



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

(A Component Unit of the Commonwealth of Puerto Rico)

Basic Financial Statements and Required Supplementary Information

June 30, 2015

(With Independent Auditors' Report Thereon)

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Independent Auditors' Report

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

We have audited the accompanying financial statements of the Employees' Retirement System of the Government of the Commonwealth of Puerto Rico (the System), which comprise the statement of fiduciary net position as of June 30, 2015, 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 Employees' Retirement System of the Government of the Commonwealth of Puerto Rico as of June 30, 2015, and the changes in its fiduciary net position for the year then ended, in accordance with U.S. generally accepted accounting principles.

**Emphasis of Matters***Uncertainty about Ability to Continue as a Going Concern*

The accompanying financial statements have been prepared assuming that the System will continue as a going concern. As discussed in notes 3 and 14 to the basic financial statements on May 3, 2017 and May 22, 2017, the Oversight Board commenced cases for the Commonwealth of Puerto Rico and the System, respectively, by filing petitions for relief under Title III of the Puerto Rico Oversight, Management, and Economic Stability Act with the United States District Court for Puerto Rico. The fiscal and financial difficulties of the Commonwealth of Puerto Rico and the System causes management to conclude that there is substantial doubt about the System's ability to continue as a going concern.

Other Matters*Required Supplementary Information*

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

KPMG LLP

San Juan, Puerto Rico
February 19, 2018

Stamp No. E304053 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.

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Management's Discussion and Analysis (Unaudited)

June 30, 2015

Introduction

The following discussion and analysis of the financial performance of the Employees' Retirement System of the Government of the Commonwealth of Puerto Rico (the System) provides an overview of its activities for the fiscal year ended June 30, 2015. Its purpose is to provide explanations and insights into the information presented in 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 1951 pursuant to Act No. 447 of May 15, 1951, as amended, to provide pension and other benefits to retired employees of the Commonwealth, its public corporations and municipalities of Puerto Rico.

The System administers a cost-sharing, multi-employer, pension plan (the pension plan) that consists of three benefit structures: (i) a cost-sharing, multi-employer, defined benefit program, (ii) a defined contribution program (System 2000 program), and (iii) a contributory hybrid program. 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.

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Required Supplementary Information is presented after the notes to the basic financial statements. Such information, although not a part of the basic financial statements, is required by the GASB. It consists of information pertaining to the System's actuarial methods and assumptions and provides data on changes in the employers' net pension liability and related ratios, the pension benefits employers' contributions, and the pension benefits' investment return as well as data on the System's other postemployment benefits.

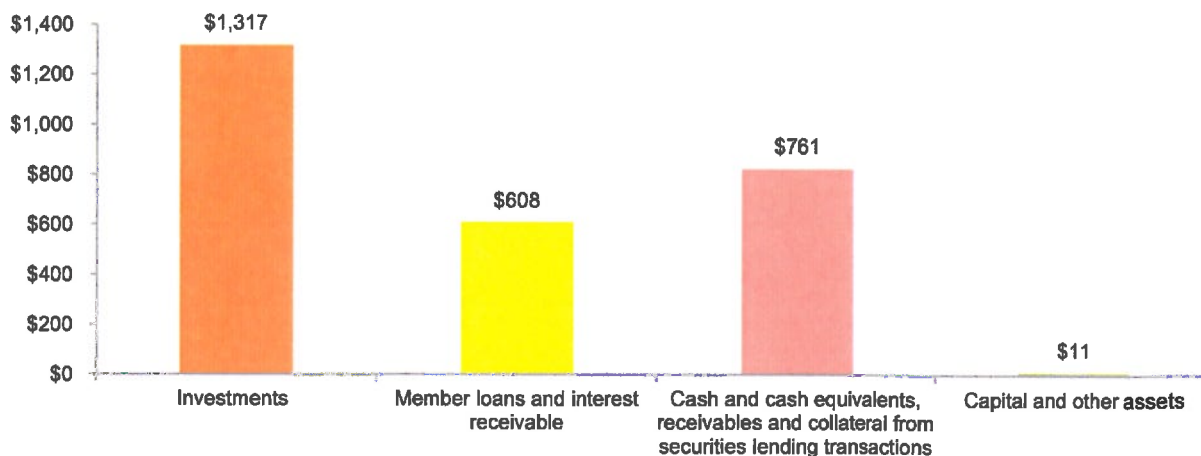
Financial Highlights

The System provides retirement benefits to employees of the Commonwealth. The System's total assets as of June 30, 2015 and 2014 amounted to approximately \$2,697 million and \$3,431 million, respectively.

As of June 30, 2015, the System's total assets consisted of the following:

- \$1,263 million of investments in bonds, stocks and nonexchange commingled trust funds
- \$54 million in investments in limited partnerships
- \$608 million in member loans and interest receivable
- \$761 million in cash and cash equivalents, receivables and collateral from securities lending transactions.
- \$11 million in capital and other assets

The System's total assets as of June 30, 2015 are presented in the following chart (in millions):



As of June 30, 2014, the System's total assets consisted of the following:

- \$2,088 million of investments in bonds, stocks and nonexchange commingled trust funds
- \$54 million in investments in limited partnerships
- \$619 million in member loans and interest receivable

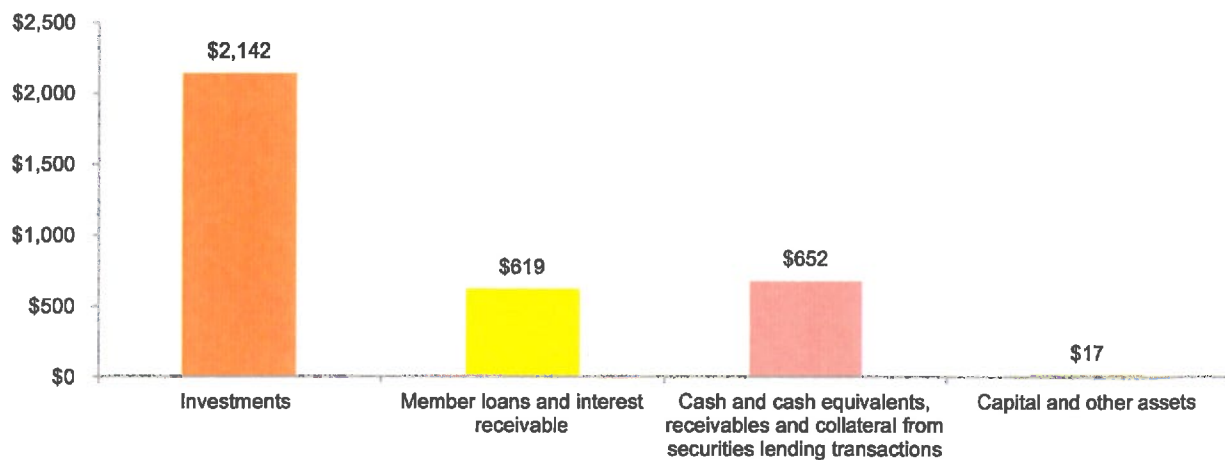
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- \$652 million in cash and cash equivalents, receivables and collateral from securities lending transactions.
- \$17 million in capital and other assets

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



- The System is in a deficit position since fiscal year 2015. The System's total liabilities exceeded total assets, representing a fiduciary net deficit position of approximately \$668 million as of June 30, 2015, compared with fiduciary net position of approximately \$81 million (total assets exceeded total liabilities) as of June 30, 2014.
- The plan's fiduciary net deficit position as a percentage of the total pension liability was negative 2.05% at June 30, 2015 and 0.27% at June 30, 2014.
- The medical insurance plan contribution, which constitutes the other postemployment healthcare benefits, is financed by the Commonwealth on a pay-as-you-go basis and consequently is unfunded.

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The following schedules present comparative summary financial statements of the System's fiduciary net position and changes in fiduciary net position for fiscal years 2015 and 2014:

Comparative Summary of Fiduciary Net Position – Pension Benefits

	<u>2015</u>	<u>2014</u>	<u>Total dollar change</u>	<u>Total percentage change</u>
	(Dollars in thousands)			
Assets:				
Cash and cash equivalents, receivables-net and collateral from securities lending transactions	\$ 761,235	652,360	108,875	16.7 %
Investments	1,316,611	2,142,022	(825,411)	(38.5)
Member loans and interest receivable – net	607,617	619,379	(11,762)	(1.9)
Capital assets and other	11,306	16,906	(5,600)	(33.1)
Total assets	<u>2,696,769</u>	<u>3,430,667</u>	<u>(733,898)</u>	<u>(21.4)</u>
Liabilities:				
Accounts payable and accrued liabilities	9,329	12,236	(2,907)	(23.8)
Bond interest payable	13,876	13,876	—	—
Payable for investment securities purchased	7,754	19,009	(11,255)	(59.2)
Securities lending obligations	80,071	126,648	(46,577)	(36.8)
Due to Commonwealth of Puerto Rico	76,613	37,082	39,531	106.6
Escrow funds of mortgage loans and guarantee insurance reserve for loans to plan members	10,212	7,895	2,317	29.3
Bonds payable	3,105,448	3,077,587	27,861	0.9
Other liabilities	61,738	55,668	6,070	10.9
Total liabilities	<u>3,365,041</u>	<u>3,350,001</u>	<u>15,040</u>	<u>0.4</u>
Net position (deficit)	<u>\$ (668,272)</u>	<u>80,666</u>	<u>(748,938)</u>	<u>(928.4)%</u>

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Comparative Summary of Changes in Fiduciary Net Position – Pension Benefits

	<u>2015</u>	<u>2014</u>	<u>Total dollar change</u>	<u>Total percentage change</u>
		(Dollar in thousands)		
Additions:				
Contributions:				
Employer contributions:				
Basic benefits	\$ 479,911	485,114	(5,203)	(1.1)%
Special benefits	186,136	228,699	(42,563)	(18.6)
Member contributions	339,650	359,862	(20,212)	(5.6)
Net investment income	29,258	225,005	(195,747)	(87.0)
Other income	28,499	30,748	(2,249)	(7.3)
Total additions	<u>1,063,454</u>	<u>1,329,428</u>	<u>(265,974)</u>	<u>(20.0)</u>
Deductions:				
Benefits paid to participants	1,541,324	1,548,423	(7,099)	(0.5)
Refunds of contributions	31,351	166,335	(134,984)	(81.2)
Interest on bonds payable	194,400	192,947	1,453	0.8
General and administrative	33,623	29,530	4,093	13.9
Other expenses	11,694	26,584	(14,890)	(56.0)
Total deductions	<u>1,812,392</u>	<u>1,963,819</u>	<u>(151,427)</u>	<u>(7.7)</u>
Net decrease in net position	(748,938)	(634,391)	(114,547)	18.1
Net position (deficit):				
Beginning of year	<u>80,666</u>	<u>715,057</u>	<u>(634,391)</u>	<u>(88.7)</u>
End of year	\$ <u>(668,272)</u>	<u>80,666</u>	<u>(748,938)</u>	<u>(928.4)%</u>

Going Concern Uncertainty of the System

The discussion in note 3 to the financial statements provides information regarding the System's going concern uncertainty.

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The System is a mature retirement system with a significant retiree population. The System's net pension liability and the fiduciary net deficit position as a percentage of the total pension liability (the funded ratio) as of June 30, 2015, are approximately \$33,337 million and negative 2.05%, respectively. The System is in a deficit position since fiscal year 2015. Based on the statutory funding requirements, the annual benefit payments and administrative expenses paid by the System were significantly larger than the member and employers' contributions to the System. Due to the small asset base, investment income was insufficient to cover the negative cash flow. Illiquid assets (employers' account receivable, net, member loans and related interest receivable, COFINA investment and investments in limited partnerships) amounted to approximately \$997 million or 36% of the System total assets as of June 30, 2015. Because of the System's liquidity issues, it may be forced to sell illiquid assets, specifically member loans, potentially at significant loss to further detriment of the System.

As described in notes 3 and 14 to the financial statements, in July 2017, the System sold investments amounting to approximately \$297 million and started operating on a "pay as you go" basis, which means that the System would be unable to pay benefits that exceed the actual employer and member contributions received (net of administrative and other expenses), from the Commonwealth.

The System's funding requirements, together with the funding requirements of the Retirement System for the Judiciary of the Commonwealth of Puerto Rico (JRS) and the Puerto Rico System of Annuities and Pensions for Teachers (TRS), 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 and the other participating employers have been facing significant 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 June 30, 2014 financial statements of the Commonwealth disclosed that there is substantial doubt about the Commonwealth ability to continue as a going concern.

On May 2, 2017, the legal shield (stay of the debt) granted by the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) protecting the Commonwealth from debt-related lawsuits expired. On May 3, 2017, the Commonwealth filed a petition for protection under Title III of PROMESA to ensure the essential services to the public, the payment of the government payroll and the suppliers.

If the Commonwealth's financial condition does not improve as a result of fiscal and budgetary measures it is taking, its ability to repay its obligations, including its regular employer contributions to the System and its additional contribution as provided by Act No. 32 of 2013 (Act No. 32), for the upcoming years, may continue to be adversely affected, and could also affect the payment of benefits and the repayment of the System's bonds payable.

Comparative Summary of Fiduciary Net Position Analysis – Pension Benefits

The basic financial statements of the System for the fiscal year ended June 30, 2015, present a decrease in net position of approximately \$749 million, resulting in a net deficit position of approximately \$668 million as of June 30, 2015, compared with a net position of approximately \$81 million as of June 30, 2014. The decrease in the net position in the fiscal year 2015 resulted from the excess of deductions, mainly benefits paid to

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participants, over additions, mainly contributions from participating employers and employees. The decrease in net position mainly caused a decrease in investments of approximately \$825 million in fiscal year 2015.

Total contributions from participating employers and members increased by approximately \$60 million, from \$1,074 million during fiscal year 2014 to approximately \$1,005 million during fiscal year 2015. Total net investment and securities lending transaction income decreased by approximately \$192 million, from approximately \$225 million during fiscal year 2014 to approximately \$33 million during fiscal year 2015. The System recognized a net depreciation in the fair value of investments of approximately \$46 million during 2015, compared with a net appreciation in the fair value of investments of approximately \$125 million recognized in 2014. Also, the System recognized an impairment loss on deposits with a governmental bank of approximately \$3 million in fiscal year 2015 (refer to note 6 to the financial statements).

Total deductions decreased by approximately \$152 million in fiscal year 2015, mainly as a result of the decrease of approximately \$135 million in the refunds of contributions paid to participating employees who resigned in 2014 mainly as a result of implementation of Act No. 3 of 2013 (Act No. 3) and the decrease of approximately \$7 million in benefits paid to participants. Benefits paid to participants amounted to approximately \$1,541 million for the fiscal year 2015 and approximately \$1,548 million for the fiscal year 2014. Refunds of contributions amounted to approximately \$31 million for the fiscal year 2015 and approximately \$166 million for the fiscal year 2014.

During fiscal year 2007, the Board of Trustees approved the issuance of bonds payable to increase the funds available to pay pension benefits to certain beneficiaries and to reduce the unfunded accrued actuarial liability. As of June 30, 2015, bonds payable amounted to approximately \$3,105 million.

Other Postemployment Healthcare Benefits

Other postemployment healthcare benefits paid during the fiscal year 2015 amounted to approximately \$97 million, a decrease of approximately \$5 million or 5% when compared to the \$102 million paid during fiscal year 2014. Effective July 1, 2013, no benefits are provided to new retirees, as required by Act No. 3.

Financial Analysis of the System

As of June 30, 2015 and 2014, the System held approximately \$608 million and \$619 million, respectively, in loans and interest receivable from plan members, which represents 32% and 22%, respectively, of the total investment portfolio, including loans. As of June 30, 2015, member loans and interest receivable consisted of \$171 million in mortgage loans, \$360 million in personal loans, \$41 million in cultural trips loans, and \$37 million in interest receivable, less \$2 million in allowance for adjustments and losses in realization. As of June 30, 2014, member loans and interest receivable consisted of approximately \$164 million in mortgage loans, approximately \$374 million in personal loans, \$45 million in cultural trips loans, and \$40 million in interest receivable, less approximately \$4 million in allowance for adjustment and losses in realization. As of June 30, 2015 and 2014, the fair value of the System's investment in limited partnerships amounted to approximately \$54 million, which represented approximately 4% and 3% of the investment portfolio, as of June 30, 2015 and 2014, respectively.

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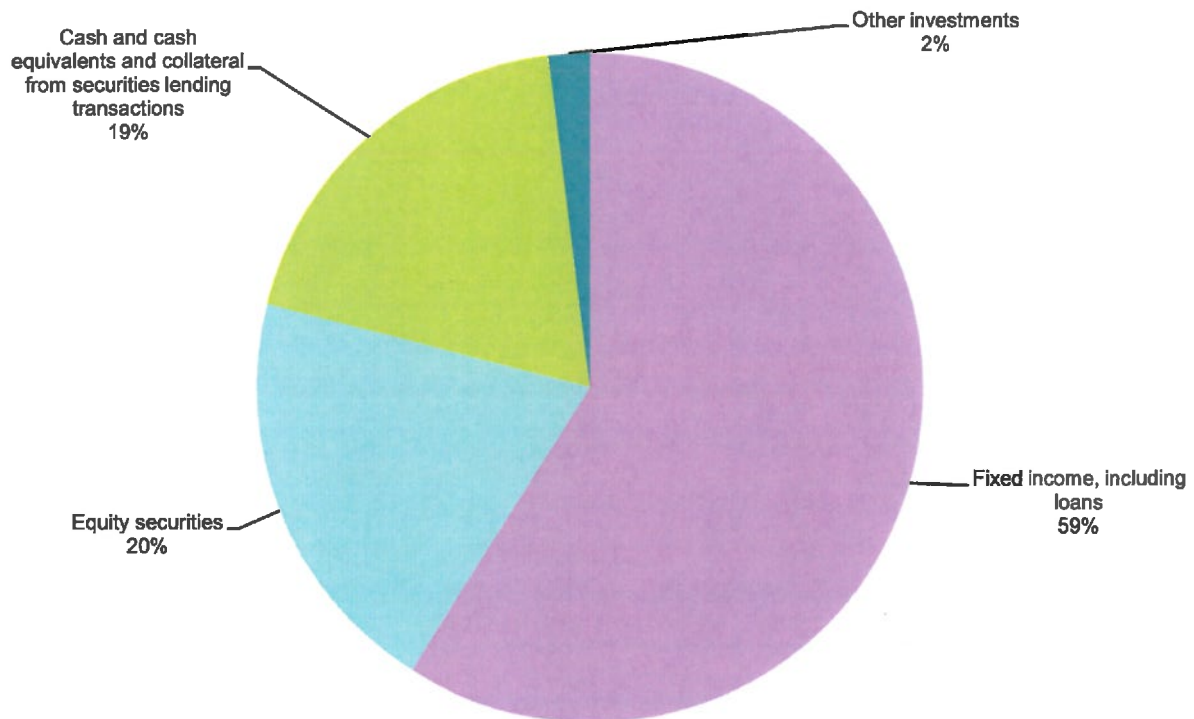
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The System earns additional investment income by lending investment securities to brokers via its custodian's securities lending program. The brokers provide collateral to the System and generally use the borrowed securities to cover short sales and failed trades. The cash collateral received from the brokers is invested in a short-term investment fund in order to earn interest. For the years ended June 30, 2015 and 2014, net income from the securities lending activity amounted to approximately \$165,000 and \$298,000, respectively.

Investment Portfolio and Capital Markets Overview

The System's total investment assets, including member loans, collateral from securities lending transactions and cash and cash equivalents (investment portfolio, including loans), as of June 30, 2015 totaled approximately \$2,367 million. Member loans amounted to \$608 million as of June 30, 2015.

As of June 30, 2015, the System's investment portfolio allocation, including member loans, was 59% in fixed-income investments, including loans receivable, 20% in equity securities, 19% in cash and short-term investments, and 2% in other investments as shown in the following chart:



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Economy and Capital Markets Overview

Following two consecutive fiscal years posting double-digit returns, the 2015 fiscal year faced headwinds across global markets. Overall, U.S. equity markets fared better than markets overseas supported by strong economic data. European markets suffered from a weakening economy as both French and German GDP growth reports indicated a sharp slowdown. The European Central Bank (ECB) also cut its benchmark lending rate to 0.15% from 0.25% in June 2014 and went further in September 2014 to cut it to 0.05%. In October 2014, the Federal Reserve ended the third round of its quantitative easing program and provided a cautious stance on raising interest rates before gradually preparing markets for a rate hike. The United States (U.S.) markets continued to outperform buoyed by evidence that the recovery picked up pace in the closing months of 2014.

The beginning of 2015 saw a bounce back in international developed markets as the ECB introduced a long awaited Quantitative Easing program and would finally begin to buy sovereign European bonds at a rate of €60bn per month until September 2016. Emerging markets also showed some signs of stabilization following a particularly difficult period plagued by sharp falls in the price of oil and the strength in the dollar. During the 2015 Fiscal Year oil prices fell over 40% as measured by the WTI Cushing Spot due to oversupply and suppressed levels of demand. Additionally, the U.S. dollar appreciated drastically relative to most currencies, rallying roughly 25% over the first nine-months of the 2015 Fiscal Year.

With continued economic growth and general support from the Fed, domestic equity markets returned 7.2% as measured by the Dow Jones U.S. Total Stock Market Index during the 2015 Fiscal Year. Conversely, developed international and emerging equity markets returned negative 4.2% and negative 5.1%, as measured by the MSCI EAFE Index and the MSCI Emerging Markets Index, respectively. The U.S. bond market provided somewhat of a safe-haven for investors. Despite a slight uptick in U.S. Treasury rates in the second half of the fiscal year, rates fell over the full fiscal year period and the broad U.S. bond market, as measured by the Barclays Aggregate Bond Index, returned 1.9%. The Barclays Intermediate Credit Index slightly trailed the broad market and returned 1.5% during period.

Industry Indices Performance Overview

Total Fund Performance

The System's total investment portfolio, including member loans, returned 3.9% while total investments, excluding loans returned 2.0% during the 2015 Fiscal Year, modestly underperforming its policy benchmark by 0.3% points. Underperformance was primarily due to an underweight allocation to domestic equities relative to the long-term target weights.

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The table below shows the fiscal year and quarter returns of major indices during the fiscal year ended June 30, 2015:

Indices	FY 2015	First quarter FY 2015	Second quarter FY 2015	Third quarter FY 2015	Fourth quarter FY 2015
Dow Jones U. S. Total Stock Market	7.2 %	(0.1)%	5.2 %	1.8 %	0.1 %
S&P 500	7.4	1.1	4.9	1.0	0.3
Russell 1000 Large Growth	10.6	1.5	4.8	3.8	0.1
Russell 1000 Large Value	4.1	(0.2)	5.0	(0.7)	0.1
Russell 3000	7.3	—	5.2	1.8	0.1
Russell 2000	6.5	(7.4)	9.7	4.3	0.4
Russell 2000 Growth	12.3	(6.1)	10.1	6.6	2.0
Russell 2000 Value	0.8	(8.6)	9.4	2.0	(1.2)
MSCI ACW ex-U.S.	(5.3)	(5.3)	(3.9)	3.5	0.5
MSCI EAFE	(4.2)	(5.9)	(3.6)	4.9	0.6
MSCI Emerging Markets	(5.1)	(3.5)	(4.5)	2.2	0.7
Barclays Aggregate Bond	1.9	0.2	1.8	1.6	(1.7)
Barclays Intermediate Credit	1.5	(0.1)	0.8	1.8	(0.9)

United States Equity Overview for the Fiscal Year 2015

U.S. equity markets as measured by the Dow Jones U.S. Total Stock Market Index gained 7.2% during the fiscal year. A majority of the sectors posted positive returns during the period with the exception of the energy, materials, and utilities sectors. From a capitalization basis, large-cap stocks were the best performers during the period, followed by mid and small-cap stocks. On a style perspective, growth stocks outpaced value stocks across all market capitalizations.

The System's domestic equity component returned 6.9% during the fiscal year, underperforming its benchmark, the Russell 3000 Index Fund, by 0.4 percentage points. Underperformance was due to the impact of cash flow timing and withdrawals. The Russell 3000 Index Fund matched its benchmark during the period. Approximately \$205.0 million was redeemed from the domestic equity component during the fiscal year in order to meet the cash needs of the System. As of June 30, 2015, the System's domestic equity assets totaled approximately \$334.2 million and represented approximately 14.1% of the System's total investment portfolio, including member loans.

International Equity Overview for the Fiscal Year 2015

International equities, as measured by the MSCI ACW ex-U.S. Index, returned negative 5.3%. Developed international equities returned negative 4.2% as measured by the MSCI EAFE Index. Japan was the strongest performing region during the period. Emerging market equities as represented by the MSCI Emerging Markets Index returned negative 5.1%.

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During the fiscal year, the System's international equity component returned negative 5.1%, outperforming its benchmark by 0.2 percentage points. Outperformance was due to modest positive tracking error during the period. Approximately \$43.0 million was redeemed from the component during the fiscal year in order to meet the cash needs of the System. At the end of the fiscal year, the component had approximately \$116.9 million in assets, representing 4.9% of the System's total investment portfolio, including member loans.

United States Fixed Income Overview for the Fiscal Year 2015

The broad U.S. fixed income market, as measured by the Barclays Aggregate Bond Index, returned 1.9% during the period. The Barclays Intermediate Credit Index, the System's benchmark for its fixed income portfolio, slightly trailed the broader U.S. fixed income market and returned 1.5%. All underlying sectors generated positive returns during the period, with the government bond and mortgage backed securities sectors providing the strongest returns. Longer duration bonds outperformed shorter duration bonds, while higher quality maturities outpaced those of lower quality.

The System's fixed income component gained 1.2% during the one year period ended June 30, 2015, modestly underperforming its benchmark by 0.3 percentage points. Chicago Equity Partners was the only outperforming manager, while Mesirow, Taplin Canida & Habacht, Popular, Santander and Barrow Hanley detracted from results. The SSGA Intermediate Credit Index Fund matched its benchmark during the period. At the end of the fiscal year, fixed income investment portfolio assets totaled approximately \$897.9 million, consisting of approximately 37.9% of the System's total investment portfolio, including member loans. Approximately \$427.0 million was redeemed from the component during the fiscal year in order to meet the cash needs of the System.

Other Investments and Member Loans Transactions

As of June 30, 2015, the System held approximately \$608 million in member loans which represented 25.7% of the total investment portfolio, including loans. Member loan balances as of June 30, 2015 were \$11 million lower than a year ago.

At the end of the 2015 Fiscal Year, the System had some exposure to limited partnerships of private equity investments valued at approximately \$54 million, which represented 2.3% of the System's total investment portfolio, including member loans.

In order to cover its deficiency of Commonwealth's employee and employer contributions under benefit payments to participants, the System liquidated part of its investment portfolio and transferred approximately \$675 million to the Commonwealth in fiscal year 2015.

Funding Status

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

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

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

Presently, the pension plan consists of three different benefit structures, which are administrated according to their specifications in each Act. For all plan members, excluding System 2000 participants, the level of contributions established by law is 8.275% of the employee salary. Under System 2000, employee contributions range from 8.275% to 10% of the salary, as specified by the employee. Under all structures, employers' contributions during the year ended June 30, 2015 were 13.275% of the employee salary.

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

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

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Market events, plus the continuous increase in the actuarial liability have had a negative effect over the employers' net pension liability. Based on the last actuarial valuation at June 30, 2014, the Employers' net pension liability amounted to approximately \$33,337 million, with a Plan's fiduciary net deficit position as a percentage of the total pension liability of negative 2.05%. The liability for postemployment healthcare benefits amounted to approximately \$1,429 million as of June 30, 2015 and was fully unfunded.

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

In 2013, the Commonwealth enacted legislation that reformed the System by, among other measures, reducing benefits, increasing employee contributions, and, in the case of active employees who were entitled to the defined benefits program, replacing most of the defined benefit elements of the system with a defined contribution system. Based on the statutory funding requirements prior to this reform, the annual benefit payments and administrative expenses of the System were significantly larger than the member and employer contributions made to the System. The reform intended to address the Commonwealth's future cash flow needs and "pay-as-you-go" requirements, while recognizing that the System would continue to have a large unfunded actuarial accrued liability and a low funded ratio. As such, the reform was intended to provide enough cash for the System to be able to pay benefits (as amended through the reform) and debt service on the pension obligation bonds, while maintaining projected System gross assets at no less than \$1 billion at all times.

In order to achieve this goal, the reform contemplated that the Commonwealth and other participating employers would have to provide additional annual funding above the statutorily prescribed contributions as required by Act No. 32. As a long-term plan, it was recognized that constant monitoring would be required to ensure that the System remained on track to meet the reform's goals. The receipt of the additional uniform contribution of Act No. 32 is critical to the System's ability to make payments as they become due.

On April 4, 2013, the Legislature enacted Act No. 3 which amended Act No. 447, Act No. 1 of 1990 (Act No. 1) and Act No. 305 to establish, among other things, a defined contribution program similar to the System 2000 Program (the Contributory Hybrid Program) to be administered by the Retirement System. All regular employees hired for the first time on or after July 1, 2013, and former employees who participated in the Defined Benefit Program and the System 2000 Program, and were rehired on or after July 1, 2013, become members of the Contributory Hybrid Program as a condition to their employment. In addition, employees who at June 30, 2013, were participants of previous plans will become part of the Contributory Hybrid Program. Act No. 3 froze all retirement benefits accrued through June 30, 2013 under the Defined Benefit Program, and

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thereafter, all future benefits will accrue under the defined contribution formula used for the 2000 System Program participants. Ceasing future defined benefit accruals under Act No. 447 and Act No. 1 and converting to a member-funded hybrid plan will result in lower benefit payments as these tiers wind down, and will make all future employer contributions available to pay benefits and bonds payable debt service.

Capital Assets

The System's investment in capital assets as of June 30, 2015 and 2014 amounted to approximately \$10.5 million and \$11 million, respectively, net of accumulated depreciation. Capital assets include land, building and improvements, construction in progress, and equipment. Building and improvements consist of the facilities in which the System has its operations.

Debt Administration

Long-term debt obligations include the System's senior funding bonds and amounted to approximately \$3,105 million and \$3,078 million as of June 30, 2015 and 2014, respectively. The System has issued three series of revenue bonds designated as "Senior Pension Funding Bonds", the proceeds of which have been used mainly to increase the funds currently available to pay pension benefits to certain of its beneficiaries and reduce its unfunded actuarial accrued liability. The Bonds are limited, nonrecourse obligations of the System, payable solely from and secured solely by a pledge of employer contributions made after the date of issuance of the first series of Bonds, and from funds held on deposit with the Bank of New York Mellon (the Fiscal Agent). The Bonds are not payable from contributions made to the System by participating employees, or from the assets acquired with the proceeds of the Bonds, or from employer contributions released by the Fiscal Agent to the System after funding of required reserves, or from any other assets of the System. These bonds are currently rated "C" by Moody's Investors Service and "CC" by Standard & Poor's Ratings Services. Refer to note 10 to the basic financial statements for further information regarding the System's long-term obligations. For the suspension of the monthly payments to the trustee of the System's bonds in July 2016, refer to Subsequent Events Section.

Subsequent Events

Subsequent events were evaluated through February 19, 2018, the date the financial statements were available to be issued, to determine if such events should be recognized or disclosed in the 2015 financial statements.

Pre-Retirement Program

On December 8, 2015, the Commonwealth enacted Act No. 211, establishing a voluntary program that provides benefits for pre-retirements to eligible employees, as defined. Act No. 211 applies to eligible employees of agencies and component units whose budgets are funded in whole or in part by the Commonwealth's General Fund, municipalities, component units that operate with their own resources (except those that have their own retirement system), Judiciary Branch, except judges, and the Commonwealth Employees Association. Act No. 211, among other provisions, established that pre-retirement benefits (pre-retirement program) will be provided to eligible employees who started contributing to the System before April 1, 1990 with at least 20 years of service and will consist of biweekly benefits of 60% of the of each employee's salary as of December 31, 2015, as defined. Pursuant to Act No. 211, the employers will continue making the applicable employee and employer contributions to the Retirement System and the employer

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contributions to the Federal Social Security and Medicare based on the average salary, as defined, as of December 31, 2015. Individual contributions to the Federal Social Security and Medicare will be deducted from the biweekly benefits to be paid to the participant. These payments will be made until the employee reaches the age of 61 years. Other benefits would include the payment of the participant's healthcare plan during the first two years of the program. Once the participant reaches age of 61 years, the participant is eligible to receive payments from the System and is entitled to a guaranteed minimum pension of 50% of their average salary (except police officers, which would be paid 60%) which related cost will be paid by the employer.

Moratorium Act and Declaration of Fiscal Emergency

On April 6, 2016, the Governor of Puerto Rico signed into law the Puerto Rico Emergency Moratorium and Rehabilitation Act (Act No. 21 or the Moratorium Act). 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.

On April 8, 2016, the Governor of Puerto Rico issued 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 have restricted 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.

On June 30, 2016, the Governor signed an executive order, EO-2016-030 (EO 30), which among other things, declared the Commonwealth to be in a state of emergency and declared a moratorium on the Commonwealth's obligation to make payments on bonds and notes issued or guaranteed by the Commonwealth. On the same date, the Governor signed an executive order, EO-2016-031 (EO 31), which among other things, declared an emergency period with respect to System and suspended the monthly payments to the trustee of the System's bonds in July 2016. These executive orders, and other executive orders signed by the Governor, also declared an emerging period over various employers of the System.

PROMESA and Related Litigation

The Commonwealth nor its component units, including the System, are eligible to seek relief under Chapter 9 of the United States Bankruptcy Code. However, on June 30, 2016, the Congress of the United States enacted PROMESA, which grants the Commonwealth and its component units access to an orderly mechanism to restructure their debts in exchange for significant federal oversight over the Commonwealth's finances. PROMESA was enacted pursuant to Section 3 of Article IV of the United States Constitution, which provides

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the U.S. Congress the power to dispose of and make all needful rules and regulations for territories. In broad terms, PROMESA seeks to provide Puerto Rico with fiscal and economic discipline through the creation of an oversight board (the Oversight Board), relief from creditor lawsuits through the enactment of a temporary stay on litigation, and two alternative methods to adjust unsustainable debt.

First, to ensure fiscal and economic discipline, PROMESA creates the Oversight Board that has plenary authority over Puerto Rico's finances. The Oversight Board's primary function is to provide fiscal oversight through the development and approval of fiscal plans and budgets, and to enforce compliance with those plans and budgets through broad-based powers such as reducing nondebt expenditures and instituting certain hiring freezes. The Oversight Board also has oversight over legislative processes because PROMESA requires the Oversight Board to review new laws and deny their enforcement if they are inconsistent with the approved fiscal plans and budgets. The Oversight Board also has authority to review contracts to ensure compliance with the fiscal plan, and to prevent the execution or enforcement of a contract, rule, executive order or regulation to the extent that it is inconsistent with the approved fiscal plan.

Second, the enactment of PROMESA also operates as a broad-based stay on litigation, applicable to all entities, with respect to claims related to Puerto Rico's financial debt, as well as on enforcement of provisions in contracts that allow for termination and the exercise of remedies based on nonpayment of financial obligations, among other conditions.

Finally, PROMESA contains two methods to adjust Puerto Rico's debts. The first method is a streamlined process to achieve modifications of financial indebtedness with the consent of a supermajority of affected financial creditors. This method has benefits such as potential speed relative to a traditional restructuring through a formal in-court process. The second method is a court-supervised debt-adjustment process, which is modeled on Chapter 9 of the U.S. Bankruptcy Code. This process includes the so-called "cram-down" power, which may provide Puerto Rico with flexibility in debt adjustment, but it also gives the Oversight Board total control over the adjustment process and includes certain provisions designed to protect creditor interests. On August 31, 2016, the U.S. President announced the appointment of seven members to the Oversight Board.

On January 29, 2017, the Commonwealth enacted Act No. 5, the Financial Emergency and Fiscal Responsibility Act of 2017 (Act No. 5 or the Financial Emergency Act). Act No. 5 is intended to facilitate and encourage a voluntary negotiation process under PROMESA between the Governor of Puerto Rico and/or the Puerto Rico Fiscal Agency and Financial Advisory Authority, on behalf of the Commonwealth, and the creditors of the Commonwealth and its instrumentalities. Act No. 5 authorizes the Commonwealth, within the parameters established by PROMESA, to designate certain services necessary for the health, safety and welfare of the residents of Puerto Rico and provided by the Commonwealth and its instrumentalities as "essential services", in accordance with the Constitution of Puerto Rico.

Act No. 5 amended and repealed portions of the Act No. 21, as amended by Act 40-2016 and Act 68-2016 (the Moratorium Act). The Moratorium Act, and executive orders issued by the Governor under the Moratorium Act (the Executive Orders), permitted the Government of Puerto Rico to withhold the timely payment of its obligations at a point in time before the enactment of PROMESA. The enactment of PROMESA has, however, established processes and timelines for the resolution of the Commonwealth's financial emergency that preempt and supersede provisions of the Moratorium Act. Through PROMESA and the establishment of the

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Oversight Board, Puerto Rico has been given tools to establish fiscal discipline, restructure its debt, and restore opportunity to the Territory.

On May 1, 2017, the PROMESA Stay expired, permitting the substantial litigation brought by bondholders and other creditors against the Commonwealth and its instrumentalities to resume. As a result, on May 3, 2017, the Oversight Board commenced a Title III case for the Commonwealth by filing a petition for relief under Title III of PROMESA. On May 21, 2017, the Oversight Board commenced Title III cases for the System by filing similar petitions for relief under Title III of PROMESA. On May 11, 2017, United States Supreme Court Chief Justice John Roberts designated United States District Judge Laura Taylor Swain as the presiding judge in the Title III cases. All of the foregoing Title III cases have been consolidated for procedural purposes only and are being jointly administered under Case No. 17-3283-LTS in the United States District Court for the District of Puerto Rico.

Faced with the eventual insolvency of the System and the inability to reach a consensual restructuring agreement with its creditors, on May 21, 2017, the Oversight Board filed a petition for relief for the System pursuant to PROMESA Section 304(a), 48 U.S.C. §2164. As such, the System is a debtor in a proceeding pursuant to PROMESA Title III, 48 U.S.C. §2161, et seq. Pursuant to PROMESA Section 315 (48 U.S.C. §2175), the Oversight Board serves as the debtor's representative in the Title III proceedings.

On June 23, 2017, the Legislature approved the Other Assignments for the Fiscal Year 2017-2018 Joint Resolution, which among other things, ordered the System, JRS, and TRS to liquidate their assets and pass the net proceeds to the Treasury Department of the Commonwealth. On July 20, 2017 the System sold investments amounting to approximately \$297 million.

On June 24, 2016, Fitch downgraded from "CC" to "C" the System bonds and placed them on "negative" outlook since default of some kind was deemed inevitable. Fitch cited "the breakdown of negotiations between the Commonwealth and major bondholders, the recent ruling by the U.S. Supreme Court on the Commonwealth's bankruptcy legislation, and the slow process of federal legislation in support of the Commonwealth" as indicators that a debt restructuring, deferral or default has become inevitable. Fitch also indicated that recently released proposals and counterproposals between the Commonwealth and bondholders indicate a distressed debt exchange of some kind was inevitable. Moreover, Fitch expressed that with sizeable debt service payments due on July 1, 2016, the probability of default on the general obligation debt is high. Soon after the missed payments of July 1, 2016 imposed by the Moratorium Act and related executive orders, S&P downgraded to the lowest level of "D" the general obligation bonds of the Commonwealth, while Fitch did the same. On April 6, 2017, Moody's downgraded the System bonds to a level C rating from its previous ratings of Ca and Ca, respectively. On that same date, Moody's reaffirmed the Caa3 rating on the Commonwealth's GO bonds. On June 7, 2017, S&P downgraded COFINA's senior and junior lien bonds to the default rating of D, in response to Title III Judge Swain order not to make the COFINA's scheduled debt service for June 1, July 1 and August 1, 2017; but to maintain such funds in a trust account until the judge decides on the case, further discussed above.

On July 17, 2017, Judge Swain approved agreement a Joint Stipulation reached between the System and certain System bondholders. In the Stipulation, the parties also agreed that the System would make interest payments due on October 1, 2017 from the System's Prepetition Segregated Account (which was created pursuant to a stipulation and order dated January 17, 2017) and that these payments would constitute

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adequate protection for the creditors until October 31, 2017 with respect to the automatic stay. In addition, the System and certain bondholders agreed that, the System would seek a declaratory relief challenging the validity, priority, extent and enforceability of the prepetition and post-petition liens and security interests asserted by certain bondholders with respect to bonds issued by the System. The stipulation also calls for payment of approximately \$14 million in interest due July 1, 2017 and missed by the System, after commencement of its Title III case. The System will also pay subsequent monthly interest payments until October 1, 2017, or approximately \$42 million in total.

On July 21, 2017, pursuant to the Joint Stipulation the Oversight Board, on behalf of the System filed a declaratory relief challenging the validity, priority, extent and enforceability of the prepetition and post-petition liens and security interests asserted by Defendants with respect to bonds issued by the System. The complaint contends that the Defendants' alleged liens and security interests are not perfected because the required UCC financing statements and subsequent amendments were defective. The System also challenges, among other things, the System Bondholders' alleged security interest in post-petition employer contributions. Defendants have asserted counter-claims related to the same issues.

On November 28, 2017, certain System Bondholders (the Puerto Rico Funds) filed a motion to require the System to continue making payments from Prepetition Segregated Account (Created pursuant to the Stipulation) until the court rules on the parties' motion for summary judgment, the Court granted the motion in part. Specifically, the Court ordered the System to transfer the December 2017 and January 2018 interest payments pursuant to the Stipulation, and going forward to transfer the interest payment by the 20th of each month until the earlier of (i) the Court's order on the motion for summary judgment, or (ii) the exhaustion of the funds in the Prepetition Segregated Account.

Enactment of Pay-as-you-go and related litigation under Title III of PROMESA

On April 30, 2016, the Governor issued an Executive Order, EO-2016-014 (EO 14), which declared a payment moratorium with respect to certain obligations of GDB (see related disclosure on the executive action taken imposing a moratorium on GDB's obligations further below under the Component Units section of this note). EO 14 also declared an emergency period with respect to certain obligations of PRIFA that are secured by a letter of credit issued by GDB. Pursuant to EO 14, on May 1, 2016, GDB failed to make a principal payment of approximately \$367 million in respect of its notes.

In August 2016 and monthly thereafter, the fiscal agent under the Pension Funding Bond Resolution (the Resolution) of the System's bonds notified to the System that it failed to transfer the requisite employers' contributions on the last business day of each month. The fiscal agent is not seeking to collect or recover any indebtedness from, enforce any judgment against, or obtain possession of, exercise control over, any property of or from, the Commonwealth or any of its instrumentalities, including the System, or exercise any act that is stayed by PROMESA, the Financial Emergency Act, the Moratorium Act, or any Executive Orders related thereto. Consistent with PROMESA, the financial Emergency Act, the Moratorium Act, and any Executive Orders, the fiscal agent is not exercising at this time any rights or remedies against the Commonwealth or any of its instrumentalities, including the System.

On October 30, 2016, the Oversight Board designated Puerto Rico, the System, JRS, TRS, the University of Puerto Rico and twenty-one public corporations of Puerto Rico as "covered entities" subject to oversight under

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PROMESA. Section 405(b) of PROMESA also imposes a temporary stay of litigation and claims against Puerto Rico and its instrumentalities for various matters (as the same may be extended under PROMESA, the Enactment Stay), with the hope that the Government of Puerto Rico, on its own behalf and on behalf of its instrumentalities, will enter into voluntary negotiations with its creditors to reorganize and settle the repayment of its debt obligations, while simultaneously embarking on a responsible restructuring of the Government of Puerto Rico and its instrumentalities that realigns the essential services required for the health, safety, and welfare of the residents of Puerto Rico with the timely repayment of its debt obligations. Pursuant to PROMESA, ongoing fiscal planning, budgeting, legislative, and executive action of Puerto Rico, as well as consensual and nonconsensual debt restructurings and the issuance, guarantee, exchange, modification, repurchase, or redemption of debt, is subject to oversight.

The Title III cases were commenced in part due to the May 2 expiration of the PROMESA Stay. Title III of PROMESA incorporates the automatic stay provisions of Bankruptcy Code Section 362 and 922, which are made applicable to the Title III cases pursuant to PROMESA Section 301(a).

On June 27, 2017, the Treasury Department issued Circular Letter No. 1300 46 17 in order to convey to the central government agencies, public corporations and municipalities the new implementation procedures to adopt, effective, July 1, 2017, the new "pay-as-you-go (PayGo)" mechanism for all of the Commonwealth's Retirement Systems. With the start of the fiscal year 2018, employers' contributions, contributions ordered by special laws and the Additional Uniform Contribution were all eliminated and replaced by a monthly PayGo charge that will be collected from the aforementioned government entities to pay retirees. The Commonwealth Retirement Systems will determine and administer the payment amount per retiree that will be charged to each agency, public corporation and municipality. The PayGo charge must be submitted to the Treasury Department before the 15th day of each month along with the individual contributions withheld from active employees. As liquid retirement funds become depleted, the PayGo charge is expected to increase.

In addition to the establishment of the PayGo mechanism, on August 23, 2017, the Commonwealth enacted Act to Guarantee the Payment to Our Pensioners and Establish a New Plan for Defined Contributions for Public Servants (Act 106 2017), which reformed the System, JRS and TRS, so that their active participants would deposit their individual contributions in a new Defined Contribution Plan that will be managed by a private entity. Act 106 2017 creates the legal framework so that the Commonwealth can guarantee payments to pensioners through the PayGo scheme. With this system, the Commonwealth makes pension payments from the General Fund, according to the money available. Approximately \$2 billion was allocated for these purposes in the fiscal year 2018 budget. Act 106 2017 also created a Defined Contribution Plan, similar to a 401(k) plan, which guarantees the contributions of public servants, because future benefits will not be paid by the retirement systems. However, under the PayGo system, Puerto Rico's municipalities will remain obligated on their pension obligations.

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Act No. 106-2017, among other things, amends Act No. 3 with respect to the System's governance, funding and benefits for active members of the actual program and new hired members. By this act, the System's Board of Trustees was substituted with the Retirement Board of the Government of Puerto Rico (Retirement Board). Pursuant this act the Retirement Board will also be in charge of the governance of the System and the JRS. The Retirement Board has thirteen members; five ex-officio, four representatives of the active participants and four representatives of the public interest.

Act No. 106-2017 also terminates the actual program for the System participants as of June 30, 2017. The members of the actual program and new system members hired since July 1, 2017 will be enrolled in a new defined contributions program that will be selected by the Retirement Board. The accumulated balance on the accounts of the actual program will be transferred to the members account at the new defined contributions program. The System' active members of the defined contributions program will retain their benefits as stated under Act 91 of March 29, 2003.

Act 106-2017 also ordered a suspension of the System' loan programs and ordered a merger of the administrative structures of the retirement systems. At the Retirement Board discretion, the administration of the system benefits might be externalized. The employees of the System that are not retained under the new administrative structure will be transferred to other public agencies in conformity with Act 8 of February 8, 2017.

On July 27, 2017, System Bondholders, initiated a complaint against the Commonwealth, the Oversight Board, the Puerto Rico Fiscal Agency and Financial Advisory Authority, the System, Governor of Puerto Rico and Treasury Secretary. The lawsuit seeks a declaration that that Commonwealth legislation, Joint Resolution 188 and Act 106-2017 (the PayGo Legislation) is void ab initio on the grounds that it violates the automatic stay under the Bankruptcy Code and violates the Takings and Contract Clauses of the U.S. Constitution. The System, represented by the Oversight Board and the Puerto Rico Fiscal Agency and Financial Advisory Authority, moved to dismiss the complaint in full on November 17, 2017. The motion was fully briefed as of January 24, 2018. No hearing has been set on the motion.

On September 20, 2017, Puerto Rico got a direct hit from Hurricane Maria, the strongest hurricane to hit the island in almost a century, the System's building was extremely destroyed by Hurricane Maria causing the relocation of the employees. The System has entered into a lease agreement with the Puerto Rico Public Buildings Authority in order to relocate its offices to a different building and be able to continue operations. This lease agreement has caused the System to negotiate some additional contracts and eliminate others related to auxiliary services. Management of the System is in the process of determining the extent of damages.

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Statement of Fiduciary Net Position

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(In thousands)

	<u>Pension</u>	<u>Post employment healthcare benefits</u>	<u>Total</u>
Assets:			
Cash and cash equivalents:			
Deposits with Government Development Bank for Puerto Rico (GDB):			
Unrestricted	\$ 93,575	—	93,575
Restricted	34,685	—	34,685
Deposits with GDB held by the Puerto Rico Department of Treasury	11,780	—	11,780
Deposits at commercial banks – restricted	12,580	—	12,580
Money market funds:			
Unrestricted	96,394	—	96,394
Restricted	112,443	—	112,443
U.S. Treasury bill – restricted	1,590	—	1,590
Total cash and cash equivalents	<u>363,047</u>	<u>—</u>	<u>363,047</u>
Receivables, net:			
Employers – net of allowance for uncollectible accounts of \$222,015	183,359	—	183,359
Due from Retirement System for the Judiciary of the Commonwealth of Puerto Rico	7,090	—	7,090
Investments sold	108,607	—	108,607
Accrued investment income	5,314	—	5,314
Other	13,747	—	13,747
Total receivables, net	<u>318,117</u>	<u>—</u>	<u>318,117</u>
Collateral from securities lending transactions	80,071	—	80,071
Investments:			
Bonds and notes	794,761	—	794,761
Nonexchange commingled trust funds	467,823	—	467,823
Investments in limited partnerships	54,026	—	54,026
Stocks	1	—	1
Total investments	<u>1,316,611</u>	<u>—</u>	<u>1,316,611</u>
Member loans and interest receivable – net	607,617	—	607,617
Capital assets – net	10,521	—	10,521
Other assets	785	—	785
Total assets	<u>\$ 2,696,769</u>	<u>—</u>	<u>2,696,769</u>

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

Statement of Fiduciary Net Position

June 30, 2015

(In thousands)

	<u>Pension</u>	<u>Post employment healthcare benefits</u>	<u>Total</u>
Liabilities:			
Accounts payable and accrued liabilities	\$ 9,329	—	9,329
Bond interest payable	13,876	—	13,876
Payable for investment securities purchased	7,754	—	7,754
Securities lending obligations	80,071	—	80,071
Due to Commonwealth of Puerto Rico	76,613	—	76,613
Escrow funds of mortgage loans and guarantee insurance reserve for member loans	10,212	—	10,212
Bonds payable	3,105,448	—	3,105,448
Other liabilities	<u>61,738</u>	<u>—</u>	<u>61,738</u>
Total liabilities	3,365,041	—	3,365,041
Contingencies (note 13)			
Unrestricted net deficit position	<u>\$ (668,272)</u>	<u>—</u>	<u>(668,272)</u>

See accompanying notes to basic financial statements.

**EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT
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Statement of Changes in Fiduciary Net Position

Year ended June 30, 2015

(In thousands)

	<u>Pension</u>	<u>Post employment healthcare benefits</u>	<u>Total</u>
Additions:			
Contributions:			
Employer contributions:			
Basic benefits, net of provision for uncollectible contributions of \$131,288	\$ 479,911	—	479,911
Special benefits	186,136	97,374	283,510
Member contributions	339,650	—	339,650
Total contributions	<u>1,005,697</u>	<u>97,374</u>	<u>1,103,071</u>
Investment income:			
Net depreciation in fair value of investments	(46,453)	—	(46,453)
Impairment loss on deposits with governmental bank (note 6)	(3,342)	—	(3,342)
Interest	81,603	—	81,603
Dividends	60	—	60
Less investment expense, other than from securities lending	(2,775)	—	(2,775)
Net income from investing, other than from securities lending	<u>29,093</u>	<u>—</u>	<u>29,093</u>
Securities lending income	216	—	216
Less securities lending expenses	(51)	—	(51)
Net income from securities lending	<u>165</u>	<u>—</u>	<u>165</u>
Net investment income	<u>29,258</u>	<u>—</u>	<u>29,258</u>
Other income	<u>28,499</u>	<u>—</u>	<u>28,499</u>
Total additions	<u>1,063,454</u>	<u>97,374</u>	<u>1,160,828</u>
Deductions:			
Benefits paid to participants:			
Annuities	1,337,848	—	1,337,848
Special benefits	186,136	97,374	283,510
Death benefits	17,340	—	17,340
Refunds of contributions	31,351	—	31,351
Interest on bonds payable	194,400	—	194,400
General and administrative	33,623	—	33,623
Other expenses	11,694	—	11,694
Total deductions	<u>1,812,392</u>	<u>97,374</u>	<u>1,909,766</u>
Net decrease in net position	<u>(748,938)</u>	<u>—</u>	<u>(748,938)</u>
Net position (deficit):			
Beginning of year	<u>\$0,666</u>	<u>—</u>	<u>80,666</u>
End of year	<u>\$ (668,272)</u>	<u>—</u>	<u>(668,272)</u>

See accompanying notes to basic financial statements.

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June 30, 2015

(1) Organization

The Employees' Retirement System of the Government of the Commonwealth of Puerto Rico (the System) is a trust created by the Legislature of the Commonwealth of Puerto Rico (the Commonwealth) pursuant to Act No. 447 on May 15, 1951 (Act No. 447), as amended, to provide pension and other benefits to retired employees of the Commonwealth, its public corporations and municipalities of Puerto Rico. The System administers a cost-sharing, multi-employer, pension plan (the pension plan). The System also administers post-employment healthcare benefits provided by the Commonwealth to retired plan members (the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities Medical Insurance Plan Contribution – ERS MIPC), an unfunded, cost-sharing, multi-employer defined benefit other postemployment benefit.

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

The System and the JRS, also a component unit of the Commonwealth, are both administered by Puerto Rico Government Employees and Judiciary Retirement Systems Administration (the Administration). The Administration allocated 98.38% of its general and administrative expenses to the System during the year ended June 30, 2015. The methodology used to determine the allocation is based on total employer and participating employees' contributions to the System, divided by the aggregate total of employers' and participating employees' contributions to the System and JRS, combined.

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June 30, 2015

(2) Summary of Significant Accounting Policies

The following are the significant accounting policies followed by the System in the preparation of its 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 and payable.

(b) Use of Estimates

The preparation of the basic financial statements requires management to make 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 certain 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 money market funds, U.S. Treasury bill, and certificates of deposit in GDB (a component unit of the Commonwealth) and in commercial banks. Restricted cash deposited with GDB consists of payments received from mortgage loan holders in the servicing of loans (escrow accounts), expired checks not claimed by the plan members, restricted for repayments, and temporary amounts to be transferred to the Bank of New York Mellon (trustee) restricted for bond debt service requirements. Restricted money market funds consist of funds held by the trustee to maintain the debt service funds and the sinking funds for the repayment of the System's bonds payable.

(d) Investments

Investments are reported at fair value. The fair value of investments is based on quoted prices, if available. The System has investments in limited partnerships and nonexchange commingled trust funds valued at approximately \$54 million and \$468 million, respectively, as of June 30, 2015. Fair values of investments in limited partnerships have been estimated in the absence of readily determinable fair values, based on information provided by the underlying fund managers. Nonexchange commingled trust funds are reported at their net asset value (NAV). The NAV includes the market value of the securities in the fund plus any receivables, payables, and accrued fund expenses.

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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 less an allowance for uncollectible amounts. The maximum amount that was loaned to plan members for mortgage loans is \$100,000, and \$5,000 for personal, and cultural trip loans.

The System services mortgage loans with aggregate principal balances of approximately \$2.5 million at June 30, 2015, related to certain mortgage loans sold to the Federal National Mortgage Association for a fee of 0.25%. The sale contract stipulates that the System must repurchase any loans with payments in arrears over 90 days.

(f) 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 loans to plan members is revised each year and adjusted accordingly based on the annual higher claim amount of a five-year period increased by a management determined percentage.

(g) Capital Assets

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

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

	<u>Years</u>
Building	50
Buildings improvements	10
Equipment, furniture, fixtures, and vehicles	5-10

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(h) Termination Benefits

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

(i) Recently Issued Accounting Pronouncements

The following new accounting standards has been issued but not yet effective:

- 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. GASB Statement No. 72 provides fair value application guidance and 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). This Statement is effective for fiscal years beginning after June 15, 2015. The System is evaluating the impact of this new statement.
- GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*. Provisions of this statement that are applicable to System include clarification of information that is required to be presented as notes to the required supplementary information. The provisions of this Statement for pension plans that are within the scope of Statement 67 or for pensions that are within the scope of Statement 68 are effective for fiscal years beginning after June 15, 2015. The System believes this statement will have limited impact on the financial statements.
- GASB Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other than Pension Plans*. This Statement replaces Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*. It also includes requirements for defined-contribution OPEB plans that replace the requirements for those OPEB plans in Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, as amended, Statement No. 43, and Statement No. 50, *Pension Disclosures*. The scope of this Statement includes OPEB plans-defined benefit and defined contribution-administered through trusts that meet the following criteria:
 - Contributions from employers and nonemployer contributing entities to the OPEB plan and earnings on those contributions are irrevocable.

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- OPEB plan assets are dedicated to providing OPEB to plan members in accordance with the benefit terms.
- OPEB plan assets are legally protected from the creditors of employers, nonemployer contributing entities, and the OPEB plan administrator. If the plan is a defined benefit OPEB plan, plan assets also are legally protected from creditors of the plan members.

This Statement also includes requirements to address financial reporting for assets accumulated for purposes of providing defined-benefit OPEB through OPEB plans that are not administered through trusts that meet the specified criteria. The provisions of this statement are effective for fiscal years beginning after June 15, 2016. The System is evaluating the impact of this new statement.

- GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. This Statement identifies in the context of the current governmental financial reporting environment the hierarchy of GAAP. The "GAAP hierarchy" consists of the sources of accounting principles used to prepare financial statements of state and local governmental entities in conformity with GAAP and the framework for selecting those principles. This Statement reduces the GAAP hierarchy to two categories of authoritative GAAP and addresses the use of authoritative and nonauthoritative literature in the event that the accounting treatment for a transaction or other event is not specified within a source of authoritative GAAP. This Statement supersedes Statement No. 55, *The Hierarchy of GAAP for State and Local Governments*. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2015. The System believes this statement will have limited impact on the financial statements.
- GASB Statement No. 82, *Pension Issues – an Amendment of GASB Statements No 67, No. 68 and No. 73*. This Statement addresses certain issues that have been raised with respect to GASB Statements No. 67, No. 68, and No. 73. The Statement is designed to improve consistency in the application of the pension standards by clarifying or amending related areas of existing guidance. Specifically, this Statement addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements. Prior to the issuance of this Statement, GASB Statements No. 67 and No. 68 required presentation of covered-employee payroll, which is the payroll of employees that are provided with pensions through the pension plan, and ratios that use that measure, in schedules of required supplementary information. This Statement amends GASB Statements No. 67 and No. 68 to instead require the presentation of covered payroll, defined as the payroll on which contributions to a pension plan are based, and ratios that use that measure. This Statement clarifies that a deviation, as the term is used in Actuarial Standards of Practice issued by the Actuarial Standards Board, from the guidance in an Actuarial Standard of Practice is not considered to be in conformity with the requirements of GASB Statement No. 67, GASB Statement No. 68, or GASB Statement No. 73 for the selection of assumptions used in determining the total pension liability and related measures. This Statement clarifies that payments that are made by an employer to satisfy contribution requirements that are identified by the pension

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plan terms as plan member contribution requirements should be classified as plan member contributions for purposes of GASB Statement No. 67 and as employee contributions for purposes of GASB Statement No. 68. It also requires that an employer's expense and expenditures for those amounts be recognized in the period for which the contribution is assessed and classified in the same manner as the employer classifies similar compensation other than pensions (for example, as salaries and wages or as fringe benefits). This Statement is not effective until fiscal year 2017, except for the requirements of this Statement for the selection of assumptions in a circumstance in which an employer's pension liability is measured as of a date other than the employer's most recent fiscal year-end. In that circumstance, the requirements for the selection of assumptions are effective for that employer in the first reporting period in which the measurement date of the pension liability is on or after June 15, 2017. The System is evaluating the impact of this new statement.

- GASB Statement No. 85, *Omnibus 2017*. The objective of this Statement is to address practice issues that have been identified during implementation and application of certain GASB Statements. This Statement addresses a variety of topics including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits (OPEB)). The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2017. The System is evaluating the impact of this new statement.

(3) Going Concern Uncertainty

The System's net pension liability was approximately \$33,337.4 million and the fiduciary net position was a deficit of approximately (\$668.3 million) as of June 30, 2015. The Commonwealth and the other participating employers have been facing significant fiscal and economic challenges in recent years due to, among other factors, continued budget deficits, a prolonged economic recession, high unemployment, population decline, and high levels of debt and pension obligations which has significantly inhibited their ability to make employer contributions to the plan. Accordingly, the annual benefit payments and administrative expenses paid by the System have been significantly larger than the member and employers' contributions resulting in the System going into a deficit position in fiscal year 2015.

On May 2, 2017, the legal shield granted by the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) protecting the Commonwealth from debt-related lawsuits expired. On May 3, 2017, the Commonwealth filed a petition for protection under Title III of PROMESA to ensure the essential services to the public, the payment of the government payroll and the suppliers.

Faced with the eventual insolvency of the System and the inability to reach a consensual restructuring agreement with the System's creditors, on May 21, 2017, the Governor submitted a letter to the Fiscal Oversight Board created by PROMESA (the Oversight Board) stating that the System desired to effect a plan to adjust its debts under Title III of PROMESA. Also, on May 21, 2017, the Oversight Board filed a petition for the System in the United States District Court for the District of Puerto Rico, commencing a Title III case for the System. On June 15, 2017, the United States Trustee appointed an Official Committee of Retired Employees in the Commonwealth's Title III cases.

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As further described in note 14, the System sold investments in July 2017, amounting to approximately \$297 million.

Management's Conclusion on Going Concern Consideration

Based on the fiscal and financial difficulties of both the Commonwealth and the System discussed above, management believes there is substantial doubt about the ability of the System to continue as a going concern.

Management's Remediation Plan

In response to the current and contemplated financial difficulties facing the Commonwealth and the System, and as further described in note 14, on June 27, 2017, the Treasury Department issued Circular Letter No. 1300-46-17 in order to convey to the central government agencies, public corporations and municipalities the new implementation procedures to adopt, effective, July 1, 2017, the new "pay-as-you-go" (PayGo) mechanism for all of the Commonwealth Retirement Systems. With the start of the fiscal year 2018, employers' contributions, contributions ordered by special laws, and the Additional Uniform Contribution were all eliminated and replaced by a monthly PayGo charge that will be collected from the aforementioned government entities to pay retirees. The System will determine and administer the payment amount per retiree that will be charged to each agency, public corporation and municipality. As liquid retirement funds become depleted, the PayGo charge is expected to increase.

In addition to the establishment of the PayGo mechanism, on August 23, 2017, the Governor signed into law the Act to Guarantee the Payment to Our Pensioners and Establish a New Plan for Defined Contributions for Public Servants (Act 106-2017), which reformed the Commonwealth Retirement Systems so that their active participants would deposit their individual contributions in a new Defined Contribution Plan, that will be managed by a private entity. Act 106-2017 creates the legal framework so that the Government can guarantee payments to pensioners through the PayGo scheme. With this system, the Government makes pension payments from the general fund, according to the money available. Act 106-2017 also created a Defined Contribution Plan under which future benefits will not accumulate. However, under the PayGo system, Puerto Rico's municipalities will remain obligated on their pension obligations.

The System is also suspending the loans program, and reducing general and administrative expenses mostly through employee attrition due to normal retirement and reduction in professional services contracts.

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(4) Plan Description

Pension Benefits

The System administers different benefit structures pursuant to Act No. 447, as amended, including a cost-sharing, multi-employer, defined benefit program, a defined contribution program (System 2000 program) and a contributory hybrid program. Benefit provisions vary depending on member's date of hire. Substantially all full-time employees of the Commonwealth and its instrumentalities (73 Commonwealth agencies, 78 municipalities, and 55 public corporations, including the System) are covered by the System. Membership is mandatory for all regular, appointed, and temporary employees of the Commonwealth at the date of employment. Membership is optional for the Governor of the Commonwealth, Commonwealth secretaries, head of public agencies and instrumentalities, among others.

At July 1, 2014, membership of the System consisted of the following:

Retirees and beneficiaries currently receiving benefits	\$ 110,922
Current participating employees – defined benefit	55,735
Current participating employees – System 2000 and Act No. 3	64,055
Disabled members, receiving benefits	<u>15,820</u>
Total membership	\$ <u>246,532</u>

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. Act No. 3, in conjunction with other recent funding and design changes, provided for a comprehensive reform of the System. This summary details the provisions under Act No. 3.

Certain provisions are different for the three groups of members who entered the System prior to July 1, 2013 as described below:

- Members of Act No. 447 are generally those members hired before April 1, 1990.
- Members of Act No. 1 are generally those members hired on or after April 1, 1990 and on or before December 31, 1999.
- Members of Act No. 305 (or System 2000) are generally those members hired on or after January 1, 2000 and on or before June 30, 2013.

All regular employees hired for the first time on or after July 1, 2013, and former employees who participated in the defined benefit program and the System 2000 program, and were rehired on or after July 1, 2013, become members of the Contributory Hybrid Program as a condition to their employment. In addition, employees who at June 30, 2013, were participants of previous programs became part of the Contributory Hybrid Program on July 1, 2013.

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Each member has a Nonforfeitable right to the value of his/her account. Members have three options to invest their contributions. Investment income is credited to the member's account semiannually. The Commonwealth does not guarantee benefits at retirement age.

The assets of the defined benefit program, the defined contribution program and the Contributory Hybrid Program are pooled and invested by the System. Future benefit payments will be paid from the same pool of assets.

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.

(a) Service Retirements

- (1) *Eligibility for Act No. 447 Members* – Act No. 447 members who were eligible to retire as of June 30, 2013 continue to be eligible to retire at any time. Prior to July 1, 2013, Act No. 447 members could retire upon (1) attainment of age 55 with 25 years of credited service, (2) attainment of age 58 with 10 years of credited service, (3) any age with 30 years of credited service, (4) for Public Officers in High Risk Positions (the Commonwealth Police and Firefighter Corps, the Municipal Police and Firefighter Corps and the Custody Office Corps), attainment of age 50 with 25 years of credited service, and (5), for Mayors of municipalities, attainment of age 50 with 8 years of credited service as a Mayor. In addition, Act No. 447 members who attained 30 years of credited service by December 31, 2013 are eligible to retire at any time.

Act No. 447 members who were not eligible to retire as of June 30, 2013 and did not attain 30 years of credited service by December 31, 2013 are eligible to retire upon attainment of the retirement eligibility age shown in the table below with 10 years of credited service.

Date of birth	Attained age as of June 30, 2013	Retirement eligibility age
July 1, 1957 or later	55 or less	61
July 1, 1956 to June 30, 1957	56	60
Before July 1, 1956	57 and up	59

In addition to the requirements in the table above, Act No. 447 Public Officers in High Risk Positions who were not eligible to retire as of June 30, 2013 and did not attain 30 years of credited service by December 31, 2013 are eligible to retire directly from active service upon the attainment of age 55 with 30 years of credited service.

- (2) *Eligibility for Act No. 1 Members* – Act No. 1 members who were eligible to retire as of June 30, 2013 continue to be eligible to retire at any time. Prior to July 1, 2013, Act No. 1 members could retire upon (1) attainment of age 55 with 25 years of credited service, (2) attainment of age 65 with 10 years of credited service, (3) for Public Officers in High Risk Positions, any age with 30 years of

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credited service, and (4) for Mayors, attainment of age 50 with 8 years of credited service as a Mayor.

Act No. 1 members who were not eligible to retire as of June 30, 2013 are eligible to retire upon attainment of age 65 with 10 years of credited service. In addition, Act No. 1 Public Officers in High Risk Positions who were not eligible to retire as of June 30, 2013 are eligible to retire directly from active service upon the attainment of age 55 with 30 years of credited service.

- (3) *Eligibility for System 2000 Members* – System 2000 members who were eligible to retire as of June 30, 2013 continue to be eligible to retire at any time. Prior to July 1, 2013, System 2000 members could retire upon attainment of age 55 for Public Officers in High Risk Positions and attainment of age 60 otherwise.

System 2000 members who were not eligible to retire as of June 30, 2013 are eligible to retire upon attainment of age 55 for Public Officers in High Risk Positions and upon attainment of the retirement eligibility age shown in the table below otherwise.

Date of birth	Attained age as of June 30, 2013	Retirement eligibility age
July 1, 1957 or later	55 or less	65
July 1, 1956 to June 30, 1957	56	64
July 1, 1955 to June 30, 1956	57	63
July 1, 1954 to June 30, 1955	58	62
Before July 1, 1954	59 and up	61

- (4) *Eligibility for Members Hired after June 30, 2013* – Attainment of age 58 if a Public Officer in a High Risk Position and attainment of age 67 otherwise.

(b) Service Retirement Annuity Benefits

An annuity is payable for the lifetime of the member equal to the annuitized value of the balance in the hybrid contribution account at the time of retirement, plus, for Act No. 447 and Act No. 1 members, the accrued benefit determined as of June 30, 2013. If the balance in the hybrid contribution account is \$10,000 or less, it shall be paid as a lump sum instead of as an annuity.

- (1) *Accrued Benefit as of June 30, 2013 for Act No. 447 Members* – The accrued benefit as of June 30, 2013 shall be determined based on the average compensation, as defined, for Act No. 447 members, the years of credited service, and the attained age of the member all as of June 30, 2013. For Act No. 447 Mayors, the highest compensation, as defined, as a Mayor is determined as of June 30, 2013.

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If the Act No. 447 member had at least 30 years of credited service as of June 30, 2013, the accrued benefit equals 65% of average compensation if the member was under age 55 as of June 30, 2013 or 75% of average compensation if the member was at least age 55 as of June 30, 2013. For participants selecting to coordinate with social security (the Coordination Plan), the benefit is re-calculated at the Social Security Retirement Age (SSRA), as defined, as 1.5% of average compensation up to \$6,600 multiplied by years of credited service, up to 30 years, plus 65% (75% if member was at least age 55 as of June 30, 2013) of average compensation in excess of \$6,600.

If the Act No. 447 member had less than 30 years of credited service as of June 30, 2013, and attains 30 years of credited service by December 31, 2013, the accrued benefit equals 55% of average compensation if the member was under age 55 as of June 30, 2013 or 60% of average compensation if the member was at least age 55 as of June 30, 2013. For participants selecting the Coordination Plan, the benefit is re-calculated at SSRA as 1.5% of average compensation up to \$6,600 multiplied by years of credited service, up to 30 years, plus 55% (60% if member was at least age 55 as of June 30, 2013) of average compensation in excess of \$6,600. Member contributions received from Act No. 447 members eligible for this transitory benefit during the period beginning July 1, 2013 and ending upon the attainment of 30 years of credited service are considered pre-July 1, 2013 contributions; the contributions to the hybrid contribution account begin after the member attains 30 years of credited service.

If the Act No. 447 member had less than 30 years of credited service as of December 31, 2013, the accrued benefit equals 1.5% of average compensation multiplied by years of credited service up to 20 years, plus 2% of average compensation multiplied by years of credited service in excess of 20 years. Maximum benefit is 75% of average compensation. Except for Commonwealth Police and Commonwealth Firefighters, the benefit is actuarially reduced for each year payment commences prior to age 58. For participants selecting the Coordination Plan, the basic benefit is re-calculated at SSRA as 1% of average compensation up to \$6,600 multiplied by years of credited service up to 20 years, plus 1.5% of average compensation up to \$6,600 multiplied by years of credited service in excess of 20 years, plus 1.5% of average compensation in excess of \$6,600 multiplied by years of credited service up to 20 years, plus 2.0% of average compensation in excess of \$6,600 multiplied by years of credited service in excess of 20 years. Except for Police and Firefighters, the benefit is actuarially reduced for each year payment commences prior to age 58.

For Act No. 447 Mayors with at least 8 years of credited service as a mayor, the accrued benefit will not be less than 5% of highest compensation, as defined, as a Mayor for each year of credited service as a Mayor up to 10 years, plus 1.5% of highest compensation as Mayor for each year of non-Mayoral credited service up to 20 years, plus 2.0% of highest compensation as Mayor for each year of non-Mayoral credited service in excess of 20 years. Non-Mayoral credited service includes service earned as a Mayor in excess of 10 years. Maximum benefit is 90% of highest compensation as a Mayor.

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- (2) *Accrued Benefit as of June 30, 2013 for Act No. 1 Members* – The accrued benefit as of June 30, 2013 shall be determined based on the average compensation for Act No. 1 members, the years of credited service, and the attained age of the member all as of June 30, 2013. For Act No. 1 Mayors, the highest compensation as a Mayor is determined as of June 30, 2013.

If the Act No. 1 member is a police officer or firefighter with at least 30 years of credited service as of June 30, 2013, the accrued benefit equals 65% of average compensation if the member was under age 55 as of June 30, 2013 or 75% of average compensation if the member was at least age 55 as of June 30, 2013.

For all other Act No. 1 members, the accrued benefit equals 1.5% of average compensation multiplied by years of credited service. The benefit is actuarially reduced for each year payment commences prior to age 65.

For Act No. 1 Mayors with at least 8 years of credited service as a mayor, the accrued benefit will not be less than 5% of highest compensation as a Mayor for each year of credited service as a Mayor up to 10 years, plus 1.5% of highest compensation as Mayor for each year of non-Mayoral credited service up to 20 years, plus 2.0% of highest compensation as Mayor for each year of non-Mayoral credited service in excess of 20 years. Non-Mayoral credited service includes service earned as a Mayor in excess of 10 years. Maximum benefit is 90% of highest compensation as a Mayor.

(c) Compulsory Retirement

All Act No. 447 and Act No. 1 Public Officers in High Risk Positions must retire upon attainment of age 58 and 30 years of credited service. A two year extension may be requested by the member from the Superintendent of the Puerto Rico Police, the Chief of the Firefighter Corps, or supervising authority as applicable.

(d) Termination Benefits

(1) Lump Sum Withdrawal

Eligibility: A Member is eligible upon termination of service prior to 5 years of service or if the balance in the hybrid contribution account is \$10,000 or less.

Benefit: The benefit equals a lump sum payment of the balance in the hybrid contribution account as of the date of the permanent separation of service.

(2) Deferred Retirement

Eligibility: A Member is eligible upon termination of service with 5 or more years of service (10 years of credited service for Act No. 447 and Act No. 1 members) prior to the applicable retirement eligibility, provided the member has not taken a lump sum withdrawal of the accumulated contributions and the hybrid contribution account.

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Benefit: An annuity payable for the lifetime of the member commencing at the applicable retirement eligibility age is equal to the annuitized value of the balance in the hybrid contribution account at the time of retirement, plus, for Act No. 447 and Act No. 1 members, the accrued benefit determined as of June 30, 2013.

(e) Death Benefits

(1) Pre-Retirement Death Benefit

Eligibility: Any current nonretired member is eligible.

Benefit: A refund of the hybrid contribution account, plus the accumulated contributions for Act No. 447 and Act No. 1 members.

(2) High-Risk Death Benefit under Act No. 127

Eligibility: Police, firefighters, and other employees in specified high-risk positions who die in the line of work due to reasons specified in Act No. 127 of 1958, as amended.

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

Children's Benefit: 50% of the participant's compensation at date of death, payable as an annuity, and allocated pro-rata among eligible children. The annuity is payable for life for a disabled child, until age 18 for a nondisabled child not pursuing studies, and until age 25 for a nondisabled child who is pursuing studies.

Benefit if No Spouse or Children: The parents of the member shall each receive 50% of the participant's compensation at date of death, payable as an annuity for life.

Post-death Increases: Effective July 1, 1996 and subsequently every three years, the above death benefits are increased by 3% provided that the beneficiary(ies) had been receiving payments for at least three years.

The cost of these benefits is paid by the Commonwealth's General Fund.

(3) Post-Retirement Death Benefit for Members who Retired prior to July 1, 2013

Eligibility: Any retiree or disabled member receiving a monthly benefit who has not elected a reversionary annuity and whose benefits commenced prior to July 1, 2013.

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Benefit: The benefit is as follows (Law No. 105, as amended by Law No. 4):

- (i) For those married or with dependent children at the time of death, the annual income to a widow, or widower or dependent children is equal to 60% (50% if in the Coordination Plan — 30% prior to January 1, 2004) of the retirement benefit payable for life for a surviving spouse and/or disabled children and payable until age 18 (age 25 if pursuing studies) for nondisabled children. If in the Coordination Plan, the benefit to the surviving spouse does not begin until the spouse's attainment of age 60 and the surviving spouse must have been married to the member for at least 10 years to be eligible for this benefit. The increase in the percentage from 30% to 50% if the Coordination Plan is paid by the Commonwealth's General Fund for former government employees or by the public enterprise or municipality for their former employees.
- (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. Either the Commonwealth's General Fund for former government employees or the public enterprise or municipality for their former employees pays the difference, up to \$250, between (1) the accumulated contributions less the lifetime annual income paid and (2) \$1,000. The System pays for the rest.

(4) Post-Retirement Death Benefit for Members who Retired after June 30, 2013

Eligibility: Any retiree or disabled member who began receiving a monthly benefit after June 30, 2013.

Benefit: If the member elected at the time of retirement to transfer a portion of the annuity to a beneficiary by selecting an actuarially equivalent optional form of payment, the benefit is the applicable survivor benefit selected.

For all members, the excess, if any, of the hybrid contribution account, plus the accumulated contributions for Act No. 447 and Act No. 1 members, at the time of retirement over the total annuity payments paid to the member and any beneficiary per the terms of the optional form of payment shall be payable to a beneficiary or the member's estate.

- (5) Beneficiaries receiving occupational death benefits as of June 30, 2013 continue to be eligible to receive such benefits.

(f) Disability Benefits

(1) Disability

Eligibility: All members are eligible upon the occurrence of disability.

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Benefit. The balance of the hybrid contribution account payable as lump sum distribution, an immediate annuity or a deferred annuity at the election of the participant. Act No. 447 and Act No. 1 members remain eligible to receive the accrued benefit as of June 30, 2013 commencing at the applicable retirement eligibility age.

(2) *High Risk Disability under Act No. 127*

Eligibility. Police, firefighters, and other employees in specified high-risk positions who are disabled in the line of work due to reasons specified in Act No. 127 of 1958 (as amended).

Benefit. 80% (100% for Act No. 447 members) of compensation as of date of disability, payable as an annuity. If the member dies while still disabled, this annuity benefit continues to his beneficiaries. Beneficiaries include the surviving spouse and/or disabled children (for life), nondisabled children until age 18 (age 25 if pursuing studies), and the parents if no other beneficiaries. Effective July 1, 1996 and subsequently every three years, the disability benefit is increased by 3% provided that the member (or beneficiary) had been receiving payments for at least three years (Act No. 127 of 1958, as amended). The cost of these benefits is paid by the Commonwealth's General Fund.

- (3) Members who qualified for occupational or nonoccupational disability benefits as of June 30, 2013 continue to be eligible to receive such benefits.

(g) **Special Benefits**

(1) *Minimum Benefits*

(i) *Past Ad hoc Increases*

The Legislature, from time to time, increases pensions for certain retirees as described in Act No. 124 approved on June 8, 1973 and Act No. 23 approved on September 23, 1983. The benefits are paid 50% by the Commonwealth's General Fund and 50% by the System.

- (ii) *Minimum Benefit for Members who Retired before July 1, 2013 (Act No. 156 of 2003, Act No. 35 of 2007, and Act No. 3)*

The minimum monthly lifetime income for members who retired or become disabled before July 1, 2013 is \$500 per month effective July 1, 2013 (\$400 per month effective July 1, 2007 and \$300 per month up to June 30, 2007). The increase in the minimum monthly benefit from \$200 per month to \$300 per month is paid by the Commonwealth's General Fund for former government and certain public corporations without their own treasuries employees or by certain public corporations with their own treasuries or municipalities for their former employees. The increase in the minimum monthly benefit from \$300 per month to \$400 per month is to be paid by the System for former government and certain public corporations without their own treasuries employees or by certain public corporations with their own treasuries or municipalities for their former employees.

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(iii) Coordination Plan Minimum Benefit

A minimum monthly benefit is payable upon attainment of SSRA such that the benefit, when added to the Social Security Benefit, is not less than the benefit payable prior to SSRA.

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

The Legislature, from time to time, increases pensions by 3% for retired and disabled members. Beneficiaries are not entitled to COLAs granted after the retiree's death. The first increase was granted by Act No. 10 of 1992. Subsequent 3% increases have been granted every third year since 1992, with the latest 3% increase established on April 24, 2007 and effective July 1, 2007 (retroactive to January 1, 2007) for retired and disabled members that were receiving a monthly benefit on or before January 1, 2004. In addition, effective July 1, 2008, any retired or disabled member that was receiving a monthly annuity on or before January 1, 2004 less than \$1,250 per month received an increase of up to 3% without exceeding the limit of \$1,250 per month. The COLAs granted in 1992 to all retirees and in 1998 to retirees who are former government or municipal employees shall be paid by the System. All other COLAs granted in 1995 and later shall be paid by the Commonwealth's General Fund for former government and certain public corporations without their own treasuries employees or by certain public corporations with their own treasuries or municipalities for their former employees.

(3) *Special "Bonus" Benefits*

(i) Christmas Bonus (Act No. 144, as Amended by Act No. 3)

An annual bonus of \$200 for each retiree, beneficiary, and disabled member paid in December provided the member retired prior to July 1, 2013. This benefit is paid from the supplemental contributions received from the Commonwealth's General Fund for former government and certain public corporations without their own treasuries employees or by certain public corporations with their own treasuries or municipalities for their former employees.

(ii) Medication Bonus (Act No. 155, as Amended by Act No. 3)

An annual bonus of \$100 for each retiree, beneficiary, and disabled member to cover health costs paid in July provided the member retired prior to July 1, 2013. Evidence of coverage is not required. The amount is prorated if there are multiple beneficiaries. This benefit is paid from the supplemental contributions received from the Commonwealth's General Fund for former government and certain public corporations without their own treasuries employees or by certain public corporations with their own treasuries or municipalities for their former employees.

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(h) Contributions

(1) Member Contributions

Effective July 1, 2013, contributions by members are 10% of compensation. However, for Act No. 447 members who selected the Coordination Plan, the member contributions are 7% of compensation up to \$6,600 plus 10% of compensation in excess of \$6,600 during the 2013-2014 fiscal year and 8.5% of compensation up to \$6,600 plus 10% of compensation in excess of \$6,600 during the 2014-2015 fiscal year. Members may voluntarily make additional contributions to their hybrid contribution account.

Prior to July 1, 2013, contributions by Act No. 447 members selecting the Coordination Plan were 5.775% of compensation up to \$6,600 plus 8.275% of compensation in excess of \$6,600. Contributions by all other members were 8.275% of compensation. System 2000 members may also have made voluntary contributions of up to 1.725% of compensation prior to July 1, 2013.

(2) Employer Contributions (Article 2-116, as Amended by Law No. 116 of 2010 and Act No. 3)

Prior to July 1, 2011, employer contributions were 9.275% of compensation. Effective July 1, 2011, employer contributions are 10.275% of compensation. For the next four fiscal years effective July 1, employer contributions will increase annually by 1% of compensation. For the five fiscal years thereafter, employer contributions will increase annually by 1.25% of compensation, reaching an employer contribution rate of 20.525% of compensation effective July 1, 2020.

(3) Supplemental Contributions from the Commonwealth's General Fund, Certain Public Corporations, and Municipalities (Act No. 3)

Effective July 1, 2013, the System will receive a supplemental contribution of \$2,000 each fiscal year for each pensioner (including beneficiaries receiving survivor benefits) who was previously benefitting as an Act No. 447 or Act No. 1 member while an active employee. This supplemental contribution will be paid by the Commonwealth's General Fund for former government and certain public corporations without their own treasuries employees or by certain public corporations with their own treasuries or municipalities for their former employees.

(4) Additional Uniform Contribution (Act No. 32, as Amended)

The additional uniform contribution will be certified by the external actuary of the System each fiscal year from 2014-2015 through 2032-2033 as necessary to avoid having the projected gross assets of the System, during any subsequent fiscal year, to fall below \$1 billion. The additional uniform contribution is to be paid by the Commonwealth's General Fund, public corporations with their own treasuries, and municipalities. The additional uniform contribution determined for fiscal years 2014, 2015 and 2016 was \$120 million. The additional uniform contribution determined for fiscal year 2016-2017 is \$596 million, payable at the end of the fiscal year.

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(i) Early Retirement Programs

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

On July 2, 2010, the Commonwealth enacted Act No. 70 establishing a program that provides benefits for early retirement or economic incentives for voluntary employment termination to eligible employees, as defined. Act No. 70 of 2010 (Act No. 70) also established that early retirement benefits will be provided to eligible employees that have completed between 15 to 29 years of creditable services and will consist of monthly benefits ranging from 37.5% to 50% of each employees' monthly salary. Benefits under this program will be paid by the Commonwealth's the General Fund and by the public corporations, covering their respective employees until the plan member reaches the later of age 55 for members under Act No. 447 or age 65 for members under Act No. 1, or the date the plan member would have completed 30 years of service had the member continued employment. In addition, the public corporations will also be required to continue making the required employee and employer contributions to the System. The Commonwealth's General Fund will be required to continue making its required employer contributions. The System will be responsible for benefit payments afterwards. As of June 30, 2015, the System recorded a liability of approximately \$18 million for its responsibility as an employer under Act No. 70.

The contribution requirement to the System is established by law and is not actuarially determined. The special benefits contributions of approximately \$186 million in 2015 mainly represent contributions from the Commonwealth's General Fund, public corporations and municipalities 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 by the Commonwealth's General Fund for former government and certain public corporations without their own treasuries employees, and by certain public corporations with their own treasuries and municipalities for their former employees. 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.

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

ERS MIPC is a cost-sharing, multi-employer defined benefit other postemployment benefit plan sponsored by the Commonwealth. ERS MIPC covers a payment of up to \$100 per month to the eligible medical insurance plan selected by the member provided the member retired prior to July 1, 2013 (Act No. 483, as amended by Act No. 3). Substantially all fulltime employees of the Commonwealth's primary government, and certain municipalities of Puerto Rico and certain component units of the Commonwealth not having their own postemployment benefit plan, were covered by the OPEB.

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Commonwealth employees became members upon their date of employment. Plan members were eligible for benefits upon reaching the pension benefits retirement ages.

At July 1, 2014, the membership consisted of the following:

Membership:	
Retired members	\$ 97,056
Disabled members	<u>15,820</u>
Total membership	<u>\$ 112,876</u>

The contribution requirement of ERS MIPC is established by Act No. 95 approved on June 29, 1963. This OPEB plan is financed by the Commonwealth on a pay-as-you-go basis. There is no contribution requirement from the plan member during active employment. Retirees contribute the amount of the healthcare insurance premium not covered by the Commonwealth contribution. As a result, these OPEB are 100% unfunded. During the year ended June 30, 2015, OPEB contributions amounted to \$97 million.

The funding of the OPEB benefits is provided to the System through legislative appropriations each July 1 by the Commonwealth's General Fund for former government and certain public corporations without their own treasuries employees, and by certain public corporations with their own treasuries and municipalities for their former employees. The legislative appropriations are considered estimates of the payments to be made by the System for the healthcare benefits throughout the year.

(5) Net Pension Liability

The components of the net pension liability as of June 30, 2015 were as follows (dollars in thousands):

Total pension liability	\$ 32,669,162
Plan's fiduciary net deficit	<u>668,272</u>
Net pension liability	<u>\$ 33,337,434</u>
Plan's fiduciary net deficit as a percentage of the total pension liability	2.05 %

(a) Actuarial Methods and Assumptions

The census data collection date is at beginning-of-year. The liability results as of June 30, 2015 are based on projecting the System obligations determined as of the census data collection date of July 1, 2014 for one year, using roll-forward methods and assuming no liability gains or losses.

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The actuarial valuation used the following actuarial assumptions:

Inflation	2.50%
Municipal bond index	3.80%, 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 and the current general economy.
Mortality	<p>Pre-retirement Mortality:</p> <p>For general employees not covered under Act No. 127, RP-2014 Employee Mortality Rates for males and females adjusted to reflect Mortality Improvement Scale MP-2015 from the 2006 base year, and projected forward using MP-2015 on generational basis. For members covered under Act No. 127, RP-2014 Employee Mortality Rates with blue collar adjustments for males and females adjusted to reflect Mortality Improvement Scale MP-2015 from the 2006 base year, and projected forward using MP-2015 on generational basis. As generational tables, they reflect mortality improvements both before and after the measurement date.</p> <p>100% of deaths while in active service are assumed to be occupational for members covered under Act No. 127.</p> <p>Post-retirement Healthy Mortality:</p> <p>Rates which vary by gender are assumed for healthy retirees and beneficiaries based on a study of plan's experience from 2007 to 2012 and updated expectations regarding future mortality improvement. The 2010 base rates are equal to 92% of the rates from the UP-1994 Mortality Table for Males and 95% of the rates from the UP-1994 Mortality Table for Females, both projected from 1994 to 2010 using Scale AA. The base rates are projected using Mortality Improvement Scale MP-2015 on a generational basis. As a generational table, it reflects mortality improvements both before and after the measurement date.</p> <p>Post-retirement Disabled Mortality:</p> <p>Rates which vary by gender are assumed for disabled retirees based on a study of plan's experience from 2007 to 2012 and updated expectations regarding future mortality improvement. The 2010 base rates are equal to 105% of the rates from the UP-1994 Mortality Table for Males and 115% of the rates from the UP-1994 Mortality Table for Females. The base rates are projected using Mortality Improvement Scale MP-2015 on a generational basis. As a generational table, it reflects mortality improvements both before and after the measurement date.</p>

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Most other demographic assumptions used in the July 1, 2014 valuation were based on the results of an actuarial experience study using data as of June 30, 2003, June 30, 2005 and June 30, 2007.

(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 System's Board of Trustees during December 2013 and the actuary's capital market assumptions as of June 30, 2015. In addition, the assumption reflects that loans to members comprise approximately 20% of the portfolio and, have an approximate return of 9.1% with no volatility. The long-term expected rate of return on pension benefits investments of 6.55% as of June 30, 2015 equal to the highest debt service of the senior pension funding bonds payable which range from 5.85% per year to 6.55% per year.

The pension plan's policy in regard to allocation of invested assets is established and may be amended by the System's Board of Trustees. Plan assets are managed on a total return basis with a long-term objective of achieving and maintaining a positive impact on the System's financial condition for the benefits provided through the pension programs. The following asset allocation policy as of June 30, 2015 was adopted by the System's Board of Trustees:

	<u>Target allocation</u>	<u>Long-term expected rate of return</u>
Asset class:		
Domestic equity	25 %	6.4 %
International equity	10	6.7
Fixed income	64	6.3
Cash	<u>1</u>	<u>3.0</u>
Total	<u>100 %</u>	

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.

(c) Discount Rate

The asset basis for the date of depletion projection is the System's fiduciary net position (the gross assets plus deferred outflows of resources less the gross liabilities, including the senior pension funding bonds payable, plus deferred inflows of resources). On this basis, the System's fiduciary net position was exhausted in the fiscal year 2015.

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The System's fiduciary net position was not projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the tax free municipal bond index (Bond Buyer General Obligation 20-Bond Municipal Bond Index) was applied to all periods of projected benefits payments to determine the total pension liability. The discount rate was 3.80% as of June 30, 2015.

The date of depletion projection of the actuarial report does not include any amounts from the additional uniform contribution required by Act No. 32 because of actual fiscal and budgetary financial difficulties, continued budget deficits and liquidity risks of the Commonwealth and the municipalities, and in the event that their financial condition do not improve in the near term.

The July 1, 2014, actuarial valuation reflects an increase of \$3,198 million in the net pension liability as a result of the changes in assumptions of \$2,781 million, mainly related to the decrease in the discount rate as required by GASB Statement No. 67 from 4.29% in fiscal year 2014 to 3.80% in fiscal year 2015 and the Plan Fiduciary Net Deficit Position of approximately \$668 million as of June 30, 2015, which effects were offset by a decrease of \$464 million in the total pension liability as a result 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 3.80%, as well as what it would be if it were calculated using a discount rate of 1%-point lower (2.80%) or 1% point higher (4.80%) than the current rate (dollars in thousands):

	<u>1% Decrease (2.80%)</u>	<u>Current discount rate (3.80%)</u>	<u>1% Increase (4.80%)</u>
Net pension liability	\$ 38,004,512	33,337,434	29,513,508

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

Cash and Cash Equivalents

Cash and cash equivalents as of June 30, 2015 consisted of the following (in thousands):

	<u>Carrying amount</u>	<u>Depository bank balance</u>	<u>Amount uninsured and uncollateralized</u>
Deposits with GDB	\$ 128,260	133,371	133,371
Deposits with GDB held by the Puerto Rico Department of Treasury	11,780	—	—
Deposits with Puerto Rico commercial banks	12,580	12,580	—
Money market funds	208,837	N/A	N/A
U.S. Treasury bill	1,590	N/A	—
Total	<u>\$ 363,047</u>	<u>145,951</u>	<u>133,371</u>

N/A= Not applicable.

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

Restricted cash and cash equivalent amounted to approximately \$161.3 million as of June 30, 2015 and consisted of the following:

- Approximately \$121.7 million of funds are restricted for the debt service of the bonds payable, of which approximately \$112.4 million of funds were deposited at trustee in money market funds and approximately \$9.2 million of funds were deposited at GDB.
- Approximately \$38.0 million of funds are restricted for repayments of mortgage and personal loans administrated by the mortgage servicers and the System, for expired checks not claim by the plan members, and other purposes, of which approximately \$25.5 million of funds for were deposited at GDB and approximately \$12.6 million were deposited at Puerto Rico commercial banks.

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Impairment Loss on Deposits with GDB

Management concluded that the information available prior to the issuance of the System's financial statements for the year ended June 30, 2015 indicates that it is probable that an impairment loss on the System's deposits held with GDB exists as of June 30, 2015.

The Commonwealth and its public entities have not been able to repay their loans from GDB, which has significantly affected GDB's liquidity and ability to repay its obligations.

GDB faces significant risks and uncertainties and it currently does not have sufficient liquid financial resources to meet obligations when they come due. Pursuant to enacted legislation in April 2016, as explained in note 14, the Governor of the Commonwealth ordered the suspension of loan disbursements by GDB, imposed restrictions on the withdrawal and transfer of deposits from GDB, and imposed a moratorium on debt obligations of GDB, among other measures.

Because of the nonpayment by the Commonwealth of the appropriation to GDB and GDB's inability to restructure its debt considering the broader fiscal crisis faced by the Commonwealth, GDB is in default of its debt obligations since May 1, 2016. In April 2016, the Governor imposed on GDB emergency operational restrictions and debt moratorium.

Due to the conditions and events described above, GDB's management believes substantial doubt exists as the GDB's ability to continue as a going concern.

On April 28, 2017, the Oversight Board approved the liquidation proposal included in the GDB's fiscal plan, that calls for an orderly winding down its operations over ten years.

Based on an evaluation of the availability and recoverability of such funds, an impairment loss on these deposits has been recorded on the System's financial statements as follows (expressed in thousands):

Deposits held with GDB at June 30, 2015			
	Carrying value before impairment loss	Impairment loss	Carrying value
Type of deposit:			
Interest bearing accounts	\$ 122,016	(3,342)	118,674
Time deposit	21,366	—	21,366
Total	<u>\$ 143,382</u>	<u>(3,342)</u>	<u>140,040</u>

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In addition, management estimates that additional impairment losses on deposits held with GDB of approximately \$18 million and \$9 million will be recorded in the System's financial statements for the years ended June 30, 2016 and 2017, respectively, corresponding to new certificates of deposit opened during such fiscal years for a total impairment loss on deposits held with the GDB of approximately \$30 million as of April 30, 2017. The realizable balance of the deposits held with the GDB as of June 30, 2015 was determined based on the corresponding actual collections received from the GDB on such deposits after the June 30, 2015 year end.

Investments

For the year ended June 30, 2015, the annual money-weighted rate of return on investments, net of investment expenses, was 0.24%. The money-weighted rate of return expresses investment performance, net of investment expense, adjusted for the changing amounts actually invested.

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, 2015:

(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, 2015, securities investments were registered in the name of the System and were held in the possession of the System's custodian banks, except for securities lent. Securities lent are not exposed to custodial credit risk. Cash collateral received from securities 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. All issuances shall be rated investment grade by at least two of the nationally recognized rating agencies. The portfolio is expected to maintain a minimum weighted average credit quality of either "A-" or better.

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The credit quality ratings of bonds and notes and nonexchange commingled fixed income trust fund as of June 30, 2015, are as follows (in thousands):

Investment type	Rating (1)					CCC-	Not rated	Total
	AAA	AA+ to AA-	A+ to A-	BBB+ to BBB-	BB+ to BB-			
Bonds and notes:								
U.S. government agencies obligations:								
Federal Home Loan Bank (FHLB)	\$ —	5,367	—	—	—	—	—	5,367
Federal National Mortgage Association (FNMA)	—	7,121	—	—	—	—	—	7,121
Federal Home Loan Mortgage Corporation (FHLMC)	—	8,420	—	—	—	—	—	8,420
Federal Farm Credit Banks (FFCB)	—	5,737	—	—	—	—	—	5,737
Mortgage and asset-backed securities:								
FNMA	—	4,411	—	—	—	—	—	4,411
FHLMC	—	1,939	—	—	—	—	—	1,939
Collateralized mortgage obligations (CMO) – others	—	—	—	—	—	—	212	212
Commercial mortgages	4,917	—	—	—	—	—	—	4,917
Asset-backed securities	—	—	—	—	—	—	7,631	7,631
U.S. corporate bonds and notes	14,799	63,815	223,895	183,061	14,333	—	1,163	501,066
Non U.S. corporate bonds	2,294	3,373	34,361	38,539	9,274	—	8,475	96,316
U.S. municipal bonds	2,736	2,834	3,221	—	—	—	—	8,791
COFINA bonds	—	—	—	—	—	89,139	—	89,139
Total bonds and notes	24,746	103,017	281,477	221,600	23,607	89,139	17,481	741,067
Nonexchange commingled fixed income trust fund – SSgA Intermediate fund								
	7,082	6,518	22,170	23,041	12	—	—	58,823
Total	\$ 31,828	109,535	283,647	244,641	23,619	89,139	17,481	799,890

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

Approximately \$54 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, 2015, there are no investments in any issuer that represent 5% or more of the System's total investments, except for its investment in COFINA Bonds.

Pursuant to Act No. 96 of June 16th, 2011, during the fiscal year ended June 30, 2011, the System received a special contribution of approximately \$163 million from the Puerto Rico Infrastructure Financing Authority, an instrumentality of the Commonwealth. The contribution was invested in bonds issued by the Puerto Rico Sales Tax Financing Corporation (known as COFINA by its Spanish

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acronym), which provide for a 7% accretion rate and maturity dates between 2043 and 2048. COFINA is a blended component unit of the Commonwealth. As required by Act No. 96 of June 16th, 2011, the System cannot voluntarily dispose the COFINA Bonds unless such request has been approved by the GDB. The COFINA Bonds have a fair value of approximately \$89 million as of June 30, 2015.

(d) Interest Rate Risk

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

The contractual maturity of investments as of June 30, 2015, 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.

Investment type	Maturity (in years)				
	Within one year	After one to five years	After five to ten years	After ten years	Total
Bonds and notes:					
U.S. government securities:					
U.S. Treasury notes	\$ —	10,476	13,857	—	24,333
U.S. Treasury note strips	—	—	21,445	—	21,445
U.S. Treasury bonds	—	—	—	2,057	2,057
U.S. government sponsored agencies notes:					
FHLB	—	5,367	—	—	5,367
FNMA	—	4,820	2,301	—	7,121
FHLMC	—	6,901	1,519	—	8,420
FFCB	2,110	1,984	1,643	—	5,737
Mortgage and asset-backed securities:					
GNMA	—	—	—	5,859	5,859
FNMA	—	27	325	4,059	4,411
FHLMC	—	—	—	1,939	1,939
Collateralized mortgage obligations (CMO) – others	—	—	—	212	212
Commercial mortgages	—	—	—	4,917	4,917
Asset-backed securities	—	—	4,521	3,110	7,631
U.S. corporate bonds and notes	34,063	254,461	186,144	26,398	501,066
Non U.S. corporate bonds	3,487	41,255	50,682	892	96,316
U.S. municipal bonds	2,782	611	5,398	—	8,791
COFINA bonds	—	—	—	89,139	89,139
Total bonds and notes	42,442	325,902	287,835	138,582	794,761

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Investment type	Maturity (in years) ⁽¹⁾				Total
	Within one year	After one to five years	After five to ten years	After ten years	
Nonexchange commingled fixed income trust fund – SSgA Intermediate Fund (1):					
U.S.	\$ —	38,641	—	—	38,641
Non-U.S.	—	20,182	—	—	20,182
Total bonds and notes and nonexchange commingled fixed income trust fund	\$ 42,442	384,725	287,835	138,582	853,584
Stocks					1
Nonexchange commingled equity trust funds and investments in limited partnerships:					
Nonexchange commingled equity trust funds:					
U.S. – SSgA Russell 3000 Fund					292,145
Non-U.S. – SSgA MSCI ACWI Ex USA Fund					116,855
investments in limited partnerships					54,026
Total nonexchange commingled equity trust funds and investments in limited partnerships					463,026
Total investments					\$ 1,316,611

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

(e) Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. As of June 30, 2015, the SSgA MSCI ACWI Ex USA Fund and the SSgA Intermediate Fund is subject to foreign currency risk.

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As of June 30, 2015, the composition of the underlying investments in the SSgA MSCI ACWI Ex USA and in the SSgA Intermediate Funds by country was as follows:

<u>Country</u>	<u>SSgA MSCI ACWI EX USA Fund</u>	<u>SSgA Intermediate Fund</u>
Japan	16 %	2 %
United Kingdom	14	3
Canada	7	5
France	7	—
Switzerland	7	1
Germany	6	4
Australia	5	1
China	5	—
Korea	3	—
Spain	3	—
Taiwan	3	—
Brazil	2	2
Hong Kong	2	—
India	2	—
Italy	2	—
Netherlands	2	—
South Africa	2	—
Sweden	2	—
Denmark	1	—
Singapore	1	—
United States	—	66
Mexico	—	2
Others	8	14
Total	100 %	100 %

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(i) *Nonexchange Commingled Trust Funds*

As of June 30, 2015, the System owned shares in the SSgA Russell 3000 Index Non-Lending Fund (SSgA Russell 3000 Fund), the SSgA MSCI ACWI Ex USA Non-Lending Fund (SSgA MSCI ACWI Ex USA Fund), and the SSgA Intermediate Fund as follows (in thousands):

Fund name	Shares	Value
SSgA Russell 3000 Fund	13,581	\$ 292,145
SSgA MSCI ACWI Ex USA Fund	6,426	116,855
SSgA Intermediate Fund	2,020	58,823
Total nonexchange commingled trust funds		<u>\$ 467,823</u>

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

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

As of June 30, 2015, the investments underlying the SSgA Russell 3000 Fund, SSgA MSCI ACWI Ex USA Fund, and the SSgA Intermediate Fund had the following sector allocations:

Sector	SSgA Russell 3000 Fund	SSgA MSCI ACWI Ex USA Fund
Information technology	19 %	8 %
Financials	18	28
Healthcare	15	9
Consumer discretionary	13	12
Industrials	11	11
Consumer staples	8	10
Energy	7	7
Materials	4	7
Utilities	3	3
Telecommunication services	2	5
	<u>100 %</u>	<u>100 %</u>

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	SSgA Intermediate Fund
Corporate – industrial	45 %
Corporate – finance	30
Non corporates	21
Corporate – utility	4
Total	<u>100 %</u>

(ii) *Investments in Limited Partnerships*

The fair value of investments in limited partnerships at June 30, 2015, amounted to approximately \$54 million and is presented as private equity investments in the basic Statement of Fiduciary Net Position. The allocations of net gains and losses to limited partners are based on certain percentages, as established in the limited partnership agreements. Investments in limited partnerships are not rated by a nationally recognized statistical rating organization.

In accordance with the partnership agreements, the System's investments can only be redeemed upon distribution from funds managers; usually in the form of a sale of its holdings or dividends distributed. As of June 30, 2015, the System does not intend to sell its investments in limited partnerships for an amount different to that presented in the financial statements.

On July 31, 2014, the Guayacán Fund of Funds L.P was dissolved by Grupo Guayacán, Inc. The final distribution of the fund was received by the System in December 2014.

As of June 30, 2015, the date of commitment, total commitment, 2015 contributions, contributions to date at cost, and estimated fair value of investments in limited partnerships are as follows (in thousands):

	<u>Date of commitment</u>	<u>Total commitment</u>	<u>2015 Contributions</u>	<u>Contributions to date at cost</u>	<u>Estimated fair value</u>
Grupo Guayacán, Inc.- Guayacán Fund of Funds II, LP	August 1999	\$ 25,000	—	23,681	2,042
Advent-Morro Equity Partner, Inc.:					
Guayacán Private Equity Fund, LP	January 1997	5,000	—	4,645	2,214
Guayacán Private Equity Fund II, LP	April 2007	25,000	1,428	21,350	22,238
Venture Capital Fund, Inc.	November 1995	800	—	800	713
GF Capital Management and Advisors, LLC – GF Capital Private Equity Fund LP	December 2006	25,000	—	25,792	24,933
Chase Capital Partners Private: Equity Fund of Funds Corporate Investors II, LTD	July 2000	20,000	—	18,994	1,886
Martineau Bay Resort, s. en c. (s.e.)	July 1998	1,796	—	1,796	—
Total		<u>\$ 102,596</u>	<u>1,428</u>	<u>97,058</u>	<u>54,026</u>

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(iii) *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, 2015, the collateral received represented 102% of the fair value of the total securities lent.

The securities on loan for which collateral was received as of June 30, 2015, consisted of the following (in thousands):

Description	Fair value of underlying securities
U.S. government securities:	
U.S. Treasury bills	\$ 910
U.S. Treasury notes	17,770
U.S. Treasury note strips	24,683
U.S. Treasury bonds	900
U.S. government sponsored agencies notes:	
FHLB	1,094
FNMA	2,672
FHLMC	1,816
U.S. corporate bonds and notes	21,076
Non U.S. corporate bonds and notes	7,434
Total	\$ <u>78,355</u>

The underlying collateral for these securities had a fair value of approximately \$80.1 million as of June 30, 2015. The collateral received was invested in a money market fund sponsored by the custodian bank. As of June 30, 2015, the short-term investment fund consisted of securities purchased under agreements to resell.

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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) Accounts Receivable from Employers

As of June 30, 2015, accounts receivable from employers consisted of the following (in thousands):

Early retirement programs	\$ 3,264
Special laws	59,964
Employer and employee contributions	318,540
Interest on late payments	<u>23,606</u>
Total accounts receivable from employers	405,374
Less allowance for adjustments and losses in realization	<u>(222,015)</u>
Total accounts receivable from employers – net	<u>\$ 183,359</u>

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

As more fully described in note 3, the Commonwealth and many of its instrumentalities, which are the employers as it relates to the System, have been facing significant fiscal and economic challenges. Further, in recent months, the rating downgrade and widening of credit spreads for the Commonwealth's public sector and public corporations' debt has put further strain on liquidity and sources of funding of the employers. Consequently, most of the receivables from employers are delinquent past established payment dates and/or installment plan due dates. In other instances, amounts past due have continued to be renegotiated to later dates.

As of June 30, 2015, the System recorded an allowance of approximately \$222.0 million for adjustments and losses in realization of the additional uniform contributions due from the Commonwealth for the fiscal years 2014 and 2015 because, as explained in note 3, its collectability is uncertain at this moment.

Although certain measures have been taken to improve the collection of such receivables, the timing of collections from employers affects the liquidity needs of the System. Management is of the opinion that, except for the additional uniform contributions of the Commonwealth of approximately \$222.0 million, other amounts due from employers are collectible; however this situation could ultimately affect the payment of benefits to members or repayment of the System's bonds payable, should any such amounts become uncollectible in the future.

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(8) Member Loans and Interest Receivable

Loans receivable from plan members are guaranteed by the contributions of plan members and by other sources, including mortgage deeds and any unrestricted amount remaining in the escrow funds. In addition, collections on loans receivable are received through payroll withholdings. The latest maximum amount of loans to plan members for mortgage loans was \$100,000 and \$5,000 for personal and cultural trip loans. The originations of mortgage loans were frozen in December 2013 and those related to personal and cultural loans were frozen in November 2016. During the years ended June 30, 2014 and 2013, personal loans with principal balances amounting to approximately \$100 million and \$88 million, respectively, were sold to two financial institutions. As per servicing agreements, the System is in charge of the servicing, administration and collection of the loans and outstanding principal balances at and after closing date for a servicing fee of 2%.

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

As of June 30, 2015, the composition of loans and interest receivable from plan members is summarized as follows (in thousands):

Loans receivable:	
Personal	\$ 360,379
Mortgage	170,785
Cultural trips	<u>41,368</u>
Total loans to plan members	572,532
Accrued interest receivable	37,416
Less allowance for adjustments and losses in realization	<u>(2,331)</u>
Total loans and interest receivable from plan members – net	<u>\$ 607,617</u>

(9) Other Assets

As of June 30, 2015, other assets mainly consist of repossessed and foreclosed properties acquired through foreclosure proceedings related to delinquent mortgage loans. Foreclosed properties are valued at the outstanding principal balance of the related mortgage loan upon foreclosure. These properties will be sold under a bidding process intended to recover the outstanding principal balance of the related mortgage loan. A gain or loss is recognized at the time of sale.

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

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In August 2014, the System sold land with a carrying value of approximately \$4.7 million to a public corporation of the Commonwealth for approximately \$9.0 million and realized a gain on disposition of asset of approximately \$4.3 million. This gain of disposition of assets is included as part of other income in the Statement of Changes in Fiduciary Net Position for the year ended June 30, 2015.

(10) Bonds Payable

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

On January 31, 2008, the System issued the first series of Bonds, which consisted of approximately \$1,589 million aggregate principal amount of Senior Pension Funding Bonds, Series A (the Series A Bonds). On June 2, 2008, the System issued the second of such series of Bonds, which consisted of approximately \$1,059 million aggregate principal amount of Senior Pension Funding Bonds, Series B (the Series B Bonds). Finally, on June 30, 2008, the System issued the third and final of such series of Bonds, which consisted of approximately \$300 million aggregate principal amount of Senior Pension Funding Bonds, Series C (the Series C Bonds).

The following is a summary of changes in the bonds payable principle balance (in thousands):

	<u>Maturity</u>	<u>Balance at June 30, 2014</u>	<u>Accretion</u>	<u>Balance at June 30, 2015</u>
5.85% to 6.45% Term and Capital Appreciation Bonds Series A	2023–2058	\$ 1,610,427	4,196	1,614,623
6.25% to 6.55% Term and Capital Appreciation Bonds Series B	2028–2058	1,172,487	23,235	1,195,722
6.15% to 6.50% Term and Capital Appreciation Bonds Series C	2028–2043	301,235	214	301,449
Bond discounts		(6,562)	216	(6,346)
Total		<u>\$ 3,077,587</u>	<u>27,861</u>	<u>3,105,448</u>

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As of June 30, 2015, the outstanding principal balance of the Bonds is as follows (in thousands):

<u>Description</u>	
Series A Bonds:	
Capital Appreciation Bonds, maturing in 2028, bearing interest at 6.20%	\$ 70,853
Term Bonds, maturing in 2023, bearing interest at 5.85%	200,000
Term Bonds, maturing from 2031 through 2038, bearing interest at 6.15%	679,000
Term Bonds, maturing from 2039 through 2042, bearing interest at 6.20%	332,770
Term Bonds, maturing from 2055 through 2058, bearing interest at 6.45%	<u>332,000</u>
Total Series A Bonds outstanding	<u>1,614,623</u>
Series B Bonds:	
Capital Appreciation Bonds, maturing from 2028 through 2030, bearing interest at 6.40%	220,485
Capital Appreciation Bonds, maturing from 2031 through 2034, bearing interest at 6.45%	159,137
Term Bonds, maturing in 2031, bearing interest at 6.25%	117,100
Term Bonds, maturing from 2036 through 2039, bearing interest at 6.30%	270,000
Term Bonds, maturing from 2055 through 2058, bearing interest at 6.55%	<u>429,000</u>
Total Series B Bonds outstanding	<u>1,195,722</u>
Series C Bonds:	
Capital Appreciation Bonds, maturing in 2030, bearing interest at 6.50%	3,449
Term Bonds, maturing in 2028, bearing interest at 6.15%	110,000
Term Bonds, maturing in 2038, bearing interest at 6.25%	45,000
Term Bonds, maturing in 2043, bearing interest at 6.30%	<u>143,000</u>
Total Series C Bonds outstanding	<u>301,449</u>
Total bonds outstanding	3,111,794
Less bonds discount	<u>(6,346)</u>
Bonds payable – net	<u>\$ 3,105,448</u>

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

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

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

Redemption period	Subject bonds	Amount
July 1, 2021	Term bonds (final maturity July 1, 2023)	\$ 50,000
July 1, 2022	Term bonds (final maturity July 1, 2023)	70,000
July 1, 2023	Term bonds (final maturity July 1, 2023)	80,000
	Subtotal	200,000
July 1, 2031	Term bonds (final maturity July 1, 2038)	3,000
July 1, 2032	Term bonds (final maturity July 1, 2038)	4,500
July 1, 2033	Term bonds (final maturity July 1, 2038)	4,000
July 1, 2034	Term bonds (final maturity July 1, 2038)	133,500
July 1, 2035	Term bonds (final maturity July 1, 2038)	133,500
July 1, 2036	Term bonds (final maturity July 1, 2038)	133,500
July 1, 2037	Term bonds (final maturity July 1, 2038)	133,500
July 1, 2038	Term bonds (final maturity July 1, 2038)	133,500
	Subtotal	679,000
Total		\$ 879,000

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

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

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

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

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

Redemption period	Subject bonds	Amount
July 1, 2024	Term bonds (final maturity July 1, 2028)	\$ 18,700
July 1, 2025	Term bonds (final maturity July 1, 2028)	22,000
July 1, 2026	Term bonds (final maturity July 1, 2028)	29,150
July 1, 2027	Term bonds (final maturity July 1, 2028)	36,300
July 1, 2028	Term bonds (final maturity July 1, 2028)	<u>3,850</u>
	Subtotal	<u>110,000</u>
July 1, 2029	Term bonds (final maturity July 1, 2038)	100
July 1, 2030	Term bonds (final maturity July 1, 2038)	540
July 1, 2031	Term bonds (final maturity July 1, 2038)	100
July 1, 2032	Term bonds (final maturity July 1, 2038)	3,420
July 1, 2033	Term bonds (final maturity July 1, 2038)	4,320
July 1, 2034	Term bonds (final maturity July 1, 2038)	100
July 1, 2035	Term bonds (final maturity July 1, 2038)	11,940
July 1, 2036	Term bonds (final maturity July 1, 2038)	2,160
July 1, 2037	Term bonds (final maturity July 1, 2038)	7,920
July 1, 2038	Term bonds (final maturity July 1, 2038)	<u>14,400</u>
	Subtotal	<u>45,000</u>

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Redemption period	Subject bonds	Amount
July 1, 2039	Term bonds (final maturity July 1, 2043)	\$ 28,600
July 1, 2040	Term bonds (final maturity July 1, 2043)	28,600
July 1, 2041	Term bonds (final maturity July 1, 2043)	28,600
July 1, 2042	Term bonds (final maturity July 1, 2043)	28,600
July 1, 2043	Term bonds (final maturity July 1, 2043)	28,600
		<u>143,000</u>
Total		\$ <u>298,000</u>

Debt service requirements in future years on the System's bonds as of June 30, 2015 are as follows (in thousands):

	Principal	Interest	Total
Year ending June 30:			
2016	\$ —	166,519	166,519
2017	—	166,519	166,519
2018	—	166,519	166,519
2019	—	166,519	166,519
2020	—	166,519	166,519
2021–2025	218,700	799,171	1,017,871
2026–2030	648,055	747,700	1,395,755
2031–2035	897,165	700,709	1,597,874
2036–2040	1,036,940	484,531	1,521,471
2041–2045	279,250	266,815	546,065
2046–2050	—	247,568	247,568
2051–2055	—	247,568	247,568
2056–2060	761,000	82,048	843,048
	<u>3,841,110</u>	<u>4,408,705</u>	<u>\$ 8,249,815</u>
Less:			
Unaccrued interest	(729,316)		
Unamortized discount	<u>(6,346)</u>		
Total	\$ <u>3,105,448</u>		

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

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

Starting in August 2016, and monthly thereafter, the fiscal agent under the Resolution of the System's bonds notified to the System that it failed to transfer the requisite employers' contributions on the last business day of each month. The fiscal agent is not seeking to collect or recover any indebtedness from, enforce any judgment against, or obtain possession of, exercise control over, any property of or from, the Commonwealth or any of its instrumentalities, including the System, or exercise any act that is stayed by PROMESA, the Puerto Rico Financial Emergency and Fiscal Responsibility Act of January 29, 2017 (Act No. 5 or the Financial Emergency Act), the Puerto Rico Emergency Moratorium and Financial Rehabilitation Act (Act No. 21 or the Moratorium Act), or any Executive Orders related thereto. Consistent with PROMESA, the Financial Emergency Act, the Moratorium Act, and any Executive Orders, the fiscal agent is not exercising at this time any rights or remedies against the Commonwealth of Puerto Rico or any of its instrumentalities, including the System.

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

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

The System's other postemployment healthcare benefits (OPEB) funded status as of June 30, 2015, 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
\$ —	1,428,788	1,428,788	—	\$ 3,319,280	43 %

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.

Act No. 3 eliminated the medical insurance plan contribution of \$100 per month for future retirees effective July 1, 2013.

The census data collection date is at beginning-of-year. The liability results as of June 30, 2015 are based on projecting the System obligations determined as of the census data collection date of July 1, 2014 for one year, using roll-forward methods and assuming no liability gains or losses. The amortization period for GASB Statement No. 45 has been reduced to the expected future lifetime of current in pay members.

The actuarial valuations used the following actuarial assumptions:

Actuarial cost method	Entry age normal
Amortization method	18 years closed (beginning July 1, 2014), level dollar
Remaining amortization period	18 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	Not applicable
Cost of living adjustment	Not applicable

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

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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.

(13) Contingencies

The System is a defendant in a lawsuit challenging the constitutionality of Act No. 3.

The plaintiffs requested the System to honor the participants of an employer of the System, the benefits available to them under Act No. 447 which were affected by Act No. 3 of 2013, with the economic consequences that this would entail. On February 13, 2015, the Puerto Rico Supreme Court denied the plaintiff's recourse. On March 6, 2014, the plaintiffs filed an amended complaint, including the System's Board of Trustees as a defendant and including a torts claim against the System's Administration and its Board of Trustees.

With respect to this lawsuit, the System, in consultation with legal counsel, has determined that at this stage of the proceedings they cannot offer an opinion as to the probable outcome. Accordingly, management does not consider necessary making any provision in its books for these cases and intends to contest them vigorously.

The System is also a defendant in a lawsuit brought by pensioners of the System. They filed the claim on behalf of the System against the underwriters of certain pension bonds of the System and some of the former members of the Board of Trustees of the System. The complaint requested \$800 million in damages resulting from the \$3 billion bond issuance in 2008 that, according to the plaintiffs, compromised the solvency of the System. On December, 2016, the Court of First Instance permitted the transpose of the System as plaintiff in the Complaint. This case is in its initial stages, therefore no provision for liability, if any, which may result upon adjudication of this lawsuit has been recorded by the System.

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

(14) Subsequent Events

Subsequent events were evaluated through February 19, 2018, the date the financial statements were available to be issued, to determine if such events should be recognized or disclosed in the 2015 financial statements.

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Pre-Retirement Program

On December 8, 2015, the Commonwealth enacted Act No. 211, establishing a voluntary program that provides benefits for pre-retirements to eligible employees, as defined. Act No. 211 applies to eligible employees of agencies and component units whose budgets are funded in whole or in part by the Commonwealth's General Fund, municipalities, component units that operate with their own resources (except those that have their own retirement system), Judiciary Branch, except judges, and the Commonwealth Employees Association. Act No. 211, among other provisions, established that pre-retirement benefits (pre-retirement program) will be provided to eligible employees who started contributing to the System before April 1, 1990 with at least 20 years of service and will consist of biweekly benefits of 60% of the of each employee's salary as of December 31, 2015, as defined. Pursuant to Act No. 211, the employers will continue making the applicable employee and employer contributions to the Retirement System and the employer contributions to the Federal Social Security and Medicare based on the average salary, as defined, as of December 31, 2015. Individual contributions to the Federal Social Security and Medicare will be deducted from the biweekly benefits to be paid to the participant. These payments will be made until the employee reaches the age of 61 years. Other benefits would include the payment of the participant's healthcare plan during the first two years of the program. Once the participant reaches age of 61 years, the participant is eligible to receive payments from the System and is entitled to a guaranteed minimum pension of 50% of their average salary (except police officers, which would be paid 60%) which related cost will be paid by the employer.

Moratorium Act and Declaration of Fiscal Emergency

On April 6, 2016, the Governor of Puerto Rico signed into law the Puerto Rico Emergency Moratorium and Rehabilitation Act (Act No. 21 or the Moratorium Act). 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.

On April 8, 2016, the Governor of Puerto Rico issued 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 have restricted 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.

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On June 30, 2016, the Governor signed an executive order, EO-2016-030 (EO 30), which among other things, declared the Commonwealth to be in a state of emergency and declared a moratorium on the Commonwealth's obligation to make payments on bonds and notes issued or guaranteed by the Commonwealth. On the same date, the Governor signed an executive order, EO-2016-031 (EO 31), which among other things, declared an emergency period with respect to System and suspended the monthly payments to the trustee of the System's bonds in July 2016. These executive orders, and other executive orders signed by the Governor, also declared an emerging period over various employers of the System.

PROMESA and Related Litigation

The Commonwealth nor its component units, including the System, are eligible to seek relief under Chapter 9 of the United States Bankruptcy Code. However, on June 30, 2016, the Congress of the United States enacted PROMESA, which grants the Commonwealth and its component units access to an orderly mechanism to restructure their debts in exchange for significant federal oversight over the Commonwealth's finances. PROMESA was enacted pursuant to Section 3 of Article IV of the United States Constitution, which provides the U.S. Congress the power to dispose of and make all needful rules and regulations for territories. In broad terms, PROMESA seeks to provide Puerto Rico with fiscal and economic discipline through the creation of the Oversight Board, relief from creditor lawsuits through the enactment of a temporary stay on litigation, and two alternative methods to adjust unsustainable debt.

Pursuant to PROMESA Section 405, the enactment of PROMESA imposed an automatic stay on all litigation against Puerto Rico and its instrumentalities, as well as any other judicial or administrative actions or proceedings to enforce or collect claims against the Commonwealth and its instrumentalities (the PROMESA Stay). This stay initially was effective until February 15, 2017, but was extended 75 days by the Oversight Board through May 1, 2017.

On January 29, 2017, the Commonwealth enacted Act No. 5, the Financial Emergency Act. Act No. 5 is intended to facilitate and encourage a voluntary negotiation process under PROMESA between the Governor of Puerto Rico and/or the Puerto Rico Fiscal Agency and Financial Advisory Authority, on behalf of the Commonwealth, and the creditors of the Commonwealth and its instrumentalities. Act No. 5 authorizes the Commonwealth, within the parameters established by PROMESA, to designate certain services necessary for the health, safety and welfare of the residents of Puerto Rico and provided by the Commonwealth and its instrumentalities as "essential services", in accordance with the Constitution of Puerto Rico.

On May 1, 2017, the PROMESA Stay expired, permitting the substantial litigation brought by bondholders and other creditors against the Commonwealth and its instrumentalities to resume. As a result, on May 3, 2017, the Oversight Board commenced a Title III case for the Commonwealth by filing a petition for relief under Title III of PROMESA. On May 21, 2017, the Oversight Board commenced Title III cases for the System by filing similar petitions for relief under Title III of PROMESA. On May 11, 2017, United States Supreme Court Chief Justice John Roberts designated United States District Judge Laura Taylor Swain as the presiding judge in the Title III cases. All of the foregoing Title III cases have been consolidated for procedural purposes only and are being jointly administered under Case No. 17-3283-LTS in the United States District Court for the District of Puerto Rico.

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Faced with the eventual insolvency of the System and the inability to reach a consensual restructuring agreement with its creditors, on May 21, 2017, the Oversight Board filed a petition for relief for the System pursuant to PROMESA Section 304(a), 48 U.S.C. §2164. As such, the System is a debtor in a proceeding pursuant to PROMESA Title III, 48 U.S.C. §2161, et seq. Pursuant to PROMESA Section 315 (48 U.S.C. §2175), the Oversight Board serves as the debtor's representative in the Title III proceedings.

On June 23, 2017, the Legislature approved the Other Assignments for the Fiscal Year 2017-2018 Joint Resolution, which among other things, ordered the System, JRS, and TRS to liquidate their assets and pass the net proceeds to the Treasury Department of the Commonwealth. On July 20, 2017 the System sold investments amounting to approximately \$297 million.

On June 24, 2016, Fitch downgraded from "CC" to "C" the System bonds and placed them on "negative" outlook since default of some kind was deemed inevitable. Fitch cited "the breakdown of negotiations between the Commonwealth and major bondholders, the recent ruling by the U.S. Supreme Court on the Commonwealth's bankruptcy legislation, and the slow process of federal legislation in support of the Commonwealth" as indicators that a debt restructuring, deferral or default has become inevitable. Fitch also indicated that recently released proposals and counterproposals between the Commonwealth and bondholders indicate a distressed debt exchange of some kind was inevitable. Moreover, Fitch expressed that with sizeable debt service payments due on July 1, 2016, the probability of default on the general obligation debt is high. Soon after the missed payments of July 1, 2016 imposed by the Moratorium Act and related executive orders, S&P downgraded to the lowest level of "D" the general obligation bonds of the Commonwealth, while Fitch did the same. On April 6, 2017, Moody's downgraded the System bonds to a level C rating from its previous ratings of Ca and Ca, respectively. On that same date, Moody's reaffirmed the Caa3 rating on the Commonwealth's GO bonds. On June 7, 2017, S&P downgraded COFINA's senior and junior lien bonds to the default rating of D, in response to Title III Judge Swain order not to make the COFINA's scheduled debt service for June 1, July 1 and August 1, 2017; but to maintain such funds in a trust account until the judge decides on the case, further discussed above.

On July 17, 2017, Judge Swain approved agreement a Joint Stipulation reached between the System and certain System bondholders. In the Stipulation, the parties also agreed that the System would make interest payments due on October 1, 2017 from the System's Prepetition Segregated Account (which was created pursuant to a stipulation and order dated January 17, 2017) and that these payments would constitute adequate protection for the creditors until October 31, 2017 with respect to the automatic stay. In addition, the System and certain bondholders agreed that, the System would seek a declaratory relief challenging the validity, priority, extent and enforceability of the prepetition and post-petition liens and security interests asserted by certain bondholders with respect to bonds issued by the System. The stipulation also calls for payment of approximately \$14 million in interest due July 1, 2017 and missed by the System, after commencement of its Title III case. The System will also pay subsequent monthly interest payments until October 1, 2017, or approximately \$42 million in total.

On July 21, 2017, pursuant to the Joint Stipulation the Oversight Board, on behalf of the System filed a declaratory relief challenging the validity, priority, extent and enforceability of the prepetition and post-petition liens and security interests asserted by Defendants with respect to bonds issued by the System. The complaint contends that the Defendants' alleged liens and security interests are not perfected because the required UCC financing statements and subsequent amendments were defective. The System

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also challenges, among other things, the System Bondholders' alleged security interest in post-petition employer contributions. Defendants have asserted counter-claims related to the same issues.

On November 28, 2017, certain System Bondholders (the Puerto Rico Funds) filed a motion to require the System to continue making payments from Prepetition Segregated Account (Created pursuant to the Stipulation) until the court rules on the parties' motion for summary judgment, the Court granted the motion in part. Specifically, the Court ordered the System to transfer the December 2017 and January 2018 interest payments pursuant to the Stipulation, and going forward to transfer the interest payment by the 20th of each month until the earlier of (i) the Court's order on the motion for summary judgment, or (ii) the exhaustion of the funds in the Prepetition Segregated Account.

Enactment of Pay-as-You-Go and Related Litigation under Title III of PROMESA

On June 27, 2017, the Treasury Department issued Circular Letter No. 1300 46 17 in order to convey to the central government agencies, public corporations and municipalities the new implementation procedures to adopt, effective, July 1, 2017, the new "pay-as-you-go (PayGo)" mechanism for all of the Commonwealth's Retirement Systems. With the start of the fiscal year 2018, employers' contributions, contributions ordered by special laws and the Additional Uniform Contribution were all eliminated and replaced by a monthly PayGo charge that will be collected from the aforementioned government entities to pay retirees. The Commonwealth Retirement Systems will determine and administer the payment amount per retiree that will be charged to each agency, public corporation and municipality. The PayGo charge must be submitted to the Treasury Department before the 15th day of each month along with the individual contributions withheld from active employees. As liquid retirement funds become depleted, the PayGo charge is expected to increase.

In addition to the establishment of the PayGo mechanism, on August 23, 2017, the Commonwealth enacted Act to Guarantee the Payment to Our Pensioners and Establish a New Plan for Defined Contributions for Public Servants (Act 106 2017), which reformed the System, JRS and TRS, so that their active participants would deposit their individual contributions in a new Defined Contribution Plan that will be managed by a private entity. Act 106 2017 creates the legal framework so that the Commonwealth can guarantee payments to pensioners through the PayGo scheme. With this system, the Commonwealth makes pension payments from the General Fund, according to the money available. Approximately \$2 billion was allocated for these purposes in the fiscal year 2018 budget. Act 106 2017 also created a Defined Contribution Plan, similar to a 401(k) plan, which guarantees the contributions of public servants, because future benefits will not be paid by the retirement systems. However, under the PayGo system, Puerto Rico's municipalities will remain obligated on their pension obligations.

Act No. 106-2017, among other things, amends Act No. 3 with respect to the System's governance, funding and benefits for active members of the actual program and new hired members. By this act, the System's Board of Trustees was substituted with the Retirement Board of the Government of Puerto Rico (Retirement Board). Pursuant this act the Retirement Board will also be in charge of the governance of the System and the JRS. The Retirement Board has thirteen members; five ex-officio, four representatives of the active participants and four representatives of the public interest.

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Act No. 106-2017 also terminates the actual program for the System participants as of June 30, 2017. The members of the actual program and new system members hired since July 1, 2017 will be enrolled in a new defined contributions program that will be selected by the Retirement Board. The accumulated balance on the accounts of the actual program will be transferred to the members account at the new defined contributions program. The System' active members of the defined contributions program will retain their benefits as stated under Act 91 of March 29, 2003.

Act 106-2017 also ordered a suspension of the System' loan programs and ordered a merger of the administrative structures of the retirement systems. At the Retirement Board discretion, the administration of the system benefits might be externalized. The employees of the System that are not retained under the new administrative structure will be transferred to other public agencies in conformity with Act 8 of February 8, 2017.

On July 27, 2017, System Bondholders, initiated a complaint against the Commonwealth, the Oversight Board, the Puerto Rico Fiscal Agency and Financial Advisory Authority, the System, Governor of Puerto Rico and Treasury Secretary. The lawsuit seeks a declaration that that Commonwealth legislation, Joint Resolution 188 and Act 106-2017 (the PayGo Legislation) is void ab initio on the grounds that it violates the automatic stay under the Bankruptcy Code and violates the Takings and Contract Clauses of the U.S. Constitution. The System, represented by the Oversight Board and the Puerto Rico Fiscal Agency and Financial Advisory Authority, moved to dismiss the complaint in full on November 17, 2017. The motion was fully briefed as of January 24, 2018. No hearing has been set on the motion.

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On September 20, 2017, Puerto Rico got a direct hit from Hurricane Maria, the strongest hurricane to hit the island in almost a century, the System's building was extremely destroyed by Hurricane Maria causing the relocation of the employees. The System has entered into a lease agreement with the Puerto Rico Public Buildings Authority in order to relocate its offices to a different building and be able to continue operations. This lease agreement has caused the System to negotiate some additional contracts and eliminate others related to auxiliary services. Management of the System is in the process of determining the extent of damages.

REQUIRED SUPPLEMENTARY INFORMATION

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Schedule of Changes in the Employers' Net Pension Liability and Related Ratios –
Pension Benefits (Unaudited)

Years ended June 30, 2015 and 2014

(Dollars in thousands)

	<u>2015 Amount</u>	<u>2014 Amount</u>
Total pension liability:		
Service cost	\$ 425,564	419,183
Interest	1,279,556	1,321,478
Differences between expected and annual experience	(463,898)	53,939
Changes in assumptions	2,781,098	1,198,307
Benefit payments, including refunds of contributions	<u>(1,572,675)</u>	<u>(1,714,758)</u>
Net change in total pension liability	2,449,645	1,278,149
Total pension liability – beginning	<u>30,219,517</u>	<u>28,941,368</u>
Total pension liability – ending (a)	<u>32,669,162</u>	<u>30,219,517</u>
Plan's fiduciary net position (deficit):		
Employer contributions – net of provision	673,926	713,813
Member contributions	339,650	359,862
Net investment income	29,258	225,005
Other income	28,499	30,748
Benefit payments, including refunds of member contributions	(1,572,675)	(1,714,758)
Administrative expenses	(33,623)	(29,530)
Interest on bonds payable	(194,400)	(192,947)
Other expenses	<u>(19,573)</u>	<u>(26,584)</u>
Net change in plan fiduciary net position	(748,938)	(634,391)
Total fiduciary net position – beginning	<u>80,666</u>	<u>715,057</u>
Total fiduciary net position (deficit) – ending (b)	<u>(668,272)</u>	<u>80,666</u>
Employers' net pension liability – ending (a)-(b)	<u>\$ 33,337,434</u>	<u>30,138,851</u>
Plan's fiduciary net position (deficit) as a percentage of the total pension liability	(2.05)%	0.27 %
Covered employee payroll	\$ 3,319,280	3,489,096
Employers' net pension liability as a percentage of covered employee payroll	1,004.36 %	863.80 %

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.

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

(A Component Unit of the Commonwealth of Puerto Rico)

Schedule of Investment Return – Pension Benefits (Unaudited)

Years ended June 30, 2015 and 2014

	2015	2014
Annual money-weighted rate of return, net of investment expenses	4.2 %	11.2 %

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.

**EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT
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Schedule of Employers' Contributions – OPEB (Unaudited)

(Dollars in thousands)

Fiscal year ended (1)	Annual required contributions	Actual employers' contributions	Percentage of contribution
June 30, 2015	\$ 103,878	97,374	93.7
June 30, 2014	88,508	102,085	115.3
June 30, 2013	154,999	91,823	59.2
June 30, 2012	133,654	94,664	70.8
June 30, 2011	129,395	93,851	72.5
June 30, 2010	128,294	88,599	69.1
June 30, 2009	111,683	85,385	76.5

- (1) The System's annual required contributions for the year ended June 30, 2015 and 2014 were determined by the actuarial valuation at beginning of year that was updated to roll forward the funded status to June 30, 2015 and 2014 and assuming no liability gains or losses. Prior year actuarial valuations were made using end-of-year census data.

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

**EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT
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Schedule of Funding Progress – OPEB (Unaudited)

(Dollars in thousands)

Actuarial valuation date (1)		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, 2015	\$	—	1,428,788	1,428,788	— %	\$ 3,319,280	43.0 %
June 30, 2014		—	1,438,475	1,438,475	—	3,489,096	41.2
June 30, 2013		—	1,482,879	1,482,879	—	3,489,096	42.5
June 30, 2012		—	2,120,970	2,120,970	—	3,570,339	59.4
June 30, 2011		—	1,758,389	1,758,389	—	3,666,402	48.0
June 30, 2010		—	1,699,373	1,699,373	—	3,818,332	44.5
June 30, 2009		—	1,633,159	1,633,159	—	4,292,552	38.0

(1) The System's OPEB funded status as of June 30, 2015 and 2014 were determined by the actuarial valuation at beginning of year that was updated to roll forward the funded status to June 30, 2015 and 2014 and assuming no liability gains or losses. Prior year actuarial valuations were made using end-of-year census data.

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

**EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT
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Notes to Required Supplementary Information

June 30, 2015

(1) Changes in Benefits Terms

There have not been any changes in plan provisions since the prior valuation.

(2) Changes in Assumptions

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

The investment return assumption was decreased from 6.75% per year in fiscal year 2014 to 6.55% per year in fiscal year 2015. Accordingly, the assumed investment return on the defined contribution hybrid account (80% of the net investment return assumption) was decreased from 5.40% per year in fiscal year 2014 to 5.24% per year in fiscal year 2015.

The projected mortality improvement scale was updated from Scale AA to Scale MP-205, which was published by the Society of Actuaries in October 2015. Also, as Scale MP-205 is a two-dimensional mortality scale, the base mortality rates for the post-retirement mortality assumption were set to the 2010 rates – the central year of the 2007 to 2012 System experience study upon which the rates were based. In addition, the pre-retirement mortality rates were also updated to reflect updated mortality tables published by the Society of Actuaries.

The asset basis for the date of depletion projection is the System's fiduciary net position (the gross assets plus deferred outflows of resources less the gross liabilities, including the senior pension funding bonds payable, plus deferred inflows of resources). On this basis, the System's fiduciary net position was exhausted in the fiscal year 2015.

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. 32 because of actual fiscal and budgetary financial difficulties with continued budget deficits and liquidity risks of the Commonwealth and the municipalities and in the event that their financial condition do not improve in the near term.

The System's fiduciary net position was not projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the tax free municipal bond index (Bond Buyer General Obligation 20-Bond Municipal Bond Index) was applied to all periods of projected benefits payments to determine the total pension liability.

The discount rate used to determine the total pension liability decreased from 4.29% at June 30, 2014 to 3.80% at June 30, 2015, determined under GASB Statement No. 67. Under GASB Statement No. 67, the investment return assumption is an input that is used in the calculation of the single equivalent interest rate that is used to discount these benefits to determine the Total Pension Liability. Under former 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. For fiscal years 2008 to 2010 and for fiscal years 2011, 2012 and 2013, the discount rates determined under GASB Statements No. 25 and No. 27 were 7.50%, 6.40%, 6.00% and 6.40%, respectively.

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June 30, 2015

Also, the valuations for fiscal year 2015 and 2014 reflect a salary freeze until July 1, 2017 due to Act No. 66 and the current economic conditions in Puerto Rico.

(3) Changes in Actuarial Methods since the prior Valuation

There have not been any changes in methods since the prior valuation.

In fiscal years 2015 and 2014, the census data collection date changed from end-of-year to beginning-of-year. The total pension liability at end of year was determined by actuarial valuation as of the census data collection date at beginning-of-year and was then projected forward to end-of-year, using roll-forward methods and assuming no liability gains or losses.

The June 30, 2014, actuarial valuation reflects an increase of \$3,136 million in the net pension liability as a result of the changes in assumptions of \$2,781 millions, mainly related to the decrease in the discount rate as required by GASB Statement No. 67 from 4.29% in fiscal year 2014 to 3.80% in fiscal year 2015 and the Plan Fiduciary Net Deficit Position of approximately \$605 million as of June 30, 2015, which effects were offset by a decrease of \$464 million in the total pension liability as a result differences between expected and actual experience.

(4) Method and Assumptions Used in the System's Actuarial Valuation

The following actuarial methods and assumptions were used in the System's actuarial valuation of June 30, 2015:

Actuarial cost method	Entry age normal
Asset valuation method	Market value of assets
Inflation	2.50%
Municipal bond index	3.80%, 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 and the current general economy.

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June 30, 2015

Mortality

Pre-retirement Mortality:

For general employees not covered under Act No. 127, RP-2014 Employee Mortality Rates for males and females adjusted to reflect Mortality Improvement Scale MP-2015 from the 2006 base year, and projected forward using MP-2015 on generational basis. For members covered under Act No. 127, RP-2014 Employee Mortality Rates with blue collar adjustments for males and females adjusted to reflect Mortality Improvement Scale MP-2015 from the 2006 base year, and projected forward using MP-2015 on generational basis. As generational tables, they reflect mortality improvements both before and after the measurement date.

100% of deaths while in active service are assumed to be occupational for members covered under Act No. 127.

Post-retirement Healthy Mortality:

Rates which vary by gender are assumed for healthy retirees and beneficiaries based on a study of plan's experience from 2007 to 2012 and updated expectations regarding future mortality improvement. The 2010 base rates are equal to 92% of the rates from the UP-1994 Mortality Table for Males and 95% of the rates from the UP-1994 Mortality Table for Females, both projected from 1994 to 2010 using Scale AA. The base rates are projected using Mortality Improvement Scale MP-2015 on a generational basis. As a generational table, it reflects mortality improvements both before and after the measurement date.

Post-retirement Disabled Mortality:

Rates which vary by gender are assumed for disabled retirees based on a study of plan's experience from 2007 to 2012 and updated expectations regarding future mortality improvement. The 2010 base rates are equal to 105% of the rates from the UP-1994 Mortality Table for Males and 115% of the rates from the UP-1994 Mortality Table for Females. The base rates are projected using Mortality Improvement Scale MP-2015 on a generational basis. As a generational table, it reflects mortality improvements both before and after the measurement date.