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, 2014

(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 fiduciary net position as of June 30, 2014, the related statement of changes in fiduciary 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 fiduciary net position of the Puerto Rico System of Annuities and Pensions for Teachers as of June 30, 2014, and the changes in its fiduciary net position for the year then ended, in accordance with U.S. generally accepted accounting principles.

Emphasis of Matters

Adoption of New Accounting Pronouncement

As discussed in note 2(i) to the basic financial statements, effective July 1, 2013, the System adopted Governmental Accounting Standards Board (GASB) Statement No. 67, *Financial Reporting for Pension Plans – an Amendment of GASB Statement No. 25*. Our opinion is not modified with respect to this matter.

Insolvency of the System

As discussed in note 3 to the basic financial statements, the System's fiduciary net position as a percentage of total pension liability was 11.51% as of June 30, 2014. In the opinion of management, based on information prepared by consulting actuaries, if measures are not taken to significantly increase contributions, the System will become insolvent between fiscal years 2018 and 2019 depending on the timing of receipt of contributions and the System's ability to dispose of illiquid assets. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles require that the Management's Discussion and Analysis and the schedules included under the Required Supplementary Information 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 GASB 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
December 4, 2015

Stamp No. E194038 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report

Introduction

The following discussion and analysis of the financial performance of the Puerto Rico System of Annuities and Pensions for Teachers (the System) provides an overview of its activities for the fiscal year ended June 30, 2014. Its purpose is to provide insight and additional detail into the information presented in the basic financial statements, notes to the basic financial statements, and required supplementary information. This discussion and analysis is intended to be read in conjunction with the System's financial statements.

The System is a trust created by law in 1951 by the Legislature of the Commonwealth of Puerto Rico (the Commonwealth). The purpose of the System is to provide pension and other benefits mainly to retired teachers of the Puerto Rico Department of Education (Department of Education), an agency of the Commonwealth, and the retired employees of the System. On December 24, 2013 the Commonwealth enacted Act 160 (Act No. 160-2013) as new legislation for the System, which superseded Act No. 91 of March 29, 2004 (Act No. 91-2004) and was modified by the Puerto Rico Supreme Court on April 11, 2014. As a result of the Supreme Court's decision, the System administers two benefit structures: (i) for active participants hired on or before July 31, 2014, and (ii) for participants hired on or after August 1, 2014. The System is a single-employer pension plan, as defined by Governmental Accounting Standards Board (GASB) Statement No. 67, where a primary government and its component units are considered to be one employer. The System also administers postemployment healthcare benefits provided by the Commonwealth to retired teachers of the Department of Education and retired employees of the System. The System is considered an integral part of the financial reporting of the Commonwealth and is included in the Commonwealth's basic financial statements.

Overview of the Basic Financial Statements

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

- The Statement of Fiduciary Net Position – presents the financial position of the System at fiscal year end. It provides information about the nature and amounts of resources with present service capacity that the System presently controls (assets), consumption of net assets by the System that is applicable to a future reporting period (deferred outflow of resources), presents obligations to sacrifice resources that the System has little or no discretion to avoid (liabilities), and acquisition of net assets by the System that is applicable to a future reporting period (deferred inflow of resources) with the difference between assets/deferred outflow of resources and liabilities/deferred inflow of resources being reported as net position. Investments are shown at fair value. All other assets and liabilities are determined on an accrual basis.
- The Statement of Changes in Fiduciary Net Position – presents the results of activities during the fiscal year. All changes affecting the assets/deferred outflow of resources and liabilities/deferred inflow of resources of the System are reflected on an accrual basis of when the activity occurred, regardless of the timing of the related cash flows. Changes in the fair value of investments are included in the year's activity as net appreciation (depreciation) in fair value of investments.

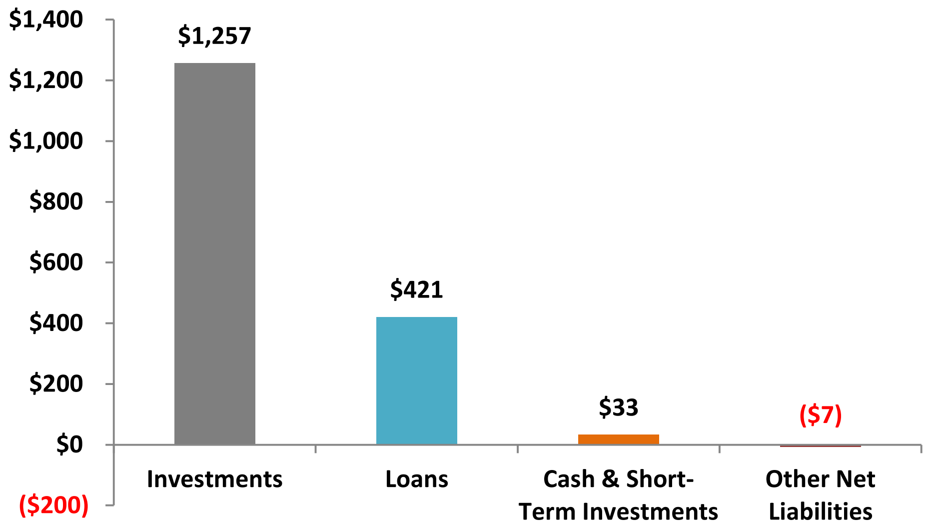
- The Notes to the Basic Financial Statements – provide additional information that is essential for an understanding of the data provided in the financial statements. The notes present information about the System's accounting policies, significant account balances and activities, material risks, obligations, contingencies, and subsequent events, if any.
- Required Supplementary Information – as required by GASB, is presented after the notes to the basic financial statements. It consists of information pertaining to the System's actuarial methods and assumptions; and provides data on changes in the employer's net pension liability and related ratios, the pension benefits employer's contributions, and the pension benefits' investment return, as well as data on the System's other postemployment benefits.

In fiscal year 2014, the System adopted GASB Statement No. 67, *Financial Reporting for Pension Plans – an Amendment of GASB Statement No. 25*. Implementation of GASB Statement No. 67 did not impact the fiduciary net position of the System; however, certain changes to note disclosures and required supplementary information have been incorporated to comply with the new standard.

Financial Highlights

- The System's fiduciary net position decreased by approximately $203 million, from $1,907 million as of June 30, 2013 to $1,704 million as of June 30, 2014. The decrease was mainly attributable to the sale of investments to cover cash shortfalls for purposes of paying the System's pension benefits, offset by a net appreciation in the fair value of investments. Net position restricted for pensions of $1,704 million as of June 30, 2014 consisted of the following:
  - $1,257 million in investments
  - $421 million in loans to plan members
  - $33 million in cash and cash equivalents and collateral from securities lending transactions (Cash and short-term investments)
  - $7 million in total liabilities, net of accounts receivable, capital assets and other assets (other net liabilities)

The total plan's fiduciary 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, 2014 amounted to $1,257 million, compared to $1,401 million at June 30, 2013.
- Contributions for the year ended June 30, 2014 amounted to $309 million, compared to $308 million for the year ended June 30, 2013.
- Net investment income for the year ended June 30, 2014 amounted to $190 million, compared to $157 million for the year ended June 30, 2013.
- Benefits paid to participants, including refunds of contributions, for the year ended June 30, 2014 amounted to $684 million, compared to $636 million for the year ended June 30, 2013.
- Administrative expenses for the year ended June 30, 2014 amounted to $20 million, compared to $24 million for the year ended June 30, 2013.
- The System's fiduciary net position as a percentage of the total pension liability at June 30, 2014 was 11.51% as determined under GASB Statement No. 67, compared to 15.6% at June 30, 2013 as determined under GASB Statement No. 25.
- 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.

The following schedules present a comparative summary of the System's net position and changes in net position for fiscal years 2014 and 2013:

Comparative Summary of Fiduciary Net Position – Pension Benefits

		2014	2013	Amount of change	Percentage change
			(Dollars in thousands)		
Assets:					
Cash and cash equivalents and collateral from securities lending transactions	$	32,658	116,097	(83,439)	(72)%
Accounts receivables		25,161	31,318	(6,157)	(20)
Investments and member loans		1,678,007	1,812,075	(134,068)	(7)
Capital assets		17,325	19,312	(1,987)	(10)
Other assets		846	781	65	8
Total assets		1,753,997	1,979,583	(225,586)	(11)
Liabilities:					
Overdraft in cash with fiscal agent		4,942	—	4,942	100
Accounts payable and accrued expenses		16,188	16,860	(672)	(4)
Escrow funds of mortgage loans and guarantee insurance reserve for loans to plan members and payable for investment securities purchased		12,917	6,373	6,544	103
Securities lending obligations and other liabilities		16,171	49,468	(33,297)	(67)
Total liabilities		50,218	72,701	(22,483)	(31)
Net position restricted for pensions	$	1,703,779	1,906,882	(203,103)	(11)%

Comparative Summary of Fiduciary Net Position Analysis – Pension Benefits

The decrease in cash and cash equivalents and collateral from securities lending transactions is due to the fluctuations year over year representing the amount of short-term investments held by investment managers at a point in time and to a decrease in collateral from securities lending transactions due to securities lending activity as of June 30, 2014. The decrease in investments and member loans is primarily attributable to the sale of investments to cover the cash shortfalls for purposes of paying the System's pension benefits, offset by a net appreciation in fair value and an increase in mortgage loans. The decrease in accounts receivable is mainly attributable to the collection of the fourth installment from the Office of Management and Budget of the Commonwealth related to an outstanding claim.

The overdraft in cash with fiscal agent of approximately $5 million as of June 30, 2014 is mainly attributable to higher pension benefits payments over member and employer contributions made by the Puerto Rico Treasury Department on behalf of the System. The decrease in accounts payable and accrued expenses is primarily due to net payments of the voluntary termination benefits liability for the employees of the System covered by Act No. 70 of July 2, 2010. The increase in escrow funds of mortgage loans and guarantee insurance reserve for loans to plan members and payable for investment securities purchased mainly corresponds to an increase in liabilities pertaining to investments purchased due to market conditions and investment managers' decisions as of fiscal year end. The decrease in securities lending obligations and other liabilities is primarily attributable to lower securities lending activity as of fiscal year end.

Comparative Summary of Changes in Fiduciary Net Position – Pension Benefits

	Years ended June 30		Amount	Percentage
	2014	**2013**	**of change**	**change**
	(Dollars in thousands)			
Additions:				
Contributions	$ 308,959	308,286	673	—%
Net investment income	190,023	157,494	32,529	21
Other income	1,416	1,432	(16)	1
Total additions	500,398	467,212	33,186	7
Deductions:				
Benefits paid to participants, including refunds of contributions	683,698	635,940	47,758	8
General and administrative expenses	19,803	23,606	(3,803)	(16)
Total deductions	703,501	659,546	43,955	7
Net decrease in net position	(203,103)	(192,334)	(10,769)	6
Net position restricted for pensions:				
Beginning of year	1,906,882	2,099,216	(192,334)	(9)
End of year	$ 1,703,779	1,906,882	(203,103)	(11)%

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

The increase in net investment income that resulted in fiscal year 2014 is mainly attributable to a net appreciation in fair value of investments due to generally favorable market conditions experienced by the investments of the System. The increase in benefits paid to participants, including refunds of contributions, 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. General and administrative expenses decreased during fiscal year 2014 mainly due to the implementation of the voluntary termination benefits program and budget reduction.

Other Postemployment Healthcare Benefits

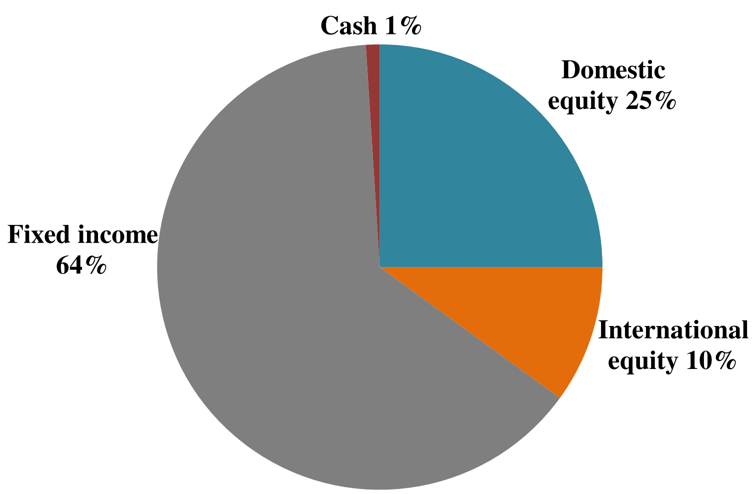
Other postemployment healthcare benefits paid during the fiscal year 2014 amounted to $36 million, compared to the $34 million paid during fiscal year 2013.

Financial Analysis of the System

The System provides retirement benefits mainly to teachers within the public education system of the Commonwealth. The System's fiduciary net position restricted for pensions at June 30, 2014, amounted to approximately $1,704 million, a decrease of approximately $203 million from approximately $1,907 million at June 30, 2013. Additions to the System's net position restricted for pensions include employer and member contributions, as well as net investment income. For fiscal year 2014, employer basic benefits contributions increased by approximately $6 million, from approximately $133 million during fiscal year 2013 to approximately $139 million during fiscal year 2014. However, member contributions decreased by approximately $4 million, from approximately $119 million during fiscal year 2013 to approximately $115 million during fiscal year 2014. The System realized a net appreciation in the fair value of investments of approximately $127 million for fiscal year 2014 compared to $87 million for fiscal year 2013.

Investment Portfolio and Capital Markets Overview

The System's asset allocation generated a return of 10.8%, on a time-weighted return basis, for the fiscal year ended June 30, 2014. The target asset allocation is as follows:



Economy and Capital Markets Overview

The beginning of the 2014 fiscal year was rewarding for investors as the Dow Jones U.S. Total Stock Market Index hit a new all-time high in September 2013, and international equities soared as Europe emerged from its recession. Equity markets continued to be influenced by external forces during the first quarter of the fiscal year, including continued loose monetary policy and congressional gridlock in Washington due to debates over the Affordable Care Act, the debt ceiling limit, and the lead up to the first government shutdown since 1995-1996. In September 2013, The Federal Open Market Committee (FOMC) surprised investors with the decision to not taper its $85 billion in monthly bond purchases. Meanwhile, in Europe, disappointing economic growth numbers, coupled with very low inflation rates prompted the European Central Bank (ECB) to cut their main policy interest rate from an ultra-low 0.50% to 0.25%. On the eve of the New Year, equity markets continued to rise as the S&P 500 reached an all-time high. The end of 2013 also marked the end of Ben Bernanke's tenure as the Federal Reserve (Fed) Chairman; Janet Yellen was nominated to succeed Mr. Bernanke. Additionally, the FOMC finally announced that it would begin to taper the rate of Treasury and mortgage-backed securities purchases by $10 billion and that it intended to do so throughout 2014. As a result, the 10-Year Treasury yield rose to a period high of 3.0% to close the year and drove fixed income market returns into negative territory.

Moving into the second half of the fiscal year, global equity markets struggled as unusually harsh winter weather was blamed for disappointing economic data in the U.S. Political turmoil in Ukraine and Turkey, coupled with weak economic data from China, triggered a sell-off in emerging markets. The economic uncertainty around the globe prompted a "risk-off" environment during the first quarter of 2014 and resulted in a flight to quality into U.S. Treasuries, driving long yields lower. However, newly appointed Fed Chairman, Janet Yellen, comments that a rise in the policy rate may occur as soon as six months following the end of Quantitative Easing which led short term rates higher. The fiscal year ended on a more positive note as both equity and fixed income markets experienced positive returns bolstered by improvement in U.S. economic data, easing tensions in Ukraine, and monetary easing in Europe. Overseas, the European Central Bank further loosened its monetary policy stance and proposed a series of measures to avoid deflationary pressures in the Eurozone. In Japan, while no further policy measures were seen, the government proposed plans to combat the continuing risk of deflation and to revitalize the Japanese economy. In addition, conditions in emerging markets improved as investor attention seemed to have moved past the political turmoil between Russia and Ukraine. Bond markets were also buoyed by the Fed's firm commitment to keep policy interest rates very low for an extended period beyond the end of 2015.

With continued support from the Fed and mostly positive economic news, domestic equity markets trended upwards throughout the fiscal year, returning 25.0%. Developed international equity markets posted a 23.6% return supported by monetary easing by the ECB. Emerging markets trailed the broader market, returning 14.3%, as confrontation escalated in Ukraine and continuing concerns regarding China's growth prospects weighed on performance. The broad U.S. fixed income market experienced modest performance relative to equity markets and returned 4.4% during the period. Intermediate credit bonds outperformed the broader U.S. fixed income market and gained 5.2%. The yield on the 10-Year U.S. Treasury ended the fiscal year roughly where it began at 2.5% after declining from its peak of 3.0% following the FOMC's decision to begin tapering its quantitative easing program. The table below shows the fiscal year and quarter returns of major indices.

(In thousands)

Industry Indices Performance Overview

Indices	FY 2013-14	First quarter FY 2014	Second quarter FY 2014	Third quarter FY 2014	Fourth quarter FY 2014
Dow Jones U.S. Total Stock Market Index	25.0%	6.2%	10.1%	2.0%	4.8%
S&P 500	24.6	5.2	10.5	1.8	5.2
S&P/Citigroup Large Growth	27.1	6.6	11.1	1.4	5.8
S&P/Citigroup Large Value	22.0	3.8	9.8	2.3	4.6
Russell 3000	25.2	6.3	10.1	2.0	4.9
Russell 2000 Index	23.6	10.2	8.7	1.1	2.0
Russell 2000 Growth	24.7	12.8	8.2	0.5	1.7
Russell 2000 Value	22.5	7.6	9.3	1.8	2.4
MSCI ACW ex-U.S.	21.8	10.1	4.8	0.5	5.0
MSCI EAFE	23.6	11.6	5.7	0.7	4.1
MSCI Emerging Markets	14.3	5.8	1.8	(0.4)	6.6
Barclays Aggregate Bond Index	4.4	0.6	(0.1)	1.8	2.0
Barclays Intermediate Credit	5.2	1.0	0.7	1.6	1.8

Total System's Investment Portfolio Performance

Money-weighted and time-weighted rates of return are two methods of measuring the performance of an investment portfolio. GASB Statement No. 67 requires disclosure of the annual money-weighted rate of return on investments in the notes to the basic financial statements. The money-weighted rate of return expresses investment performance, net of investment expense, adjusted for the changing amounts actually invested. The money-weighted rate of return incorporates the size and timing of cash flows and is calculated by finding the rate of return that will set the present values of all cash flows and terminal values equal to the value of the initial investment. The time-weighted rate of return is a method of calculating period-by-period returns that negates the effects of external cash flows. The time-weighted rate of return is a measure of the compound rate of growth in a portfolio. Given that the time-weighted method is not sensitive to contributions or withdrawals, it is used to compare the returns of investment managers. When calculating time-weighted rate of return, the effect of varying cash inflows is eliminated by assuming a single investment at the beginning of a period and measuring the growth or loss of market value to the end of that period.

The System's asset allocation generated a return of 10.8%, based on a time-weighted return method calculation, during the fiscal year 2014 trailing its policy benchmark by 70 basis points. The annual money-weighted rate of return was 11.0%. Underperformance was primarily a result of a modest underweight allocation to U.S. and international equities relative to long-term target weights throughout the period. The System's total investment portfolio including member loans as of June 30, 2014 totaled $1,696 million, composed of $1,678 million in total investments and member loans, $12 million included in cash and cash equivalents and $6 million net of accrued interest and dividend receivable, receivable from investments sold and payable for investments purchased.

U.S. Equity Overview for the Fiscal Year 2014

U.S. stocks as measured by the Dow Jones U.S. Total Stock Market Index gained 25.0% during the fiscal year. All sectors produced positive returns during the fiscal year led by information technology and materials, which were the top performing sectors. From a style perspective, growth stocks outpaced value stocks across large and small cap markets, while value stocks bested growth in the mid cap space. On a capitalization basis, mid cap stocks were the best performers during the period, followed by large and small cap stocks.

The System's domestic equity component returned 25.0% during the fiscal year, modestly underperforming its benchmark, the Russell 3000 Index Fund, by 20 basis points. Underperformance was due to the impact of timing of cash flows. The Russell 3000 Index Fund matched its benchmark during the period. Approximately $113.4 million was redeemed from the domestic equity component during the fiscal year in order to meet the cash needs of the System. As of June 30, 2014, the System's domestic equity assets totaled $327 million and represented approximately 19% of the System's total investment portfolio, including loans.

International Equity Overview for the Fiscal Year 2014

International equities, as measured by the MSCI ACW ex-U.S. Index, gained 21.8%. The Index posted positive returns for four consecutive quarters as monetary easing from the ECB provided support. Europe ex-U.K. and the U.K. were the strongest performing regions over the fiscal year.

During the fiscal year, the System's international equity component gained 20.4%, trailing its benchmark by 140 basis points. Approximately $35 million was redeemed from the component during the fiscal year in order to meet the cash needs of the System. At the end of the fiscal year, the component had $127 million in assets, representing 7% of the System's total investment portfolio, including loans.

U.S. Fixed Income Overview for the Fiscal Year 2014

The broad U.S. fixed income market, as measured by the Barclays Aggregate Bond Index, produced positive results in three of four quarters returning 4.4% in the fiscal year. The System's blended benchmark for its fixed income portfolio outperformed the broader U.S. fixed income market gaining 5%. All underlying sectors generated positive returns during the period, with the corporate bond sector providing the strongest returns followed by the mortgage-backed securities and commercial mortgage-backed securities sectors. Long duration bonds outperformed shorter duration bonds, while lower quality maturities outpaced those of higher quality.

The System's fixed income component gained 4.9% during the one year period ending June 30, 2014, modestly trailing its benchmark by 10 basis points. Approximately $165.2 million was redeemed from the component during the fiscal year in order to meet the cash needs of the System. At the end of the fiscal year, fixed income assets totaled $808 million, consisting of approximately 48% of the System's total investment portfolio, including loans.

Other Investments

As of June 30, 2014, the System held $421 million in loans to participants, which represented 25% of the total investment portfolio. Loan balances as of June 30, 2014 were higher than the $411 million balance as of June 30, 2013. The loan portfolio component gained approximately 9.2% during the one year ending June 30, 2014.

At the end of the fiscal year 2014, the System had some exposure to limited partnerships of private equity investments, which were valued at approximately $11 million and represented 1% of the System's total investment portfolio, including loans.

Capital Assets

The System's investment in capital assets as of June 30, 2014 and 2013 amounted to approximately $17 million and $19 million, respectively, net of accumulated depreciation. Capital assets include building and improvements, construction in progress, and furniture, equipment and software. Building and improvements consist of the facilities in which the System has its operations.

Net Pension Liability

The System performs an actuarial valuation of the employer's total pension liability and net pension liability at least every other year. The System's latest actuarial valuation, as of June 30, 2014, reflects a total pension liability of $14.8 billion, a fiduciary net position of $1.7 billion, a net pension liability of $13.1 billion and a fiduciary net position as a percentage of total pension liability of 11.51%. This valuation reflects an increase in total pension liability and a decrease in fiduciary net position for financial reporting purposes. The decrease in fiduciary net position is the result of a decrease in the actuarial value of assets from $1.9 billion as of June 30, 2013 to $1.7 billion as of June 30, 2014, due to the continued net funding and cash flow shortfall that is exhausting plan assets, among other factors, such as the discount rate. The GASB Statement No. 67 discount rate used in the valuation report as of June 30, 2014 is 4.33% per year. This single equivalent interest rate yields the same present value of all future benefits as using the expected return on plan assets of 6.65% until fiscal year 2018, and the June 30, 2014 tax-free municipal bond index of 4.29% beginning with fiscal year 2019, for the discount rate.

Funded Status of Other Postemployment Healthcare Benefits

The unfunded liability for other postemployment healthcare benefits amounted to approximately $543 million as of June 30, 2014 and was fully unfunded.

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 Fiduciary Net Position

June 30, 2014

(In thousands)

	Pension	Other postemployment healthcare benefits	Total
Assets:			
Cash and cash equivalents:			
Deposits at Puerto Rico commercial banks	$ 2,722	—	2,722
Deposits with Government Development Bank for Puerto Rico – restricted	3,301	—	3,301
Money market funds	11,483	—	11,483
Total cash and cash equivalents	17,506	—	17,506
Accounts receivable:			
Investments sold	4,311	—	4,311
Accrued interest and dividends receivable	6,146	—	6,146
Other	14,704	—	14,704
Total accounts receivable	25,161	—	25,161
Collateral from securities lending transactions	15,152	—	15,152
Investments:			
Bonds and notes	649,774	—	649,774
Nonexchange commingled trust funds	503,619	—	503,619
Stocks	92,900	—	92,900
Investments in limited partnerships	11,170	—	11,170
Total investments	1,257,463	—	1,257,463
Loans to plan members:			
Mortgage	158,892	—	158,892
Personal	259,765	—	259,765
Cultural trips	1,887	—	1,887
Total loans to plan members	420,544	—	420,544
Capital assets – net	17,325	—	17,325
Other assets	846	—	846
Total assets	1,753,997	—	1,753,997
Liabilities:			
Overdraft in cash with fiscal agent	4,942	—	4,942
Accounts payable	2,074	—	2,074
Accrued expenses	14,114	—	14,114
Payable for investment securities purchased	4,442	—	4,442
Securities lending obligations	15,152	—	15,152
Escrow funds of mortgage loans and guarantee insurance reserve for loans to plan members	8,475	—	8,475
Other liabilities	1,019	—	1,019
Total liabilities	50,218	—	50,218
Net position restricted for pensions	$ 1,703,779	—	1,703,779

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 Fiduciary Net Position

Year ended June 30, 2014

(In thousands)

		Pension	Other postemployment healthcare benefits	Total
Additions:				
Contributions:				
Employer:				
Basic benefits	$	139,453	—	139,453
Special benefits		49,914	35,892	85,806
Participating employees		115,461	—	115,461
Contributions transferred from other systems		4,131	—	4,131
Total contributions		308,959	35,892	344,851
Investment income:				
Net appreciation in fair value of investments		126,796	—	126,796
Interest		64,011	—	64,011
Dividends		2,148	—	2,148
Less investment expense, other than from securities lending		3,128	—	3,128
Net income from investing, other than from securities lending		189,827	—	189,827
Securities lending income		261	—	261
Less securities lending expenses		65	—	65
Net income from securities lending		196	—	196
Net investment income		190,023	—	190,023
Other income		1,416	—	1,416
Total additions		500,398	35,892	536,290
Deductions:				
Benefits paid to participants:				
Annuities and death benefits		626,027	—	626,027
Special benefits		46,964	35,892	82,856
Refunds of contributions to participating employees		10,707	—	10,707
General and administrative expenses		19,803	—	19,803
Total deductions		703,501	35,892	739,393
Net decrease in net position		(203,103)	—	(203,103)
Net position restricted for pensions:				
Beginning of year		1,906,882	—	1,906,882
End of year	$	1,703,779	—	1,703,779

See accompanying notes to basic financial statements.

(1) Organization

The Puerto Rico System of Annuities and Pensions for Teachers (the System) is a trust created by law in 1951 by the Legislature of the Commonwealth of Puerto Rico (the Commonwealth). The purpose of the System is to provide pension and other benefits mainly to retired teachers of the Puerto Rico Department of Education (Department of Education), an agency of the Commonwealth, and the retired employees of the System. The benefits provided to members of the System are established by Commonwealth of Puerto Rico law and may be amended only by the Legislature with the Governor's approval. On December 24, 2013, the Commonwealth enacted Act No. 160 (Act No. 160-2013) as new legislation for the System, which superseded Act No. 91 of March 29, 2004 (Act No. 91-2004) and was modified by the Puerto Rico Supreme Court (Supreme Court) on April 11, 2014. As a result of the Supreme Court's decision, the System administers two benefit structures: (i) for active participants hired on or before July 31, 2014, and (ii) for participants hired on or after August 1, 2014.

The System administers a single-employer pension plan, as defined by Governmental Accounting Standards Board (GASB) Statement No. 67, where a primary government and its component units are considered to be one employer. The System also administers postemployment healthcare benefits provided by 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, single-employer defined benefit other postemployment benefit plan, as defined by GASB Statement No. 67, which is funded on a pay-as-you-go-basis.

The System is considered an integral part of the financial reporting of the Commonwealth and is included in the Commonwealth's basic financial statements as a pension trust fund. The System, as a governmental retirement plan, is excluded from the provisions of the Employee Retirement Income Security Act of 1974 (ERISA). Income earned by the System is not subject to Federal and Puerto Rico taxes.

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, appointed by the Governor, one of which is a currently certified teacher in active service, and two who represent retired teachers.
- One member who is a representative of the entity in accordance with Act No. 45 of February 25, 1998, as amended. If the teachers of the Department of Education do not have a representative of the proper unit under Act No. 45-1998, as amended, the Governor may appoint a teacher in active service as member of the Board.

- 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.

(2) Summary of Significant Accounting Policies

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 U.S. generally accepted accounting principles (GAAP) as applicable to governmental organizations. Plan member contributions are recognized in the period in which the contributions are due. Employer contributions are recognized when due and the employer has legal requirement to provide the contributions. Benefits and refunds are recognized when legally due and payable.

(b) Use of Estimates

The preparation of the basic financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of net position restricted for pensions, 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 position restricted for pensions during the reporting period. The System's most significant estimates relate to the assumptions made as part of the annual actuarial valuation process to calculate the total pension liability, and the valuation of certain investments. Due to the inherent nature of these estimates, actual results could differ from those estimates.

(c) Cash and Cash Equivalents

Cash and cash equivalents consist of "overnight deposits" with the custodian bank, a commercial bank, and money market funds. Restricted cash deposited with GDB consists of escrow funds for guarantee insurance reserve for loans to plan members. Overdraft in cash with fiscal agent represents a fund account the System has at the Puerto Rico 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 $11 million and $504 million, respectively, as of June 30, 2014. 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.

(In thousands)

Securities purchases and sales are recorded on a trade-date basis. Realized gains and losses from the sale of securities and unrealized changes in the fair value of outstanding securities are included in net appreciation (depreciation) in fair value of investments. Realized gains and losses are computed as the difference between the proceeds of the sale and the cost of the investment sold, determined by the average cost method. Interest income is recorded as earned on an accrual basis. Dividend income is recorded on the ex-dividend date.

(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) Termination Benefits

The System accounts for termination benefits in accordance with GASB Statement No. 47, *Accounting for Termination Benefits*. Pursuant to the provisions of GASB Statement No. 47, the System, as an employer, should recognize a liability and expense for voluntary termination benefits (for example, early retirement incentives) when the offer is accepted and the amount can be estimated. A liability and expense for involuntary termination benefits (for example, severance benefits) should be recognized when a plan of termination has been approved by those with the authority to commit the government to the plan, the plan has been communicated to the employees, and the amount can be estimated.

(i) Adoption of Accounting Pronouncements

Effective July 1, 2013, the System adopted GASB Statement No. 67, *Financial Reporting for Pension Plans – an Amendment of GASB Statement No. 25*. GASB Statement No. 67 establishes standards of financial reporting for separately issued financial reports and specifies the required approach to measuring the net pension liability of employers for benefits provided through the pension plan, about which information is required to be presented. This Statement replaces the requirements of GASB Statements 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 equivalent arrangements (hereafter jointly referred to as trusts) that meet certain criteria.

GASB Statement No. 67 requires the disclosures of the components of the net pension liability and the assumptions and other methods used to measure the total pension liability. GASB Statement No. 67 also requires certain additional note disclosures for defined benefit pension plans including the annual money-weighted rate of return on plan investments. GASB Statement No. 67 revised the reporting requirements for required supplementary information to include schedules that provide trend information related to 1) changes in the net pension liability and related ratios, 2) the actuarially and contractually determined contributions of employer contributing entities, and 3) the annual money-weighted rate of return on plan investments. GASB Statement No. 67 provides a clearer definition of a single-employer pension plan, stating that a primary government and its component units are considered to be one employer. As a result, the System determined that the cost-sharing multi-employer defined benefit plan that was previously reported in the 2013 basic financial statements should be reported as a single-employer pension plan.

Adoption of GASB Statement No. 67 did not impact the fiduciary net position of the System; however certain changes to note disclosures and required supplementary information have been incorporated to comply with the new standard.

(Continued)

(j) Recently Issued Accounting Pronouncements

GASB Statement No. 72, *Fair Value Measurement and Application*, addresses accounting and financial reporting issues related to fair value measurements. The new requirements improve the comparability of financial statements among governments by requiring measurement of certain assets and liabilities at fair value using a consistent and more detailed definition of fair value and accepted valuation techniques. The definition of fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It also enhances fair value application guidance and related disclosures in order to provide information to financial statement users about the impact of fair value measurements on a government's financial position. GASB Statement No. 72 requires a government to make disclosures about its fair value measurements, the level of fair value hierarchy, and valuation techniques. Additional disclosures are required for certain entities that calculate the net asset value per share (or its equivalent). GASB recommends organizing your disclosures by the type of asset or liability reported at fair value. This Statement is effective for fiscal years beginning after June 15, 2015. Earlier application is encouraged.

The impact that this Statement will have on the System's financial statements has not yet been determined.

(3) Liquidity Risk and Uncertainties

Risk and Uncertainties

The System is a mature system with a significant retiree population. Based on statutory funding requirements, the annual benefit payments and administrative expenses paid by the System are significantly higher than the member and employer contributions made to the System. As a result, investment income and the System's assets are being used to cover the negative cash flow, and the System's assets are expected to continually decline until exhaustion.

The System's fiduciary net position as a percentage of total pension liability was 11.51% as of June 30, 2014. In the opinion of management, based on information prepared by consulting actuaries, if measures are not taken to significantly increase contributions, the System will become insolvent between fiscal years 2018 and 2019 depending on the timing of receipt of contributions and the System's ability to dispose of illiquid assets. The estimate of when the System will become insolvent and when its assets will be exhausted is based on significant assumptions, including the rate of return on investments, the amount and timing of collections from the Commonwealth for the member and employer contributions, as well as the estimated participant benefits and the System's administrative expenses to be paid each year.

If the System becomes insolvent, it would be operating solely on a "pay-as-you-go" basis, which means that it would be unable to pay benefits that exceed the actual employer and employee contributions received (net of administrative and other expenses), unless the Commonwealth provides the funding required to meet the pay-as-you-go retirement benefits.

The System's funding requirements, together with the funding requirements of the Employees' Retirement System of the Government of the Commonwealth of Puerto Rico (PRGERS) 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 primary 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 to, among other factors, continued budget deficits, a prolonged economic recession, high unemployment, population decline, and high levels of debt and pension obligations. The widening of credit spreads for the Commonwealth's public sector debt, the continued downgrading of the Commonwealth's credit ratings and those of many of its instrumentalities to noninvestment grade categories and the lowered-than-projected revenues have put further strain on the Commonwealth's liquidity and have affected its access to both the capital markets and private sources of financing, as well as the borrowing cost of any such funding.

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 pension plan for the upcoming years, may be adversely affected.

Remediation Plan

On July 5, 2011, the Commonwealth approved Act No. 114 (Act No. 114-2011), which provides for an increase in employer's 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. Act No. 160-2013 contemplates what was established in Act No. 114-2011 plus increases the statutory employer contribution to 20.525% starting fiscal year 2022.

On December 24, 2013, the Commonwealth approved Act No. 160-2013 to carry out a comprehensive reform of the System that, together with certain additional contributions, was projected, based on actuarial cash model assumptions, to allow the System to make benefit payments when due without depleting all of its assets first. While significant aspects of Act No. 160-2013 were declared unconstitutional by the Puerto Rico Supreme Court on April 11, 2014, the Commonwealth is still responsible for making certain additional annual contributions to the System. The legislation provides for two classes of additional contributions by the Commonwealth's General Fund to the System: (i) a Teacher's Justice Uniform Contribution (the Uniform Contribution) of $30 million in each of fiscal years 2017 and 2018 and $60 million thereafter until fiscal year 2042, and (ii) an Annual Additional Contribution commencing on fiscal year 2019 and continuing until fiscal year 2042 (the Annual Additional Contribution) equal to the amount determined by the actuaries as necessary to prevent the projected value of the gross assets of the System from falling below a $300 million level during any subsequent fiscal year. In April 2015, the System's actuaries prepared an actuarial study to determine an estimate of the Annual Additional Contribution measured as of June 30, 2014 and, based on various assumptions, projected that the Annual Additional Contribution for fiscal year 2019 and each fiscal year thereafter would be approximately $450 million. The actuarial study notes that if the Annual Additional Contribution is not paid in full during the intended fiscal years, the amount would increase in the following years. The actuaries also noted that if the System were unable to sell certain illiquid assets (consisting primarily of loans to members), currently amounting to approximately $450 million, the System may face liquidity issues since its assets are projected to fall below the $450 million illiquid asset balance during fiscal year 2018, one year before the first payment of the Annual Additional Contribution.

(In thousands)

The success of these measures cannot be assured, as it is dependent upon future events and circumstances whose outcome cannot be anticipated.

For purposes of the actuarial valuation projection as of June 30, 2014, even though there is no prior collection history of the Commonwealth's contributions required by Act No. 160-2013, the Uniform Contribution and the Annual Additional Contribution were not considered based on the following: (i) the actual fiscal and budgetary condition of the Commonwealth, and (ii) as a result of budgetary constraints, the Commonwealth did not pay similar additional contributions to PRGERS for fiscal year 2013-14 and significantly reduced its additional contribution to PRGERS for fiscal year 2014-15.

(4) Plan Description

Pension Benefits

The System administers two benefit structures pursuant to Act No. 160-2013, as modified by the April 11, 2014 decision of the Puerto Rico Supreme Court. Benefit provisions vary depending on member's date of hire as follows:

- Members hired on or before July 31, 2014 with certain distinctions for members who retire August 1, 2014 or later.
- Members hired August 1, 2014 or later.

All active teachers of the 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 July 1, 2013, the membership, as adjusted for retirements (2,234 retirees) during fiscal year 2014, consisted of the following:

Retirees, disabled members and beneficiaries currently receiving benefits	40,601
Terminated vested participants	689
Current participating employees	39,343
Total membership	80,633

This summary of plan description is intended to describe the essential features of the plan. All eligibility requirements and benefit amounts shall be determined in strict accordance with the plan document itself.

As part of the plan description information, the most important aspects of Act No. 160-2013, as modified by the April 11, 2014 decision of the Puerto Rico Supreme Court, are as follows: (i) active participants as of July 31, 2014 will continue to participate in the defined benefit pension program; (ii) starting August 1st, 2014, the defined benefit pension program will be closed for future participants and they will contribute to a contributory hybrid program; (iii) the retirement age for employees hired on or after August 1st, 2014 will increase to age 62; (iv) the employee contribution for employees hired on or after August 1st, 2014 will increase to 10% from August 1st, 2014 to June 30, 2017, 13.12% from July 1st, 2017 to June 30, 2020, and 14.02% from July 1st, 2020 and thereafter; (v) special benefits payable to active participants that retire on or before July 31st, 2014 will be reduced and (vi) special benefits and postemployment healthcare benefits will be eliminated for future retirees.

(In thousands)

I. Defined Benefit Pension Program

The members of the System hired on or before July 31, 2014 are eligible for the benefits described below:

(a) Retirement Annuity

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

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 or more	At least 10, but less than 25	1.8% of average compensation times years of service

(1) Refer to subsection (g) under Defined Benefit Pension Program.

(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 plus 2% interest accumulated as of the date of death (after discounting debts with the System). Additionally, for active participants that die on or before July 31, 2014, their beneficiaries will receive an amount equal to the annual compensation of the member at the time of death.

Postretirement – For members who retire on or before July 31, 2014: 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. Full pension for the month in which the pensioner died plus an additional fifteen-day pay period payable to the member’s eligible beneficiaries, but in no case shall the benefit be less than $1,000 (prior to discounting any debts with the System).

Postretirement – For members who retire August 1, 2014 or later: If the member elected at the time of retirement to transfer a portion of the annuity to a beneficiary by selecting an actuarially equivalent option form of payment, the applicable survivor benefit will be granted. Otherwise, the excess, if any, of the accumulated contributions at the time of retirement over the total annuity benefits received before death payable to the beneficiaries or to the member’s estate.

(f) Refunds

A participating employee who ceases his or her employment with the Commonwealth on or before July 31, 2014 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. Refer to subsection (e) under Contributory Hybrid Program with respect to a participating employee who ceases his or her employment on or after August 1, 2014.

(Continued)

(g) Early Retirement Program

On January 27, 2000, Act No. 44 was approved, which provided that effective March 9, 2000, 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. Act No. 160-2013 imposes the same obligation to the employer.

II. Contributory Hybrid Program

A hybrid plan, such as a cash balance plan, determines the benefit amount based on a formula using contributions and earning credits, has notional individual accounts for members, and provides lifetime annuity benefits. Each member has a defined contribution account which is credited with member contributions and investment yield. Upon retirement, the balance in the account is paid as a lifetime annuity. The program is defined as hybrid given that it has some features that are commonly found in defined benefit (DB) plans and other features that are commonly found in defined contribution (DC) plans, as follows:

- The members contribute a fixed percent of payroll to their account. In DB plans the percent is usually fixed. In DC plans the percent is usually elected by the member.
- The defined contribution account is credited each semester with the System's investment portfolio's net rate of return. The return is determined by the Board and will not be less than 80% of the System's investment portfolio net rate of return. Account growth via the application of investment earnings is a common feature of DC plans.
- Assets are invested by the System. This feature is more commonly found in DB plans. DC plans most commonly allow for the members to elect their investments on an individual basis and the member contributions are then actually invested in the options selected by the member.
- Upon retirement, the balance in the account is paid to the member in the form of a lifetime annuity with optional survivor benefits, with the System responsible for investment and longevity risk during retirement. The annuity feature is common to DB plans.

Members of the System hired on or after August 1, 2014 are eligible for the benefits described below:

(a) Retirement Annuity

Members with five or more years of service and $10,000 or more in contributions at the age of 62 will qualify for an annuity of the percentage acquired by contributions based on actuarial formula.

The pension of each participant shall be computed upon retirement as follows: (i) the accumulated balance of his/her contributions to the defined contribution account on the date of retirement, divided by (ii) a factor, established by the Board in consultation with its actuaries and to be determined on the basis of the actuarial life expectancy of the participant and a specific interest rate.

(b) Deferred Retirement Annuity

Members with five or more years of service and $10,000 or more in contributions will qualify for an annuity calculated based on the balance of the defined contribution account. If separated from service with the requirements but with less than 62 years of age, the annuity will be deferred until reaching 62 years of age.

(c) Disability Annuity

Any participant who enrolled in the System after August 1st, 2014, and after five years in the public service suffers a disability, whether work related or not, he/she shall be granted a disability pension by the System computed on the basis of his/her individual contributions, as determined by the System through regulations.

(d) Death Benefits

New members starting August 1st, 2014 that eventually retire and die, their beneficiaries have two options: (i) continue to receive the monthly annuity payments until the balance, if any, of the contributions to the defined contribution account is exhausted or (ii) request reimbursement in one global payment on the balance, if any.

(e) Refunds

A participant with less than five years of service or less than $10,000 in contributions qualifies for a reimbursement. Specifically, a refund of contributions and earnings in his/her defined contribution account.

III. Special Benefits

Act No. 160-2013 contemplates a reduction in the special laws for pensioners as of July 31, 2014 and the elimination of special laws for future pensioners who retire starting August 1, 2014. 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. After August 1, 2014, for active participants that retire on or before July 31, 2014 the bonus will be $200 and 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. Act No. 160-2013 kept this benefit for active participants that retire on or before July 31st, 2014.
- 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. Act No. 160-2013 eliminated this benefit for all retirees.
- 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 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. Act No. 160-2013 did not alter this benefit.
- 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. Act No. 160-2013 did not alter this benefit.
- 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. Act No. 160-2013 did not alter this benefit.
- 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. As per Act No. 160-2013, this benefit will only apply to pensioners as of July 31st, 2014 that eventually die.

The special benefits contributions of approximately $49.9 million in 2014 represent contributions from the General Fund of the Commonwealth for the special benefits granted by special laws, as detailed in this note 4. 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.

IV. Contributions

(a) Member Contributions

(a) Contributions by members hired on or before July 31, 2014 are 9% of compensation.

(b) Contributions by members hired on or after August 1, 2014 are as follows: 10% of compensation for fiscal years 2015 through 2017, 13.12% of compensation for fiscal years

2018 through 2020, and 14.02% of compensation for fiscal year 2021 and each year thereafter.

(b) Employer Contributions

(a) *Payroll-based Employer Contributions*: Contributions by the Commonwealth and the System, as applicable, are 9.5% of compensation for the fiscal year beginning July 1, 2011. For the next four fiscal years effective July 1, employer contributions will increase annually by 1%. For the next five fiscal years, employer contributions will increase annually by 1.25%, reaching an employer contribution rate of 19.75% effective July 1, 2020. Effective July 1, 2021 and later fiscal years, the employer contribution rate will be 20.525%.

(b) *Supplemental Contributions*: From fiscal year 2014-2015 and each subsequent fiscal year, the System will receive from the General Fund of the Commonwealth a contribution of $1,675 per pensioner, regardless if the pensioner retired before or after August 1, 2014, to pay for special benefits (i.e. Christmas and medication bonuses) and medical insurance plan contribution; and therefore contribute to the solvency of the System.

(c) *Teacher's Justice Uniform Contribution*: The annual contribution to be made to the System equal to $30 million in fiscal year 2016-2017, $30 million in fiscal year 2017-2018, and $60 million in fiscal year 2018-2019, and subsequent years, until fiscal year 2041-2042. The Teacher's Justice Uniform Contribution is to be funded by the Commonwealth's General Fund.

(d) *Annual Additional Contribution*: The annual contribution certified by the external actuary of the System as necessary to prevent the value of the projected gross assets of the System from falling below $300 million during any subsequent fiscal year. The Annual Additional Contribution is to be funded by the Commonwealth's General Fund from fiscal year 2018-2019 through fiscal year 2041-2042.

Other Postemployment Benefits (OPEB) – Healthcare Benefits

TRS MIPC is a single-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. Act No. 160-2013 eliminated the medical insurance plan contribution of $100 per month for members that retire on or after August 1, 2014.

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 July 1, 2013, the membership, as adjusted for retirements (2,234 retirees) during fiscal year 2014 and by Act No. 160-2013 changes, consisted of the following:

Retirees and disabled members	37,513
Terminated vested participants	689
Current participating employees	1,391
Total membership	39,593

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, 2014, OPEB contributions amounted to $35.9 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.

(5) Net Pension Liability

The components of the net pension liability of the Commonwealth as of June 30, 2014 were as follows (dollars in thousands):

Total pension liability	$ 14,807,703
Plan's fiduciary net position	1,703,779
Net pension liability	$ 13,103,924
Plan's fiduciary net position as a percentage of the total pension liability	11.51%

(a) Actuarial Methods and Assumptions

The census data collection date has changed from end-of-year to beginning-of-year. For this switchover year, the June 30, 2013 census data used in the prior valuation is also used as the July 1, 2013 census data for the current valuation. Due to outsized retirement activity during the 2013-2014 fiscal year, 2,234 reported retirements were reflected. The liability results as of June 30, 2014 are based on projecting the System obligations determined as of the census data collection date of July 1, 2013 for one year, using roll-forward methods and assuming no liability gains or losses.

(In thousands)

The actuarial valuation used the following actuarial assumptions:

Inflation	2.50%
Investment rate of return	6.65%, net of investment expenses, including inflation
Municipal Bond Index	4.29%, as per Bond Buyer General Obligation 20-Bond Municipal Bond Index
Discount rate	4.33%
Projected salary increases	2.50% general wage inflation plus service-based merit increases. No compensation increases are assumed until July 1, 2017 as a result of Act No. 66-2014.
Mortality	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.

(b) Long-Term Rate of Return on Investments

The long-term expected rate of return on pension benefits investments was determined in accordance with the asset allocation of the portfolio that was adopted by the Board during December 2010 and the actuary's capital market assumptions as of June 30, 2014. The long-term expected rate of return on pension benefits investments was 6.65% as of June 30, 2014 compared to 6.25% as of June 30, 2013.

(In thousands)

Assets are managed on a total return basis with a long-term objective of achieving and maintaining a positive impact on the System's financial condition for the benefits provided through the pension programs. The following was the Board's adopted asset allocation policy as of June 30, 2014:

Asset class	Target allocation	Long-term expected rate of return
Domestic equity	25%	6.8%
International equity	10	7.6
Fixed income	64	3.9
Cash	1	2.9
Total	100%	

The long-term expected rate of return on pension benefits investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation.

For the year ended June 30, 2014, the annual money-weighted rate of return on investments, net of investment expenses, was 11.0%. The money-weighted rate of return expresses investment performance, net of investment expense, adjusted for the changing amounts actually invested.

(c) Discount Rate

The asset basis for the date of depletion projection is the System's fiduciary net position. On this basis, the System's fiduciary net position is expected to be exhausted during fiscal year 2019. This projection assumes that certain illiquid assets (consisting primarily of loans to members), amounting to approximately $450 million as of June 30, 2014, will be converted to cash when needed.

The System's fiduciary net position is not expected to be available to make all projected future benefit payments of current active and inactive members. Therefore, the discount rate for calculating the total pension liability is equal to the single equivalent rate that results in the same actuarial present value as the long-term expected rate of return applied to benefit payments, to the extent that the pension plan's fiduciary net position is projected to be sufficient to make projected benefit payments, and the tax free municipal bond index rate (Bond Buyer General Obligation 20-Bond Municipal Bond Index) applied to benefit payments, to the extent that the pension plan's fiduciary net position is not projected to be sufficient. The discount rate was 4.33% as of June 30, 2014.

The June 30, 2014, actuarial valuation reflects increases in the total pension liability as follows: (i) approximately $83.6 million loss as a result of the changes in assumptions including the change in the discount rate as required by GASB Statement No. 67, and (ii) $170 million loss as a result of the update of the census data to reflect outsized retirement activity during the fiscal year 2014, plus the

(Continued)

difference between actual and expected benefit payments which arise from the differences in retirement activity and also actual mortality versus expectations.

(d) Sensitivity of the Net Pension Liability to Changes in the Discount Rate

The following presents the net pension liability calculated using the discount rate of 4.33%, as well as what it would be if it were calculated using a discount rate of 1 percentage-point lower (3.33%) or 1 percentage-point higher (5.33%) than the current rate (dollars in thousands):

		1% Decrease (3.33%)	Current discount rate (4.33%)	1% Increase (5.33%)
Net pension liability	$	15,173,401	13,103,924	11,396,544

(6) Cash and Cash Equivalents, Investments and Securities Lending Transactions

Pursuant to the provisions of Act No. 160-2013, the System may invest in domestic equity, international equity, and fixed income securities, among others. Asset allocation investment categories and targets are determined by and subject to the investment policy guidelines which are reviewed by the Board, in conjunction with the System's Investment Consultant, as necessary. The Board's guiding principles with respect to the investments of the System's assets are to preserve the long-term corpus of the fund, maximize total return within prudent risk parameters, have liquidity to cover cash flow needs and act in the exclusive interest of the members of the System.

(a) Cash and Cash Equivalents

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 Puerto Rico commercial banks 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. Deposits with GDB and with non-Puerto Rico commercial banks and with money market funds are uninsured and uncollateralized, as these entities are exempt from compliance with the collateralization requirement.

Cash and cash equivalents as of June 30, 2014 consisted of the following (in thousands):

		Carrying amount	Depository bank balance	Amount uninsured and uncollateralized
Deposits at commercial banks	$	2,722	4,142	868
Deposits with GDB – restricted		3,301	3,502	3,502
Money market funds		11,483	N/A	11,483
Total	$	17,506	7,644	15,853

N/A= Not applicable.

(b) *Investments*

The System's investments are exposed to custodial credit risk, credit risk, interest rate risk, concentration of credit risk, and foreign currency risk. Following is a description of these risks as of June 30, 2014:

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, 2014, investments were registered in the name of the System and were held in the possession of the custodian bank, except for securities lent.

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 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 fund as of June 30, 2014 are as follows (in thousands):

		Rating (1)				
	AAA	AA+ to AA-	A+ to A-	BBB+ to BBB-	BB+ to BB-	Total
Mortgage and asset-backed securities:						
Federal National Mortgage Association (FNMA)	$ —	599	—	—	—	599
Federal Home Loan Mortgage Corporation (FHLMC)	—	623	—	—	—	623
Collateralized mortgage obligations (CMO)	36	—	—	—	—	36
Commercial mortgages	7,116	—	—	—	—	7,116
U.S. corporate bonds and notes	7,855	64,112	230,494	181,013	13,597	497,071
Non-U.S. corporate bonds	—	16,669	50,409	35,652	723	103,453
U.S. municipal bonds	943	732	—	—	—	1,675
Total bonds and notes	15,950	82,735	280,903	216,665	14,320	610,573
Nonexchange commingled fixed income trust fund – SSgA Intermediate Fund (2)	16,911	18,632	54,017	55,101	—	144,661
Total	$ 32,861	101,367	334,920	271,766	14,320	755,234

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

(2) Fund is not rated. Rating presented for underlying investments.

Approximately $39.2 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 NAV and have no redemption restrictions.

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 fixed income portfolio must have a stated maturity and the duration 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, 2014, is summarized below (in thousands). Expected maturities will differ from contractual maturities, because counterparties may have the right to call or prepay obligations with or without call or prepayment penalties.

	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	$ —	—	4,425	—	4,425
U.S. Treasury note strips	—	—	34,229	—	34,229
Mortgage and asset-backed securities:					
GNMA	—	44	—	503	547
FNMA	—	169	232	198	599
FHLMC	—	38	278	307	623
Collateralized mortgage obligations (CMO) – Others	—	—	—	36	36
Commercial mortgages	—	—	—	7,116	7,116
U.S. corporate bonds and notes	40,221	255,599	189,958	11,293	497,071
Non-U.S. corporate bonds	2,846	58,786	41,821	—	103,453
U.S. municipal bonds	—	—	732	943	1,675
Total bonds and notes	43,067	314,636	271,675	20,396	649,774
Nonexchange commingled fixed income trust fund: (1)					
SSgA Intermediate Fund:					
U.S.	—	94,493	—	—	94,493
Non-U.S.	—	50,168	—	—	50,168
Total nonexchange commingled fixed income trust fund	—	144,661	—	—	144,661
Total bonds and notes and nonexchange commingled fixed income trust fund	$ 43,067	459,297	271,675	20,396	794,435

(Continued)

(In thousands)

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					$ 3,061
Non-U.S. corporate stock					89,839
Total stock					92,900
Nonexchange commingled equity trust funds:					
U.S. – SSgA Russell 3000 Fund					327,104
Non-U.S. – SSgA MSCI ACWI Ex USA Fund					31,854
Investments in limited partnerships					11,170
Total stocks, nonexchange commingled equity trust funds and investments in limited partnerships					463,028
Total investments					$ 1,257,463

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

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, 2014. 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.

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, 2014 are as follows (in thousands):

Investment type	Local currency	Fair value
Cash and cash equivalents	Australian Dollar	$ 12
Cash and cash equivalents	Euro	831
Cash and cash equivalents	Hong Kong Dollar	13
Cash and cash equivalents	Japanese Yen	12
Total cash and cash equivalents		868
Non-U.S. corporate stock	Australian Dollar	6,951
Non-U.S. corporate stock	British Sterling Pound	20,211
Non-U.S. corporate stock	Danish Krone	5,565
Non-U.S. corporate stock	Euro	11,617
Non-U.S. corporate stock	Hong Kong Dollar	3,465
Non-U.S. corporate stock	Japanese Yen	12,662
Non-U.S. corporate stock	New Turkish Lira	677
Non-U.S. corporate stock	New Zealand Dollar	943
Non-U.S. corporate stock	South Africa Rand	1,781
Non-U.S. corporate stock	Singapore Dollar	1,795
Non-U.S. corporate stock	South Korean Won	885
Non-U.S. corporate stock	Swedish Krona	8,434
Non-U.S. corporate stock	Swiss Franc	8,472
Total Non-U.S. corporate stock		83,458
Nonexchange commingled trust fund – SSgA MCSI ACWI Ex USA		31,854
Total cash and cash equivalents and investments exposed to foreign currency risk		$ 116,180

As of June 30, 2014, 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
United Kingdom	15%
Japan	14
Canada	8
France	7
Germany	7
Others	7
Australia	6
Switzerland	6
China	4
Korea	3
Spain	3
Taiwan	3
Brazil	2
Hong Kong	2
Italy	2
Netherlands	2
South Africa	2
Sweden	2
Denmark	1
India	1
Mexico	1
Russia	1
Singapore	1
Total	100%

(c) Investments in Nonexchange Commingled Trust Funds

As of June 30, 2014, 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	16,315	$	327,104
SSgA MSCI ACWI Ex USA Fund	1,663		31,854
SSgA Intermediate Fund	5,047		144,661
Total nonexchange commingled trust funds		$	503,619

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, 2014, 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
Information technology	18%	7%
Financials	17	26
Healthcare	13	8
Consumer discretionary	13	11
Industrials	12	11
Energy	10	10
Consumer staples	8	10
Materials	4	8
Utilities	3	4
Telecommunication services	2	5
	100%	100%

Sector	SSgA Intermediate Fund
Corporate – Industrial	45%
Corporate – Finance	30
Noncorporate	21
Corporate – Utility	4
Total	100%

(d) Investments in Limited Partnerships

The fair value of investments in limited partnerships at June 30, 2014, amounted to approximately $11 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, 2014, 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, 2014, 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	42
Guayacán Fund of Funds II, L.P.	25,000	—	23,681	2,907
Guayacán Private Equity Fund, L.P.	5,000	—	4,645	3,516
Invesco Venture Partnership, Fund III, L.P.	5,498	—	4,731	1,458
Invesco Non-U.S. Partnership Fund III, L.P.	4,500	—	4,034	243
Invesco U.S. Buyout and Expansion Capital Partnership Fund III, L.P.	3,716	—	3,236	1,140
Chase Capital Partners Private Equity Fund of Funds II, LTD	15,000	—	14,497	1,864
Total	$ 78,714	—	73,880	11,170

(e) Net Appreciation in Fair Value of Investments

For the year ended June 30, 2014, the net appreciation in fair value of investments amounted to approximately $127 million, segregated as follows (in thousands):

Investment type		Realized gain/(loss)	Unrealized gain/(loss)	Net appreciation in fair value of investments
Bonds and notes	$	3,841	7,330	11,171
Nonexchange commingled trust funds		62,405	34,838	97,243
Stocks		9,761	7,365	17,126
Investments in limited partnerships		(2,682)	3,938	1,256
Net appreciation in fair value of investments	$	73,325	53,471	126,796

(f) 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 securities lent). At June 30, 2014, the collateral received represented 103% of the fair value of the total securities lent.

The securities on loan for which collateral was received as of June 30, 2014 consisted of the following (in thousands):

		Fair value
U.S. government securities:		
U.S. Treasury notes	$	4,442
U.S. corporate bonds and notes		8,753
U.S. corporate stock		280
Non-U.S. corporate stock		1,250
Total	$	14,725

The underlying collateral for these securities had a fair value of approximately $15.2 million as of June 30, 2014. The collateral received was invested in a money market fund sponsored by the custodian bank and is included as part of Assets in the accompanying statement of fiduciary net position. As of June 30, 2014, 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 securities lent) 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.

(7) Capital Assets

For the year ended June 30, 2014, changes in capital assets consisted of the following (in thousands):

	Beginning balance	Increases	Decreases	Ending balance
Capital assets, not being depreciated:				
Construction in progress	$ 1,754	—	(458)	1,296
Capital assets, being depreciated:				
Building	26,008	—	—	26,008
Furniture and equipment	1,575	30	(29)	1,576
Computers and software	9,547	611	(1)	10,157
Building improvements	765	—	—	765
Branches improvements	286	—	(12)	274
Vehicles	85	—	—	85
Total capital assets, being depreciated	38,266	641	(42)	38,865
Accumulated depreciation and amortization	(20,708)	(2,128)	—	(22,836)
Total capital assets, being depreciated – net	17,558	(1,487)	(42)	16,029
Total capital assets – net	$ 19,312	(1,487)	(500)	17,325

(8) Other Assets

As of June 30, 2014, other assets consisted of repossessed and in-substance foreclosed properties amounting to approximately $846,000. 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.

(9) Voluntary Termination Benefits

On July 2, 2010, the Commonwealth enacted Act No. 70 (Act No. 70-2010) establishing a program that provides benefits for early retirement or economic incentives for voluntary employment termination to eligible employees, as defined. Act No. 70-2010 also established that early retirement benefits will be provided to eligible employees that have completed at least 15 years of credited services, but less than 30 years of credited services and will consist of monthly benefits ranging from 37.5% to 50% of each employees' monthly salary. Benefits under this program will be paid by the Commonwealth's General Fund and by the System, covering their respective employees until the plan member reaches the later of age of retirement or the date the plan member would have completed 30 years of service had the member continued employment. In addition, the System, as an employer, will also be required to continue making the required employee and employer contributions to the System. The Commonwealth's General Fund will be required to continue making its required employer contributions. The System will be responsible for benefit payments afterwards. Members who retired under this incentive are not eligible to receive the medical insurance plan contribution. As of June 30, 2014, the System has recorded an accrued expense of approximately $8.7 million for its responsibility as an employer under Act No. 70-2010.

(10) 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.

(11) Other Postemployment Healthcare Benefits Funded Status and Funding Progress

The System's OPEB funded status as of June 30, 2014 is as follows (dollars in thousands):

Actuarial value of plan assets	AAL	UAAL	Funded ratio	Annual covered payroll	UAAL as a percentage of annual covered payroll
$ —	543,205	543,205	—%	$ 1,171,154	46.4%

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

(In thousands)

The census data collection date has changed from end-of-year to beginning-of-year. For this switchover year, the June 30, 2013 census data used in the prior valuation is also used as the July 1, 2013 census data for the current valuation. Due to outsized retirement activity during the 2013-2014 fiscal year, 2,234 reported retirements were reflected. The liability results as of June 30, 2014 are based on projecting the System obligations determined as of the census data collection date of July 1, 2013 for one year, using roll-forward methods and assuming no liability gains or losses. In addition, the June 30, 2014 actuarial valuation reflects an estimate of the changes required by Act No. 160-2013, specifically, the elimination of the medical insurance plan contributions for members retiring on or after August 1, 2014.

The actuarial cost method for the medical insurance plan contribution was changed from the level dollar variation of the entry age normal method to the level percentage of payroll variation of the entry age normal method. Because Act 160-2013 eliminated the Medical Insurance Plan Contribution for members retiring on or after August 1, 2014, the amortization period for GASB Statement No. 45 accounting was reduced to 20 years (the average life expectancy of the closed group of current retirees who will receive this benefit) and the amortization method was changed to a level dollar basis.

The actuarial valuation used the following actuarial assumptions:

Actuarial cost method	Entry age normal
Amortization method	20 years closed (beginning July 1, 2014), level dollar
Remaining amortization period	20 years
Asset valuation method	Market value of assets
Actuarial assumptions:	
Investment rate of return	3.10%
Projected salary increases	Not applicable
Payroll growth	Not applicable
Inflation	Not applicable
Cost of living adjustment	Not applicable

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 projection 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.

(Continued)

The OPEB mortality rate assumptions are the same as that for pension benefits. Refer to note 5.

(12) Commitments

The System leases office facilities for the operation of its regional offices (Ponce, Mayagüez, Arecibo, and Caguas) under operating lease agreements, which expire at different dates through fiscal year 2017. Rent expense for the year ended June 30, 2014, amounted to approximately $290,000.

Existing operating leases expire in 2017. The minimum future payments as of June 30, 2014 are as follows (in thousands):

		Amount
Year ending June 30:		
2015	$	259
2016		194
2017		117
Total	$	570

(13) 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.

The System is a defendant in one lawsuit filed by several groups representing the teachers alleging that, since the Supreme Court declared unconstitutional the subsection in Act No. 160-2013 that established the interest rate to be paid by a member for the accreditation of services rendered but not credited, the System is unable to charge 9.5% interest on account of service credit. Prior to the adoption of Act No. 160-2013, the interest rate applicable in respect of such accreditation stood at 2% as per Board Resolution. The System believes that the claimant's allegations are not legally sustainable and the 9.5% interest rate is valid given that the percentage interest is not a contractual right of the active members; as it was not established in Act 91-2004, previous law of the System. It is the System's opinion, in consultation with legal counsel, that what the Supreme Court ruled as unconstitutional is that active participants could only pay for unaccredited services up to July 31, 2014. With the Supreme Court's ruling, active participants can continue to pay for unaccredited services and the interest to be charged is defined in Article 1, which was not declared unconstitutional. The Board addressed the issue administratively by unanimously approving a resolution, retroactive to December 24, 2013, by which it determined that the interest rate to be paid by a member for the accreditation of services rendered but not credited will be 9.5%. Should the courts not agree with the System's position, the System is exposed to reimburse the amounts already collected in excess of 2%, honor the 2% for all cases pending and new applications submitted, the actuarial impact of granting such accreditation, and to the sanctions and/or fees the court may impose. The Board, in consultation with legal counsel, is unable to assess the likelihood of an adverse resolution of the case. At this time it is not possible to determine the financial impact of said outcome.

REQUIRED SUPPLEMENTARY INFORMATION

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

Schedule of Changes in the Employer's Net Pension Liability and Related Ratios – Pension Benefits

(Unaudited)

Year ended June 30, 2014

(Dollars in thousands)

		Amount
Total pension liability:		
Service cost	$	354,159
Interest		690,742
Changes in benefit terms		(599,560)
Differences between expected and actual experience		169,851
Changes in assumptions		83,560
Benefit payments, including refunds of contributions		(683,698)
Net change in total pension liability		15,054
Total pension liability – beginning		14,792,649
Total pension liability – ending (a)		14,807,703
Plan's fiduciary net position:		
Contributions – employer		189,367
Contributions – participating employees		115,461
Contributions – transfers		4,131
Net investment income		190,023
Other income		1,416
Benefit payments, including refunds of member contributions		(683,698)
Administrative expenses		(19,803)
Net change in plan fiduciary net position		(203,103)
Total fiduciary net position – beginning		1,906,882
Total fiduciary net position – ending (b)		1,703,779
Employer's net pension liability – ending (a)-(b)	$	13,103,924
Plan's fiduciary net position as a percentage of the total pension liability		11.51%
Covered-employee payroll	$	1,171,154
Employer's net pension liability as a percentage of covered-employee payroll		1,118.89%

Schedule is intended to show information for ten years. Additional years will be displayed as they become available.

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 the Employer's Contributions – Pension Benefits (Unaudited)

Last Seven Fiscal Years

(Dollars in thousands)

		2014	2013	2012	2011	2010	2009	2008
Actuarially determined contribution	$	748,569	736,591	659,334	528,170	477,213	393,871	341,495
Contributions in relation to actuarially determined contribution (a)		189,367	187,444	176,970	159,754	164,650	171,331	156,835
Contribution deficiency	$	559,202	549,147	482,364	368,416	312,563	222,540	184,660
Covered-employee payroll (b)	$	1,171,154	1,248,674	1,292,975	1,320,400	1,370,344	1,418,304	N/D
Contribution as a percentage of covered-employee payroll (a)/(b)		16.17%	15.01%	13.69%	12.10%	12.02%	12.08%	N/D

N/D = Not determined.

Schedule is intended to show information for ten years. Additional years will be displayed as they become available.

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

Schedule of Investment Return – Pension Benefits (Unaudited)

Year ended June 30, 2014

Annual money-weighted rate of return, net of investment expenses	11.0%

Schedule is intended to show information for ten years. Additional years will be displayed as they become available.

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 Employer's Contributions – OPEB (Unaudited)

(Dollars in thousands)

Fiscal year ended	Annual required contributions	Actual employer's contributions	Percentage of contribution
June 30, 2014 (1)	$ 46,403	$ 35,892	77.3%
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

(1) The System's annual required contribution for the year ended June 30, 2014 was determined by the actuarial valuation as of June 30, 2013 that was updated to roll forward the funded status to June 30, 2014 and assumed no liability gains or losses. However, due to the large number of retirements during fiscal year 2014 (2,234 retirees), census data for new retired members was updated as of June 30, 2014. In addition, the System's annual required contribution for the year ended June 30, 2014 reflects an estimate of the changes required by Act No. 160-2013, specifically, the elimination of the medical insurance plan contributions for members retiring on or after August 1, 2014.

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 – OPEB (Unaudited)

(Dollars in thousands)

Actuarial valuation date	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
June 30, 2014 (1)	$ —	$ 543,205	$ 543,205	—	$ 1,171,154	46.4%
June 30, 2013	—	792,875	792,875	—	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

(1) The System’s OPEB funded status as of June 30, 2014 was determined by the actuarial valuation as of June 30, 2013 that was updated to roll forward the funded status to June 30, 2014 and assumed no liability gains or losses. However, due to the large number of retirements during fiscal year 2014 (2,234 retirees), census data for new retired members was updated as of June 30, 2014. In addition, the System’s OPEB funded status as of June 30, 2014 reflects an estimate of the changes required by Act No. 160-2013, specifically, the elimination of the medical insurance plan contributions for members retiring on or after August 1, 2014.

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

Changes in Benefits Terms

On December 24, 2013, the Commonwealth enacted Act No. 160 (Act No. 160-2013) as new legislation for the System, which superseded Act No. 91 of March 29, 2004 (Act No. 91-2004) and was modified by the Puerto Rico Supreme Court on April 11, 2014. Pursuant to Act No. 160-2014, the System administers two benefit structures. Benefit provisions vary depending on member's date of hire as follows:

i. Members hired on or before July 31, 2014 with certain distinctions for members who retire August 1, 2014 or later.

ii. Members hired August 1, 2014 or later.

The most important aspects of Act No. 160-2013, as modified by the April 11, 2014 decision of the Puerto Rico Supreme Court, are as follows:

a) Active participants as of July 31, 2014 will continue to participate in the defined benefit pension program;

b) Starting August 1st, 2014, the defined benefit pension program will be closed for future participants and they will contribute to a contributory hybrid program;

c) The retirement age for new employees hired on or after August 1st, 2014 is increased to age 62;

d) The employee contributions for new employees hired on or after August 1st, 2014 is increased to 10% from August 1st, 2014 to June 30, 2017, 13.12% from July 1st, 2017 to June 30, 2020, and 14.02% from July 1st, 2020 and thereafter;

e) Special benefits payable to active participants that retire on or before July 31st, 2014 will be reduced;

f) Special benefits and Postemployment Healthcare Benefits will be eliminated for members that retire on or after August 1, 2014;

g) Act No. 160-2013 maintains the same structure set forth in Act 114-2011 and further provides for an ultimate employer contribution rate of 20.525%, effective July 1, 2021;

h) Act No. 160-2013 provides for two classes of additional contributions by the Commonwealth's General Fund to the System: (i) a Teacher's Justice Uniform Contribution (the Uniform Contribution) of $30 million in each of fiscal years 2017 and 2018 and $60 million thereafter until fiscal year 2042, and (ii) an Annual Additional Contribution commencing on fiscal year 2019 and continuing until fiscal year 2042 (the Annual Additional Contribution) equal to the amount determined by the actuaries as necessary to prevent the projected value of the gross assets of the System from falling below $300 million during any subsequent fiscal year;

i) Effective July 1, 2014, the System will receive a supplemental contribution of $1,675 each fiscal year from the General Fund for each pensioner notwithstanding if the pensioner retired prior to or on or after August 1, 2014. This contribution will pay for the Medical Insurance Plan Contribution (up to $1,200 per member), the Christmas Bonus ($200 per member), and Medication Bonus ($100 per member) payable to members who retired prior to August 1, 2014. The excess amount of the supplemental contribution will remain in the System to pay down the unfunded liability.

Changes in Assumptions

Actuarial assumptions are revised periodically to more closely reflect actual, as well as anticipated future experience.

Due to the change in the census collection date to the beginning of the fiscal year, rather than the end of the fiscal year, demographic gain/loss during the year is limited to the update of the census data to reflect outsized retirement activity during the year, plus the difference between actual and expected benefit payments, which rise from the differences in retirement activity and also actual mortality versus expectations. During fiscal year 2014, these differences resulted in a loss of $170 million.

The asset basis for the date of depletion projection is the System's fiduciary net position. On this basis, the System's fiduciary net position is expected to be exhausted during fiscal year 2018-2019. This projection assumes that certain illiquid assets (consisting primarily of loans to members), currently amounting to approximately $450 million as of June 30, 2014, will be converted to cash when needed.

In addition, the date of depletion projection of the actuarial report does not include any amounts from the additional contributions required by Act No. 160-2013, specifically the Uniform Contribution and the Annual Additional Contribution, because of actual fiscal and budgetary financial difficulties with continued budget deficits and liquidity risks of the Commonwealth and in the event that its financial condition does not improve in the near term.

The System's fiduciary net position is not expected to be available to make all projected future benefit payments of current active and inactive members. Therefore, the discount rate for calculating the total pension liability is equal to the single equivalent rate that results in the same actuarial present value as the long-term expected rate of return applied to benefit payments, to the extent that the plan's fiduciary net position is projected to be sufficient to make projected benefit payments, and the tax free municipal bond index rate (Bond Buyer General Obligation 20-Bond Municipal Bond Index) applied to benefit payments, to the extent that the plan's fiduciary net position is not projected to be sufficient.

This valuation reflects an increase in the investment return assumption from 6.25% as of June 30, 2013 to 6.65% as of June 30, 2014. Under GASB Statements No. 25 and No. 27, the investment return assumption was used to discount all projected Basic System Pension Benefits and System Administered Pension Benefits to determine the Actuarial Accrued Liability. Under GASB Statement No. 67, the investment return assumption is an input that is used in the calculation of the single equivalent interest rate that is used to discount these benefits to determine the Total Pension Liability. GASB Statement No. 67 also requires that the plan sponsor select a municipal bond index for use in developing the single equivalent interest rate. The index selected for the System is the Bond Buyer General Obligation 20-Bond Municipal Bond Index. The index rate decreased from 4.63% as of June 30, 2013 to 4.29% as of June 30, 2014. Therefore, the discount rates used to determine the annual required contribution and the total pension liability decreased from 6.25% at June 30, 2013, in accordance with GASB Statement No. 25, to 4.33% at June 30, 2014, in accordance with GASB Statement No. 67. For fiscal years 2008 to 2010, 2011 and 2012, the discount rates were 8.00%, 6.40%, and 5.95%, respectively.

Also, the fiscal year valuation reflects a salary freeze from July 1, 2014 until July 1, 2017 due to Act No. 66-2014 and a reduction in the general wage inflation assumption from 3.5% to 2.5%.

Changes in Actuarial Methods since the Prior Valuation

The census data collection date has changed from end-of-year to beginning-of-year. For this switchover year, the June 30, 2013 census data used in the prior valuation is also used as the July 1, 2013 census data for the current valuation. Due to outsized retirement activity during the 2013-2014 fiscal year, 2,234 reported retirements were reflected. The liability results as of June 30, 2014 are based on projecting the System obligations determined as of the census data collection date of July 1, 2013 for one year, using roll-forward methods and assuming no liability gains or losses.

The June 30, 2014 actuarial valuation reflects an increase of approximately $83.6 million in the total pension liability as a result of the changes in assumptions including the change in the discount rate as required by GASB Statement No. 67.

Method and Assumptions Used in Calculation of the System's Annual Required Contributions

Unless otherwise noted above, the following actuarial methods and assumptions were used to determine contribution rates reported in the Schedule of the Employer's Contributions:

Inflation	2.50%
Investment rate of return	6.65%, net of investment expenses, including inflation
Municipal Bond Index	4.29%, as per Bond Buyer General Obligation 20-Bond Municipal Bond Index
Discount rate	4.33%
Projected salary increases	2.50% general wage inflation plus service-based merit increases. No compensation increases are assumed until July 1, 2017 as a result of Act No. 66-2014.
Mortality	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.