KPMG

EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT OF THE COMMONWEALTH OF PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

Basic Financial Statements and Required Supplementary Schedules

June 30, 2013

(With Independent Auditors' Report Thereon)

EMPLOYEES’ RETIREMENT SYSTEM OF THE GOVERNMENT
OF THE COMMONWEALTH OF PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

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Independent Auditors' Report

The Board of Trustees
Employees' Retirement System of
the Government of the Commonwealth of Puerto Rico:

We have audited the accompanying financial statements of the Employees' Retirement System of the Government of the Commonwealth of Puerto Rico (the System), which comprise the statement of plan net position as of June 30, 2013, the related statement of changes in its plan net position for the year then ended, and the related notes to the financial statements, which collectively comprise the System's basic financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net position of the Employees' Retirement System of the Government of the Commonwealth of Puerto Rico as of June 30, 2013, and the changes in plan net position for the year then ended in accordance with U.S. generally accepted accounting principles.

Emphasis of a Matter

As discussed in note 1 to the basic financial statements, the System's unfunded actuarial accrued liability and funded ratio for pension benefits as of June 30, 2013 was approximately $22,981 million and 3.1%, respectively. In the opinion of management, based on information prepared by consulting actuaries, the System's assets will be less than its obligations (including bonds payable but excluding unfunded actuarial accrued liability) by the fiscal year 2015. In addition, annual cash flow estimates for the foreseeable future are presently estimated to continue to reduce the net position unless other measures are taken. Further, as described in note 10, future employers' contributions have been pledged for the payment of debt service, consequently further depletion of System's assets could result in inability to pay benefits and bonds.

Other Matters

Required Supplementary Information

U.S. Generally accepted accounting principles require that the information in the Management's Discussion and Analysis, Schedule of Employers' Contributions, and Schedule of Funding Progress on pages 3–14 and 51–53 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

KPMG LLP

San Juan, Puerto Rico
June 30, 2014

Stamp No. E125997 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.

Introduction

The Employees' Retirement System of the Government of the Commonwealth of Puerto Rico (the System) administers retirement and other plan member benefits, such as personal, cultural and mortgages loans, occupational and nonoccupational disability annuities and death benefits. The System also administers postemployment healthcare benefits provided by the Commonwealth of Puerto Rico for its retired members. The System presents in the Management's Discussion and Analysis an overview of the annual basic financial statements and provides a narrative discussion and analysis of the financial activities for the fiscal year ended June 30, 2013. The financial performance of the System is discussed and analyzed within the context of the accompanying basic financial statements and disclosures.

Overview of the Basic Financial Statements

Management's discussion and analysis introduces the System's basic financial statements. The basic financial statements include the statement of plan net position, statement of changes in plan net position, and notes to the basic financial statements. The System also includes additional information to supplement the basic financial statements.

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

Both of these statements provide information about the overall status of the System. The System uses the accrual basis of accounting to prepare its basic financial statements.

The statement of plan net position includes all of the System's assets and liabilities, with the difference reported as net position held in trust for pension benefits. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the System as a whole is improving or deteriorating.

The statement of changes in plan net position reports the change in the System's net position held in trust for pension benefits during the year. All current year additions and deductions are included regardless of when cash is received or paid.

Notes to Basic Financial Statements

The notes to the basic financial statements provide additional information that is essential for an understanding of the data provided in the statements of plan net position and changes in plan net position.

Required Supplementary Information

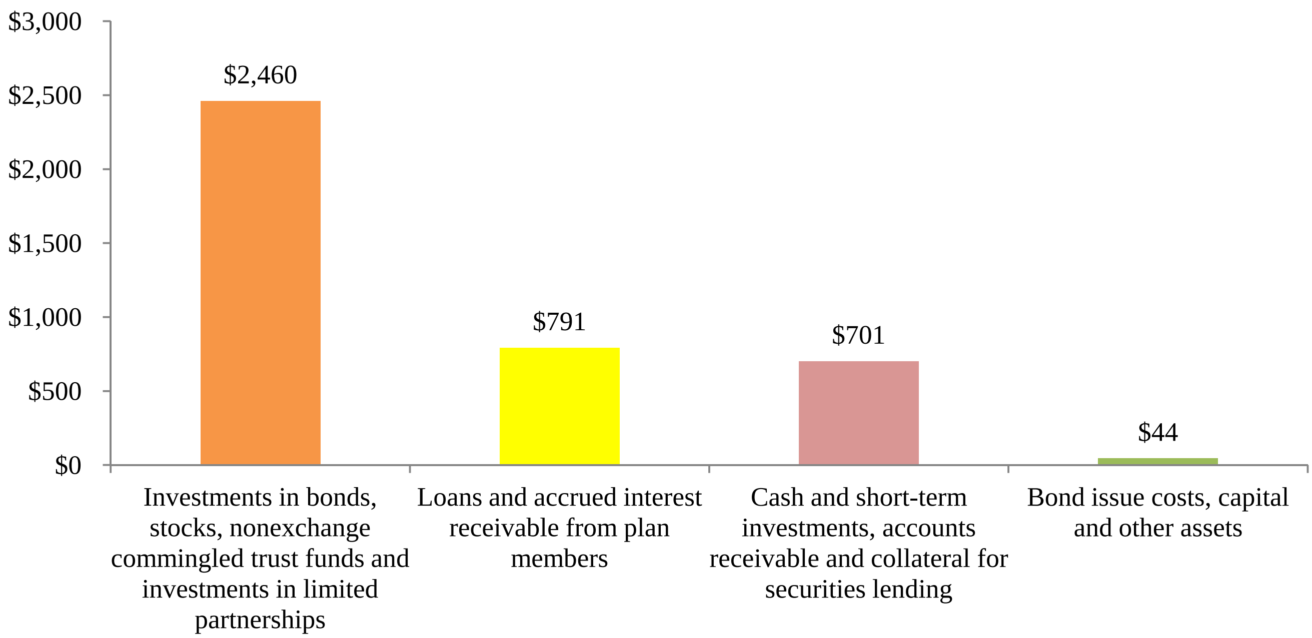
The required supplementary information consists of two schedules and related notes concerning the funded status of the benefits administered by the System.

Financial Highlights

The System provides retirement benefits to employees of the Commonwealth. The System's total assets as of June 30, 2013 and 2012, amounted to $3,996 million and $4,480 million, respectively.

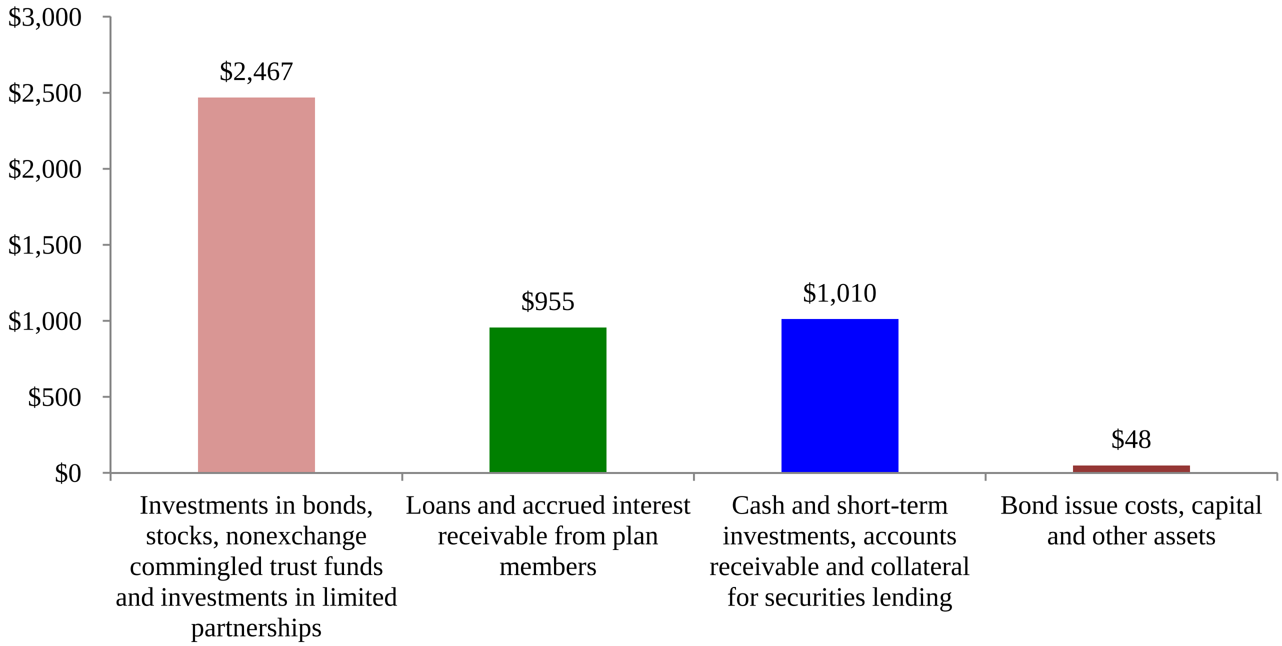
As of June 30, 2013, the System's total assets consist of the following:

- $2,405 million of investments in bonds, stocks and nonexchange commingled trust funds
- $55 million in investments in limited partnerships
- $791 million in loans and accrued interest receivable from plan members
- $577 million in cash and short-term investments, and accounts receivable, plus $124 million in collateral for securities lending
- $44 million in bond issue costs, capital and other assets



As of June 30, 2012, the System's total assets consist of the following:

- $2,410 million of investments in bonds, stocks and nonexchange commingled trust funds
- $57 million in investments in limited partnerships
- $955 million in loans and accrued interest receivable from plan members
- $955 million in cash and short-term investments, and accounts receivable, plus $55 million in collateral for securities lending
- $48 million in bond issue costs, capital and other assets



- The System's total assets exceeded total liabilities by $731 million (plan net position) for the current fiscal year compared to the prior year, for which assets exceeded liabilities by $1,238 million.
- Loans to plan members amounted to $791 million as of June 30, 2013, compared to $955 million as of June 30, 2012.
- The System's funded ratio of the actuarial accrued liability for pension benefits at June 30, 2013 was 3.1%, compared to 4.5% at June 30, 2012.
- The medical insurance plan contribution, which constitutes the other postemployment healthcare benefits, is financed by the Commonwealth on a pay-as-you-go basis and consequently is unfunded.

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

Comparative Summary of Plan Net Position – Pension Benefits
(Dollars in thousands)

	2013	2012	Total dollar change	Total percentage change
Assets:				
Cash and short-term investments and total accounts receivable	$ 701,032	1,009,873	(308,841)	(30.6)%
Investments	2,459,874	2,466,733	(6,859)	(0.3)
Loans and interest receivable from plan members – net of allowance	791,161	955,057	(163,896)	(17.2)
Capital assets and other	43,836	48,119	(4,283)	(8.9)
Total assets	3,995,903	4,479,782	(483,879)	(10.8)
Liabilities:				
Accounts payable and accrued liabilities	13,905	27,718	(13,813)	(49.8)
Securities lending obligations	124,411	54,870	69,541	126.7
Bond interest payable	13,876	13,877	(1)	—
Funds of mortgage loans and guarantee insurance reserve for loans to plan members and investments purchased	7,483	90,735	(83,252)	(91.8)
Bonds payable	3,051,189	3,026,593	24,596	0.8
Other liabilities	53,697	28,457	25,240	88.7
Total liabilities	3,264,561	3,242,250	22,311	0.7
Net position held in trust for pension benefits	$ 731,342	1,237,532	(506,190)	(40.9)%

Comparative Summary of Changes in Plan Net Position – Pension Benefits
(Dollars in thousands)

		2013	2012	Total dollar change	Total percentage change
Additions:					
Contributions:					
Employers	$	424,704	388,103	36,601	9.4%
Participating employees		322,528	316,178	6,350	2.0
Special benefits		203,943	193,351	10,592	5.5
Net investment income		245,022	272,382	(27,360)	(10.0)
Other income		22,035	24,727	(2,692)	(10.9)
Total additions		1,218,232	1,194,741	23,491	2.0
Deductions:					
Benefits paid to participants		1,430,712	1,376,892	53,820	3.9
Refunds of contributions		52,307	52,228	79	0.2
Interest on bonds payable		192,230	190,737	1,493	0.8
General and administrative		33,078	45,393	(12,315)	(27.1)
Other expenses		16,095	15,770	325	2.1
Total deductions		1,724,422	1,681,020	43,402	2.6
Decrease in plan net position	$	(506,190)	(486,279)	(19,911)	4.1%

Comparative Summary of Plan Net Position Analysis – Pension Benefits

The basic financial statements of the System for the fiscal year ended June 30, 2013, present a decrease in net assets of approximately $506 million, when compared to the prior fiscal year. This was mostly the result of a decrease in loans and interest receivable from plan members of $164 million and a decrease in cash, short-term investments and total accounts receivable of $309 million. The Board of Trustees approved the sale of personal loans. During the years ended June 30, 2013 and 2012, personal loans with principal balances amounting to approximately $88 million and $225 million, respectively, were sold to two financial institutions.

Participating employees' and employers' contributions increased by approximately $43 million, from $704 million during fiscal year 2012 to $747 million during fiscal year 2013. The System recognized a net appreciation in the fair value of investments of $121 million during 2013, which represents an increase of $22 million from the net appreciation of $99 million recognized in 2012.

During fiscal year 2007, the Board of Trustees approved the issuance of bonds payable to increase the funds available to pay pension benefits to certain beneficiaries and to reduce the unfunded accrued actuarial liability. As of June 30, 2013, bonds payable amounted to $3,051 million.

Other Postemployment Healthcare Benefits

Other postemployment healthcare benefits paid during the fiscal year 2013 amounted to $92 million, a decrease of 3% when compared to the $95 million paid during fiscal year 2012.

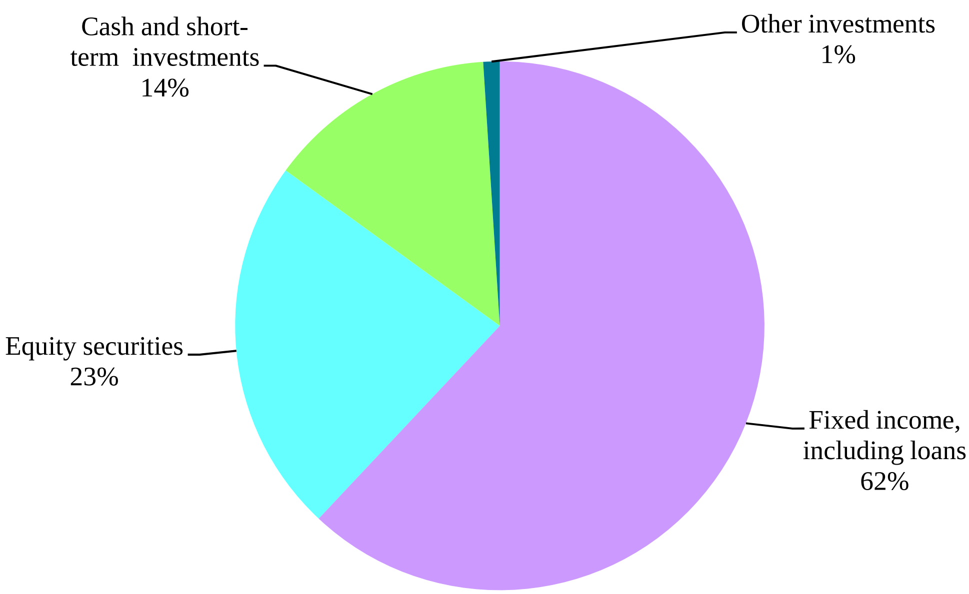
Financial Analysis of the System

As of June 30, 2013 and 2012, the System held approximately $791 million and $955 million, respectively, in loans and interest receivable from plan members, which represents 24% and 28%, respectively of the total investment portfolio, including loans. As of June 30, 2013, loans and interest receivable from plan members consist of $160 million in mortgage loans, $528 million in personal loans, $68 million in cultural trips loans, and $40 million in accrued interest receivable, less $4 million in allowance for adjustments and losses in realization. As of June 30, 2012, loans and interest receivable from plan members consist of $153 million in mortgage loans, $695 million in personal loans, $72 million in cultural trips loans, and $40 million in accrued interest receivable, less $5 million in allowance for adjustment and losses in realization. As of June 30, 2013 and 2012, the fair value of the System's investment in limited partnerships amounted to $55 and $57 million, respectively, which represents approximately 3% of the investment portfolio, as of June 30, 2013 and 2012.

The System earns additional investment income by lending investment securities to brokers via its custodian's securities lending program. The brokers provide collateral to the System and generally use the borrowed securities to cover short sales and failed trades. The cash collateral received from the brokers is invested in a short-term investment fund in order to earn interest. For the years ended June 30, 2013 and 2012, net income from the securities lending activity amounted to approximately $115,000 and $139,000, respectively.

Investment Portfolio and Capital Markets Overview

As of June 30, 2013, the System's asset allocation is 62% in fixed-income investments, including loans receivable, 23% in equity securities, 14% in cash and short-term investments, and 1% in other investments as shown in the following chart:



Economy and Capital Markets Overview

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

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

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

The table below shows the fiscal year and quarter returns of major indices.

Industry Indices Performance Overview

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

Total Fund Performance

The System generated a return of 7.8% during the 2012-2013 fiscal year, outperforming its policy benchmark by 70 basis points. Outperformance was primarily a result of being overweight United States and international equities relative to the long-term target weights as equities overall outperformed fixed income. The overweight allocation to equities was a consequence of the System gradually de-risking its investment program (shifting from equities into bonds). This transition was concluded at the end of the fiscal year. The System's total investments, including loans as of June 30, 2013 totaled $3,251 million.

United States Equity Overview for the Fiscal Year 2013

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

The System's domestic equity component generated a return of 21.4% during the fiscal year, performing in line with its' benchmark, the Russell 3000 Index. Approximately $46 million was redeemed from the SSgA S&P 500 Index Fund and was liquidated as part of portfolio rebalancing and to meet the cash needs of the System. As of June 30, 2013, the System's domestic equity assets totaled $617 million and represented approximately 19% of the System's total investments, including loans.

International Equity Overview for the Fiscal Year 2013

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

During the fiscal year, the System's international equity component generated a return of 14.6%, outperforming the component's benchmark by 140 basis points. The SSgA ACW ex-United States Index Fund performed in line with its' benchmark. Approximately $55 million was redeemed from the component during the fiscal year as part of portfolio rebalancing and to meet the cash needs of the System. The SSgA ACW ex-U.S. Index Fund was added in July 2012 as part of the portfolio's shift to passive equity exposure. (Additional details are provided below in the Other Investments and Transactions section). At the end of the fiscal year, the component had $244 million in assets, representing 7% of the System's total investments, including loans.

United States Fixed Income Overview for the Fiscal Year 2012

The United States fixed income market, as measured by the Barclays Aggregate Bond Index, produced positive results for the first two quarters of the period only to reverse gains in the second half resulting in a loss of 0.7% during the fiscal year. All underlying sectors generated negative returns during the period, with the exception of

(Continued)

corporate, asset-backed, and commercial mortgage backed securities. Long-term government bonds experienced the largest decline, while shorter-term bonds produced modest positive results.

The System's fixed income component generated a return of 1.2% during the one year ending June 30, 2013, underperforming the component's benchmark by 40 basis points. Taplin, Canida, & Habacht, Popular, and Mesirow contributed to outperformance, while Santander detracted from results. At the end of the fiscal year, fixed income assets totaled $1,398 million, consisting of approximately 43% of the System's total investments, including loans. Approximately $131 million was redeemed from the component during the fiscal year as part of portfolio rebalancing and to meet the cash needs of the System.

In expanding the portfolio's active intermediate credit mandate, Chicago Equity Partners and Barrow Hanley were added to the portfolio during July 2012. Prior to this, the portfolio only had one other active intermediate credit manager, Taplin, with the majority of intermediate credit exposure obtained through the SSgA Intermediate Credit Index Fund.

Other Investments and Transactions

As of June 30, 2013, the System held $791 million in loans to participants which represented 24% of total investments, including loans. Loan balances as of June 30, 2013 were less than the $955 million held one year ago.

At the end of the 2013 fiscal year, the System had some exposure to limited partnerships of private equity investments which were valued at approximately $55 million and represented 2% of the System's total investments, including loans.

Funding Status

The System was created by Act No. 447 of May 15, 1951 and, since its inception, lacked proper planning. The levels of contributions were relatively low and still remain low in comparison to the level of benefits. In addition, all retirement systems in place before 1951 were merged into the System, which then had to absorb all of their unfunded liabilities. Afterwards, in 1973, the benefits structure was enhanced without the appropriate increase in contribution levels. As more people joined the government labor force and then retired under the new enhanced benefit structure, the gap between the assets available to pay benefits and the actuarial obligation started its steeping course.

In 1990, in an effort to withstand the increase in the unfunded liability, the benefit structure was modified to decrease the benefits and to postpone the retirement age from 55 to 65, in order to provide a more affordable benefit structure. Also, the level of contributions was raised and Act No. 447 was amended to provide that any increase in benefits would require actuarial studies and identification of the financing source.

Ten years later, the continuing increase in the unfunded liability required further action. As a result, the original defined benefit structure was closed to new plan members joining the System on or after January 1, 2000. To provide a retirement alternative, the pension benefit structure was further amended to provide for a cash balance program, similar to a cash balance plan, to be funded only by participating employees' contributions. That program is known as the Retirement Savings Account Program (System 2000). Under System 2000, the employers' contributions continue at the same level as the original defined benefit structure, but are being used to fund the accrued actuarial liability of the original defined benefit structure that was closed. Also under System 2000, the disability benefits are to be provided through a private insurance long term disability program to those plan members that voluntarily elect to enroll in such program. On September 15, 2004, Act No. 296 was enacted to amend the dispositions of Act No. 305 of September 24, 1999 regarding disbursements and the disability benefits program. After the amendment, any plan member that leaves public service may request that the balance in his/her savings account be transferred to a qualified retirement vehicle such as an individual retirement account or a qualified retirement plan in Puerto Rico. Act No. 296 also provides flexibility on the establishment of the disability program; but still, the employees must finance the program.

Presently, the pension plan consists of three different benefit structures, which are administrated according to their specifications in the Act. For all plan members, excluding System 2000 participants, the level of contributions established by law is 8.275% of the employee salary. Under System 2000, employee contributions range from 8.275% to 10% of the salary, as specified by the employee. Under all structures, employers' contributions during the year ended June 30, 2013 were 11.275% of the employee salary.

On February 27, 2007, the System's administration and the Government Development Bank for Puerto Rico, acting as the System's fiscal agent, presented to the Board of Trustees a financial transaction for the issuance of pension funding bonds. The System authorized the issuance of one or more series of bonds (the Bonds) in order to increase the funds available to pay pension benefits and to reduce the unfunded accrued actuarial pension liability. The System pledged future employers' contributions to the payment of the Bonds, invested the proceeds of the Bonds, and used these investments and the earnings thereon to provide pension benefits to beneficiaries. On January 31, 2008, the System issued the first series of the Bonds, which consisted of approximately $1,589 million aggregate principal amount of Senior Pension Funding Bonds, Series A. On June 2, 2008, the System issued the second of such series of Bonds, which consisted of approximately $1,059 million aggregate principal amount of Senior Pension Funding Bonds, Series B. Finally, on June 30, 2008, the System issued the third and final of such series of Bonds, which consisted of approximately $300 million aggregate principal amount of Senior Pension Funding Bonds, Series C.

Nevertheless, the System's actuarial obligation continues its increasing trend as a result of the continuous increase in the pensioners' population and its longevity and the fact that incoming pensioners have higher salaries and consequently, they are entitled to even higher annuities. Since 1990, there have been no other increases in the employers' or participating employees' contributions to cope with those factors and, therefore, the level of contributions remains low in comparison to the level of pension benefits.

Market events, plus the continuous increase in the actuarial liability have had a negative effect over the System's unfunded actuarial accrued liability. Based on the last actuarial valuation at June 30, 2013 the System's unfunded liability for pension benefits amounted to $22,981 million, with a funding level of 3.1%. The unfunded liability for postemployment healthcare benefits amounted to approximately $1,483 million and was fully unfunded.

The bottom line is that the capital markets by themselves cannot solve the System's funding problem. In order to improve the System's funding ratio, the Commonwealth enacted Law 116 increasing the employers' contribution rate from 9.275% to 10.275% of employee compensation for the 2011-2012 fiscal year, 1% annually for each of the next four years, and 1.25% annually for each of the five years thereafter, reaching an aggregate contribution rate of 20.525% effective July 1, 2020. Other measures taken to improve the System's funding, include 1) improving the collection of late contributions by receiving such contributions directly from the Municipal Revenue Collection Center (known as CRIM by its spanish acronym) when a municipality fails to send their contributions within 30 days from the due date or from the Department of Treasury of the Commonwealth in the case of public corporations; 2) implementation of Act No. 70 establishing early retirement incentives; 3) revision of the Employee Personal Loan Policy by reducing personal and cultural loan amounts to $5,000 each, from $15,000 and $10,000, respectively; and 4) the receipt of $162.5 million in bonds issued by the Puerto Rico Sales Tax Financing Corporation (known as COFINA by its spanish acronym).

Capital Assets

The System's investment in capital assets as of June 30, 2013 and 2012, amounted to approximately $9 million and $12 million respectively, net of accumulated depreciation. Capital assets include land, building and improvements, construction in progress, and equipment. Building and improvements consist of the facilities in which the System has its operations.

Requests for Information

The financial report is designed to provide a general overview of the System's finances, 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 Commonwealth of Puerto Rico Government Employees and Judiciary Retirement Systems Administration, 437 Ponce de León Avenue, Hato Rey, Puerto Rico 00918.

EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT
OF THE COMMONWEALTH OF PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Plan Net Position

June 30, 2013

(In thousands)

	Pension	Post employment healthcare benefits	Total
Assets:			
Cash and short-term investments:			
Deposits at commercial banks	$ 80,683	—	80,683
Deposits with Puerto Rico Department of Treasury	80,433	—	80,433
Deposits with Government Development Bank for Puerto Rico:			
Unrestricted	50,094	—	50,094
Restricted	35,811	—	35,811
Deposits with Bank of New York Mellon:			
Unrestricted	141,542	—	141,542
Restricted	26,503	—	26,503
Collateral from securities lending transactions	124,411	—	124,411
Total cash and short-term investments	539,477	—	539,477
Investments:			
Bonds and notes	1,351,177	—	1,351,177
Nonexchange commingled trust funds	1,053,555	—	1,053,555
Investments in limited partnerships	55,067	—	55,067
Stocks	75	—	75
Total investments	2,459,874	—	2,459,874
Total cash and investments	2,999,351	—	2,999,351
Loans and interest receivable from plan members – net of allowance for adjustments and losses in realization	791,161	—	791,161
Accounts receivable:			
Employers	131,033	—	131,033
Due from Commonwealth of Puerto Rico	2,940	—	2,940
Due from Retirement System for the Judiciary of the Commonwealth of Puerto Ricc	2,174	—	2,174
Investments sold	729	—	729
Accrued investment income	11,494	—	11,494
Other	13,185	—	13,185
Total accounts receivable	161,555	—	161,555
Capital assets – net	8,594	—	8,594
Bond issue costs – net	29,981	—	29,981
Other assets	5,261	—	5,261
Total assets	$ 3,995,903	—	3,995,903

EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT OF THE COMMONWEALTH OF PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Plan Net Position

June 30, 2013

(In thousands)

		Pension	Post employment healthcare benefits	Total
Liabilities:				
Accounts payable and accrued liabilities	$	13,905	—	13,905
Securities lending obligations		124,411	—	124,411
Bond interest payable		13,876	—	13,876
Escrow funds of mortgage loans and guarantee insurance reserve for loans to plan members		7,483	—	7,483
Bonds payable		3,051,189	—	3,051,189
Other liabilities		53,697	—	53,697
Total liabilities		3,264,561	—	3,264,561
Contingencies (note 13)				
Net position held in trust for pension benefits	$	731,342	—	731,342

See accompanying notes to basic financial statements.

EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT OF THE COMMONWEALTH OF PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Changes in Plan Net Position

Year ended June 30, 2013

(In thousands)

		Pension	Post employment healthcare benefits	Total
Additions:				
Contributions:				
Employers:				
Basic benefits	$	424,704	—	424,704
Special benefits		203,943	91,823	295,766
Participating employees		322,528	—	322,528
Total contributions		951,175	91,823	1,042,998
Investment income:				
Interest income		127,377	—	127,377
Dividend income		242	—	242
Net appreciation of investments		120,956	—	120,956
Total investment income		248,575	—	248,575
Less investment expense		3,553	—	3,553
Net investment income		245,022	—	245,022
Other income		22,035	—	22,035
Total additions		1,218,232	91,823	1,310,055
Deductions:				
Benefits paid to participants:				
Annuities		1,218,958	—	1,218,958
Special benefits		201,742	91,823	293,565
Death benefits		10,012	—	10,012
Refunds of contributions:				
Employers		971	—	971
Participating employees		51,336	—	51,336
Interest on bonds payable		192,230	—	192,230
General and administrative		33,078	—	33,078
Other expenses		16,095	—	16,095
Total deductions		1,724,422	91,823	1,816,245
Net decrease in net position held in trust f		(506,190)	—	(506,190)
Net position held in trust for pension benefits:				
Beginning of year		1,237,532	—	1,237,532
End of year	$	731,342	—	731,342

See accompanying notes to basic financial statements.

(1) Organization and Summary of Significant Accounting Policies

The Employees' Retirement System of the Government of the Commonwealth of Puerto Rico (the System) was created by Act No. 447 on May 15, 1951 (Act No. 447). The System administers a cost-sharing, multi-employer, defined benefit pension plan (the pension plan). The System also administers post employment healthcare benefits provided by the Commonwealth of Puerto Rico (the Commonwealth) to retired plan members (the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities Medical Insurance Plan Contribution – ERS MIPC), an unfunded, cost-sharing, multi-employer defined benefit other postemployment benefit. The System is considered an integral part of the financial reporting and is included in the Commonwealth's basic financial statements. The System, as a governmental retirement plan, is excluded from the provisions of the Employee Retirement Income Security Act of 1974 (ERISA).

The System's governance is vested in a Board of Trustees (the Board), which sets policy and oversees the operations consistent with applicable laws. There are eleven members of the Board, as follows: the Puerto Rico Secretary of the Treasury (or her appointee), the President of the Government Development Bank for Puerto Rico (or his appointee), the Commissioner of Municipal Affairs (or his appointee) and the Director of the Office of Human Resources of the Commonwealth (or his appointee), as ex officio members; three members appointed to three-year terms by the Governor of the Commonwealth (the Governor), two of whom must be members of the System and one member of the Retirement System for the Judiciary of the Commonwealth of Puerto Rico, with at least ten years of credited service; and two members who are a pensioners of each system. The other two members are the President of the Federation of Mayors and the President of the Association of Mayors. The Board is also responsible for appointing the Administrator of the System.

As of June 30, 2013, the pension plan has an unfunded actuarial accrued liability (UAAL) of approximately $22,981 million, representing a 3.1% funding ratio. In the opinion of management and based on information prepared by consulting actuaries, it is estimated that starting in fiscal year 2015, the System's assets will be less than its obligations (including bonds payable but excluding its UAAL) resulting in a deficit net position. In addition, annual cash flow estimates for the foreseeable future are presently estimated to continue to reduce the net position unless other measures are taken. As described in note 10, future employers' contributions have been pledged for the payment of debt service, consequently further depletion of the System's assets could result in the inability to pay benefits and bonds.

The estimate of when the System's net position will become a deficit and when its assets would be exhausted is based on significant assumptions, including the rate of return on investments, the amount and timing of collections from the Commonwealth for the member, employer contributions and the employers' additional contribution (Act No. 32), which as discussed below, was estimated in $120 million annually, as well as the estimated participant benefits and the System's administrative expenses to be paid each year.

To improve the liquidity and solvency of the System, the Commonwealth enacted Act No. 32 of June 25, 2013, which provides for incremental annual contributions from the Commonwealth General Fund beginning in fiscal year 2014 and up to the fiscal year 2033. This additional contribution will be determined annually based on actuarial studies to be performed by the System's actuaries. An appropriation for such additional contribution of approximately $120 million was included in the Commonwealth's budget for the fiscal year 2014. However, as a result of budgetary constraints at the present time management believes that approximately $90 million of this amount will not be collected as expected during fiscal year 2014. Further, this additional contribution was reduced to $28.2 million for the Commonwealth's proposed budget for the fiscal year 2015.

The Commonwealth has been facing a number of fiscal and economic challenges in recent years due, among other factors, to continued budget deficits, a prolonged economic recession, high unemployment, population decline, and high levels of debt and pension obligations. In recent months, the widening of credit spreads for the Commonwealth's public sector debt and the recent downgrading of the Commonwealth's credit ratings and those of many of its instrumentalities to noninvestment grade have put further strain on the Commonwealth's liquidity and may affect its access to both the capital markets and private sources of financing, as well as the borrowing cost of any such funding. The System's funding requirements, together with the funding requirements of the Retirement System for the Judiciary of the Commonwealth of Puerto Rico and the Puerto Rico System of Annuities and Pensions for Teachers, could have a direct negative effect on the Commonwealth's General Fund, since the Commonwealth is the plan sponsor and is obligated to make contributions to fund each of the systems.

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 regular employer contributions to the System and its additional contribution as provided by Act No. 32, for the upcoming years, may continue to be adversely affected, and could also affect the payment of benefits and the repayment of the System's bond payable.

On July 2, 2010, the Commonwealth enacted Act No. 70 establishing a program that provides benefits for early retirement or economic incentives for voluntary employment termination to eligible employees, as defined. Act No. 70 also established that early retirement benefits will be provided to eligible employees that have completed between 15 to 29 years of creditable 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 General Fund of the Commonwealth (the General Fund) and by the public corporations, covering their respective employees until the plan member reaches the later of age 55 for members under Act No. 447 or age 65 for members under Act No. 1, or the date the plan member would have completed 30 years of service had the member continued employment. In addition, the public corporations will also be required to continue making the required employee and employer contributions to the System. The General Fund will be required to continue making its required employer contributions. The System will be responsible for benefit payments afterwards. As of June 30, 2013 the System has recorded a liability of approximately $16 million for its responsibility as an employer under Act No. 70.

On July 6, 2011, the Commonwealth enacted Act No. 116 increasing the employers' contribution rate from 9.275% to 10.275% of employee compensation for the 2011-2012 fiscal year, an additional 1% annually for each of the next four years, and 1.25% annually for each of the five years thereafter, reaching an aggregate contribution rate of 20.525% effective July 1, 2020.

Other measures taken to improve the liquidity of the pension plan include, among others, 1) Act. No. 32 enacted on June 25, 2013 (Act. No. 32) in an attempt to provide additional measures to improve the collections of late contributions from employers; 2) revision of the Personal Loan Policy by limiting personal and cultural loan amounts to $5,000 each, from $15,000 and $10,000, respectively; and 3) the receipt of a special contribution from the Commonwealth that was invested in junior subordinated capital appreciation bonds issued by the Puerto Rico Sales Tax Financing Corporation (the COFINA Bonds) amounting to $162.5 million (see note 11).

On April 4, 2013, the Governor signed into law Act No. 3 of 2013 (Act No. 3), in order to implement a comprehensive reform plan to address the System's unfunded actuarial accrued liability. Act No. 3 became effective on July 1, 2013 and amended the provisions of the different benefits structures under the System through several measures that include, among others:

1. For active participants of the contributory defined benefit programs under Act No. 447 and Act No. 1, all retirement benefits accrued through June 30, 2013 were frozen, and thereafter, all future benefits will accrue under the defined contribution formula used for System 2000 participants, and will be paid at retirement through a lifetime annuity.
2. Increased the minimum pension for current retirees from $400 to $500 per month.
3. Retirement age for Act No. 447 participants will be gradually increased from age 58 to age 61.
4. Retirement age for active System 2000 participants will be gradually increased from age 60 to age 65.
5. Transitioning active participants under Act No. 1 and Act No. 447 to a defined contribution plan similar to System 2000.
6. Eliminated the "merit annuity" available to participants who joined the System prior to April 1, 1990 (see note 2).
7. The retirement age for new employees is increased to age 67, except for new state and municipal police officers, firefighters, and custody officers, which will be age 58.
8. The employee contribution rate was increased from 8.275% to 10%.
9. For System 2000 participants, the retirement benefits will no longer be paid as a lump sum distribution, instead, they will be paid through a lifetime annuity.
10. Eliminated or reduced various retirement benefits previously granted by special laws, including Christmas and summer bonuses. The Christmas bonus was reduced from $600 to $200 and was eliminated for future retirees. The summer bonus was eliminated. Resulting employer contributions savings will be contributed to the System.
11. Disability benefits were eliminated and substituted for a mandatory disability insurance policy.

12. Survivor benefits were modified.

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

The System and the Retirement System for the Judiciary of the Commonwealth of Puerto Rico (JRS), also a component unit of the Commonwealth, are both administered by Puerto Rico Government Employees and Judiciary Retirement Systems Administration (the Administration). The Administration allocated 1.73% of its general and administrative expenses to JRS during the year ended June 30, 2013. The methodology used to determine the allocation of the Administration's expenses is based on total employer and participating employees' contributions to JRS, divided by the aggregate total of employers' and participants' contributions to the System and JRS, combined.

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

(a) Basis of Presentation

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

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

(b) Use of Estimates

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

(c) Cash and Short-Term Investments

Cash and short-term investments consist of overnight deposits with the custodian bank, securities lending collateral, money market funds, and certificates of deposits in Government Development Bank for Puerto Rico (GDB) (a component unit of the Commonwealth) and commercial banks. Restricted cash deposited with GDB consists of payments received from mortgage loan holders in the servicing of loans (escrow accounts) and expired checks not claimed by the plan members, restricted for repayments. Restricted cash in Bank of New York Mellon consists of cash deposited with trustee to maintain the debt service funds and the sinking funds for the retirement of the System's bonds payable.

(d) Investments

Investments are recorded 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 $55 million and $1,054 million, respectively, as of June 30, 2013. Fair values of investments in limited partnerships have been estimated in the absence of readily determinable fair values, based on information provided by the underlying fund managers. Nonexchange commingled trust funds are reported at their net asset value (NAV).

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

(e) Loans to Plan Members

Mortgage, personal, and cultural trip loans to plan members are stated at their outstanding principal balance less an allowance for uncollectible amounts. The maximum amount that may be loaned to plan members for mortgage loans is $100,000, and $5,000 for personal, and cultural trip loans.

The System services mortgage loans with aggregate principal balances of approximately $4 million at June 30, 2013, related to certain mortgage loans sold to the Federal National Mortgage Association for a fee of 0.25%. The sale contract stipulates that the System must repurchase any loans with payments in arrears over 90 days.

(f) Insurance Premiums, Claims, and Reserve for Life Insurance on Loans to Plan Members

Premiums collected and benefits claimed are recorded as additions and deductions, respectively. The guarantee insurance reserve for life insurance on loans to plan members is revised each year and adjusted accordingly based on the annual higher claim amount of a five-year period increased by a management determined percentage.

(g) Capital Assets

Capital assets include building, building improvements, and furniture and equipment. 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 equal to or in excess of four years. Capital assets are recorded at

(Continued)

historical cost or their estimated historical cost if actual historical costs are not available. Donated capital assets are recorded at their estimated fair value at time of donation.

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

	Years
Building	50
Buildings improvements	10
Equipment, furniture, fixtures, and vehicles	5–10

(h) Recently Issued Accounting Pronouncements

The GASB has issued the following accounting pronouncements that have effective dates after June 30, 2013:

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

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

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

(2) Plan Description

Pension Benefits

The pension plan consists of different benefit structures pursuant to Act No. 447, as amended, including a cost-sharing, multi-employer, defined benefit program and a cash balance program, similar to a cash balance plan. The pension plan is sponsored by the Commonwealth, public corporations, and municipalities of Puerto Rico. Substantially all full-time employees of the Commonwealth and its instrumentalities (73 Commonwealth agencies, 78 municipalities, and 64 public corporations, including the System) are covered by the System. All regular, appointed, and temporary employees of the Commonwealth become plan members at the date of employment. Participation is optional for Commonwealth officers appointed by the Governor and Head of agencies.

At June 30, 2013, membership of the System consists of the following:

Retired and beneficiaries currently receiving benefits	107,848
Current participating employees – defined benefit	62,163
Cash balance system 2000 participating employees	63,508
Disabled members, not receiving benefits	16,649
Total membership	250,168

There were no terminated members entitled to but not yet receiving benefits.

Plan members, other than those joining the System after March 31, 1990, are eligible for the benefits described below:

(a) Retirement Annuity

Plan members are eligible for a retirement annuity upon reaching the following age:

Policemen and firefighters	Other employees
50 with 25 years of credited service	55 with 25 years of credited service
58 with 10 years of credited service	58 with 10 years of credited service

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

(b) Merit Annuity

Plan members are eligible for merit annuity with a minimum of 30 years or more of credited service. The annuity for which the plan member is eligible is limited to a minimum of 65% and a maximum of 75% of the average compensation.

(c) Deferred Retirement Annuity

A participating employee who ceases to be an employee of the Commonwealth after having accumulated a minimum of 10 years of credited service qualifies for retirement benefits provided his/her contributions to the System are not withdrawn until attainment of 58 years of age.

(d) Coordinated Plan

On the coordinated plan, the participating employee contributes a 5.775% of the monthly salary for the first $550 and 8.275% for the excess over $550. By the time the employee reaches 65 years old and begins to receive social security benefits, the pension benefits are reduced by the following:

- $165 per month if retired with 55 years of age and 30 years of credited service
- $110 per month if retired with less than 55 years of age and 30 years of credited service
- All other between $82 and $100 per month
- Disability annuities under the coordinated plan are also adjusted at age 65 and in some cases can be reduced over $165 per month

(e) Noncoordinated Plan

On the noncoordinated plan, the participating employee contributes an 8.275% of the monthly salary and does not have any change on the pension benefits upon receiving social security benefits.

(f) Reversionary Annuity

A plan member, upon retirement, could elect to receive a reduced retirement annuity giving one or more benefit payments to his/her dependents. The life annuity payments would start after the death of the retiree for an amount not less than $240 yearly or greater than the annuity payments being received by the retiree.

(g) Occupational Disability Annuity

A participating employee, who as a direct result of the performance of his/her occupation is totally and permanently disabled, is eligible for a disability annuity of 50% of the compensation received at the time of the disability.

(h) Nonoccupational Disability Annuity

A participating employee totally and permanently disabled for causes not related to his/her occupation, and with no less than 10 years of credited service, is eligible for an annuity of 1.5% of the average compensation of the first 20 years of credited services increased by 2% for every additional year of credited service in excess of 20 years.

(i) Death Benefits

Occupational

Surviving Spouse – annuity equal to 50% of the participating employee's salary at the date of the death.

Children – $10 per month for each child, minor or student, up to a maximum benefit per family of 100% of the participating employee's salary at the date of the death. If no spouse survives, or dies while receiving the annuity payments, each child, age 18 or under, is eligible to receive an annuity of $20 per month up to the attainment of 18 years of age or the completion of his/her studies.

Nonoccupational

Beneficiary – the contributions and interest accumulated as of the date of the death plus an amount equal to the annual compensation at the time of the death.

Postretirement – Beneficiary with surviving spouse age 60 or over and child, age 18 or under, up to 50% (60%, if not covered under Title II of the Social Security Act) of retiree's pension or otherwise the excess, if any, of the accumulated contributions at the time of retirement over the total annuity benefits received before death, limited to a minimum of $1,000.

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

(j) Amendments to Benefits Structure for Plan Members who Joined the System on or After April 1, 1990

Act No. 1 of February 16, 1990, made certain amendments applicable to new participating employees joining the System effective April 1, 1990. These changes consist principally of an increase in the retirement age from 55 to 65, a decrease in the benefit percentage of the average compensation in the occupational disability and occupational death benefits annuities from 50% to 40%, and the elimination of the merit annuity for participating employees (except policemen and firemen) who have completed 30 years of creditable service.

(k) Special Benefits

During fiscal years 2003 to 2007, the Commonwealth granted additional benefits to the System's retirees. As of June 30, 2013, these benefits are being funded through special appropriations from the

Commonwealth for the amount corresponding to the Commonwealth agencies and from the public corporations and municipalities. 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 respective employer.

- Summer bonus – An annual bonus of $100 for each retiree, beneficiary, and disabled member paid each July. This benefit is prorated if there are multiple beneficiaries and is funded by the Commonwealth.

- Medication bonus – An annual bonus of $100 for each retiree, beneficiary, and disabled member paid each July to cover health costs. Evidence of coverage is not required.

- Cost of living adjustment for pension benefits (COLA) – Act No. 10 of May 21, 1992, provided for increases of 3% every three years, of the pensions paid by the System to those plan members with three or more years of retirement. The Act requires further legislation to grant this increase every three years, subject to the presentation of actuarial studies regarding its costs and the source of financing. Since fiscal year 1992 to 2007 there have been other acts addressing the COLA, such as Act No. 207 of August 13, 1995; Act No. 221 of August 9, 1998; Act No. 40 of June 13, 2001; Act No. 157 of June 27, 2003; and Act No. 35 of April 24, 2007.

  On April 24, 2007, the Governor signed into law Act No. 35 to provide for an increase of 3% of the pension paid by the System to those plan members whose monthly pension was less than $1,250, effective on July 1, 2008.

To protect the financial health of the System, the increases granted pursuant to the above laws are being financed through annual appropriations from the Commonwealth and contributions from municipalities and public corporations.

(l) Early Retirement Programs

The Municipality of San Juan issued the Resolution No. 41, dated May 5, 2008, which provided an early retirement program for the municipality's employees. The Municipality of San Juan will reimburse the annuities and other benefits paid by the System during a five-year period, plus the employer and employee contributions with respect to the plan members covered until they reach the normal retirement age.

The Puerto Rico Environmental Quality Board (EQB) implemented an early retirement program for its employees under the Law 224 Act No. 7 dated August 9, 2008. EQB has already made the initial payment and would reimburse the remaining balance on annuities and other benefits paid by the System in four installments on each July 31 starting in 2009 through 2012. The EQB was at default on the retirement plan payment, so they requested a new payment plan. The ERS Board of Trustees approved a Payment Plan for the debt balance due of the Retirement program for 24 months starting in March 2014.

(m) Amendment to Act No. 447 Effective January 1, 2000, to Create System 2000

On September 24, 1999, Law 305, an amendment to Act No. 447 of May 15, 1951, which created the System, was enacted to provide for a new benefit structure, similar to a cash balance plan, known as System 2000, to cover employees joining the System on or after January 1, 2000.

Employees participating in the System as of December 31, 1999, were allowed to elect either to stay in the defined benefit structure or transfer to System 2000. People joining the public sector on or after January 1, 2000, are only allowed to become members of System 2000. Under System 2000, contributions received from participants are pooled and invested by the System, together with the assets corresponding to the defined benefit structure. Future benefit payments under the original defined benefit structure and System 2000 will be paid from the same pool of assets. As a different benefit structure, System 2000 is not a separate plan, and as such, is not presented separately from the original defined benefit structure, pursuant to the provisions of GASB Statement No. 25. The Commonwealth does not guarantee benefits at retirement age.

The annuity benefits to participants is based on a formula which assumes that each year the employee's contribution (with a minimum of 8.275% of the employee's salary up to a maximum of 10%) will be invested as instructed by the employee in an account which either: (1) earns a fixed rate based on the two-year Constant Maturity Treasury Notes or, (2) earns a rate equal to 90% of the return of the System's investment portfolio (net of management fees), or (3) earns a combination of both alternatives. Plan members receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability benefits are not granted under System 2000 rather should be provided to those plan members that voluntarily elect to participate in a private insurance long-term disability program. The employers' contributions (11.275% of the employee's salary for 2013) with respect to employees under System 2000 will continue but will be used to fund the defined benefit plan. System 2000 reduced the retirement age from 65 years to 60 for those employees who joined the current plan on or after January 1, 2000.

Other Postemployment Benefits (OPEB) - Healthcare Benefits

ERS MIPC is a cost-sharing, multi-employer defined benefit other postemployment benefit plan sponsored by the Commonwealth. Its benefit consists of a maximum of $100 per month per retiree. Substantially all fulltime employees of: (1) the Commonwealth's primary government and (2) certain municipalities of Puerto Rico and certain component units of the Commonwealth not having their own postemployment benefit plan are covered by the OPEB.

Commonwealth employees become plan members upon their date of employment. Plan members are eligible for benefits upon reaching the following age:

Police and Firemen:
- 50 with 25 years of credited service
- 58 with 10 years of credited service

Other Employees:
- 55 with 25 years of credited service
- 58 with 10 years of credited service

At June 30, 2013, the membership consists of the following:

Membership	
Active	125,671
Retirees	94,395
Disabled	16,649
Total membership	236,715

(3) Funding Policy

Pension Benefits

The contribution requirement to the System is established by law and is not actuarially determined. Required employers' contributions through June 30, 2013, consisted of 11.275% of applicable payroll in the cases of municipalities, central government, and public corporations. Required employee contribution consists of 5.775% of the first $550 of the monthly salary with the excess at 8.275% for the coordinated benefit structure and 8.275% of the total monthly salary for participating employee's contributions for the non-coordinated benefit structure. If necessary, additional non payroll related contributions from the Commonwealth should ultimately cover any deficiency between the participating employers' and employee's contributions and the System's pension benefit obligations and general and administrative deductions.

The special benefits contributions of approximately $204 million in 2013 mainly represent contributions from the General Fund of the Commonwealth for the special benefits granted by special laws, as detailed in note 2. The funding of the special benefits is provided to the System through legislative appropriations each 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.

The June 30, 2013, actuarial valuation reflects an increase in the assumed rate of return from 6.0% to 6.4%, which resulted in a decrease of approximately $1,290 million in the actuarial accrued liability. The significant assumptions underlying the actuarial computations are presented in note 4.

OPEB

The contribution requirement of ERS MIPC is established by Act No. 95 approved on June 29, 1963. This OPEB plan is financed by the Commonwealth on a pay-as-you-go basis. There is no contribution requirement from the plan member during active employment. Retirees contribute the amount of the healthcare insurance premium not covered by the Commonwealth contribution. As a result, these OPEB are 100% unfunded. During the year ended June 30, 2013, OPEB contributions amounted to $91.8 million.

The funding of the healthcare benefits is provided to the System through legislative appropriations each July 1. The legislative appropriations are considered estimates of the payments to be made by the System for the healthcare benefits throughout the year.

(4) Funded Status and Funding Progress

The System's funded status as of June 30, 2013, the most recent actuarial valuation date, 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
Pension	$ 731,342	$ 23,712,081	$ 22,980,739	3.1%	$ 3,489,096	658.6%
OPEB	$ —	$ 1,482,879	$ 1,482,879	-%	$ 3,489,096	42.5%

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

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

Pension Benefits

Valuation date	June 30, 2013
Actuarial cost method	Projected unit credit cost method
Amortization method	30 years closed, level dollar
Remaining amortization period	24 years
Asset valuation method	Market Value of Assets
Actuarial assumptions:	
Investment rate of return	6.4%
Projected salary increases	3%
Projected payroll growth	2.5%
Inflation	2.5%
Cost of living adjustment	3% triennial increases. (statutory COLA rate) for members under Act 127 who become disabled or die in the line of duty.

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

OPEB

Valuation date	June 30, 2013
Actuarial cost method	Projected unit credit cost method
Amortization method	30 years closed, level dollar
Remaining amortization period	24 years
Asset valuation method	Market Value of Assets
Actuarial assumptions:	
Investment rate of return	3.25%
Projected salary increases	Not applicable
Projected 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 projections of OPEB for financial reporting purposes does not explicitly incorporate the potential effects of legal or contractual funding limitations on the pattern of cost sharing between the employer and plan members in the future.

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

Mortality rate assumptions for both pension benefits and OPEB are:

- Pre-retirement Mortality **—** For general employees not covered under Act 127, RP-2000 Employee Mortality Rates for males and females projected on a generational basis using Scale AA. For members covered under Act 127, RP-2000 Employee Mortality Rates with blue collar adjustments for males and females, projected on a generational basis using Scale AA. As generational tables, they reflect mortality improvements both before and after the measurement date. 100% of deaths while in active service are assumed to be occupational for members covered under Act 127.

- Postretirement 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 95% 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 measurement date.

- Postretirement Disabled Mortality — Rates which vary by gender are assumed based on a study of plan's experience from 2007 to 2012 equal to 105% of the rates from the UP-1994 Mortality Table for males and 115% of the rates for females. No provision was made for future mortality improvement.

(5) Deposits and Investments

Deposits

Custodial credit risk for deposits is the risk that, in an 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 must 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, Bank of New York Mellon, and with other non Puerto Rico commercial banks are uninsured and uncollateralized, as these entities are exempt from compliance with the collateralization requirement.

As of June 30, 2013, depository bank balances of approximately $397.7 million were uninsured and uncollateralized as follows (in thousands):

		Carrying amount	Depository bank balance	Amount uninsured and uncollateralized
Cash equivalents	$	80,683	80,683	80,683
Deposits with Puerto Rico Department of Treasury		80,433	43,830	43,830
Deposits with GDB		85,905	105,101	105,101
Deposits with Bank of New York Mellon		168,045	168,045	168,045
Total	$	415,066	397,659	397,659

Investments

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

(a) Custodial Credit Risk

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

(b) Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. All fixed-income securities at the time of purchase must be of investment grade quality. All issuances shall be rated investment grade by at least two of the nationally recognized rating agencies. The portfolio is expected to maintain a minimum weighted average credit quality of either "A–" or better.

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

Investment type		RATING (1)							
		AAA	AA+ to AA-	A+ to A-	BBB+ to BBB-	BB+ to BB-	CCC	Not rated	Total
Bonds and notes:									
U.S. government agencies obligations:									
Federal Home Loan Bank (FHLB)	$	—	19,989	—	—	—	—	—	19,989
Federal National Mortgage Association (FNMA)		—	5,139	—	—	—	—	—	5,139
Federal Home Loan Mortgage Corporation (FHLMC)		—	16,356	—	—	—	—	—	16,356
Federal Farm Credit Banks (FFCB)		—	5,723	—	—	—	—	—	5,723
Mortgage and asset-backed securities:									
FNMA		—	17,645	—	—	—	—	—	17,645
FHLMC		—	7,901	—	—	—	—	—	7,901
Collateralized mortgage obligations (CMO) – Others		8	387	—	—	99	401	—	895
Commercial mortgages		16,578	—	—	—	—	—	—	16,578
Asset-backed securities		779	—	—	—	—	—	—	779
U.S. corporate bonds and notes		8,417	92,554	356,767	247,005	31,630	—	5,273	741,646
Non U.S. corporate bonds		—	26,599	72,311	41,121	7,159	—	12,075	159,265
Foreign government bonds and notes		—	5,537	1,075	—	918	—	—	7,530
U.S. municipal bonds		2,106	3,262	3,344	—	—	—	—	8,712
Commonwealth bonds		—	—	—	985	—	—	—	985
GDB bonds		—	—	—	4,587	—	—	—	4,587
COFINA bonds		—	—	229,819	—	—	—	—	229,819
Total bonds and notes		27,888	201,092	663,316	293,698	39,806	401	17,348	1,243,549
Nonexchange commingled fixed income trust fund – SSgA Intermediate fund		23,397	23,050	75,558	71,041	—	—	—	193,046
Total	$	51,285	224,142	738,874	364,739	39,806	401	17,348	1,436,595

(1) Rating obtained from Standard & Poor's or equivalent rating by Moody's Investor Service or Fitch Ratings.

Approximately $108 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 consists of shares of the State Street Global Advisor (SSgA) Intermediate U.S. Credit Index Non-Lending Fund (the SSgA Intermediate Fund). The investment objective of the SSgA Intermediate Fund is to replicate the Barclays U.S. Intermediate Credit Bond Index by investing exclusively in fixed income securities. Shares of the SSgA Intermediate Fund can be redeemed on a daily basis at NAV and have no redemption restrictions.

(c) Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of the System's investment in a single issuer. As of June 30, 2013, there are no investments in any issuer that represent 5% or more of the System's net position, except for its investment in COFINA Bonds further described in note 11.

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

Fund name	Shares	Value
SSgA MSCI ACWI Ex USA Fund	15,534	$ 243,745
SSgA Russell 3000 Fund	38,509	616,764
SSgA Intermediate Fund	7,086	193,046
Total nonexchange commingled trust funds		$ 1,053,555

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

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

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

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

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

(d) Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. In accordance with its investment policy, the System manages its exposure to declines in fair values by structuring the investment portfolio so that securities mature to meet cash requirements for benefit payments, thereby avoiding the need to sell securities on the open market prior to maturity. Investments in equity securities are not subject to the maximum maturity policy since they do not carry a maturity date. The System is expected to achieve capital preservation and income generation by investing in a diversified portfolio of marketable, investment grade intermediate credit and core fixed-income securities.

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

	Maturity (in years)				
Investment type	**Within one year**	**After one to five years**	**After five to ten years**	**After ten years**	**Total**
Bonds and notes:					
U.S. government securities:					
U.S. Treasury notes	$ 29,946	2,064	12,287	—	44,297
U.S. Treasury note strips	—	—	33,282	—	33,282
U.S. Treasury Inflation-Protected Securities (TIPS)	—	3,038	10,640	3,109	16,787
U.S. government sponsored agencies notes:					
FHLB	—	14,092	5,897	—	19,989
FNMA	—	2,783	2,356	—	5,139
FHLMC	606	9,057	6,693	—	16,356
FFCB	—	4,176	1,547	—	5,723
Mortgage and asset-backed securities:					
GNMA	—	—	—	13,262	13,262
FNMA	—	—	690	16,955	17,645
FHLMC	—	—	—	7,901	7,901
Collateralized mortgage obligations (CMO) – others	8	—	—	887	895
Commercial mortgages	—	—	—	16,578	16,578
Asset-backed securities	—	779	—	—	779
U.S. corporate bonds and notes	68,184	348,916	297,941	26,605	741,646
Non U.S. corporate bonds	13,691	77,526	63,782	4,266	159,265
Foreign government bonds and notes	—	2,868	3,744	918	7,530
U.S. municipal bonds	—	589	6,017	2,106	8,712
Commonwealth bonds	—	985	—	—	985
GDB bonds	—	4,587	—	—	4,587
COFINA bonds	—	—	—	229,819	229,819
Total bonds and notes	112,435	471,460	444,876	322,406	1,351,177
Nonexchange commingled fixed income trust fund - SSgA Intermediate Fund (1):					
U.S.	—	129,090	—	—	129,090
Non-U.S.	—	63,956	—	—	63,956
Total bonds and notes and nonexchange commingled fixed income trust fund	$ 112,435	664,506	444,876	322,406	1,544,223
Stocks, nonexchange commingled equity trust funds and investments in limited partnerships:					
Non-U.S. corporate stock					75
Nonexchange commingled equity trust funds:					
U.S.- SSgA Russell 3000 Fund					616,764
Non-U.S. – SSgA MSCI ACWI Ex USA Fund					243,745
Investments in limited partnerships					55,067
Total stocks, nonexchange commingled equity trust funds and investments in limited partnerships					915,651
Total investments					$ 2,459,874

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

(e) Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. As of June 30, 2013, the SSgA MSCI ACWI Ex USA Fund is subject to foreign currency risk.

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

Country	Currency	SSgA MSCI ACWI EX USA Fund
Japan	Japanese Yen	16 %
United Kingdom	British Sterling Pound	15
Canada	Canada Dollar	7
France	Euro	7
Other	Various	7
Switzerland	Swiss Franc	7
Australia	Australian Dollar	6
Germany	Euro	6
China	Chinese Renminbi	4
Brazil	Brazilian Real	3
Korea	South Korean Won	3
Taiwan	New Taiwan Dollar	3
Hong Kong	Hong Kong Dollar	2
India	Indian Rupee	2
Netherlands	Euro	2
South Africa	South African Rand	2
Spain	Euro	2
Sweden	Swedish Krona	2
Italy	Euro	1
Mexico	Mexican Peso	1
Russia	Russian Ruble	1
Singapore	Singapore Dollar	1
Total		100 %

Investments in Limited Partnerships

The fair value of investments in limited partnerships at June 30, 2013, amounted to approximately $55 million and are presented as private equity investments in the basic Statement of Plan Net Position. The allocations of net gains and losses to limited partners are based on certain percentages, as established in the limited partnership agreements. Investments in limited partnerships are not rated by a nationally recognized statistical rating organization.

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

As of June 30, 2013, the date of commitment, total commitment, 2013 contributions, contributions to date at cost, and estimated fair value of investments in limited partnerships are as follows (in thousands):

	Date of commitment	Total commitment	2013 Contributions	Contributions to date at cost	Estimated fair value
Grupo Guayacán, Inc.:					
Guayacán Fund of Funds, LP	September 1996	$ 25,000	—	23,820	1,250
Guayacán Fund of Funds II, LP	August 1999	25,000	—	23,681	4,529
Advent-Morro Equity Partner, Inc.:					
Guayacán Private Equity Fund, LP	January 1997	5,000	—	4,645	3,414
Guayacán Private Equity Fund II, LP	April 2007	25,000	—	19,030	20,460
Venture Capital Fund, Inc.	November 1995	800	—	800	862
GF Capital Management and Advisors, LLC – GF Capital Private Equity Fund LP	December 2006	25,000	1,324	25,576	20,287
Chase Capital Partners Private: Equity Fund of Funds Corporate Investors II, LTD	July 2000	20,000	—	18,955	4,265
Martineau Bay Resort, s. en c. (s.e.)	July 1998	1,796	—	1,796	—
Total		$ 127,596	1,324	118,303	55,067

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

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

Description		Fair value of underlying securities
U.S. government securities:		
U.S. Treasury bill	$	1,000
U.S. Treasury notes		13,522
U.S. Treasury note strips		33,232
U.S. Treasury Inflation-Protected Securities (TIPS)		6,110
U.S. government sponsored agencies notes:		
FHLB		7,750
FNMA		2,744
FHLMC		7,775
FFCB		1,024
U.S. corporate bonds and notes		45,443
Non U.S. corporate bonds and notes		2,861
Total	$	121,461

The underlying collateral for these securities had a fair value of approximately $124.4 million as of June 30, 2013. The collateral received was invested in a money market fund sponsored by the custodian bank and is included as part of cash and cash equivalents in the accompanying statement of plan net position. As of June 30, 2013, the short-term investment fund consisted of securities purchased under agreements to resell.

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

(6) Loans and Interest Receivable from Plan Members

Loans receivable from plan members are guaranteed by the contributions of plan members and by other sources, including mortgage deeds and any unrestricted amount remaining in the escrow funds. In addition, collections on loans receivable are received through payroll withholdings. For the year ended June 30, 2013 the maximum amount of loans to plan members for mortgage loans was $100,000 and $5,000 for personal and cultural trip loans. During the years ended June 30, 2013 and 2012, personal loans with principal balances amounting to approximately $88 and $225 million, respectively, were sold to two financial institutions. As per servicing agreements, the System is in charge of the servicing, administration and collection of the loans and outstanding principal balances at and after closing date for a servicing fee of 2%.

The allowance for adjustments and losses in realization is considered a general allowance for all categories of loans and interest receivable, except mortgage loans, and also a specific allowance for the special collection project loans balances.

As of June 30, 2013, the composition of loans and interest receivable from plan members is summarized as follows (in thousands):

Loans receivable:		
Personal	$	527,877
Mortgage		160,109
Cultural trips		67,896
Total loans to plan members		755,882
Accrued interest receivable		39,656
Less allowance for adjustments and losses in realization		(4,377)
Total loans and interest receivable from plan members – net	$	791,161

(7) Accounts Receivable from Employers

As of June 30, 2013, accounts receivable from employers consisted of the following (in thousands):

Early retirement programs	$	5,458
Special laws		42,749
Employer and employee contributions		71,383
Interest on late payments		11,443
Total	$	131,033

According to Act No. 447, each employer must pay, on a monthly basis, the amounts corresponding to contributions and loan repayments, on or before the fifteenth day of the following month. After that date, interest is charged as established by the System.

As more fully described in note 1, the Commonwealth and many of its instrumentalities, which are the employers as it relates to the System, have been facing significant fiscal and economic challenges. Further, in recent months, the rating downgrade and widening of credit spreads for the Commonwealth's public sector and public corporations' debt has put further strain on liquidity and sources of funding of the employers. Consequently, most of the receivables from employers are delinquent past established payment dates and/or installment plan due dates. In other instances, amounts past due have continued to be renegotiated to later dates.

(Continued)

Although certain measures have been taken to improve the collection of such receivables, the timing of collections from employers affects the liquidity needs of the System. Management is of the opinion that all amounts from employers are collectible, however this situation could ultimately affect the payment of benefits to members or repayment of the System's bonds payable, should any such amounts become uncollectible in the future.

(8) Capital Assets

Capital assets activity for the year ended June 30, 2013 was as follows (in thousands):

	Beginning balance	Increases	Decreases	Ending balance
Capital assets, not being depreciated:				
Land	$ 969	—	—	969
Construction in progress	472	50	—	522
Total capital assets, not being depreciated	1,441	50	—	1,491
Capital assets, being depreciated:				
Building and improvements	12,747	326	—	13,073
Vehicle	—	79	—	79
Equipment	11,950	879	3,522	9,307
Total capital assets, being depreciated	24,697	1,284	3,522	22,459
Less accumulated depreciation for:				
Building and improvements	4,494	404	—	4,898
Equipment	9,976	482	—	10,458
Total accumulated depreciation	14,470	886	—	15,356
Total capital assets being depreciated – net	10,227	398	3,522	7,103
Total capital assets – net	$ 11,668	448	3,522	8,594

(9) Other Assets

As of June 30, 2013, other assets consist of (in thousands):

Executed land	$	4,699
Repossessed and foreclosed properties		562
Total	$	5,261

Repossessed and foreclosed properties consist mainly of properties acquired through foreclosure proceedings related to delinquent mortgage loans. Foreclosed properties are valued at the outstanding principal balance of the related mortgage loan 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 in the United States of America, are not material. Management believes that the carrying value of these properties approximates fair value.

(10) Bonds Payable

Senior Pension Funding Bonds – On February 27, 2007, the System's administration and GDB, acting as the System's fiscal agent (the Fiscal Agent), presented to the Board of Trustees, a financial transaction for the issuance of pension funding bonds in order to reduce the System's unfunded actuarial accrued liability. The Bonds are limited, non-recourse obligations of the System, payable solely from and secured solely by a pledge of employer contributions made after the date of issuance of the first series of Bonds, and from funds held on deposit with the Bank of New York (the Fiscal Agent). The Bonds are not payable from contributions made to the System by participating employees, or from the assets acquired with the proceeds of the Bonds, or from employer contributions released by the Fiscal Agent to the System after funding of required reserves, or from any other assets of the System. The System invested the proceeds of the Bonds and used these investments and the earnings thereon to provide pension benefits to its beneficiaries.

On January 31, 2008, the System issued the first series of Bonds, which consisted of approximately $1,589 million aggregate principal amount of Senior Pension Funding Bonds, Series A (the Series A Bonds). On June 2, 2008, the System issued the second of such series of Bonds, which consisted of approximately $1,059 million aggregate principal amount of Senior Pension Funding Bonds, Series B (the Series B Bonds). Finally, on June 30, 2008, the System issued the third and final of such series of Bonds, which consisted of approximately $300 million aggregate principal amount of Senior Pension Funding Bonds, Series C (the Series C Bonds). The following is a summary of changes in the bonds payable principle balance (in thousands):

	Maturity	Balance at June 30, 2012	Accretion	Balance at June 30, 2013
5.85% to 6.45% Term and Capital Appreciation Bonds Series A	2023-2058	$ 1,602,749	3,713	1,606,462
6.25% to 6.55% Term and Capital Appreciation Bonds Series B	2028-2058	1,129,989	20,479	1,150,468
6.15% to 6.50% Term and Capital Appreciation Bonds Series C	2028-2043	300,848	188	301,036
Bond discounts		(6,993)	216	(6,777)
Total		$ 3,026,593	24,596	3,051,189

As of June 30, 2013, the outstanding principal balance of the Bonds is as follows (in thousands):

Description		
Series A Bonds:		
Capital Appreciation Bonds, maturing in 2028, bearing interest at 6.20%	$	62,692
Term Bonds, maturing in 2023, bearing interest at 5.85%		200,000
Term Bonds, maturing from 2031 through 2038, bearing interest at 6.15%		679,000
Term Bonds, maturing from 2039 through 2042, bearing interest at 6.20%		332,770
Term Bonds, maturing from 2055 through 2058, bearing interest at 6.45%		332,000
Total Series A Bonds outstanding		1,606,462
Series B Bonds:		
Capital Appreciation Bonds, maturing from 2028 through 2030, bearing interest at 6.40%		194,401
Capital Appreciation Bonds, maturing from 2031 through 2034, bearing interest at 6.45%		139,967
Term Bonds, maturing in 2031, bearing interest at 6.25%		117,100
Term Bonds, maturing from 2036 through 2039, bearing interest at 6.30%		270,000
Term Bonds, maturing from 2055 through 2058, bearing interest at 6.55%		429,000
Total Series B Bonds outstanding		1,150,468
Series C Bonds:		
Capital Appreciation Bonds, maturing in 2030, bearing interest at 6.50%		3,036
Term Bonds, maturing in 2028, bearing interest at 6.15%		110,000
Term Bonds, maturing in 2038, bearing interest at 6.25%		45,000
Term Bonds, maturing in 2043, bearing interest at 6.30%		143,000
Total Series C Bonds outstanding		301,036
Total bonds outstanding		3,057,966
Less bonds discount		(6,777)
Bonds payable – net	$	3,051,189

Series A Bonds – The aggregate principal amount of the Series A Bonds issued amounted to approximately $1,589 million of which $1,544 million were issued as term bonds (the Series A Term Bonds) and $45 million were issued as capital appreciation bonds (the Series A Capital Appreciation Bonds). Interest in the Series A Term Bonds are payable monthly on the first day of each month. Interest on the Series A Capital Appreciation Bonds are not payable on a current basis, but are added to the principal of the Capital Appreciation Bonds on each January 1 and July 1 (Compounding Dates), and are treated as if accruing in equal daily amounts between Compounding Dates, until paid at maturity or upon redemption. Interest shall be computed on the basis of a 360 day year consisting of twelve 30 day months.

The Series A Bonds are subject to redemption at the option of the System from any source, in whole or in part at any time on or after July 1, 2018, at a redemption price equal to the principal amount (in the case of Series A Capital Appreciation Bonds, the accreted amount) of the Series A Bonds, plus accrued interest to the redemption date, and without premium.

In addition, the following Series A Term Bonds are subject to mandatory redemption in part commencing on July 1, 2021 to the extent of the sinking fund requirement for said bonds set forth below at a redemption price equal to 100% of the principal amount thereof plus accrued interest as follows (in thousands):

Redemption Period	Subject Bonds		Amount
July 1, 2021	Term bonds (final maturity July 1, 2023)	$	50,000
July 1, 2022	Term bonds (final maturity July 1, 2023)		70,000
July 1, 2023	Term bonds (final maturity July 1, 2023)		80,000
	Subtotal		200,000
July 1, 2034	Term bonds (final maturity July 1, 2038)		133,500
July 1, 2035	Term bonds (final maturity July 1, 2038)		133,500
July 1, 2036	Term bonds (final maturity July 1, 2038)		133,500
July 1, 2037	Term bonds (final maturity July 1, 2038)		133,500
July 1, 2038	Term bonds (final maturity July 1, 2038)		133,500
	Subtotal		667,500
Total		$	867,500

The System complied with the sinking fund requirements at June 30, 2013.

Series B Bonds – The aggregate principal amount of the Series B Bonds amounted to approximately $1,059 million of which $816 million were issued as term bonds (the Series B Term Bonds) and $243 million were issued as capital appreciation bonds (the Series B Capital Appreciation Bonds). Interest in the Series B Term Bonds are payable monthly on the first day of each month. Interest on the Series B Capital Appreciation Bonds are not payable on a current basis, but are added to the principal of the Series B Capital Appreciation Bonds on each January 1 and July 1 (Compounding Dates), and are treated as if accruing in equal daily amounts between Compounding Dates, until paid at maturity or upon redemption. Interest shall be computed on the basis of a 360 day year consisting of twelve 30 day months.

The Series B Bonds are subject to redemption at the option of the System from any source, in whole or in part at any time on or after July 1, 2018, at a redemption price equal to the principal amount (in the case of Series B Capital Appreciation Bonds, the accreted amount) of the Series B Bonds, plus accrued interest to the redemption date, and without premium.

Series C Bonds – The aggregate principal amount of the Series C Bonds amounted to approximately $300 million of which $298 million were issued as term bonds (the Series C Term Bonds) and $2 million were issued as capital appreciation bonds (the Series C Capital Appreciation Bonds). Interest in the Series C Term Bonds are payable monthly on the first day of each month. Interest on the Series C Capital Appreciation Bonds are not payable on a current basis, but are added to the principal of the Series C Capital Appreciation Bonds on each January 1 and July 1 (Compounding Dates), and are treated as if accruing in equal daily amounts between Compounding Dates, until paid at maturity or upon redemption. Interest shall be computed on the basis of a 360 day year consisting of twelve 30 day months.

The Series C Bonds are subject to redemption at the option of the System from any source, in whole or in part at any time on or after July 1, 2018, at a redemption price equal to the principal amount (in the case of Series C Capital Appreciation Bonds, the accreted amount) of the Series C Bonds, plus accrued interest to the redemption date, and without premium.

In addition, the following Series C Term Bonds are subject to mandatory redemption in part commencing on July 1, 2024 to the extent of the sinking fund requirement for said bonds set forth below at a redemption price equal to 100% of the principal amount thereof plus accrued interest as follows (in thousands):

Redemption Period	Subject Bonds		Amount
July 1, 2024	Term bonds (final maturity July 1, 2028)	$	18,700
July 1, 2025	Term bonds (final maturity July 1, 2028)		22,000
July 1, 2026	Term bonds (final maturity July 1, 2028)		29,150
July 1, 2027	Term bonds (final maturity July 1, 2028)		36,300
July 1, 2028	Term bonds (final maturity July 1, 2028)		3,850
	Subtotal		110,000
July 1, 2029	Term bonds (final maturity July 1, 2038)		100
July 1, 2030	Term bonds (final maturity July 1, 2038)		540
July 1, 2031	Term bonds (final maturity July 1, 2038)		100
July 1, 2032	Term bonds (final maturity July 1, 2038)		3,420
July 1, 2033	Term bonds (final maturity July 1, 2038)		4,320
July 1, 2034	Term bonds (final maturity July 1, 2038)		100
July 1, 2035	Term bonds (final maturity July 1, 2038)		11,940
July 1, 2036	Term bonds (final maturity July 1, 2038)		2,160
July 1, 2037	Term bonds (final maturity July 1, 2038)		7,920
July 1, 2038	Term bonds (final maturity July 1, 2038)		14,400
	Subtotal		45,000
July 1, 2039	Term bonds (final maturity July 1, 2043)		28,600
July 1, 2040	Term bonds (final maturity July 1, 2043)		28,600
July 1, 2041	Term bonds (final maturity July 1, 2043)		28,600
July 1, 2042	Term bonds (final maturity July 1, 2043)		28,600
July 1, 2043	Term bonds (final maturity July 1, 2043)		28,600
	Subtotal		143,000
Total		$	298,000

The System complied with the sinking fund requirements at June 30, 2013.

Debt service requirements in future years on the System's bonds as of June 30, 2013 are as follows (in thousands):

	Principal	Interest	Total
Year ending June 30:			
2014	$ —	166,519	166,519
2015	—	166,519	166,519
2016	—	166,519	166,519
2017	—	166,519	166,519
2018	—	166,519	166,519
2019–2023	120,000	823,233	943,233
2024–2028	186,150	760,552	946,702
2029–2033	1,054,405	725,324	1,779,729
2034–2038	960,885	603,205	1,564,090
2039–2043	730,070	320,472	1,050,542
2044–2048	28,600	247,718	276,318
2049–2053	—	247,568	247,568
2054–2058	539,900	179,875	719,775
2059	221,100	1,201	222,301
	3,841,110	4,741,743	8,582,853
Less:			
Unaccreted interest	(783,144)		
Unamortized discount	(6,777)		
Total	$ 3,051,189		

Pledge of Employer Contributions Pursuant to Security Agreement – The System entered into a Security Agreement with the Fiscal Agent for the benefit of the bondholders, pursuant to which the System pledged to the Fiscal Agent, and granted the Fiscal Agent a security interest in employer contributions made after January 31, 2008, which was the date of issuance of the first series of bonds, and the funds on deposit with the Fiscal Agent under the various accounts established under the Pension Funding Bond Resolution (the Resolution).

The Resolution and the Security Agreement constitute a contract between the System and the Fiscal Agent, on behalf of the owners of the bonds. The pledge, covenants and agreements of the System set forth in the Resolution and the Security Agreement shall be for the equal benefit, protection and security of the owners of the bonds, regardless of time or times of their issuance or maturity, and shall be of equal rank, without preference, priority or distinction of any of the bonds over any other bond, except as expressly provided in or permitted by the Resolution. Annual employer contributions that are made after January 31, 2008, which was the date of issuance of the first series of bonds, in accordance with the Act and amounts on deposit in the different accounts created pursuant to the Resolution for the benefits of the owners of the bonds, are pledged for annual debt service requirements as established. The pledge is irrevocable so long as any bonds are outstanding under the terms of the Resolution.

(11) COFINA Bonds

Pursuant to Act No. 96 of June 16th, 2011, during the fiscal year ended June 30, 2011, the System received a special contribution of approximately $163 million from the Puerto Rico Infrastructure Financing Authority, an instrumentality of the Commonwealth. The contribution was invested in bonds issued by the Puerto Rico Sales Tax Financing Corporation (known as COFINA by its spanish acronym), which provide for a 7% accretion rate and maturity dates between 2043 and 2048. COFINA is a blended component unit of the Commonwealth. As required by Act No. 96 of June 16th, 2011, the System cannot voluntary dispose the COFINA Bonds unless such request has been approved by the GDB. The COFINA Bonds have a fair value of approximately $230 million as of June 30, 2013.

(12) 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. The plan members who obtained these loans from the System pay the coverage in its entirety. The life insurance rates are actuarially determined and do not vary by age, sex, or health status.

(13) Contingencies

The System is a defendant or co-defendant in various lawsuits resulting from the ordinary conduct of its operations. Based on the advice of legal counsel and considering insurance coverages, management is of the opinion that the ultimate liability, if any, will not have a significant effect on the financial status of the System.

REQUIRED SUPPLEMENTARY INFORMATION

EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT OF THE COMMONWEALTH OF PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

Schedule of Employers' Contributions

(Unaudited)

(Dollars in thousands)

Plan	Fiscal year ended	Annual required contributions	Actual employers' contributions	Percentage of contribution
Pension*	June 30, 2013	$ 2,192,821	$ 628,647	28.7%
	June 30, 2012	2,019,467	589,767	29.2
	June 30, 2011	1,734,979	701,399	40.4
	June 30, 2010	1,459,774	531,136	36.4
	June 30, 2009	1,258,695	595,863	47.3
	June 30, 2008	1,191,275	662,275	55.6
Other Postemployment Healthcare Benefits	June 30, 2013	$ 154,999	$ 91,823	59.2%
	June 30, 2012	133,654	94,664	70.8
	June 30, 2011	129,395	93,851	72.5
	June 30, 2010	128,294	88,599	69.1
	June 30, 2009	111,683	85,385	76.5
	June 30, 2008	110,650	80,019	72.3

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

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

EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT OF THE COMMONWEALTH OF PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

Schedule of Funding Progress

(Unaudited)

(Dollars in thousands)

Plan	Actuarial valuation date	Actuarial value of plan assets	AAL	UAAL	Funded ratio	Annual covered payroll	UAAL percentage of annual covered payroll
Pension*	June 30, 2013	$ 731,342	$ 23,712,081	$ 22,980,739	3.1%	$ 3,489,096	658.6%
	June 30, 2012	1,236,873	27,645,786	26,408,913	4.5	3,570,339	739.7
	June 30, 2011	1,723,811	25,457,354	23,733,543	6.8	3,666,402	647.3
	June 30, 2010	1,667,358	21,370,006	19,702,648	7.8	3,818,332	516.0
	June 30, 2009	1,851,223	18,943,586	17,092,363	9.8	4,292,552	398.2
	June 30, 2008	2,607,086	N/D	N/D	N/D	N/D	N/D
Other Postemployment Healthcare Benefits	June 30, 2013	$ —	$ 1,482,879	$ 1,482,879	0%	$ 3,489,096	42.5%
	June 30, 2012	—	2,120,970	2,120,970	—	3,570,339	59.4
	June 30, 2011	—	1,758,389	1,758,389	—	3,666,402	48.0
	June 30, 2010	—	1,699,373	1,699,373	—	3,818,332	44.5
	June 30, 2009	—	1,633,159	1,633,159	—	4,292,552	38.0
	June 30, 2008	—	N/D	N/D	N/D	N/D	N/D

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

N/D = Not determined.

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

(1) Schedule Of Employers' Contributions

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

The System's schedule of employers' contributions includes both Commonwealth's and participating employees' contributions as the Commonwealth's contributions, ultimately, should cover any deficiency between the participating employees' contributions, pension benefits, and the System's administration costs.

The information was obtained from the last actuarial report as of June 30, 2013.

(2) Schedule of Funding Progress

The schedule of funding progress provides information about the funded status of the System and the progress being made in accumulating sufficient assets to pay benefits when due. The information was obtained from the last actuarial report as of June 30, 2013.