$ —	$ 792,875	$ 792,875	—%	$ 1,248,674	63.5%

The schedules of funding progress, presented as required supplementary information following the notes to the basic financial statements, presents multiyear trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the AAL for benefits.

Additional information as of the June 30, 2013 valuation is as follows:

Pension Benefits

Actuarial cost method	Entry Age Normal
Amortization method	30 years closed, level percent of payroll
Remaining amortization period	24 years
Asset valuation method	Market Value of Assets
Actuarial assumptions:	
Investment rate of return	6.25%
Projected salary increases	3.5% general wage inflation plus a service-based merit increase
Inflation	2.5%
Cost-of-living adjustment	None assumed

The projections of pension benefits for financial reporting purposes do not explicitly incorporate the potential effects of legal or contractual funding limitations.

OPEB

Actuarial cost method	Entry Age Normal
Amortization method	30 years closed, level percent of payroll
Remaining amortization period	24 years
Asset valuation method	Market Value of Assets
Actuarial assumptions:	
Investment rate of return	3.25%
Projected salary increases	3.5% general wage inflation plus a service-based merit increase
Inflation	2.5%
Cost-of-living adjustment	None assumed

Actuarial valuations of an ongoing plan involve estimates of the net value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment and mortality. Amounts determined are subject to continuous revision as actual results are compared with past expectations and new estimates are made about the future.

Calculations are based on the types of benefits provided under the terms of the substantive plan at the time of each valuation and on the pattern of sharing of costs between the employer and plan members to that point. The projections of OPEB for financial reporting purposes does not explicitly incorporate the potential effects of legal or contractual funding limitations on the pattern of cost sharing between the employer and plan members in the future.

The actuarial calculations reflect a long–term perspective. Consistent with that perspective, actuarial methods and assumptions used include techniques that are designed to reduce short–term volatility in actuarial accrued liabilities and actuarial value of assets.

Mortality rate assumptions for both pension benefits and OPEB are:

- Pre-retirement Mortality - RP 2000 Employee Mortality Rates for males and females, projected on a generational basis using Scale AA. As a generational table, it reflects mortality improvements both before and after the measurement date.

- Post-retirement Healthy Mortality - Rates which vary by gender are assumed for healthy retirees and beneficiaries based on a study of plan's experience from 2007 to 2012 equal to 92% of the rates from the UP-1994 Mortality Table for Males and 87% of the rates from the UP-1994 Mortality Table for Females. The rates are projected on a generational basis starting in 1994 using Scale AA. As a generational table, it reflects mortality improvements both before and after the measurement date.

- Post-retirement Disabled Mortality - Rates which vary by gender are assumed for disabled retirees based on a study of plan's experience from 2007 to 2012 equal to the rates in the UP-1994 Mortality Table for males and females. No provision was made for future mortality improvement for disabled retirees.

(5) Deposits and Investments

Pursuant to the provisions of Act No. 91-2004, the System may invest in domestic equity, international equity, and fixed-income securities, among others.

Deposits

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the System may not be able to recover deposits or collateral securities that are in the possession of an outside party. The Commonwealth requires that public funds deposited in commercial banks in Puerto Rico be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of the Commonwealth. Funds deposited with GDB are not covered by this Commonwealth requirement.

As of June 30, 2013, approximately $64.8 million of the depository bank balances were uninsured and uncollateralized as follows (in thousands):

		Carrying amount	Depository bank balance	Amount uninsured and uncollateralized
Cash	$	2,880	3,785	1
Cash equivalents		56,303	56,303	56,303
Cash with fiscal agent		5,196	5,196	5,196
Cash deposited with GDB		3,298	3,298	3,298
Total	$	67,677	68,582	64,798

As of June 30, 2013, uninsured and uncollateralized cash and cash equivalents amounting to $1,000 and $56.3 million, respectively, represent cash and highly liquid short-term investments held by the System's custodian bank. These deposits are exempt from the collateral requirement established by the Commonwealth.

Investments

The System's investments are exposed to custodial credit risk, credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. Following is a description of these risks as of June 30, 2013:

(a) Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the System may not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. At June 30, 2013, investments were registered in the name of the System and were held in the possession of the custodian bank, except for securities lent.

(b) Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Fixed income securities are subject to credit risk. Credit quality rating is one method of assessing the ability of the issuer to meet its obligation. The System's investment guidelines establish that all issues shall be rated investment grade by at least two of the nationally recognized rating agencies. The portfolio is expected to maintain a minimum weighted average credit quality of "A–" or better using either Moody's or Standard & Poor's credit ratings.

The credit quality ratings and fair value of bonds and notes and nonexchange commingled fixed income trust funds as of June 30, 2013 are as follows (in thousands):

		Rating (1)					
	AAA	AA+ to AA-	A+ to A-	BBB+ to BBB-	BB+ to BB-	B	Total
Mortgage and asset-backed securities:							
Federal National Mortgage Association (FNMA)	$ —	13,754	—	—	—	—	13,754
Federal Home Loan Mortgage Corporation (FHLMC)	—	15,321	—	—	—	—	15,321
Collateralized mortgage obligations (CMO)	48	—	—	—	—	—	48
Commercial mortgages	7,021	—	—	—	—	—	7,021
Asset-backed securities	1,486	—	—	—	—	40	1,526
U.S. corporate bonds and notes	6,877	57,827	244,611	180,926	19,487	—	509,728
Non-U.S. corporate bonds	—	19,512	51,008	27,350	2,320	—	100,190
Foreign government bonds and notes	—	5,204	—	—	918	—	6,122
U.S. municipal bonds	919	—	—	—	—	—	919
Total bonds and notes	16,351	111,618	295,619	208,276	22,725	40	654,629
Nonexchange commingled fixed income trust fund – SSgA Intermediate Fund	14,534	14,318	46,936	44,129	—	—	119,917
Total	$ 30,885	125,936	342,555	252,405	22,725	40	774,546

(1) Ratings obtained from Standard & Poor's. In the absence of rating by Standard & Poor's, the equivalent ratings by Moody's Investor Service or Fitch Ratings were utilized.

Approximately $87.5 million of the total System investments consist of U.S. government and Government National Mortgage Association (GNMA) mortgage-backed securities, which carry no risk, therefore, not included within the above table.

The System invests in a U.S. fixed income fund which is presented within nonexchange commingled trust funds. The U.S. fixed income fund consists of shares of the State Street Global Advisors (SSgA) Intermediate U.S. Credit Index Non-Lending Fund (SSgA Intermediate Fund). The investment objective of the fund is to approximate as closely as practicable, before expenses, the performance of the Barclays U.S. Intermediate Credit Bond Index over the long term. Shares of the SSgA Intermediate Fund can be redeemed on a daily basis at their net asset value (NAV) and have no redemption restrictions.

(c) Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of the System's investment in a single issuer. There are no investments in any one issuer that represent 5% or more of total investments as of June 30, 2013. The System's investment guidelines specify that no more than 5% of a manager's assets at market shall be invested in the securities of any single issuer.

As of June 30, 2013, the System owned shares in the SSgA Russell 3000 Index Non-Lending Fund (SSgA Russell 3000 Fund), the SSgA MSCI ACWI Ex USA Non-Lending Fund (SSgA MSCI ACWI Ex USA Fund), and the SSgA Intermediate Fund as follows (in thousands):

Fund name	Shares		Value
SSgA Russell 3000 Fund	24,279	$	388,852
SSgA MSCI ACWI Ex USA Fund	2,422		38,006
SSgA Intermediate Fund	4,402		119,917
Total nonexchange commingled trust funds		$	546,775

The investment objective of the SSgA Russell 3000 Fund is to approximate as closely as practicable, before expenses, the performance of the Russell 3000 Index over the long term. Shares can be redeemed on a daily basis at NAV and have no redemption restrictions.

The investment objective of the SSgA MSCI ACWI Ex USA Fund is to approximate as closely as practicable, before expenses, the performance of the MSCI ACWI ex USA Index over the long term. Shares can be redeemed semi-monthly at NAV and have no redemption restrictions.

As of June 30, 2013, the investments underlying the SSgA Russell 3000 Fund, SSgA MSCI ACWI Ex USA Fund, and the SSgA Intermediate Fund had the following sector allocations:

Sector	SSgA Russell 3000 Fund	SSgA MSCI ACWI Ex USA Fund
Financials	18%	26%
Information technology	17	7
Consumer discretionary	13	10
Healthcare	12	8
Industrials	11	11
Energy	10	9
Consumer staples	9	11
Materials	4	9
Utilities	3	3
Telecommunication services	3	6
Totals	100%	100%

Sector	SSgA Intermediate Fund
Corporate – Industrial	42%
Corporate – Finance	30
Noncorporate	20
Corporate – Utility	6
Cash	2
Total	100%

(d) Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The System is expected to achieve capital preservation and income generation by investing in a diversified portfolio of marketable investment-grade fixed-income securities. The System's investment guidelines specify that the duration of the portfolio is expected to vary no more than between 75% and 125% of the duration of the respective benchmark. The System's management monitors interest rate risk by evaluating the performance of each investment manager.

The contractual maturity of investments as of June 30, 2013, is summarized as follows (in thousands):

	Maturity (in years)				
Investment type	**Within one year**	**After one to five years**	**After five to ten years**	**After ten years**	**Total**
Bonds and notes:					
U.S. government securities:					
U.S. Treasury notes	$ 24,986	—	7,717	—	32,703
U.S. Treasury note strips	—	—	31,785	—	31,785
U.S. Treasury Inflation-Protected Securities (TIPS)	—	—	14,790	—	14,790
Mortgage and asset-backed securities:					
GNMA	—	72	—	8,167	8,239
FNMA	—	221	318	13,215	13,754
FHLMC	—	—	245	15,076	15,321
Collateralized mortgage obligations (CMO) – Others	—	—	—	48	48
Commercial mortgages	—	—	—	7,021	7,021
Asset-backed securities	—	1,486	—	40	1,526
U.S. corporate bonds and notes	49,457	250,045	173,116	37,110	509,728
Non-U.S. corporate bonds	8,948	53,797	32,493	4,952	100,190
Foreign government bonds and notes	—	3,069	2,135	918	6,122
U.S. municipal bonds	—	—	—	919	919
Total bonds and notes	83,391	308,690	262,599	87,466	742,146
Nonexchange commingled fixed income trust fund: (1)					
SSgA Intermediate Fund:					
U.S.	—	80,344	—	—	80,344
Non-U.S	—	39,573	—	—	39,573
Total nonexchange commingled fixed income trust fund	—	119,917	—	—	119,917
Total bonds and notes and nonexchange commingled fixed income trust fund	$ 83,391	428,607	262,599	87,466	862,063

Investment type	Maturity (in years) Within one year	After one to five years	After five to ten years	After ten years	Total
Stocks, nonexchange commingled equity trust funds and investments in limited partnerships:					
U.S. corporate stock					2,959
Non-U.S. corporate stock					94,340
Total stock					97,299
Nonexchange commingled equity trust funds:					
U.S. – SSgA Russell 3000 Fund					388,852
Non-U.S. – SSgA MSCI ACWI Ex USA Fund					38,006
Investments in limited partnerships					14,823
Total stocks, nonexchange commingled equity trust funds and investments in limited partnerships					538,980
Total investments					$ 1,401,043

(1) Nonexchange commingled fixed income trust fund was classified based on effective duration.

(e) 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 System's investment portfolio is exposed to foreign currency risk through international holdings in commingled investment funds and separate accounts.

Investments and deposits exposed to foreign currency risk as of June 30, 2013 are as follows (in thousands):

Investment type	Local currency		Fair value
Cash and cash equivalents	Australian Dollar	$	21
Cash and cash equivalents	Euro		555
Cash and cash equivalents	Japanese Yen		47
Cash and cash equivalents	British Sterling Pound		4
Cash and cash equivalents	Singapore Dollar		7
Total cash and cash equivalents			634
Non-U.S. corporate stock	Australian Dollar		7,297
Non-U.S. corporate stock	British Sterling Pound		21,382
Non-U.S. corporate stock	Danish Krone		4,314
Non-U.S. corporate stock	Euro		12,411
Non-U.S. corporate stock	Hong Kong Dollar		3,756
Non-U.S. corporate stock	Japanese Yen		16,217
Non-U.S. corporate stock	New Zealand Dollar		1,403
Non-U.S. corporate stock	South Africa Rand		787
Non-U.S. corporate stock	Singapore Dollar		1,345
Non-U.S. corporate stock	South Korean Won		1,015
Non-U.S. corporate stock	Swedish Krona		8,048
Non-U.S. corporate stock	Swiss Franc		9,534
Non-U.S. corporate stock	Turkish Lira		906
Total Non-U.S. corporate stock			88,415
Nonexchange commingled trust fund – SSgA MCSI ACWI Ex USA			38,006
Total cash and cash equivalents and investments exposed to foreign currency risk		$	127,055

As of June 30, 2013, the composition of the underlying investments in the SSgA MSCI ACWI Ex USA Fund by country was as follows:

Country	**SSgA MSCI ACWI Ex USA Fund**
Japan	16%
United Kingdom	15
France	7
Switzerland	7
Canada	7
Other	7
Germany	6
Australia	6
China	4
Korea	3
Taiwan	3
Brazil	3
Spain	2
Netherlands	2
Sweden	2
Hong Kong	2
India	2
South Africa	2
Italy	1
Singapore	1
Mexico	1
Russia	1
Total	100%

Investments in Limited Partnerships

The fair value of investments in limited partnerships at June 30, 2013, amounted to approximately $14.8 million. The allocations of net gains and losses to limited partners are based on certain percentages, as established in the limited partnership agreements. Investments in limited partnerships are not rated by a nationally recognized statistical rating organization.

In accordance with the partnership agreements, the System's investments can only be redeemed upon distribution from funds managers; usually in the form of a sale of its holdings or dividends distributed. As of June 30, 2013, the System does not intend to sell its investments in limited partnerships for an amount different to that presented in the financial statements.

As of June 30, 2013, the System had capital commitments and contributions as follows (in thousands):

	Total commitments	Fiscal year contributions	Cumulative contributions	Fair value
Guayacán Fund of Funds, L.P.	$ 20,000	—	19,056	1,000
Guayacán Fund of Funds II, L.P.	25,000	—	23,681	4,529
Guayacán Private Equity Fund, L.P.	5,000	—	4,645	3,512
Invesco Venture Partnership, Fund III, L.P.	5,498	—	4,731	1,631
Invesco Non-U.S. Partnership Fund III, L.P.	4,500	—	4,034	565
Invesco U.S. Buyout & Expansion Capital Partnership Fund III, L.P.	3,716	25	3,236	1,420
Chase Capital Partners Private Equity Fund of Funds II, LTD	15,000	20	14,497	2,166
Total	$ 78,714	45	73,880	14,823

Net Appreciation in Fair Value of Investments

For the year ended June 30, 2013, the net appreciation in fair value of investments amounted to approximately $86.6 million, segregated as follows (in thousands):

Investment type	Realized gain	Unrealized gain/(loss)	Net appreciation (depreciation) in fair value of investments
Bonds and notes	$ 10,510	(33,109)	(22,599)
Nonexchange commingled trust funds	28,860	61,511	90,371
Stocks	7,219	10,393	17,612
Investments in limited partnerships	1,113	76	1,189
Net appreciation in fair value of investments	$ 47,702	38,871	86,573

Securities Lending Transactions

The System participates in a securities lending program, whereby securities are transferred to an independent broker or dealer in exchange for collateral in the form of cash, government securities, and/or irrevocable bank letters of credit with a simultaneous agreement to return the collateral for the same securities in the future. Collateral is marked to market daily and the agent places a request for additional collateral from brokers, if needed. The custodian bank is the agent for the securities lending program.

At year-end, there was no credit risk exposure to borrowers because the amounts the System owes the borrowers (the collateral) exceeded the amounts the borrowers owe the System (the loaned securities). At June 30, 2013, the collateral received represented 102% of the fair value of the total securities lent.

The securities on loan for which collateral was received as of June 30, 2013 consisted of the following (in thousands):

		Fair value
U.S. government securities:		
U.S. Treasury notes	$	7,763
U.S. Treasury note strips		31,738
U.S. Treasury Inflation-Protected Securities (TIPS)		3,672
U.S. corporate bonds and notes		1,374
U.S. corporate stock		244
Non-U.S. corporate stock		2,467
Total	$	47,258

The underlying collateral for these securities had a fair value of approximately $48.4 million as of June 30, 2013. The collateral received was invested in a money market fund sponsored by the custodian bank and is included as part of cash and cash equivalents in the accompanying statement of plan net position. As of June 30, 2013, the short-term investment fund consisted of securities purchased under agreements to resell.

Under the terms of the securities lending agreement, the System is fully indemnified against failure of the borrowers to return the loaned securities (to the extent the collateral is inadequate to replace the loaned securities) or failure to pay the System for income distributions by the securities' issuers while the securities are on loan. In addition, the System is indemnified against loss should the lending agent fail to demand adequate and appropriate collateral on a timely basis.

(6) Capital Assets

For the year ended June 30, 2013, changes in capital assets consisted of the following (in thousands):

	June 30, 2012	Additions	Retirements	June 30, 2013
Depreciable capital assets:				
Building	$ 26,008	—	—	26,008
Furniture and equipment	1,818	76	(319)	1,575
Computers and software	9,658	171	(282)	9,547
Building improvements	765	—	—	765
Branches improvements	274	12	—	286
Vehicles	42	55	(12)	85
Total depreciable capital assets	38,565	314	(613)	38,266
Accumulated depreciation and amortization	(19,376)	(1,332)	—	(20,708)
Not depreciable – project in progress	1,696	58	—	1,754
Capital assets – net	$ 20,885	(960)	(613)	19,312

(7) Other Assets

As of June 30, 2013, other assets consisted of repossessed and in-substance foreclosed properties amounting to approximately $781,000. Repossessed and in-substance foreclosed properties consist mainly of properties acquired or to be acquired upon foreclosure proceedings as collateral from delinquent mortgage loans. Foreclosed properties are valued at the outstanding principal balance of the related mortgage upon foreclosure. These properties will be sold under a bidding process intended to recover the outstanding principal balance of the related mortgage loan. A gain or loss is recognized at the time of sale.

Differences resulting from the recognition of losses at the point of sale rather than upon foreclosure, as required by GAAP, are not material. Management believes that the carrying value of these properties approximates fair value.

(8) Guarantee Insurance Reserve for Loans to Plan Members

The System provides life insurance that guarantees the payment of the outstanding principal balance of mortgage, personal, and cultural trip loans in case of death of a plan member. This coverage is paid in its entirety by the plan members who obtain these loans from the System.

(9) Commitments

The System leases office facilities for the operation of its regional offices (Ponce, Mayagüez, Arecibo, Humacao, and Caguas) under operating lease agreements, which expire at different dates through fiscal year 2017. Rent expense for the year ended June 30, 2013, amounted to approximately $307,000.

Existing operating leases expire in 2017. The minimum future payments as of June 30, 2013 are as follows (in thousands):

		Amount
Year ending June 30:		
2014	$	296
2015		259
2016		194
2017		117
Total	$	866

(10) Contingencies

The System is a defendant or codefendant in various lawsuits resulting from the ordinary conduct of its operations. Management and legal counsel believe that there are no contingent matters that would have a material adverse effect on the System's financial status.

(11) Subsequent Events

Act No. 160 was enacted on December 24, 2013 (Act No. 160-2013) as new legislation for the System. The goal underlying Act No. 160-2013 is for the System to have the ability to make benefit payments when due. The restructuring of future liabilities of the System, coupled with an increase in inflows into the System, is projected to allow the System to pay all pension benefits as they become due. The reform is designed to protect accrued pension benefits.

Act No. 160-2013 contemplates a series of reforms which play a critical role over time in supporting the ability of the System to pay benefits including, among others: (i) freezing the retirement benefits that participants will have accrued under the current defined benefit system as of July 31, 2014; (ii) replacing this defined benefit going forward with a defined contribution plan; (iii) increasing the retirement age of participants; (iv) increasing employee contributions; and (v) eliminating and reducing certain benefits granted to future and existing retirees under special laws. It also provides for certain additional employer contributions by the Commonwealth.

The constitutionality of Act No. 160-2013 was challenged in several lawsuits brought by participants of the System. The Puerto Rico Supreme Court (the Supreme Court) appointed a Special Master to conduct an evidentiary hearing on the facts and suspended the effectiveness of Act No. 160-2013 pending final Resolution of the constitutional challenge. On February 7, 2014, the Special Master issued its report and on February 11, 2014, the Supreme Court issued an order granting parties until March 3, 2014 to file briefs on the constitutionality of Act No. 160-2013.

On April 11, 2014, the Supreme Court declared certain sections of Act No. 160-2013 unconstitutional while maintaining the constitutionality of the following: (i) all changes made to the benefit structure apply to future participants that are hired after July 31, 2014; (ii) elimination of special laws benefits for participants that retire on or after August 1, 2014; and (iii) reduction of special laws benefits to current retirees as of July 31, 2014. Currently, the Supreme Court's decision is under the Commonwealth's evaluation and analysis in order to determine the course of action to undertake.

REQUIRED SUPPLEMENTARY INFORMATION

PUERTO RICO SYSTEM OF ANNUITIES AND PENSIONS FOR TEACHERS
(A Component Unit of the Commonwealth of Puerto Rico)

Schedule of Employers' Contributions

(Unaudited)

Dollars in thousands

Plan	Fiscal year ended		Annual required contribution	Actual employers' contribution	Percentage of contribution
Pension *	June 30, 2013	$	736,591	187,444	25.5%
	June 30, 2012		659,334	176,970	26.8
	June 30, 2011		528,170	159,754	30.3
	June 30, 2010		477,213	164,650	34.5
	June 30, 2009		393,871	171,331	43.5
	June 30, 2008		341,495	156,835	45.9
Other Postemployment Healthcare Benefits	June 30, 2013		45,669	34,239	75.0%
	June 30, 2012		41,069	34,471	83.9
	June 30, 2011		39,925	33,432	83.7
	June 30, 2010		42,487	30,161	71.0
	June 30, 2009		38,015	29,333	77.2
	June 30, 2008		36,836	28,266	76.7

***** Liabilities are for basic System benefits and selected System administered benefits.

See accompanying notes to required supplementary information and independent auditors' report.

PUERTO RICO SYSTEM OF ANNUITIES AND PENSIONS FOR TEACHERS
(A Component Unit of the Commonwealth of Puerto Rico)

Schedule of Funding Progress

(Unaudited)

Dollars in thousands

Plan	Actuarial valuation date	Actuarial value of plan assets	AAL	UAAL	Funded ratio	Annual covered payroll	UAAL percentage of annual covered payroll
Pension*	June 30, 2013	$ 1,906,882	12,251,995	10,345,113	15.6%	1,248,674	828.5%
	June 30, 2012	2,099,563	12,350,836	10,251,273	17.0	1,292,975	792.8
	June 30, 2011	2,385,863	11,448,609	9,062,746	20.8	1,320,400	686.4
	June 30, 2010	2,221,977	9,279,776	7,057,799	23.9	1,370,344	515.0
	June 30, 2009	2,157,593	8,721,515	6,563,922	24.7	1,418,304	462.8
	June 30, 2008	N/D	N/D	N/D	N/D	N/D	N/D
Other Postemployment Healthcare Benefits	June 30, 2013	—	792,875	792,875	0%	1,248,674	63.5%
	June 30, 2012	—	797,332	797,332	—	1,292,975	61.7
	June 30, 2011	—	706,069	706,069	—	1,320,400	53.5
	June 30, 2010	—	694,230	694,230	—	1,370,344	50.7
	June 30, 2009	—	750,382	750,382	—	1,418,304	52.9
	June 30, 2008	—	N/D	N/D	N/D	N/D	N/D

* Liabilities are for basic System benefits and selected System administered benefits.

N/D = Not Determined.

See accompanying notes to required supplementary information and independent auditors’ report.

(1) Schedule of Employers' Contributions

The schedule of employers' contributions provides information about the annual required contribution (ARC) and the extent to which contributions made cover the ARC. The ARC is the annual required contribution for the year calculated with certain parameters, which include actuarial methods and assumptions.

(2) Schedule of Funding Progress

The schedule of funding progress provides information about the funded status of the System and the progress being made in accumulating assets to pay benefits when due.