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# RETIREMENT SYSTEM FOR THE JUDICIARY OF THE COMMONWEALTH OF PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

Basic Financial Statements and Required Supplementary Information

June 30, 2014

(With Independent Auditors' Report Thereon)

**RETIREMENT SYSTEM FOR THE JUDICIARY OF THE COMMONWEALTH OF PUERTO RICO**

(A Component Unit of the Commonwealth of Puerto Rico)

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**KPMG LLP**
American International Plaza
Suite 1100
250 Muñoz Rivera Avenue
San Juan, PR 00918-1819

# Independent Auditors' Report

The Board of Trustees
The Retirement System for the Judiciary
of the Commonwealth of Puerto Rico:

We have audited the accompanying financial statements of the Retirement System for the Judiciary of the Commonwealth of Puerto Rico (the System), which comprise the statement of fiduciary net position as of June 30, 2014, the related statement of changes in fiduciary net position for the year then ended, and the related notes to the financial statements, which collectively comprise the System's basic financial statements.

### *Management's Responsibility for the Financial Statements*

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

### *Auditors' Responsibility*

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

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

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

### *Opinion*

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net position of the Retirement System for the Judiciary of the Commonwealth of Puerto Rico as of June 30, 2014, and the changes in its fiduciary net position for the year then ended, in accordance with U.S. generally accepted accounting principles.

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***Emphasis of Matters***

*Adoption of New Accounting Pronouncement*

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

*Insolvency of the System*

As discussed in note 3 to the basic financial statements, the System's fiduciary net pension position as a percentage of total pension liability was 9.17% as of June 30, 2014. In the opinion of management, based on information prepared by consulting actuaries, if measures are not taken to significantly increase contributions, the System will become insolvent by fiscal year 2018. Our opinion is not modified with respect to this matter.

*Restatement of Net Position*

As discussed in Note 2(i) to the basic financial statements, net position restricted for pensions as of June 30, 2013 has been restated to correct a misstatement in the system's previously issued 2013 financial statements. Our opinion is not modified with respect to this matter.

**Other Matter**

*Required Supplementary Information*

U.S. generally accepted accounting principles require that the information in the Management's Discussion and Analysis and the schedules included under Required Supplementary Information in the accompanying table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the GASB who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

KPMG LLP

San Juan, Puerto Rico
May 20, 2016

Stamp No. E214612 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.

## Introduction

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

The System is a trust created by the Legislature of the Commonwealth of Puerto Rico (the Commonwealth) in 1954 pursuant to Act No. 12 of October 19, 1954, as amended, to provide pension and other benefits to retired judges of the Judiciary Branch of the Commonwealth. The System administers two benefit structures: (i) for active participants hired on or before July 31, 2014, and (ii) for participants hired on or after August 1, 2014. The System is a single-employer pension plan. The System also administers postemployment healthcare benefits provided by the Commonwealth to retired plan members. The System is considered an integral part of the financial reporting of the Commonwealth and is included in the Commonwealth's basic financial statements.

## Overview of the Basic Financial Statements

The following discussion and analysis is intended to serve as an introduction to the System's basic financial statements. The basic financial statements are prepared in accordance with Governmental Accounting Standards Board (GASB) pronouncements and include the following:

- The Statement of Fiduciary Net Position – presents the financial position of the System at fiscal year end. It provides information about the nature and amounts of resources with present service capacity that the System presently controls (assets), consumption of net assets by the System that is applicable to a future reporting period (deferred outflow of resources), presents obligations to sacrifice resources that the System has little or no discretion to avoid (liabilities), and acquisition of net assets by the System that is applicable to a future reporting period (deferred inflow of resources) with the difference between assets/deferred outflow of resources and liabilities/deferred inflow of resources being reported as net position. Investments are shown at fair value. All other assets and liabilities are determined on an accrual basis.
- The Statement of Changes in Fiduciary Net Position – presents the results of activities during the fiscal year. All changes affecting the assets/deferred outflow of resources and liabilities/deferred inflow of resources of the System are reflected on an accrual basis of when the activity occurred, regardless of the timing of the related cash flows. Changes in the fair values of investments are included in the year's activity as net appreciation (depreciation) in fair value of investments.
- The Notes to the Basic Financial Statements – provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes present information about the System's accounting policies, significant account balances and activities, material risks, obligations, contingencies, and subsequent events, if any.
- Required Supplementary Information – as required by GASB, is presented after the notes to the basic financial statements. It consists of information pertaining to the System's actuarial methods and assumptions

and provides data on changes in the employer's net pension liability and related ratios, the pension benefits employer's contributions, and the pension benefits' investment return as well as data on the System's other postemployment benefits.

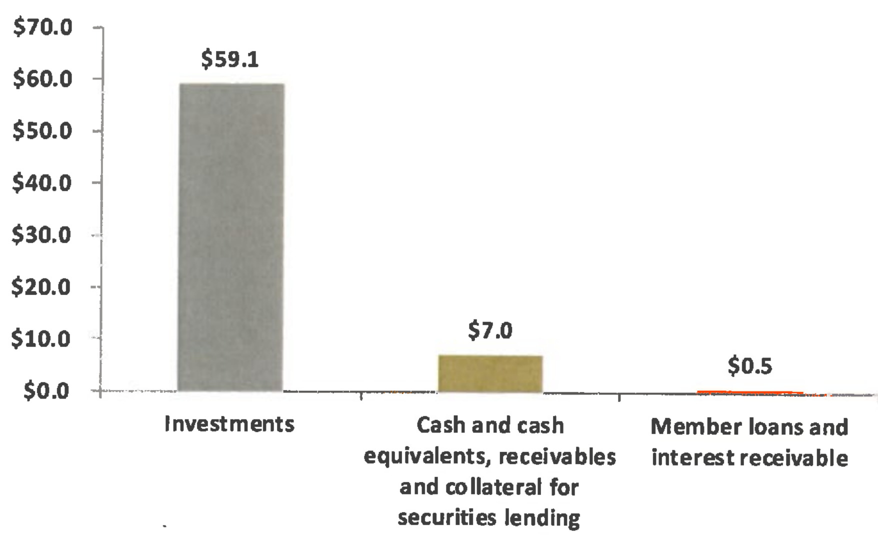
In fiscal year 2014, the System adopted GASB Statement No. 67, *Financial Reporting for Pension Plans – an Amendment of GASB Statement No. 25*. Implementation of GASB Statement No. 67 did not impact the fiduciary net position of the System; however, certain changes to note disclosures and required supplementary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

***Financial Highlights***

The System provides retirement benefits to the employees of the Judiciary Branch of the Commonwealth. As of June 30, 2014, the System had $66.7 million in total assets, which consisted of the following:

- $59.1 million in investments
- $7 million in cash and cash equivalents, receivables, and collateral from securities lending transactions
- $542,000 in member loans and interest receivable from plan members

The System's total assets as of June 30, 2014 are presented in the following chart (in millions):

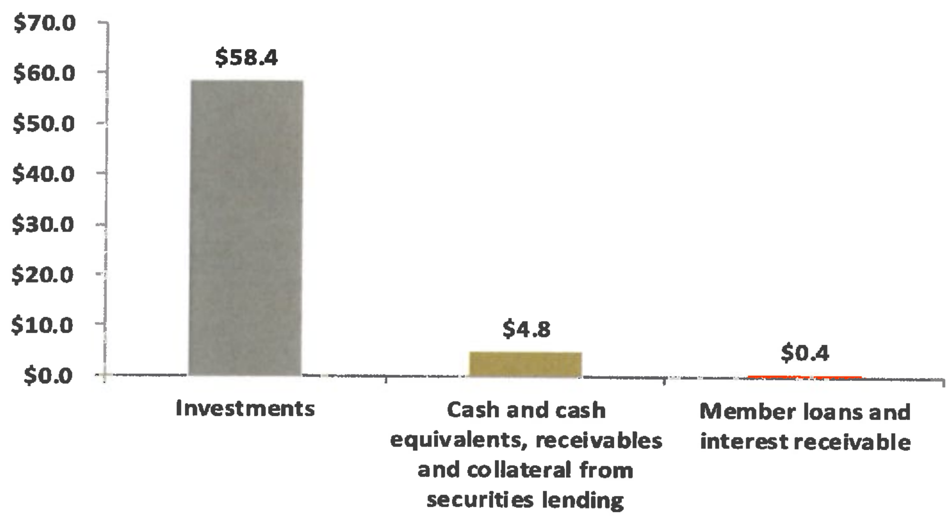



As of June 30, 2013, the System had $63.6 million in total assets, which consisted of the following:

- $58.4 million in investments

- $4.8 million in cash and cash equivalents, receivables, and collateral from securities lending transactions
- $436,000 in member loans and interest receivable

The System's total assets as of June 30, 2013 are presented in the following chart (in millions):




- The System's fiduciary net position as a percentage of the total pension liability was 9.17% at June 30, 2014. The medical insurance plan contribution, which constitutes the other postemployment benefits, is financed by the Commonwealth on a pay-as-you-go basis and consequently is unfunded.

The following schedules present comparative summary of the System's fiduciary net position and changes in fiduciary net position as of and for the years ended June 30, 2014 and 2013:

**Comparative Summary of Fiduciary Net Position – Pension Benefits**

| | | 2014 | 2013 (as restated) | Amount of change | Percentage change |
|---|---|---|---|---|---|
| | | | (Dollars in thousands) | | |
| Assets: | | | | | |
| Cash and cash equivalents, accounts receivable and collateral from securities lending transactions | $ | 6,999 | 4,799 | 2,200 | 45.8% |
| Investments | | 59,128 | 58,354 | 774 | 1.3 |
| Member loans and interest receivable | | 542 | 436 | 106 | 24.3 |
| Total assets | | 66,669 | 63,589 | 3,080 | 4.8 |
| Liabilities: | | | | | |
| Payable for investment securities purchased | | 190 | — | 190 | 100.0 |
| Securities lending obligations | | 827 | 2,002 | (1,175) | (58.7) |
| Due to the Employees' Retirement System of the Government of the Commonwealth of Puerto Rico | | 19,122 | 15,870 | 3,252 | 20.5 |
| Escrow funds to plan members and guarantee insurance reserve for loans to plan members | | 29 | 65 | (36) | (55.4) |
| Other liabilities | | 434 | 336 | 98 | 29.2 |
| Total liabilities | | 20,602 | 18,273 | 2,329 | 12.7 |
| Net position restricted for pensions | $ | 46,067 | 45,316 | 751 | 1.7% |

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

| | | 2014 | 2013 (as restated) | Amount of change | Percentage change |
|---|---|---|---|---|---|
| | | | (Dollars in thousands) | | |
| Additions: | | | | | |
| Contributions: | | | | | |
| Employer: | | | | | |
| Basic benefits | $ | 10,762 | 10,034 | 728 | 7.3% |
| Special benefits | | 1,230 | 1,368 | (138) | (10.1) |
| Member | | 3,804 | 2,825 | 979 | 34.7 |
| Net investment and security lending transactions income | | 9,713 | 6,694 | 3,019 | 45.1 |
| Other income | | 59 | 603 | (544) | (90.2) |
| Total additions | | 25,568 | 21,524 | 4,044 | 18.8 |
| Deductions: | | | | | |
| Benefits paid to participants | | 22,437 | 21,152 | 1,285 | 6.1 |
| Refunds of contributions | | 230 | — | 230 | 100.0 |
| General and administrative expenses | | 578 | 496 | 82 | 16.5 |
| Other deductions | | 1,572 | 959 | 613 | 63.9 |
| Total deductions | | 24,817 | 22,607 | 2,210 | 9.8 |
| Net change in net position | | 751 | (1,083) | 1,834 | (169.3) |
| Net position restricted for pensions: | | | | | |
| Beginning of year | | 45,316 | 46,399 | (1,083) | (2.3) |
| End of year | $ | 46,067 | 45,316 | 751 | 1.7% |

Subsequent to the issuance of the System's 2013 financial statements, management of the System identified various errors in such previously issued financial statements. The System found unrecorded amounts due to the Employees' Retirement System of the Government of the Commonwealth of Puerto Rico (PRGERS) resulting from net benefits paid by PRGERS to the System's retirees and beneficiaries and from unallocated PRGERS' general and administrative expenses and other expenses. As a result, the System's net position as of July 1, 2012 was reduced by approximately \$12.2 million, including an estimate of \$4.2 million for the lost income to be restored to PRGERS. Additionally, the net investment and security lending transactions income, the benefits paid to participants, the general and administrative expenses and the other deductions for the year ended June 30, 2013 were increased (decreased) by approximately \$22,000; \$699,000; (\$129,000); and \$959,000, respectively, to correct these errors.

- The System's total assets as of June 30, 2014 exceeded total liabilities by \$46.1 million (net position restricted for pensions). As of June 30, 2013, total assets exceeded liabilities by \$45.3 million.

- The fair value of the System's investments, excluding member loans and interest receivable, as of June 30, 2014 amounted to \$59.1 million compared to \$58.4 million as of June 30, 2013.
- Member loans and interest receivable amounted to approximately \$542,000 as of June 30, 2014, compared to \$436,000 as of June 30, 2013.

**Other Postemployment Healthcare Benefits**

Other postemployment healthcare benefits paid during the fiscal year 2014 amounted to \$302,000, an increase of 3.8% when compared to the \$291,000 paid during fiscal year 2013.

**Insolvency of the System**

The discussion in note 3 to the financial statements provides information regarding the System's liquidity risk and uncertainties. Liquidity risk is the risk of not having sufficient liquid financial resources to meet obligations when they come due.

The System's net pension liability (under the newly adopted GASB Statement No. 67) and the funded ratio as of June 30, 2014, are approximately \$456.0 million and 9.17%, respectively. Based on statutory funding requirements, the annual benefit payments and administrative expenses paid by the System were significantly larger than the employee and employer contributions received by the Systems. In the opinion of management and based on information prepared by consulting actuaries, if measures are not taken to significantly increase contributions to the System, the System will be in a deficit position by fiscal year 2018.

The estimate of when each of the System will become insolvent and when its assets will be exhausted is based on significant assumptions, including the rate of return on investments, the amount and timing of collections from the Commonwealth for the member and employer contributions, as well as the estimated participant benefits and the System's administrative expenses to be paid each year.

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

The System's funding requirements, together with the funding requirements of the Employees' Retirement System of the Government of the Commonwealth of Puerto Rico and the Puerto Rico System of Annuities and Pensions for Teachers, could have a negative effect on the Commonwealth's General Fund, since the Commonwealth is the primary sponsor and is obligated to make contributions to fund each of the systems.

The Commonwealth has been facing a number of fiscal and economic challenges in recent years due, among other factors, to continued budget deficits, a prolonged economic recession, high unemployment, population decline, and high levels of debt and pension obligations.

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 for the upcoming years, may continue to be adversely affected, and could also affect the payment of benefits.

**Financial Analysis of the System**

The basic financial statements of the System for the fiscal year ended June 30, 2014 present an increase in net position restricted for pensions of $751,000 as compared to a decrease of approximately $1.1 million for the fiscal year ended June 30, 2013. This was mainly the result of an increase in total investments, at fair value, of approximately $774,000 and an increase in cash and cash equivalents, accounts receivable and collateral from securities lending transactions of approximately $2.2 million. The increase in total liabilities mainly consisted of an increase of approximately $3.3 million in the Due to PRGERS and an increase of approximately $98,000 in other liabilities, which were partially offset by a decrease of approximately $1.2 million in securities lending obligations.

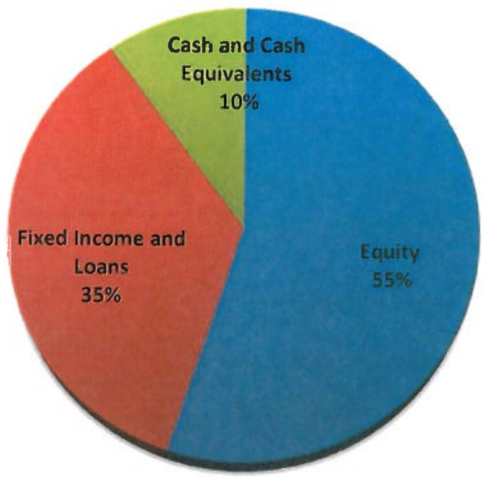
The System's additions in the statement of changes in fiduciary net position include employer and member's contributions, as well as investment income. For fiscal year 2014, employer and member's contributions increased by approximately $1.6 million. The System recognized a net appreciation in the fair value of investments of approximately $8.9 million during 2014, which represents an increase of $3.1 million from the net appreciation of $5.8 million recognized in fiscal year 2013.

The System and PRGERS, also a component unit of the Commonwealth, are administered by the Puerto Rico Government Employees and Judiciary Retirement Systems Administration (the Administration). The Administration allocated 1.57% of its general and administrative expenses to the System. This percentage is based on total employer and participating employees' contributions to the System, divided by the aggregate total of employer and participants' contributions to the System and PRGERS, combined.

**Investment Portfolio and Capital Markets Overview**

The asset allocation of the System's investment portfolio fulfills the System's needs and, since it is adequately balanced, it provides protection in case of a market downturn. As of June 30, 2014, the asset allocation of the

System's investment portfolio was 35% in fixed income investments, including loans, 55% in equity securities, and 10% in cash and cash equivalents as shown in the following chart:




***Economy and Capital Markets Overview***

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

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

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

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

***Industry Indices Performance Overview***

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

***Total System's Investment Portfolio Performance***

The System's asset allocation generated a return of 16.4% during the 2013-2014 fiscal year, outperforming its policy benchmark by 1.3 percentage points. Outperformance was attributable to an overweight allocation to domestic equities and a corresponding underweight allocation to fixed income relative to long-term target weights. The System's total investment portfolio, including member loans, as of June 30, 2014 totaled $65.4 million, composed of $59.1 million in total investments, $542,000 in member loans and accrued interest receivable, and $5.7 million in cash and cash equivalents.

***U.S. Equity Overview for the Fiscal Year 2014***

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

The System's domestic equity component returned 24.4% during the fiscal year, trailing its benchmark, the Russell 3000 Index, by 0.8 percentage points. Underperformance was primarily due to the impact of cash flow timing and withdrawals. The SSgA S&P 500 Index Fund experienced modest negative tracking error. Approximately $6.1 million was redeemed from the SSgA S&P 500 Index Fund to meet the cash needs of the System during the fiscal year. As of June 30, 2014, the System's domestic equity assets totaled $26.0 million and represented approximately 39.7% of the System's total investment portfolio, including member loans and operational cash.

***International Equity Overview for the Fiscal Year 2014***

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

During the fiscal year, the System's international equity component gained 22.0%, outperforming its benchmark by 0.2 percentage points. The SSgA ACW ex-U.S. Index Fund experienced modest positive tracking error during the period. Approximately $2.1 million was redeemed from the component in order to meet the cash needs of the System. At the end of the fiscal year, the component had $10.4 million in assets, representing 16.0% of the System's total investment portfolio, including member loans and operational cash.

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

The U.S. fixed income market, as measured by the Barclays Aggregate Bond Index, produced positive results in three of four quarters returning 4.4% in the fiscal year. The Barclays Intermediate Credit Index, the System's benchmark for its fixed income portfolio, outperformed the broader U.S. fixed income market gaining 5.2%. All underlying sectors generated positive returns during the period, with the corporate bond sector providing the strongest returns followed by the mortgage-backed securities and commercial mortgage-backed securities sectors. Long duration bonds outperformed shorter duration bonds while lower quality maturities outpaced those of higher quality.

The System's fixed income component gained 5.8% during the period, outperforming its benchmark by 1.3 percentage points. Taplin, Canida, & Habacht, contributed to outperformance while SSgA Intermediate Credit Index experienced modest negative tracking error. At the end of the fiscal year, fixed income assets totaled $22.7 million, consisting of approximately 38.0% of the System's total investment portfolio, including member loans and operational cash.

***Other Investments***

As of June 30, 2014, the System held $542,000 in member loans and interest receivable, which represented 0.8% of the total portfolio's assets, including member loans and operational cash. Member loan balances as of June 30, 2014 were $106,000 higher than a year ago. As of June 30, 2014, these loans consisted of $100,000 in mortgage loans $360,000 in personal loans, $58,000 in cultural trip loans, and $24,000 of interest receivable applicable to the pool of loans. As of June 30, 2013, these loans consisted of $358,000 in personal loans, $53,000 in cultural trip loans, and $25,000 of interest receivable applicable to the pool of loans.

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 order to earn interest. For financial statements purposes, the amount of securities that was involved in securities lending transactions as of June 30, 2014 has been presented, along with the required disclosures, in accordance with current government accounting pronouncements. During fiscal years 2014 and 2013, net income from the securities lending amounted to approximately $3,200 and $3,300, respectively.

**Funded Status of Other Postemployment Healthcare Benefits**

The unfunded liability for postemployment healthcare benefits amounted to approximately $6.5 million as of June 30, 2014 and was fully unfunded.

**Recent Developments**

On December 24, 2013, the Governor of Puerto Rico signed into law Act No. 162 of 2013 (Act No. 162), in order to implement a comprehensive reform plan to address the System's unfunded actuarial accrued liability. Act No. 162 included various changes applicable to all participants and retirees. The constitutionality of said Act was challenged by participants of the System and, on February 21, 2014, the Puerto Rico Supreme Court (the Supreme Court) declared certain sections of Act No. 162 unconstitutional while maintaining the constitutionality changes to only apply prospectively. The Commonwealth and the System's administration are currently implementing the reform as modified by the decision of the Supreme Court.

**Subsequent Events**

On April 6, 2016, the Governor of Puerto Rico signed into law the Puerto Rico Emergency Moratorium and Rehabilitation Act ("Act No. 21"). Among other objectives, Act No. 21 allows the Governor to declare – at some point in the future – a moratorium on debt service payments and to stay related creditor remedies for a temporary period for the Commonwealth, the Government Development Bank for Puerto Rico ("GDB"), the Economic

Development Bank for Puerto Rico, and certain additional government instrumentalities in Puerto Rico, including the System. The temporary period set forth in Act No. 21 lasts until January 31, 2017, with a possible two-month extension in the Governor's discretion. The provisions regarding the moratorium and stay in respect of any obligations owed by the System require executive action of the Governor to become effective. At this time, the Governor has not taken any executive action in respect of the System.

On April 8, 2016, the Governor of Puerto Rico signed an executive order, EO-2016-010 (the "Executive Order"), declaring GDB to be in a state of emergency pursuant to Act No. 21. The Executive Order, in accordance with the emergency powers provided for in Act No. 21, implemented a regulatory framework governing GDB's operations and liquidity, including establishing a procedure with respect to governmental withdrawals, payments, and transfer requests in respect of funds held on deposit at GDB and loan disbursements by GDB. The procedures implemented by the Executive Order may result in restrictions on the ability of the System to withdraw any funds held on deposit at GDB or to receive any disbursements on loans granted by GDB during the period of the Executive Order, which is in effect until June 30, 2016. However, while the Executive Order created a stay on the enforcement of certain financial debt obligations of GDB, it did not impose a moratorium on any financial debt obligation of GDB. The Executive Order did not declare an emergency period for the Commonwealth itself, the System or any other entity, other than GDB.

**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 Leon Avenue, Hato Rey, Puerto Rico, 00918.

**RETIREMENT SYSTEM FOR THE JUDICIARY OF THE COMMONWEALTH OF PUERTO RICO**

(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Fiduciary Net Position

June 30, 2014

(In thousands)

| | | Pension | Post employment healthcare benefits | Total |
|---|---|---|---|---|
| Assets: | | | | |
| Cash and cash equivalents: | | | | |
| Deposits with Government Development Bank for Puerto Rico (GDB) | $ | 2,434 | — | 2,434 |
| Deposits with GDB held by the Puerto Rico Department of Treasury | | 709 | — | 709 |
| Money market funds | | 2,545 | — | 2,545 |
| Total cash and cash equivalents | | 5,688 | — | 5,688 |
| Receivables: | | | | |
| Employer | | 283 | — | 283 |
| Accrued interest | | 175 | — | 175 |
| Other | | 26 | — | 26 |
| Total receivables | | 484 | — | 484 |
| Collateral from securities lending transactions | | 827 | — | 827 |
| Investments: | | | | |
| Bonds and notes | | 19,232 | — | 19,232 |
| Nonexchange commingled trust funds | | 39,896 | — | 39,896 |
| Total investments | | 59,128 | — | 59,128 |
| Member loans and interest receivable | | 542 | — | 542 |
| Total assets | | 66,669 | — | 66,669 |
| Liabilities: | | | | |
| Payable for investment securities purchased | | 190 | — | 190 |
| Securities lending obligations | | 827 | — | 827 |
| Due to the Employees' Retirement System of the Government of the Commonwealth of Puerto Rico | | 19,122 | — | 19,122 |
| Escrow funds to plan members and guarantee insurance reserve for loans to plan members | | 29 | — | 29 |
| Other liabilities | | 434 | — | 434 |
| Total liabilities | | 20,602 | — | 20,602 |
| Net position restricted for pensions | $ | 46,067 | — | 46,067 |

See accompanying notes to basic financial statements.

**RETIREMENT SYSTEM FOR THE JUDICIARY**
**OF THE COMMONWEALTH OF PUERTO RICO**
(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Changes in Fiduciary Net Position

Year ended June 30, 2014

(In thousands)

| | | Pension | Post employment healthcare benefits | Total |
|---|---|---|---|---|
| Additions: | | | | |
| Contributions: | | | | |
| Employer: | | | | |
| Basic benefits | $ | 10,762 | — | 10,762 |
| Special benefits | | 1,230 | 302 | 1,532 |
| Member | | 3,804 | — | 3,804 |
| Total contributions | | 15,796 | 302 | 16,098 |
| Investment income: | | | | |
| Net appreciation in fair value of investments | | 8,868 | — | 8,868 |
| Interest | | 842 | — | 842 |
| Less investment expense, other than from security lending | | — | — | — |
| Net income from investing other than from securities lending | | 9,710 | — | 9,710 |
| Securities lending income | | 4 | — | 4 |
| Less securities lending expense | | (1) | — | (1) |
| Net income from securities lending | | 3 | — | 3 |
| Net investment income | | 9,713 | — | 9,713 |
| Other income | | 59 | — | 59 |
| Total additions | | 25,568 | 302 | 25,870 |
| Deductions: | | | | |
| Benefits paid to participants: | | | | |
| Annuities | | 21,489 | — | 21,489 |
| Special benefits | | 948 | 302 | 1,250 |
| Refunds of contributions | | 230 | — | 230 |
| General and administrative expenses | | 578 | — | 578 |
| Other expenses | | 1,572 | — | 1,572 |
| Total deductions | | 24,817 | 302 | 25,119 |
| Net increase in net position | | 751 | — | 751 |
| Net position restricted for pensions: | | | | |
| Beginning of year, as restated (note 2(i)) | | 45,316 | — | 45,316 |
| End of year | $ | 46,067 | — | 46,067 |

See accompanying notes to basic financial statements.

## (1) Organization

The Retirement System for the Judiciary of the Commonwealth of Puerto Rico (the System) is a trust created by the Legislature of the Commonwealth of Puerto Rico (the Commonwealth) in 1954 pursuant to Act No. 12 of October 19, 1954 (Act No. 12), as amended, to provide pension and other benefits to retired judges of the Judiciary Branch of the Commonwealth. The System administers a single-employer defined-benefit pension plan (the pension plan). The System also administers postemployment healthcare benefits provided by the Commonwealth to retired plan members (the Retirement System for the Judiciary of the Commonwealth of Puerto Rico Medical Insurance Plan Contribution – JRS MIPC), an unfunded, single-employer defined benefit other postemployment benefit plan. The System is considered an integral part of the financial reporting and is included in the Commonwealth's basic financial statements as a pension trust fund. The System, as a governmental retirement plan, is excluded from the provisions of the Employee Retirement Income Security Act of 1974 (ERISA). Income earned by the System is not subject to Federal and Puerto Rico taxes.

The 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 Employees' Retirement System of the Government of the Commonwealth of Puerto Rico (PRGERS) and one member of the System, 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.

The System and PRGERS, also a component unit of the Commonwealth, are both administered by the Puerto Rico Government Employees and Judiciary Retirement Systems Administration (the Administration). The Administration allocated 1.57% of its general and administrative expenses to the System during the year ended June 30, 2014. The methodology used to determine the allocation of the Administration's expenses is based on total employer and participating employees' contributions to the System, divided by the aggregate total of employers' and participants' contributions to the System and PRGERS, combined.

## (2) Summary of Significant Accounting Policies

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

### *(a) Basis of Presentation*

The accompanying financial statements have been prepared on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles (GAAP) as applicable to governmental organizations. Plan member contributions are recognized in the period in which the contributions are due. Employer contributions are recognized when due and the employer has legal requirement to provide the contributions. Benefits and refunds are recognized when legally due pursuant to statutory requirements.

*(b)* ***Use of Estimates***

Management of the System has made significant estimates and assumptions relating to the reporting of assets and liabilities and in the disclosures of contingencies to prepare these financial statements in conformity with GAAP. The System's most significant estimates relate to the total pension liability, and the valuation of alternative investments. Due to the inherent nature of these estimates, actual results could differ from those estimates.

*(c)* ***Cash and Cash Equivalents***

Cash equivalents include all highly liquid debt instruments with original maturities of three months or less from the date of acquisition. Cash and cash equivalents consist of deposits in GDB and money market funds.

*(d)* ***Investments***

Investments are reported at fair value. The fair value of investments is based on quoted prices, if available. The System has investments in nonexchange commingled trust funds valued at approximately $39.9 million as of June 30, 2014. Nonexchange commingled trust funds are reported at their net asset value (NAV). The NAV includes the market value of the securities in the fund plus any receivables, payables, and accrued fund expenses.

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

*(e)* ***Member Loans***

Mortgage, personal, and cultural trip loans to plan members are stated at their outstanding principal balance. No allowance for uncollectible amounts has been established since loans to plan members are collected through payroll withholdings and secured by mortgage deeds and plan members' contributions. 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 carrying value of these loans approximates their fair value.

*(f)* ***Guarantee Insurance Reserve for Member Loans***

Premiums collected and benefits claimed are recorded as additions and deductions, respectively. The guarantee insurance reserve for life insurance on member loans 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) Adoption of Accounting Pronouncements*

Effective July 1, 2013, the System adopted GASB Statement No. 67, *Financial Reporting for Pension Plans – an Amendment of GASB Statement No. 25*. GASB Statement No. 67 establishes standards of financial reporting for separately issued financial reports and specifies the required approach to measuring the net pension liability of employers for benefits provided through the pension plan. This Statement replaces the requirements of GASB Statements No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and GASB Statement No. 50, *Pension Disclosures*, as they relate to pension plans that are administered through trusts or equivalent arrangements (hereafter jointly referred to as trusts) that meet certain criteria.

GASB Statement No. 67 requires the disclosures of the components of the net pension liability and the assumptions and other methods used to measure the total pension liability. GASB Statement No. 67 also requires certain additional note disclosures for defined benefit pension plans including the annual money-weighted rate of return on plan investments. GASB No. 67 revised the reporting requirements for required supplementary information to include schedules that provide trend information related to 1) changes in the net pension liability and related ratios, 2) the actuarially and contractually determined contributions of employer contributing entities, and 3) the annual money-weighted rate of return on plan investments.

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

### *(h) Recently Issued Accounting Pronouncement*

GASB Statement No. 72, *Fair Value Measurement and Application*, addresses accounting and financial reporting issues related to fair value measurements. The new requirements improve the comparability of financial statements among governments by requiring measurement of certain assets and liabilities at fair value using a consistent and more detailed definition of fair value and accepted valuation techniques. The definition of fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It also enhances fair value application guidance and related disclosures in order to provide information to financial statement users about the impact of fair value measurements on a government's financial position. GASB Statement No. 72 requires a government to make disclosures about its fair value measurements, the level of fair value hierarchy, and valuation techniques. Additional disclosures are required for certain entities that calculate the net asset value per share (or its equivalent). GASB recommends organizing your disclosures by the type of asset or liability reported at fair value. This Statement is effective for fiscal years beginning after June 15, 2015. Earlier application is encouraged. The impact that this Statement will have on the System's financial statements has not yet been determined.

### *(i) Restatement of Net Position Restricted for Pensions*

While preparing the 2014 financial statements, management of the System identified an error whereby benefit payments for System retirees were paid from the incorrect pension plan, PRGERS. Between 1991 and 2013, the PRGERS paid \$8.4 million, net, related to System retirees. As a result of the incorrect payments made by PRGERS, it is estimated that PRGERS lost \$5.2 million of net investment income over time. The total of these amounts, and an \$86 thousand error related to general and administrative expenses, is the amount by which the System's beginning net position restricted for pensions is overstated. In addition, the System's 2013 change in net position restricted for pensions would have decreased by \$1.5 million. The following is a reconciliation of the June 30, 2013 net position restricted for pensions as previously reported and as reported in these financial statements:

| | | |
|---|---|---|
| Net position restricted for pensions – as previously reported | $ | 59,012 |
| Correction of errors | | (13,696) |
| Net position restricted for pensions – as restated | $ | 45,316 |

## (3) Liquidity Risk and Uncertainties

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

The System's fiduciary net position as a percentage of total pension liability was 9.17% as of June 30, 2014. In the opinion of management, based on information prepared by consulting actuaries, if measures are not taken to significantly increase contributions, the System will become insolvent by fiscal year 2018. The estimate of when the System will become insolvent is based on significant assumptions, including the rate of return on investments, the amount and timing of collections from the Commonwealth for the member and employer contributions, as well as the estimated participant benefits and the System's administrative expenses to be paid each year.

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

The System's funding requirements, together with the funding requirements of PRGERS 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 primary plan sponsor and is obligated to make contributions to fund each of the systems.

The Commonwealth has been facing a number of fiscal and economic challenges in recent years due, among other factors, to continued budget deficits, a prolonged economic recession, high unemployment, population decline, and high levels of debt and pension obligations. The widening of credit spreads for the

Commonwealth's public sector debt, the continued downgrading of the Commonwealth's credit ratings and those of many of its instrumentalities to noninvestment grade categories and the lower-than-projected revenues have put further strain on the Commonwealth's liquidity and have affected its access to both the capital markets and private sources of financing, as well as the borrowing cost of any such funding.

If the Commonwealth's financial condition does not improve as a result of fiscal and budgetary measures it is taking, its ability to repay its obligations, including its employer contributions to the pension plan for the upcoming years, may be adversely affected.

***Remediation Plan***

Starting in 2008, the pension plan and the Commonwealth entered into an agreement to increase the employer contributions from 20% to 30.34%. Employee contributions consist of 8% of the employees' monthly salary. Contributions from the Commonwealth should ultimately cover any deficiencies between the employer's and employees' contributions and the System's pension benefit obligation and administrative costs.

On December 24, 2013, the Governor of Puerto Rico signed into law Act No. 162 of 2013 (Act No. 162) intending to help address the System's possible insolvency. Act No. 162 included various changes applicable to all participants and retirees, as modified by the February 21, 2014 decision of the Puerto Rico Supreme Court which limited the effect of the reform as follows:

1. Members hired prior to December 24, 2013 maintain the existing benefits.

2. Members hired from December 24, 2013 to June 30, 2014 will accrue a maximum pension of 60% of salary and will contribute 10% of salary. In addition, the Christmas bonus, summer bonus and medication bonus were eliminated.

3. Members hired on or after July 1, 2014 will be covered by a contributory, hybrid program with defined benefit and defined contribution components. Refer to note 4 for the new program's provisions.

In addition, Section 17 of Act No. 162 enacted an additional employer contribution designed to avoid having the projected gross assets of the System, during any fiscal year subsequent to 2015, fall below $20 million. Under this Section, the System shall commission an actuarial valuation to determine the annual additional employer contribution. The first annual additional employer contribution corresponding to fiscal year 2015, determined at $11.6 million due by June 30, 2015, was not received and the budget of the Commonwealth's General Fund for fiscal year 2015-2016 does not include an appropriation for such additional contribution. The actuarial study notes that if the annual additional employer contribution is not paid in full during the intended fiscal years, the amount would increase in the following years. Timely payment of the annual additional employer contribution is a critical component of the reform in order for the System to be able to make payments as they come due without depleting all of its assets first.

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

## (4) Plan Description

***Pension Benefits***

The System administers two benefit structures pursuant to Act No. 12 of 1954, as amended by Act No. 162 of 2013. Benefit provisions vary depending on member's date of hire as follows:

- Judges hired on or before June 30, 2014 with certain distinctions for judges hired December 24, 2013 to June 30, 2014 (contributory, defined benefit program).
- Judges hired July 1, 2014 or later (contributory, hybrid program).

All judges of the Judiciary Branch of the Commonwealth are members of the System. Members include all persons holding a position as Judge of the Puerto Rico Supreme Court, Judge of the Court of Appeals, Superior Judges of the Court of First Instance, and Municipal Judges of the Court of First Instance in the Commonwealth.

At July 1, 2013, the membership consisted of the following:

| | |
|---|---|
| Retirees and beneficiaries currently receiving benefits | 430 |
| Current participating employees | 364 |
| Terminated vested participants, not yet receiving benefits | 59 |
| Total membership | 853 |

The benefits provided to members of the System are established by Commonwealth law and may be amended only by the Legislature, with the Governor's approval.

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

***Pension Plan Provisions Applicable to Judges Hired on or before June 30, 2014 (Pre – Act No. 162 Members)***

***(a) Service Retirement Annuity Benefits***

An annuity payable for the lifetime of the member equal to the applicable benefit detailed below.

***(1) Normal Retirement***

Basic Eligibility: Age 60 with 10 years of credited service.

Basic Benefit: 25% of highest salary, as defined, plus 5% of highest salary, as defined, for each year of credited service in excess of 10 years, subject to a maximum of 75% of highest salary if



(Continued)

hired before December 24, 2013 and 60% of highest salary if hired between December 24, 2013 and June 30, 2014.

Eligibility for Judges who serve without a Fixed Tenure: 10 years of credited service. This enhanced eligibility is not available to judges who are appointed after June 28, 2007 to an unlimited term.

Benefit for Judges who serve without a Fixed Tenure: 25% of the salary corresponding to the office during the retirement period, plus 5% of such salary for each year of credited service in excess of 10 years, subject to a maximum of 100% of such salary. If the judge has served in a position without a fixed tenure for a total of at least 8 years, the 25% increases to 50% in the preceding formula. This enhanced benefit is not available to judges who are appointed after June 28, 2007 to an unlimited term.

Optional Eligibility: Age and credited service as shown in the table below, provided at least 8 years of credited service were earned in office as a judge.

| Age | Years of Credited Services |
|---|---|
| Less than 60 | 30 |
| 62 | 20 |
| 61 | 21 |
| 60 | 22 |
| 59 | 23 |
| 58 | 24 |
| 57 | 25 |
| 56 | 26 |
| 55 | 27 |

Optional Benefit: 75% of highest salary if hired before December 24, 2013 and 60% of highest salary if hired between December 24, 2013 and June 30, 2014.

Enhanced Eligibility: Any judge who has served without a fixed tenure for at least 3 years and has at least 25 years of credited service. This enhanced benefit is not available to judges who are appointed after June 28, 2007 to an unlimited term.

Enhanced Benefit: 75% of the salary earned at the time of retirement.

Compulsory Retirement: All judges must retire by age 70. If the judge has less than 10 years of credited service, the judge can elect a refund of accumulated contributions or a proportional part of the basic benefit based on completed years and months of credited service.

***(2) Early Retirement***

Basic Eligibility: 20 years of credited service before age 60.

Basic Benefit: The basic benefit payable under Normal Retirement, reduced on an actuarial equivalent basis for each month that early retirement date precedes age 60. However, no actuarial reduction is applied for judges who serve without a fixed tenure.

Optional Eligibility: 20 years of credited service, provided at least 8 years of credited service were earned in office as a judge.

Optional Benefit: 75% of highest salary if hired before December 24, 2013 and 60% of highest salary if hired between December 24, 2013 and June 30, 2014, reduced on an actuarial equivalent basis for each month that early retirement date precedes the age specified in the table under Optional Eligibility under Normal Retirement for the applicable years of credited service.

***(b) Termination Benefits***

***(1) Lump Sum Withdrawal***

Eligibility: A member is eligible upon termination of service.

Benefit: The benefit equals a refund of accumulated contributions.

***(2) Deferred Retirement***

Eligibility: A member is eligible upon termination of service prior to age 60 and after 10 years of credited service, provided the member has not taken a lump sum withdrawal.

Benefit: The benefit, commencing at age 60, is equal to the benefit payable upon Normal Retirement.

***(c) Death Benefits***

***(1) Occupational Death Benefit***

Eligibility: The beneficiaries of any active participant who dies from an employment-related cause under the Workmen's Accident Compensation Act.

Spouse's Benefit: 50% of the participant's salary at date of death, payable as an annuity until death or remarriage.

Children's Benefit: $10 ($20 if full orphan) for each child payable monthly until child's age 18 or completion of studies, if later. The maximum family benefit is 75% of the participant's salary at date of death.

Benefit if No Spouse or Children: Refund of accumulated contributions, plus an amount equal to one year of compensation, as defined, in effect at the time of death.

*(2) Pre-retirement Death Benefit*

Eligibility: Any current non-retired member is eligible, provided not eligible for the Occupational Death Benefit.

Benefit:

(i) While in active service, the benefit equals a refund of accumulated contributions; plus an amount equal to one year of compensation in effect at the time of death.

(ii) While not in active service, the benefit equals a refund of accumulated contributions.

*(3) Special Pre-retirement Death Benefit*

Eligibility: An active participant who was eligible to retire at the date of death with a surviving spouse or dependent children.

Benefit: The post-retirement death benefits described below assuming the active participant retired the day before the date of death.

*(4) Post-retirement Death Benefit*

Eligibility: Any retiree or disabled member receiving a monthly benefit.

Benefit:

(i) For those married or with dependent children at the time of death, an annual income equal to 60% of the retirement benefit at time of death, payable for life for a surviving spouse and/or disabled children and payable until age 18 or completion of studies, if later, for nondisabled children.

(ii) The benefit, when there is no relation as stated above, is equal to the remaining balance of accumulated contributions at the time of retirement after the deduction of lifetime annual income paid and is payable to a beneficiary or to the Member's estate. In no case shall the benefit be less than $1,000. The Commonwealth's General Fund pays the difference, up to $500, between (1) the accumulated fees, as defined, with interest less the lifetime annual income paid and (2) $1,000. The System pays for the rest.

*(d) Disability Benefits*

*(1) Non-occupational Disability*

Eligibility: All members are eligible for Non-occupational Disability upon 10 years of credited service and the occurrence of disability.

Benefit: 30% of average compensation, plus 1% of average compensation for each year of credited service in excess of 10 years, payable as an annuity; subject to a maximum of 50% of average compensation.

***(2) Occupational Disability***

Eligibility: All members disabled while in the course and as a consequence of their work, as certified by two physicians appointed by the Plan Administrator, and provided the member is receiving compensation from the Workmen's Accident Compensation Act.

Benefit: 50% of Salary at date of disability, payable as an annuity, reduced by any payments received from the State Insurance Fund under the Workmen's Accident Compensation Act.

***(e) Special Benefits***

***(1) Cost-of-Living Adjustments (COLA) to Pension Benefits***

Effective January 1, 2001, commencing January 1, 2002 and subsequently every three years thereafter, the annual benefit is increased by 3% for retirees and disabled members provided that the member had been receiving payments for at least three years.

These COLAs are paid by the Commonwealth's General Fund. In addition, an ad-hoc 3% COLA was granted effective January 1, 1999 and is paid by the System.

***(2) Special "Bonus" Benefits***

(i) ***Christmas Bonus (Act No. 144)***: An annual bonus of $600 for each retiree, beneficiary, and disabled member paid in December provided the judge was hired before December 24, 2013. The System pays $150 per retiree, beneficiary, and disabled member and the balance is paid by the Commonwealth's General Fund.

(ii) ***Summer Bonus (Act No. 37)***: An annual bonus of $100 for each retiree, beneficiary, and disabled member paid in July provided the judge was hired before December 24, 2013. The amount is prorated if there are multiple beneficiaries. This benefit is paid by the Commonwealth's General Fund.

(iii) ***Medication Bonus (Act No. 155)***: An annual bonus of $100 for each retiree, beneficiary, and disabled member to cover health costs paid in July provided the judge was hired before December 24, 2013. Evidence of coverage is not required. The amount is prorated if there are multiple beneficiaries. This benefit is paid by the Commonwealth's General Fund.

Judges hired on December 24, 2013 and thereafter are not eligible for these special "bonus" benefits.



(Continued)

*(f)* ***Contributions***

*(1)* ***Member Contributions***: Contributions by members are 8.0% of compensation if hired before December 24, 2013 and 10.0% of compensation if hired between December 24, 2013 and June 30, 2014.

*(2)* ***Employer Contributions:***

- ***Payroll-based Employer Contributions***: Contributions by the Commonwealth are 30.34% of compensation. Prior to July 1, 2008, the employer contribution rate was 20.0% of compensation.
- ***Additional Uniform Contribution (Act No. 162 of 2013)***: Beginning with the fiscal year 2015, the System will receive an additional uniform contribution as necessary to avoid having the projected gross assets of the System, during any subsequent fiscal year, to fall below $20 million.

***Pension Plan Provisions Applicable to Judges Hired on or after July 1, 2014 (Act No. 162 Members)***

Members hired on or after July 1, 2014 will be covered by a contributory, hybrid plan with defined benefit and defined contribution components as follows:

(a) Defined Benefit (DB) provisions:

- DB accrued benefit of 1.5% of the last 5-year final average earnings for each year of service.
- Only judicial service counts towards service; prior government service is not included and cannot be transferred.
- Normal retirement age of 65 with 12 years of service.
- Early retirement age of 55 with 12 years of service, with an actuarial reduction of the DB accrued benefit if benefits commence early.
- Deferred vested benefit after 12 years of service with benefits commencing at normal retirement age, provided member has not taken a lump sum withdrawal of DC component. Benefits may begin at early retirement age but would be reduced as specified above.
- The monthly DB component benefit will be paid as a single life annuity.

(b) Defined Contributions (DC) provisions:

- Member contributions of 12% of pay.
- The member contributions are credited to a notional account each year.
- Normal retirement age of 65 with 12 years of service.

- Early retirement age of 55 with 12 years of service.
- Members who separate from employment with less than 12 years of service would receive their notional account as a lump sum.
- Members who separate from employment with 12 or more years of service would receive their benefit in the form of a mandatory annuity.
- Members who separate at or after early or normal retirement age would receive an immediate annuity.
- Members who separate prior to early retirement age for reasons other than disability would receive a deferred annuity commencing at early or normal retirement age, with interest credits continuing to accrue to the account during the deferral period.
- The mandatory annuity would be in the form of a "modified cash refund" of the member's notional account balance – which means that if the accumulated annuity payments at the time of post-retirement death are less than the account balance at the time of retirement, then the beneficiary would receive the remainder of the account balance.

(c) The death and disability benefits for these members are as follows:

- Beneficiaries of members who die while actively employed would receive a lump sum payment of the members' accumulated account balance at the time of death. No monthly benefit would be payable.
- Upon disability after 5 years of service and before age 65, the disability benefit, payable immediately, equals the smaller of (1) 33% of last 5-year final average compensation or (2) the sum of the DB accrued benefit (without reduction for early commencement) and the annuity derived from an immediate annuitization of the DC notional account.

The contribution requirement to the System is established by law and is not actuarially determined. The special benefits contributions of approximately $1.2 million in 2014 represent contributions from the Commonwealth's General Fund for the special benefits identified above granted by special laws. 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.

***Other Postemployment Benefits (OPEB) – Healthcare Benefits***

JRS MIPC is a single-employer defined benefit other postemployment benefit plan sponsored by the Commonwealth. Its benefit covers a payment of up to $100 per month to the eligible medical insurance plan selected by the retiree or disabled member. JRS MIPC covers all judges of the Judiciary Branch of the Commonwealth. Plan members are eligible for benefits upon reaching the age of 60 with 10 years of service.

At July 1, 2013, the membership consisted of the following:

| | |
|---|---|
| Retirees | 430 |
| Current participating employees | 364 |
| Terminated vested participants, receiving benefits | 59 |
| Total membership | 853 |

The contribution requirement of JRS MIPC is established by Act No. 95 approved on June 29, 1963. This OPEB plan is financed by the Commonwealth on a pay-as-you-go basis. There is no contribution requirement from the plan member during active employment. Retirees contribute the amount of the healthcare insurance premium not covered by the Commonwealth contribution. As a result, these OPEB are 100% unfunded. During the year ended June 30, 2014, OPEB contributions amounted to $302,000.

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. Deficiencies in legislative appropriations are covered by the System's own funds until recovered through future legislative appropriations. Any surplus of legislative appropriations collected over healthcare benefits paid is combined with the assets held in trust for the payment of other pension benefits.

## (5) Net Pension Liability

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

| | | |
|---|---|---|
| Total pension liability | $ | 502,075 |
| Plan's fiduciary net position | | 46,067 |
| Net pension liability | $ | 456,008 |
| Plan's fiduciary net position as a percentage of the total pension liability | | 9.17% |

### *(a) Actuarial Methods and Assumptions*

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

The actuarial valuation used the following actuarial assumptions:

| | |
|---|---|
| Inflation | 2.50% |
| Investment rate of return | 5.35%, net of investment expenses, including inflation |
| Municipal bond index | 4.29%, as per Bond Buyer General Obligation 20-Bond Municipal Bond Index |
| Projected salary increases | 3.00% per year. No compensation increases are assumed until July 1, 2017 as a result of Act No. 66. |
| Mortality | Pre-retirement Mortality: RP-2000 Employee Mortality Rates with white collar adjustments for males and females, projected on a generational basis using Scale AA. As generational tables, it reflects mortality improvements both before and after the measurement date. |
| | Among deaths while in active service, 50% are assumed to be occupational and 50% are assumed to be nonoccupational. |
| | Post-retirement Healthy Mortality: RP-2000 Healthy Annuitant Mortality Rates with white collar adjustments for males and females, projected on a generational basis using Scale AA. As generational tables, it reflects mortality improvements both before and after the measurement date. |
| | Post-retirement Disabled Mortality: RP-2000 Disabled Annuitant Mortality Rates, without projection. No provision was made for future mortality improvement for disabled retirees. |

### *(b) Long-term Expected Rate of Return*

The long-term expected rate of return on pension benefits investments was determined in accordance with the asset allocation of the portfolio that was adopted by the Board during October 2014 and the actuary's capital market assumptions as of June 30, 2014. The long-term expected rate of return on pension benefits investments was 5.35% and 6.30% as of June 30, 2014 and 2013, respectively.

The pension plan's policy in regard to allocation of invested assets is established and may be amended by the Board. Plan assets are managed on a total return basis with a long-term objective of achieving and maintaining a fully funded status for the benefits provided through the pension plan.

The following was the Board's adopted asset allocation policy:

| Asset class | Target allocation | Long-term expected rate of return |
|---|---|---|
| Domestic equity | 18% | 6.8% |
| International equity | 7 | 7.6 |
| Fixed income | 74 | 3.9 |
| Cash | 1 | 2.9 |
| Total | 100% | |

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

For the year ended June 30, 2014, the annual money-weighted rate of return on pension plan investments, net of pension plan investment expenses, was 17.85%. The money-weighted rate of return expresses investment performance, net of investment expense, adjusted for the changing amounts actually invested.

### (c) *Date of Depletion and Discount Rate*

The asset basis for the date of depletion projection is the System's fiduciary net position. On this basis, the System's fiduciary net position is expected to be exhausted in the fiscal year 2018.

The System's fiduciary net position is not expected to be available to make all projected future benefit payments of current active and inactive members. Therefore, the discount rate for calculating the total pension liability is equal to the single equivalent rate that results in the same actuarial present value as the long-term expected rate of return applied to benefit payments, to the extent that the pension plan's fiduciary net position is projected to be sufficient to make projected benefit payments, and the tax free municipal bond index rate (Bond Buyer General Obligation 20-Bond Municipal Bond Index) applied to benefit payments, to the extent that the pension plan's fiduciary net position is not projected to be sufficient. The discount rate was 4.30% as of June 30, 2014.

The June 30, 2014, actuarial valuation reflects an increase of approximately $7.6 million in the total pension liability as a result of the changes in assumptions related to the change in the discount rate as required by GASB Statement No. 67 and a decrease of approximately $1.7 million in the total pension liability as a result of differences between expected and actual experience.

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

The following presents the net pension liability calculated using the discount rate of 4.30%, as well as what it would be if it were calculated using a discount rate of 1 percentage-point lower (3.30%) or 1 percentage-point higher (5.30%) than the current rate (dollars in thousands):

| | | 1% Decrease (3.30%) | Current discount rate (4.30%) | 1% Increase (5.30%) |
|---|---|---|---|---|
| Net pension liability | $ | 521,958 | 456,008 | 401,507 |

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

### *Cash and Cash Equivalents*

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

| | | Carrying amount | Depository bank balance | Amount uninsured and uncollateralized |
|---|---|---|---|---|
| Deposits with GDB | $ | 2,434 | 2,434 | 2,434 |
| Deposits with GDB held by the Puerto Rico Department of Treasury | | 709 | 1,947 | 1,947 |
| Money market funds | | 2,545 | N/A | N/A |
| Total | $ | 5,688 | 4,381 | 4,381 |

N/A= Not applicable.

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the System may not be able to recover deposits or collateral securities that are in the possession of an outside party. The Commonwealth requires that public funds deposited in commercial banks in Puerto Rico be fully collateralized for the amount deposited in excess of the federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of the Commonwealth. Deposits with GDB and money market funds are uninsured and uncollateralized, as these entities are exempt from compliance with the collateralization requirement.

### *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, 2014:

#### *(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, 2014, investments were registered in the name of the System and were held in the possession of the System's custodian bank, except for securities lent. Securities lent are not exposed to custodial credit risk. Cash collateral received from lending transactions invested in short-term investments is exposed to custodial credit risk.

#### *(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. The System's investment policy limits the investment in corporate debt securities to the top ratings issued by nationally recognized statistical rating organizations. The policy requires the debt securities portfolio to maintain a minimum weighted average credit quality of either "A-" or better.

The credit quality ratings and fair value of bonds and notes and nonexchange commingled fixed income trust fund as of June 30, 2014 are as follows (in thousands):

| | | Rating (1) | | | | | |
|---|---|---|---|---|---|---|---|
| **Investment type** | | **AAA** | **AA+ to AA-** | **A+ to A-** | **BBB+ to BBB-** | **BB+ to BB-** | **Total** |
| Mortgage and asset-backed securities: | | | | | | | |
| Federal National Mortgage Association (FNMA) | $ | — | 1,639 | — | — | — | 1,639 |
| Federal Home Loan Mortgage Corporation (FHLMC) | | — | 1,835 | — | — | — | 1,835 |
| U.S. corporate bonds and notes | | — | — | 4,040 | 3,923 | 209 | 8,172 |
| Non U.S. corporate bonds | | — | 896 | 681 | 1,337 | — | 2,914 |
| Total bonds and notes | | — | 4,370 | 4,721 | 5,260 | 209 | 14,560 |
| Nonexchange commingled fixed income trust fund – SSgA Intermediate Fund (2) | | 409 | 450 | 1,305 | 1,332 | — | 3,496 |
| Total | $ | 409 | 4,820 | 6,026 | 6,592 | 209 | 18,056 |

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

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

Approximately $5 million of the total system investments consist of U.S. government and Government National Mortgage Association (GNMA) mortgage-backed securities, which carry no risk, therefore, not included within the above table.

The System invests in a U.S. fixed income fund which consists of shares of the State Street Global Advisor (SSgA) Intermediate U.S. Credit Index Non-Lending Fund (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, 2014, there are no investments in any one issuer that represent 5% or more of the System's net position.

### *(d) Interest Rate Risk*

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The System 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. The System is expected to achieve capital preservation and income generation by investing in a diversified portfolio of marketable, investment-grade, intermediate credit fixed-income securities.



(Continued)

The contractual maturity of investments as of June 30, 2014, is summarized below (in thousands). Expected maturities will differ from contractual maturities, because counterparties may have the right to call or prepay obligations with or without call or prepayment penalties.

| | Maturity (in years) | | | | |
|---|---|---|---|---|---|
| Investment type | Within 1 year | After 1 to 5 years | After 5 to 10 years | After 10 years | Total |
| Bonds and notes: | | | | | |
| U.S. government securities: | | | | | |
| U.S. Treasury notes | $ 1,013 | — | — | — | 1,013 |
| U.S. Treasury bonds | — | — | — | 242 | 242 |
| U.S. Treasury Inflaction-Proctected Securities (TIPS) | — | 500 | 1,766 | — | 2,266 |
| Mortgage and asset-backed securities: | | | | | |
| GNMA | — | — | — | 1,151 | 1,151 |
| FNMA | — | 7 | — | 1,632 | 1,639 |
| FHLMC | — | — | — | 1,835 | 1,835 |
| U.S. corporate bonds and notes | 750 | 1,558 | 2,563 | 3,301 | 8,172 |
| Non-U.S. corporate bonds | 203 | 1,129 | 520 | 1,062 | 2,914 |
| Total bonds and notes | 1,966 | 3,194 | 4,849 | 9,223 | 19,232 |
| Nonexchange commingled fixed income trust fund [1] – SSgA Intermediate Fund: | | | | | |
| U.S. | — | 2,284 | — | — | 2,284 |
| Non-U.S | — | 1,212 | — | — | 1,212 |
| Total bonds and notes and nonexchange commingled fixed income trust fund | $ 1,966 | 6,690 | 4,849 | 9,223 | 22,728 |
| Nonexchange commingled equity trust funds: | | | | | |
| U.S. – SSgA S&P 500 Fund | | | | | 25,962 |
| Non-U.S. – SSgA MSCI ACWI Ex USA Fund | | | | | 10,438 |
| Total nonexchange commingled equity trust funds | | | | | 36,400 |
| Total investments | | | | | $ 59,128 |

[1] Nonexchange commingled fixed income trust fund was classified based on effective duration.

### (e) *Foreign Currency Risk*

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

As of June 30, 2014, the composition of the underlying investments in the SSgA MSCI ACWI Ex USA Fund by country was as follows:

| Country | SSgA MSCI ACWI EX USA Fund |
|---|---|
| United Kingdom | 15% |
| Japan | 14 |
| Canada | 8 |
| France | 7 |
| Germany | 7 |
| Switzerland | 6 |
| Australia | 6 |
| China | 4 |
| Korea | 3 |
| Taiwan | 3 |
| Spain | 3 |
| Brazil | 2 |
| Hong Kong | 2 |
| Netherlands | 2 |
| South Africa | 2 |
| Sweden | 2 |
| Italy | 2 |
| Denmark | 1 |
| India | 1 |
| Mexico | 1 |
| Russia | 1 |
| Singapore | 1 |
| Others | 7 |
| Total | 100% |

**Nonexchange Commingled Trust Funds**

As of June 30, 2014, the System owned shares in the SSgA S&P 500 Flagship Securities Lending Fund (SSgA S&P 500 Fund), the SSgA MSCI ACWI Ex USA Non-Lending Fund (SSgA MSCI ACWI Ex USA Fund), and the SSgA Intermediate Fund as follows (in thousands):

| Fund name | Shares | Fair value |
|---|---|---|
| SSgA S&P 500 Fund | 59 | $ 25,962 |
| SSgA MSCI ACWI Ex USA Fund | 545 | 10,438 |
| SSgA Intermediate Fund | 122 | 3,496 |
| Total nonexchange commingled trust funds | | $ 39,896 |

The investment objective of the SSgA S&P 500 Fund is to approximate as closely as practicable, before expenses, the performance of the S&P 500 Index over the long term. Shares can be redeemed on a daily basis at NAV and have no redemption restrictions.

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

As of June 30, 2014, the investments underlying the SSgA S&P 500 Fund, SSgA MSCI ACWI Ex USA Fund, and the SSgA Intermediate Fund had the following sector allocations:

| Sector | SSgA S&P 500 Fund | SSgA MSCI ACWI Ex USA Fund |
|---|---|---|
| Information technology | 19% | 7% |
| Financials | 16 | 26 |
| Healthcare | 13 | 8 |
| Consumer discretionary | 12 | 11 |
| Industrials | 11 | 11 |
| Energy | 11 | 10 |
| Consumer staples | 10 | 10 |
| Materials | 3 | 8 |
| Utilities | 3 | 4 |
| Telecommunication services | 2 | 5 |
| Total | 100% | 100% |

| Sector | SSgA Intermediate Fund |
|---|---|
| Corporate – Industrial | 45% |
| Corporate – Finance | 30 |
| Non Corporates | 21 |
| Corporate – Utility | 4 |
| Total | 100% |

**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 securities lent). At June 30, 2014, the collateral received represented 102% of the fair value of the total securities lent. Securities lent and collateral received as of June 30, 2014 are summarized as follows (in thousands):

**Securities Lent**

| Description | | Fair value of underlying securities |
|---|---|---|
| U.S. government securities: | | |
| U.S. Treasury bonds | $ | 242 |
| U.S. Treasury Inflation-Protected Securities (TIPS) | | 568 |
| Total | $ | 810 |

**Collateral Received**

| Description | | Fair value of underlying securities |
|---|---|---|
| Certificates of deposit | $ | 580 |
| Commercial paper | | 247 |
| Total | $ | 827 |

Cash collateral received from securities lending transaction invested in short-term investments is exposed to custodial credit risk. Under the terms of the securities lending agreement, the System is fully indemnified against failure of the borrowers to return the securities lent (to the extent the collateral is inadequate to replace the securities lent) or failure to pay the System for income distributions by the securities' issuers while the securities are on loan. In addition, the System is indemnified against loss should the lending agent fail to demand adequate and appropriate collateral on a timely basis.

## (7) Member Loans and Interest Receivable

Loans and interest receivable from plan members are substantially 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 deductions. 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 composition of loans and interest receivable from plan members as of June 30, 2014 is summarized as follows (in thousands):

| | | |
|---|---|---|
| Member loans receivable: | | |
| Personal | $ | 360 |
| Mortgage | | 100 |
| Cultural trips | | 58 |
| Total member loans receivable | | 518 |
| Accrued interest receivable | | 24 |
| Total member loans and interest receivable | $ | 542 |

## (8) Other Postemployment Healthcare Benefits Funded Status and Funding Progress

The System's other postemployment healthcare benefits (OPEB) funded status as of June 30, 2014, the most recent actuarial valuation date, is as follows (dollars in thousands):

| Actuarial value of plan assets | Actuarial Accrued Liability (AAL) | Unfunded Actuarial Accrued Liability (UAAL) | Funded ratio | Annual covered payroll | UAAL as a percentage of annual covered payroll |
|---|---|---|---|---|---|
| $ — | 6,540 | 6,540 | -% | $ 31,707 | 20.6% |

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

The census data collection date has changed from end-of-year to beginning-of-year. For this switchover year, the June 30, 2013 census data used in the prior valuation is also used as the July 1, 2013 census data for the current valuation. The liability results as of June 30, 2014 are based on projecting the System obligations determined as of the census data collection date of July 1, 2013 for one year, using roll-forward methods and assuming no liability gains or losses. In addition, the actuarial cost method was revised in fiscal year 2014 from projected unit credit (used on the actuarial valuation for fiscal years 2013 and before) to the entry age normal method to conform to the requirements of pension benefits.

The actuarial valuations used the following actuarial assumptions:

| | Measurement Date June 30, 2014 |
|---|---|
| Actuarial cost method | Entry age normal with normal costs as level percentage of pay |
| Amortization method | 30 years closed, level percentage of payroll |
| Remaining amortization period | 12 years |
| Asset valuation method | Not applicable |
| Actuarial assumptions: | |
| Investment rate of return | 3.10% |
| Projected salary increases | Not applicable |
| Projected payroll growth | Not applicable |
| Inflation | 0% until June 30, 2017; 3% thereafter |

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

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

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

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

## (9) Guarantee Insurance Reserve for Member Loans

The System provides life insurance that guarantees the payment of the outstanding principal balance of mortgage, personal, and cultural trip loans in case of death of a plan member. This coverage is paid in its entirety by the plan members who obtain these loans from the System. The life insurance rates are actuarially determined and do not vary by age, sex, or health status.

## (10) Contingencies

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

## (11) Subsequent Events

Subsequent events were evaluated through May 20, 2016, the date the financial statements were available to be issued, to determine if such events should be recognized or disclosed in the 2014 financial statements.

On April 6, 2016, the Governor of Puerto Rico signed into law the Puerto Rico Emergency Moratorium and Rehabilitation Act ("Act No. 21"). Among other objectives, Act No. 21 allows the Governor to declare – at some point in the future – a moratorium on debt service payments and to stay related creditor remedies for a temporary period for the Commonwealth, the GDB, the Economic Development Bank for Puerto Rico, and certain additional government instrumentalities in Puerto Rico, including the System. The temporary period set forth in Act No. 21 lasts until January 31, 2017, with a possible two-month extension in the Governor's discretion. The provisions regarding the moratorium and stay in respect of any obligations owed by the System require executive action of the Governor to become effective. At this time, the Governor has not taken any executive action in respect of the System, and Act No. 21 does not currently affect the System's obligations, including to make debt service payments.

On April 8, 2016, the Governor of Puerto Rico signed an executive order, EO-2016-010 (the "Executive Order"), declaring GDB to be in a state of emergency pursuant to Act No. 21. The Executive Order, in accordance with the emergency powers provided for in Act No. 21, implemented a regulatory framework governing GDB's operations and liquidity, including establishing a procedure with respect to governmental withdrawals, payments, and transfer requests in respect of funds held on deposit at GDB and loan disbursements by GDB. The procedures implemented by the Executive Order may result in restrictions on the ability of the System to withdraw any funds held on deposit at GDB or to receive any disbursements on loans granted by GDB during the period of the Executive Order, which is in effect until June 30, 2016. However, while the Executive Order created a stay on the enforcement of certain financial debt obligations of GDB, it did not impose a moratorium on any financial debt obligation of GDB. The Executive Order did not declare an emergency period for the Commonwealth itself, the System or any other entity, other than GDB.

# REQUIRED SUPPLEMENTARY INFORMATION

**RETIREMENT SYSTEM FOR THE JUDICIARY**
**OF THE COMMONWEALTH OF PUERTO RICO**
(A Component Unit of the Commonwealth of Puerto Rico)

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

(Unaudited)

Year Ended June 30, 2014

(Dollars in thousands)

| | | Amount |
|---|---|---|
| Total pension liability: | | |
| Service cost | $ | 16,764 |
| Interest | | 22,620 |
| Changes in benefit terms | | — |
| Differences between expected and annual experience | | (1,658) |
| Changes in assumptions | | 7,601 |
| Benefit payments, including refunds of member contributions | | (22,667) |
| Net change in total pension liability | | 22,660 |
| Total pension liability – beginning | | 479,415 |
| Total pension liability – ending (a) | | 502,075 |
| Plan's fiduciary net position: | | |
| Employer contributions | | 11,992 |
| Member contributions | | 3,804 |
| Net investment income | | 9,713 |
| Other income | | 59 |
| Benefit payments, including refunds of contributions | | (22,667) |
| Administrative and other expenses | | (2,150) |
| Net change in plan fiduciary net position | | 751 |
| Total fiduciary net position – beginning, as restated | | 45,316 |
| Total fiduciary net position – ending (b) | | 46,067 |
| Employer's net pension liability – ending (a)-(b) | $ | 456,008 |
| Plan's fiduciary net position as a percentage of the total pension liability | | 9.17% |
| Covered - employee payroll | $ | 31,707 |
| Employer's net pension liability as a percentage of covered - employee payroll | | 1,438.19% |

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

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

**RETIREMENT SYSTEM FOR THE JUDICIARY**
**OF THE COMMONWEALTH OF PUERTO RICO**
(A Component Unit of the Commonwealth of Puerto Rico)

Schedule of the Employer's Contributions - Pension Benefits

Last Seven Fiscal Years

(Dollars in thousands)

| | | 2014 | 2013 | 2012 | 2011 | 2010 | 2009 | 2008 |
|---|---|---|---|---|---|---|---|---|
| Actuarially determined contribution | $ | 40,758 | 38,501 | 33,544 | 29,684 | 28,127 | 22,195 | 19,803 |
| Contributions in relation to actuarially determined contribution (a) | | 11,992 | 11,402 | 11,466 | 11,012 | 11,045 | 11,132 | 7,262 |
| Contribution deficiency | $ | 28,766 | 27,099 | 22,078 | 18,672 | 17,082 | 11,063 | 12,541 |
| Covered - employee payroll (b) | $ | 31,707 | 32,138 | 33.066 | 31.811 | 32,061 | 30.587 | N/D |
| Contribution as a percentage of covered - employee payroll (a)/(b) | | 37.82% | 35.48% | 34.68% | 34.62% | 34.45% | 36.39% | N/D |

N/D = Not determined.

Note: The contribution requirement to the System is established by law and is not actuarially determined. Schedule is intended to show information for ten years. Additional years will be displayed as they become available.

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

**RETIREMENT SYSTEM FOR THE JUDICIARY**
**OF THE COMMONWEALTH OF PUERTO RICO**
(A Component Unit of the Commonwealth of Puerto Rico)

Schedule of Investment Return - Pension Benefits (Unaudited)

Year Ended June 30, 2014

| | |
|---|---|
| Annual money-weighted rate of return, net of investment expenses | 17.85% |

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

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

**RETIREMENT SYSTEM FOR THE JUDICIARY**
**OF THE COMMONWEALTH OF PUERTO RICO**
(A Component Unit of the Commonwealth of Puerto Rico)

Schedule of Employer's Contributions - OPEB (Unaudited)

(Dollars in thousands)

| Fiscal year ended | Annual required contributions | Actual employer's contributions | Percentage of contribution |
|---|---|---|---|
| June 30, 2014 [1] | $ 684 | $ 302 | 44.1% |
| June 30, 2013 | 643 | 291 | 45.3 |
| June 30, 2012 | 554 | 294 | 53.1 |
| June 30, 2011 | 529 | 253 | 47.8 |
| June 30, 2010 | 488 | 256 | 52.5 |
| June 30, 2009 | 425 | 234 | 55.1 |

[1] The System's annual required contribution for the year ended June 30, 2014 was determined by the actuarial valuation as of June 30, 2013 that was updated to roll forward the funded status to June 30, 2014 and assuming no liability gains or losses.

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

**RETIREMENT SYSTEM FOR THE JUDICIARY**
**OF THE COMMONWEALTH OF PUERTO RICO**

(A Component Unit of the Commonwealth of Puerto Rico)

Schedule of Funding Progress - OPEB (Unaudited)

(Dollars in thousands)

| Actuarial valuation date | Actuarial value of plan assets | Actuarial Accrued Liability (AAL) | Unfunded Actuarial Accrued Liability (UAAL) | Funded ratio | Annual covered payroll | UAAL percentage of annual covered payroll |
|---|---|---|---|---|---|---|
| June 30, 2014 [1] | $ — | $ 6,540 | $ 6,540 | —% | $ 31,707 | 20.6% |
| June 30, 2013 | — | 6,705 | 6,705 | — | 32,138 | 20.9 |
| June 30, 2012 | — | 6,592 | 6,592 | — | 33,066 | 19.9 |
| June 30, 2011 | — | 5,810 | 5,810 | — | 31,811 | 18.3 |
| June 30, 2010 | — | 5,808 | 5,808 | — | 32,061 | 18.1 |
| June 30, 2009 | — | 5,643 | 5,643 | — | 30,587 | 18.5 |

[1] The System's OPEB funded status as of June 30, 2014 was determined by the actuarial valuation as of June 30, 2013 that was updated to roll forward the funded status to June 30, 2014 and assuming no liability gains or losses.

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

***Pension Benefits***

***Changes in Benefits Terms***

On December 24, 2013, the Governor of Puerto Rico signed into law Act No. 162 of 2013 (Act No. 162). The Act included various changes applicable to all participants and retirees, as modified by the February 21, 2014 decision of the Puerto Rico Supreme Court which limited the effect of the reform as follows:

1. Members hired prior to December 24, 2013 maintain the existing benefits.

2. Members hired from December 24, 2013 to June 30, 2014 will accrue a maximum pension of 60% of salary and will contribute 10% of salary. In addition, the Christmas bonus, summer bonus and medication bonus were eliminated.

3. Members hired on or after July 1, 2014 will be covered by a contributory, hybrid plan with defined benefit and defined contribution components as follows:

   (a) Defined Benefit (DB) Provisions:

   - DB accrued benefit of 1.5% of the last 5-year final average earnings for each year of service.
   - Only judicial service counts towards service; prior government service is not included and cannot be transferred.
   - Normal retirement age of 65 with 12 years of service.
   - Early retirement age of 55 with 12 years of service, with an actuarial reduction of the DB accrued benefit if benefits commence early.
   - Deferred vested benefit after 12 years of service with benefits commencing at normal retirement age, provided member has not taken a lump sum withdrawal of DC component. Benefits may begin at early retirement age but would be reduced as specified above.
   - The monthly DB component benefit will be paid as a single life annuity.

   (b) Defined Contributions (DC) Provisions:

   - Member contributions of 12% of pay.
   - The member contributions are credited to a notional account each year.
   - Normal retirement age of 65 with 12 years of service.
   - Early retirement age of 55 with 12 years of service.
   - Members who separate from employment with less than 12 years of service would receive their notional account as a lump sum.



(Continued)

- Members who separate from employment with 12 or more years of service would receive their benefit in the form of a mandatory annuity.
- Members who separate at or after early or normal retirement age would receive an immediate annuity.
- Members who separate prior to early retirement age for reasons other than disability would receive a deferred annuity commencing at early or normal retirement age, with interest credits continuing to accrue to the account during the deferral period.
- The mandatory annuity would be in the form of a "modified cash refund" of the member's notional account balance – which means that if the accumulated annuity payments at the time of post-retirement death are less than the account balance at the time of retirement, then the beneficiary would receive the remainder of the account balance.

(c) The death and disability benefits for these members are as follows:

- Beneficiaries of members who die while actively employed would receive a lump sum payment of the members' accumulated account balance at the time of death. No monthly benefit would be payable.
- Upon disability after 5 years of service and before age 65, the disability benefit, payable immediately, equals the smaller of (1) 33% of last 5-year final average compensation or (2) the sum of the DB accrued benefit (without reduction for early commencement) and the annuity derived from an immediate annuitization of the DC notional account.

In addition, Section 17 of Act No. 162 enacted an additional employer contribution. Beginning with fiscal year 2015, the System will receive an additional contribution as necessary to avoid having the projected gross assets of the System, during any subsequent fiscal year, to fall below $20 million. The System shall commission an actuarial evaluation to determine an annual additional contribution. The first annual additional contribution which corresponds to fiscal year 2015 was determined at $11.6 million and due by June 30, 2015.

***Changes in Assumptions***

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

Due to the change in the census collection date to the beginning of the fiscal year, rather than the end of the fiscal year, demographic gain/loss during the year is limited to the difference between actual and expected benefit payments, which arise from differences in termination and retirement activity and mortality versus expectations. In fiscal year 2014, this difference resulted in a gain of $1.7 million.

Under GASB Statements No. 25 and No. 27, the investment return assumption was used to discount all projected Basic System Pension Benefits and System Administered Pension Benefits to determine the Actuarial Accrued Liability. Under GASB Statement No. 67, the investment return assumption is an input that is used in the



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calculation of the single equivalent interest rate that is used to discount these benefits to determine the Total Pension Liability.

The asset basis for the date of depletion projection is the System's fiduciary net position. On this basis, the System's fiduciary net position is expected to be exhausted in the fiscal year 2018.

In addition, the date of depletion projection of the actuarial report does not include any amounts from the additional uniform contribution required by Act No. 162 because of actual fiscal and budgetary financial difficulties with continued budget deficits and liquidity risks of the Commonwealth, and in the event that their financial condition does not improve in the near term.

The System's fiduciary net position is not expected to be available to make all projected future benefit payments of current active and inactive members. Therefore, the discount rate for calculating the total pension liability is equal to the single equivalent rate that results in the same actuarial present value as the long-term expected rate of return applied to benefit payments, to the extent that the plan's fiduciary net position is projected to be sufficient to make projected benefit payments, and the tax free municipal bond index rate (Bond Buyer General Obligation 20-Bond Municipal Bond Index) applied to benefit payments, to the extent that the plan's fiduciary net position is not projected to be sufficient. The discount rates used to determine the annual required contribution and the total pension liability decreased from 6.30% at June 30, 2013 to 4.30% at June 30, 2014. For fiscal years 2008 to 2010 and for fiscal years 2011 and 2012, the discount rates were 7.50%, 6.60% and 6.10%, respectively.

Also, the fiscal year valuation reflects a salary freeze until July 1, 2017 due to Act No. 66.

***Changes in Actuarial Methods since the Prior Valuation***

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

The June 30, 2014 actuarial valuation reflects an increase of approximately $7.6 million in the total pension liability as a result of the changes in assumptions as required by GASB Statement No. 67.



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

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

| | |
|---|---|
| Asset valuation method | Market value of assets |
| Inflation | 2.50% |
| Investment rate of return | 5.35%, net of investment expenses, including inflation |
| Municipal bond index | 4.29%, as per Bond Buyer General Obligation 20-Bond Municipal Bond Index |
| Discount rate | 4.30% |
| Projected salary increases | 3.00% per year. No compensation increases are assumed until July 1, 2017 as a result of Act No. 66. |
| Mortality | Pre-retirement Mortality:<br>RP-2000 Employee Mortality Rates with white collar adjustments for males and females, projected on a generational basis using Scale AA. As generational tables, it reflects mortality improvements both before and after the measurement date.<br><br>Among deaths while in active service, 50% are assumed to be occupational and 50% are assumed to be nonoccupational.<br><br>Post-retirement Healthy Mortality:<br>RP-2000 Healthy Annuitant Mortality Rates with white collar adjustments for males and females, projected on a generational basis using Scale AA. As generational tables, it reflects mortality improvements both before and after the measurement date.<br><br>Post-retirement Disabled Mortality:<br>RP-2000 Disabled Annuitant Mortality Rates, without projection. No provision was made for future mortality improvement for disabled retirees. |