

AUDITED FINANCIAL STATEMENTS  
AND REQUIRED SUPPLEMENTARY  
INFORMATION

University of Puerto Rico Retirement System  
Years Ended June 30, 2015 and 2014  
With Report of Independent Auditors

Ernst & Young LLP



# University of Puerto Rico Retirement System

## Audited Financial Statements and Required Supplementary Information

Years Ended June 30, 2015 and 2014

### Contents

Report of Independent Auditors.....	1
Management’s Discussion and Analysis (Unaudited) .....	4
Audited Financial Statements	
Statements of Fiduciary Net Position .....	16
Statements of Changes in Fiduciary Net Position.....	17
Notes to Financial Statements.....	18
Required Supplementary Information (Unaudited)	
Schedule 1 – Schedule of Changes in the University of Puerto Rico’s Net Pension Liability .....	50
Schedule 2 – Schedule of the University of Puerto Rico’s Net Pension Liability.....	51
Schedule 3 – Schedule of the University of Puerto Rico’s Contributions.....	52
Schedule 4 – Schedule of Investment Returns.....	53
Notes to Required Supplementary Information .....	54
Report of Independent Auditors on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with <i>Government Auditing Standards</i> .....	56



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## Report of Independent Auditors

Government Board  
of the University of Puerto Rico Retirement System

### **Report on the Financial Statements**

We have audited the accompanying financial statements of the University of Puerto Rico Retirement System (the “System”), which comprise the statements of fiduciary net position as of June 30, 2015 and 2014, and the related statements of changes in fiduciary net position for the years then ended, and the related notes to the financial statements.

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

Management is responsible for the preparation and fair presentation of these financial statements in conformity 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 of material misstatement, whether due to fraud or error.

#### ***Auditor’s Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of 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 auditor’s 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 System at June 30, 2015 and 2014, and the changes in its fiduciary net position for the years then ended in conformity with U.S. generally accepted accounting principles.

### **The System's 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 Note 2 to the financial statements, the System is highly dependent on funding from the University of Puerto Rico (the "University") which receives its funding from the Commonwealth of Puerto Rico (the "Commonwealth") appropriations to finance its operations. The financial difficulties experienced by the Commonwealth, including uncertainty as to its ability to fully satisfy its obligations, also raises substantial doubt about the System's ability to continue as a going concern.

Management's plans in regard to these matters are described in Note 2. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

### **Required Supplementary Information**

Accounting principles generally accepted in the United States require that the management's discussion and analysis on pages 4 through 15 and the required supplementary information on pages 50 through 55 be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the 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, 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 financial statements, and other knowledge we obtained during our audit of the 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.

### **Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated January 25, 2017, on our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

*Ernst + Young LLP*

January 25, 2017

Stamp No. E258597  
affixed to  
the original  
of this report.

# University of Puerto Rico Retirement System

## Management's Discussion and Analysis (Unaudited)

Years Ended June 30, 2015 and 2014

### *Introduction*

The University of Puerto Rico (the "University") was organized through Law No. 135 of May 7, 1942, known as the Act of the University (superseded by Act Number 1 of January 20, 1966 as amended (the "Act No. 1")), as a public corporation and governmental instrumentality of the Commonwealth of Puerto Rico (the "Commonwealth"). On February 16, 1945 the University's Council on Higher Education, with the University's endorsement and consent, enacted a resolution to create, maintain, finance and manage the University of Puerto Rico Retirement Plan (the "System") effective January 1, 1945 in order to provide pension benefits to all university employees. The Act No. 1 designated the Governing Board as Trustee with the faculty to govern the System. In addition, the Governing Board appointed the System's Board to oversee the System administration and an Executive Director to manage its everyday affairs in accordance with the faculties and provisions of Certification Number 27 (1973-74), as amended. The System has functioned pursuant to the terms and conditions of Act No. 1 and Certification Number 27.

Our discussion and analysis of the System's financial performance provides an overview of the System's financial activities for the fiscal years ended June 30, 2015 and 2014.

### *Financial Highlights*

- The Retirement Fund reflected a 5.61% growth return for fiscal year 2015 when compared to its benchmark of 4.61%, while in fiscal year 2014 also reflected a 17.71% return over its benchmark of 16.39% for that year.
- Sustainability ratio increased from 40.8% in fiscal year 2013, to 43.9% in fiscal year 2014 and 46.6% in fiscal year 2015, demonstrating continued progress in the financial position.
- Fund performance ranked 1st and 2nd when compared against the Callan Associates peer comparison nationwide Callan Associates public fund database for June 2014 and June 2015 respectively. Database consists of approximately (300+ public funds) in the past 24 months.
- System's assets are **\$1,342,996,274**, \$1,324,028,384 and \$1,161,573,140 at the close of fiscal years 2015, 2014 and 2013, respectively (reported as net position). Marketable securities are held in a separate account to meet future benefit payments.

## University of Puerto Rico Retirement System

### Management's Discussion and Analysis (Unaudited) (continued)

- The component of Additions to Fiduciary Net Position in the year 2015 is comprised of contributions of **\$123,844,673**, net investments income of **\$76,684,124** and **\$11,403,965** in reimbursements from the University of Puerto Rico for retirees' medical insurance (maximum reimbursed amount of \$125 per retiree per month).
- Total additions to Fiduciary Net Position in fiscal year 2015 were **\$211,932,762** compared to \$344,431,574 in fiscal year 2014 and \$281,649,897 in fiscal year 2013. The decrease in additions in fiscal year 2015 was mainly caused by the lower net appreciation in fair value of investments due to market conditions of **\$58,444,468** in fiscal year 2015, compared to **\$187,942,407** in fiscal year 2014 and \$126,386,135 in fiscal year 2013.
- Deductions to Fiduciary Net Position in fiscal year 2015 were **\$192,964,872** compared to \$181,976,330 in fiscal year 2014 and \$175,985,461 in fiscal year 2013. The difference was mainly caused by benefits paid to participants of **\$176,871,770** in fiscal year 2015, compared to \$169,162,756 in fiscal year 2014 and \$162,182,241 in fiscal year 2013. Retirees receiving benefits increased to **8,247** at the end of fiscal year 2015 vs. 8,082 at the end of fiscal year 2014 and 7,863 in fiscal year 2013.

#### ***The Statement of Fiduciary Net Position and the Statement of Changes in Fiduciary Net Position***

These statements include all assets and liabilities using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, all revenues and expenses are taken into account regardless of when cash is received or paid. The Statement of Fiduciary Net Position presents plan assets and liabilities, with the difference between the two reported as net position. Over time, increases and decreases in net position measure whether the System's financial position is improving or deteriorating. The statement of Changes in Fiduciary Net Position presents how the System's net position changed during the period to determine whether the System is becoming financially stronger or weaker and to understand changes over time in the funded status of the System.

## University of Puerto Rico Retirement System

### Management's Discussion and Analysis (Unaudited) (continued)

#### *Financial Analysis*

The net position of the System during the year ended June 30, 2015 increased by approximately **\$18.97 million** or **1.43%** from the prior year (see Statements of Changes in Fiduciary Net Position for details). For fiscal year 2015 total assets decreased **\$1.74 million** or **-0.11%** from prior year. For fiscal year 2013 total assets increased \$127 million or 9.11% from prior year.

#### Statements of Fiduciary Net Position

	June 30, 2013	June 30, 2014	June 30, 2015	2013-2014 Percentage Change	2014-2015 Percentage Change
<b>Assets</b>					
Cash	\$ 24,198,235	\$ 39,984,623	\$ 22,329,050	65.24%	-44.16%
Receivables	76,165,148	41,075,631	51,810,197	-46.07%	26.13%
Investments	1,040,132,790	1,195,667,654	1,230,353,693	14.95%	2.90%
Alternative investment	15,543,756	16,602,143	18,653,369	6.81%	12.36%
Securities lending cash collateral	97,502,608	88,785,830	59,665,343	-8.94%	-32.80%
Loans to plan members	124,139,301	124,365,792	123,400,063	0.18%	-0.78%
Other net of allowances	18,222,210	16,852,940	15,505,688	-7.51%	-7.99%
Capital assets	3,633,863	3,674,252	3,548,760	1.11%	-3.42%
<b>Total Assets</b>	<b>\$ 1,399,537,911</b>	<b>\$ 1,527,008,865</b>	<b>\$ 1,525,266,163</b>	9.11%	-0.11%
<b>Liabilities</b>					
Accounts payable and accrued expenses	\$ 27,526,126	\$ 43,847,229	\$ 45,086,870	59.29%	2.83%
Obligations under securities lending	97,502,608	90,126,816	60,946,003	-7.56%	-7.56%
Escrow deposits on mortgage loans	231,158	265,173	362,327	14.72%	36.64%
Other deposits	2,618,249	3,119,655	3,584,486	19.15%	14.90%
Payables for acquisition of investments	110,086,630	65,621,608	72,290,203	-40.39%	10.16%
<b>Total Liabilities</b>	<b>237,964,771</b>	<b>202,980,481</b>	<b>182,269,889</b>	-14.70%	-10.20%
<b>Net Assets</b>	<b>\$ 1,161,573,140</b>	<b>\$ 1,324,028,384</b>	<b>\$ 1,342,996,274</b>	13.99%	1.43%

## University of Puerto Rico Retirement System

### Management's Discussion and Analysis (Unaudited) (continued)

#### Statements of Changes in Fiduciary Net Position

	June 30, 2013	June 30, 2014	June 30, 2015	2013-2014 Percentage Change	2014-2015 Percentage Change
<b>Additions:</b>					
Contributions	\$ 125,333,059	\$ 129,588,674	\$ <b>123,844,673</b>	3.40%	-4.43%
Net Investment income	146,290,472	206,595,170	<b>76,684,124</b>	41.22%	-62.88%
Medical insurance reimbursements from the University of Puerto Rico	10,026,366	8,247,730	<b>11,403,965</b>	-17.74%	<b>38.27%</b>
<b>Total additions</b>	<b>281,649,897</b>	<b>344,431,574</b>	<b>211,932,762</b>	<b>22.29%</b>	<b>-38.47%</b>
<b>Deductions:</b>					
Benefits paid to participants	162,182,241	169,162,756	<b>176,871,770</b>	4.30%	<b>4.56%</b>
General and administrative expenses	3,776,854	4,565,844	<b>4,689,137</b>	20.89%	<b>2.70%</b>
Medical insurance expenses paid to retirees from University of Puerto Rico	10,026,366	8,247,730	<b>11,403,965</b>	-17.77%	<b>38.27%</b>
<b>Total deductions</b>	<b>175,985,461</b>	<b>181,976,330</b>	<b>192,964,872</b>	<b>3.40%</b>	<b>6.04%</b>
<b>Net increase in net position restricted for pension</b>	<b>\$ 105,664,436</b>	<b>\$ 162,455,244</b>	<b>\$ 18,967,890</b>	<b>53.75%</b>	<b>-88.32%</b>

#### *Contributions and Net Investment Income*

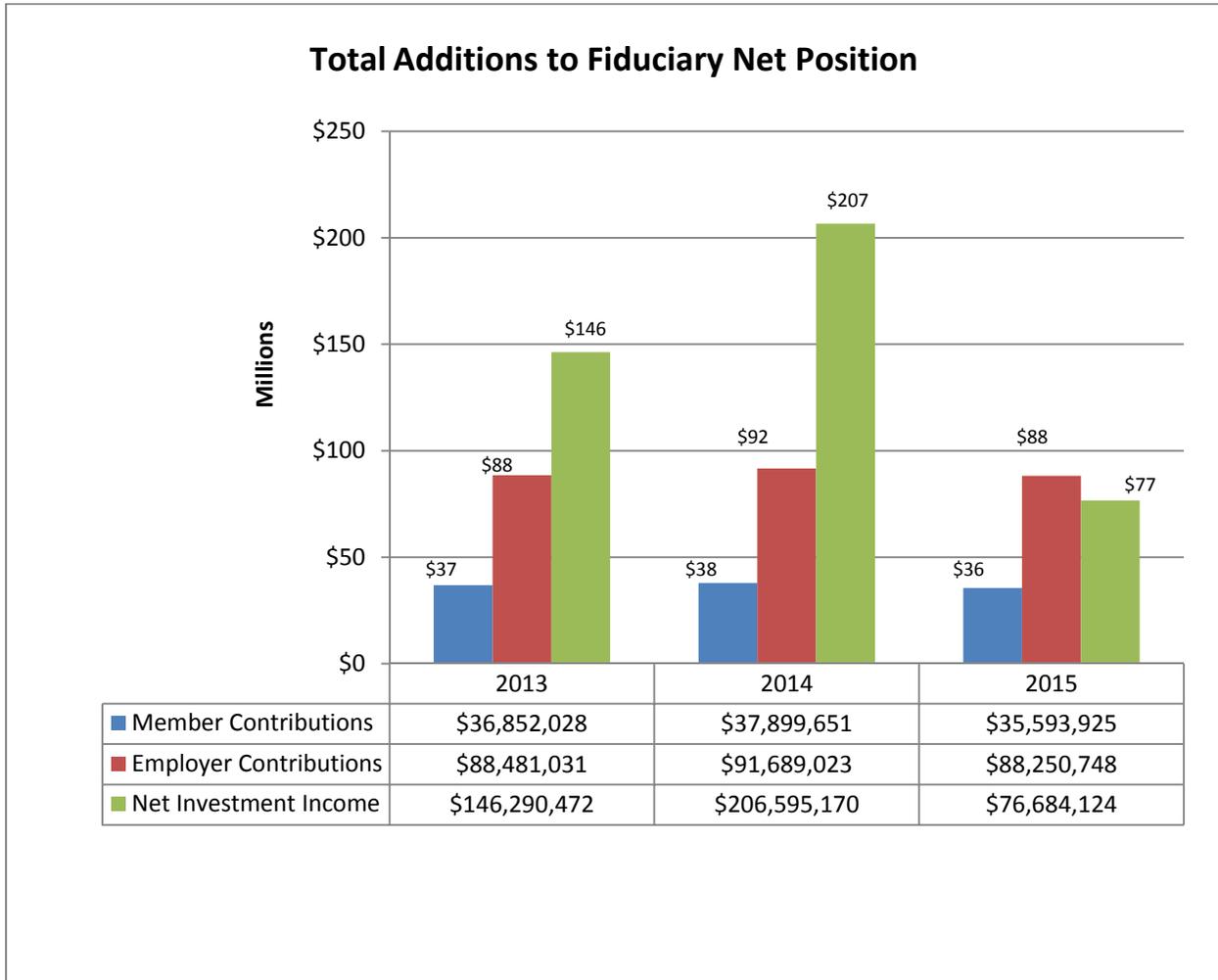
The funds needed to finance retirement benefits are obtained through employer and employee contributions and through net investment income. Contributions and net investment income for fiscal year 2015 amounted to approximately **\$200.5** million compared to \$336.2 million for fiscal year 2014. The decrease was mainly caused by the lower net appreciation of investments during fiscal year 2015 due to market conditions.

Contributions and net investment income for fiscal year 2014 amounted to approximately \$336.2 million compared to \$271.6 million for fiscal year 2013. The increase was mainly caused by the net appreciation of investments during fiscal year 2014.

## University of Puerto Rico Retirement System

### Management’s Discussion and Analysis (Unaudited) (continued)

Contributions paid by employees approximated **\$35.6** million, \$37.9 million and \$36.8 million for the years ended June 30, 2015, 2014 and 2013, respectively. This represented a decrease of approximately **\$(2.3)** million or **(6.08)%** for 2015 and an increase of \$1.1 million or 2.84% for 2014.



## University of Puerto Rico Retirement System

### Management's Discussion and Analysis (Unaudited) (continued)

#### *General and Administrative Expenses*

General expenses for the administration of the System are budgeted and approved as part of the annual budget process and are paid from the assets of the Retirement Fund. Expenses for some professional services, including outside legal counsel, auditor, investment managers, investment advisor, and actuarial services are paid directly from the System's Retirement Fund. In addition, the Board reviews and approves proposals for one-time, special projects as they arise.

Total general and administrative expenses for the System during fiscal year 2015, 2014 and 2013, amounted to **\$4,689,137**, \$4,565,844 and \$3,776,854, respectively, an increase of **\$32,293** or **(.69)%** and \$788,990 or 20.89% in 2013. As of July 1, 2015 investment custodian expenses will be reclassified to be included and considered as part of the total investment expenses since these costs are exclusively associated with the trading and other transactions of the Retirement Fund.

#### *Actuarial Standards*

Actuarial calculations are based on the current provisions of the System and on actuarial assumptions that are as of June 30, 2014 and internally consistent and reasonably based on the actual experience of the System. In addition, the calculations were completed in compliance with the laws governing the System. The actuary is a member of the American Academy of Actuaries and meets the Qualification Standards of the American Academy of Actuaries to determine the actuarial amounts contained in this report.

Future actuarial results may differ significantly from the current results presented in this report due to such factors as the following: plan experience differing from that anticipated by the economic or demographic assumptions; changes in economic or demographic assumptions; increases or decreases expected as part of the natural operation of the methodology used for these measurements (such as the end of an amortization period or additional cost or contribution requirements based on the plan's funded status); and changes in plan provisions or applicable law. Since the potential impact of such factors is outside the scope of a normal annual actuarial valuation, an analysis of the range of results is not presented herein.

## University of Puerto Rico Retirement System

### Management's Discussion and Analysis (Unaudited) (continued)

This financial report consists of two basic financial statements as follows:

- The Statement of Fiduciary Net Position which reports the Retirement Fund assets, liabilities, and resulting net position where  $\text{Assets-Liabilities} = \text{Net Position}$  held in trust for pension benefits available at the end of the fiscal year. It is a snapshot of the financial position of the Retirement Fund at that specific point in time.
- The Statement of Changes in Fiduciary Net Position summarizes the Retirement Fund financial transactions that have occurred during the fiscal year where  $\text{Additions-Deductions} = \text{Net Change in Net Position}$ . It supports the change that has occurred to the prior year's net position on the Statement of Fiduciary Net Position.

The following table summarizes the membership of the System as of June 30:

<b>Membership</b>	<b>2014</b>	<b>2013</b>
Inactive members or their beneficiaries currently receiving benefits	8,081	7,863
Inactive members entitled to but not yet receiving benefits	8,417	8,394
Active members	10,711	11,008
Total	27,209	27,265

The long-term expected rate of return of the Retirement Fund investments was determined using a lognormal distribution analysis in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) which 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. The target asset allocation and best estimates of arithmetic real rates of return for each major asset class provided by the System's investment consultant.

The discount rate used to measure the total pension liability was 6.37%. The projection of cash flows used to determine the discount rate assumed that plan member contributions will be made at the current contribution rates and that Employer contributions will be made at rates equal to the difference between actuarially determined contribution rates and the member rate. For years beginning June 30, 2015 the contribution rates reflect amortization of the System's unfunded actuarial accrued liability over a closed 40 – year period from that date as adopted by the University's Board of Governors Certification 146 (2014-2015). Based on those assumptions, the

## University of Puerto Rico Retirement System

### Management's Discussion and Analysis (Unaudited) (continued)

pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members until the plan year ending June 30, 2060. Therefore, the long-term expected rate of return on pension plan investments of 7.75% was applied to all periods of projected benefit payments through June 30, 2060 and the applicable municipal bond index rate of 3.82%, based on the Bond Buyer General Obligation 20-year Municipal Bond Index published monthly by the Board of Governors of the Federal Reserve System as of June 30, 2015, was applied to all periods of projected benefit payments after June 30, 2060. The Single Equivalent Interest Rate (SEIR) of 6.37% that discounts the entire projected benefit stream to the same amount as the sum of the present values of the two separate benefit payments streams was used to determine the total pension liability as of June 30, 2015. The SEIR at the beginning of the measurement period was 5.31% based on the long-term expected rate of return on pension plan investments of 8% applied to all periods of projected benefit payments through June 30, 2027 and the applicable municipal bond index rate of 4.35% applied to all periods of projected benefit payments after June 30, 2027.

Required Supplementary Information includes four required schedules of historical trend information as follows:

The Schedule of Changes in the University of Puerto Rico's Net Pension Liability (page 50) presents sources of changes in the net pension liability. The Schedule of the University of Puerto Rico's Net Pension Liability (page 51) includes historical information about the components of the net pension liability and related ratios, including fiduciary net position as a percentage of the total pension liability, and the net pension liability as a percentage of covered-employee payroll.

The Schedule of the University of Puerto Rico's Contributions (page 52) includes information about the actuarially determined contribution, contributions to the pension plan, and related ratios. Additionally, significant methods and assumptions used in calculating the actuarially determined contributions are presented in the notes to required supplementary information.

The Schedule of Investment Returns (page 53) includes the annual money-weighted rate of return on pension plan investments for each year.

#### *Investments*

The System's investment portfolio appreciated in fair value by approximately **\$58.4** million during fiscal year 2015, as compared to fiscal year 2014 when it appreciated by \$187.9 million and \$126.3 million in 2013. The net investment income for fiscal year 2015 amounted to **\$76.7** million a decrease of **\$130** million or (62.9)% compared to a net investment income of \$206.6 million in fiscal year 2014 and \$206.6 million increase of \$60.3 million in fiscal year 2013. The decrease

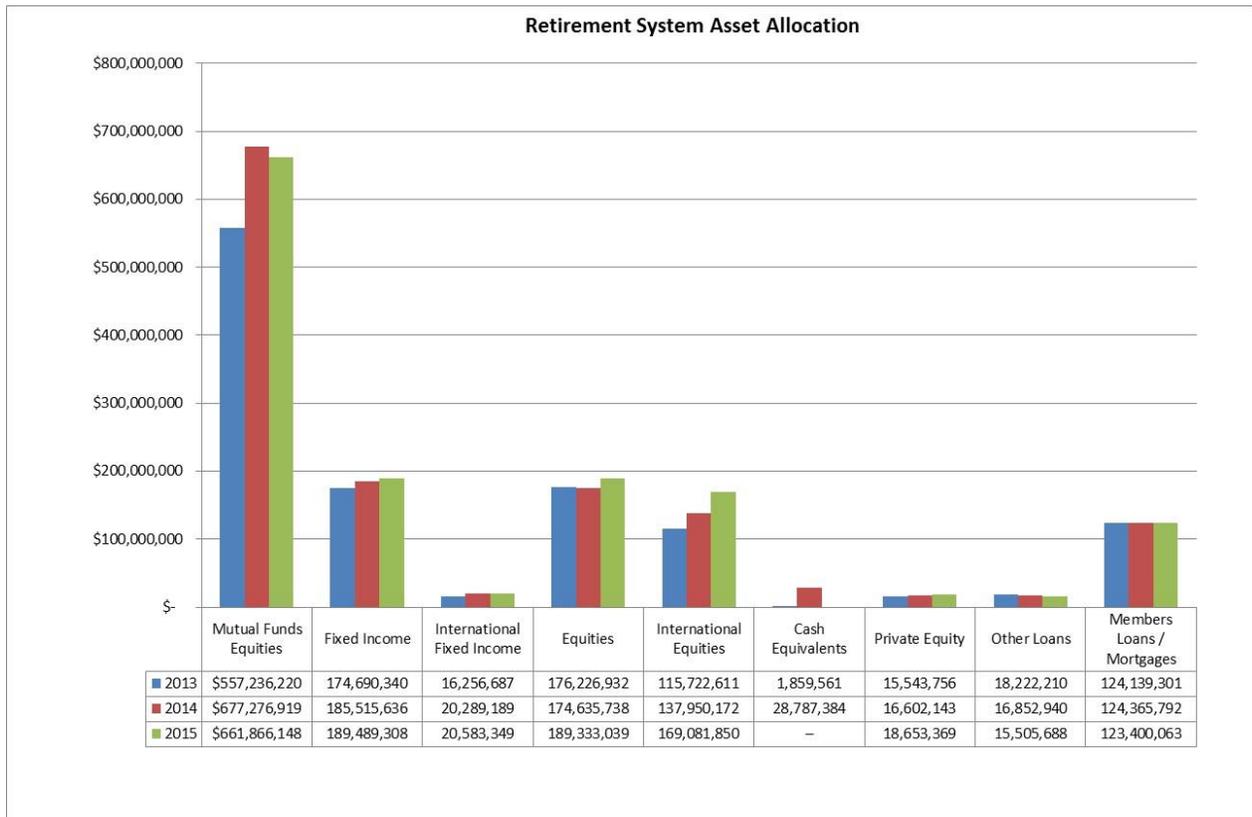
## University of Puerto Rico Retirement System

### Management’s Discussion and Analysis (Unaudited) (continued)

was caused by the lower appreciation in the fair value of assets due to market conditions. Total investment expenses during fiscal year 2015 of **\$3,120,148** decreased by **\$36,417** or **(1.15) %** as compared to fiscal year 2014 and an increase of \$493,373 or 18.53% in fiscal year 2013.

#### *Asset Allocation of the University of Puerto Rico Retirement System*

The System’s Retirement Fund comprises of more than **95%** of the total plan assets. Most of the assets are invested in marketable securities. The investment fund has **73.5%** of its assets in stocks and **13.7%** in fixed income investments, **10%** loans to participants, **1.5%** in international fixed income, and **1.3%** in private equity investments for the year ended June 30, 2015. Equity investments are diversified between domestic and foreign markets and among companies with small, medium and large capitalization. The table below shows the asset allocation as of June 30, 2015, 2014 and 2013:



## University of Puerto Rico Retirement System

### Management's Discussion and Analysis (Unaudited) (continued)

#### *Benefits Paid and Liabilities*

For the fiscal year 2015, pension benefits paid to retirees and beneficiaries were approximately **\$176.9** million, which represents an increase of approximately **\$7.7** million or **4.56%** when compared to the prior year. For the fiscal year 2014, pension benefits paid to retirees and beneficiaries were approximately \$169.1 million, which represents an increase of approximately \$6.9 million or 4.3% when compared to the fiscal year 2013.

As of June 30, 2015, the Active members and Retired members were **10,644** and **8,247** respectively, as compared to 10,728 and 8,082 as of June 30, 2014. As of June 30, 2014, the Active members and Retired members were 10,728 and 8,082 respectively, as compared to 11,008 and 7,863 as of June 30, 2013.

During fiscal year 2015, total liabilities were **\$182.3** million, which represents a decrease of **\$20.7** million or **10.2%** when compared to prior year. 40% of our total liabilities consist of unsettled transactions. During fiscal year 2014, total liabilities were \$202.9 million, which represents an increase of \$62.5 million or 44.5% when compared to prior year. A 58% of our total liabilities consist of unsettled transactions. Overall, this amount represents accounts payable to agencies, deposits for distribution to employee's contributions and accounts payables for acquisition of investments.

#### *Retirement System as a Whole*

Fiscal year 2015, reported an increase in net position of **\$19.0** million due to the return of investments held by the Plan as these investments presented positive returns that amounted to approximately \$76.7 million.

Fiscal year 2014, reported an increase in net position of \$162.5 million due to the return of investments held by the Plan as these investments presented positive returns that amounted to approximately \$155.5 million.

#### *Economic Factors*

The Puerto Rico economy has been in a recession since 2006. There has been an overall contraction in sectors of Puerto Rico's economy, principally within the manufacturing and construction sectors, coupled with declines in retail sales, budget shortfalls and diminished consumer buying power resulting in higher costs of living.

## University of Puerto Rico Retirement System

### Management's Discussion and Analysis (Unaudited) (continued)

Despite the decline in population and the increase in the average age of the population, the number of students has continued to increase as a result of the lower cost of tuition and the shifting of students from private institutions to the University.

As described above, the Commonwealth has been facing a number of fiscal and economic challenges in recent years due, among other factors, continued budget deficits, a prolonged economic recession, high unemployment, population decline, and high levels of debt and pension obligations. The Commonwealth and its affiliated entities, including the Government Development Bank for Puerto Rico ("GDB"), have experienced severe liquidity issues and are in default on significant amounts of debt. On June 30, 2016, the U.S. President signed the Puerto Rico Oversight, Management, and Economic Stability Act (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. On August 31, 2016, the U.S. President announced the appointment of seven members to the Oversight Board. It should be noted that this Oversight Board has broad powers that can be exercised in connection with addressing the financial condition of the Commonwealth and its affiliates. There is uncertainty as to what actions the Oversight Board and the Commonwealth will take, if any, and the effects they may have on the Plan.

On June 30, 2016, the Governor of the Commonwealth signed EO 31, declaring the University in a state of emergency pursuant to Act No. 21. In compliance with EO 31, the University suspended the monthly payments to the trustee of the Trust Agreement that govern the University System Revenue Bonds and the monthly payments of the Lease Agreement with DUI in July 2016.

As noted above, the System is reliant on funding from its sponsor, the University, to fully meet its obligations. The University is highly reliant on the Commonwealth for operating revenues and for governance coupled with reliance on the GDB, a component unit of the Commonwealth, for liquidity and financial management support.

As economic conditions have worsened, the Commonwealth's revenues and funding sources from GDB have been reduced, which could further reduce the University's revenues from the Commonwealth's appropriations and the University's liquidity, having an adverse effect on the University's financial position or changes in its net position. All of this has raised substantial doubt about the University's, and therefore the System's, ability to continue as a going concern and fully meet its obligations, as further discussed in Note 2 of the financial statements. We note that both the Commonwealth and the University have expressed substantial doubt about their respective ability to continue as going concerns in their most recently issued financial statements.

## University of Puerto Rico Retirement System

### Management's Discussion and Analysis (Unaudited) (continued)

As mentioned above, the fiscal year ended June 30, 2015 presented significant economic challenges and difficulties for the University. As a result, the System's management focused hard on initiatives aimed at protecting and perpetuating the retirement fund of the University. On June 29, 2016 the University confirmed, restated and acknowledged in a public deed (the "Trust Deed") all acts and faculties as applied and lawfully enforced by the Governing Board in relation to the System and its trust fund from its inception to the present-day. Thus, through the execution of the Trust Deed, the University affirmed the public and governmental nature of the System founded in the year 1945 and its organization as a de facto trust. Pursuant to the Trust Deed, the System's assets remain completely autonomous and separate of the assets of the University, the Trustee and its members and continue to be exempt from the individual or collective action of their respective creditors.

#### ***Contacting System Financial Management***

This financial report is designed to provide the Government Board, Retirement Board, participants, taxpayers, investors, and creditors with a general overview of the System's finances and to demonstrate the System's accountability for the money it receives. If you have any questions about this report or need additional financial information, contact the University of Puerto Rico Retirement System at P.O. Box 21769, San Juan, Puerto Rico 00931-1769 and (787) 751-4550.

University of Puerto Rico Retirement System

Statements of Fiduciary Net Position

	June 30	
	2015	2014
<b>Assets</b>		
Cash and cash equivalents	\$ 22,329,050	\$ 39,984,623
Investments at fair value:		
U.S. Government and Agencies' obligations	38,316,850	56,441,450
Foreign bonds	20,583,349	20,289,189
Corporate bonds and other debentures	82,303,666	150,774,923
Foreign common stock	169,081,850	137,950,172
Common stock	189,333,039	765,352,688
Mortgage-backed securities	66,801,132	62,677,909
Municipal bonds	1,708,469	1,871,750
Sovereign debt	359,190	309,573
Commingled funds equity	661,866,148	–
Alternative investments	18,653,369	16,602,143
Invested securities lending cash collateral	59,665,343	88,785,830
Loans to plan members:		
First mortgages	39,589,301	40,373,993
Personal installments	83,810,762	83,991,799
Other, net of allowance for doubtful accounts of \$72,782 and \$111,614 in 2015 and 2014, respectively	15,505,688	16,852,940
Other receivables	211,521	210,745
Accrued interest receivable on investments	1,447,644	1,196,931
Receivables from sale of investments	39,520,205	39,270,851
Contributions receivable from Puerto Rico Treasury Department	1,807,837	389,173
Accounts receivable from University of Puerto Rico	8,822,990	7,931
Capital assets, net of accumulated depreciation of \$1,015,226 and \$876,894 in 2015 and 2014, respectively	3,548,760	3,674,252
Total assets	1,525,266,163	1,527,008,865
<b>Liabilities</b>		
Accounts payable and accrued expenses	45,086,870	43,847,229
Obligation under securities lending	60,946,003	90,126,816
Escrow deposits on mortgage loans	362,327	265,173
Other deposits and pending distribution funds	3,584,486	3,119,655
Payable for acquisition of investments	72,290,203	65,621,608
Total liabilities	182,269,889	202,980,481
Net position restricted for pensions	\$ 1,342,996,274	\$ 1,324,028,384

*See accompanying notes.*

University of Puerto Rico Retirement System

Statements of Changes in Fiduciary Net Position

	<b>Year Ended June 30</b>	
	<b>2015</b>	<b>2014</b>
<b>Additions:</b>		
Contributions:		
Employer	\$ 88,250,748	\$ 81,189,023
Participants	35,593,925	37,899,651
Actuarial deficit funds collection	–	10,500,000
	<b>123,844,673</b>	<b>129,588,674</b>
Investment income:		
Net appreciation in fair value of investments	58,444,468	187,942,407
Interest	17,241,206	17,116,166
Dividends	4,118,598	4,693,162
	<b>79,804,272</b>	<b>209,751,735</b>
Less investment expenses	3,120,148	3,156,565
Net investment income	<b>76,684,124</b>	<b>206,595,170</b>
Medical insurance reimbursements from University of Puerto Rico	11,403,965	8,247,730
Total additions	<b>211,932,762</b>	<b>344,431,574</b>
<b>Deductions:</b>		
Benefits paid to participants	176,871,770	169,162,756
General and administrative expenses	4,689,137	4,565,844
Medical insurance expenses paid to retirees	11,403,965	8,247,730
Total deductions	<b>192,964,872</b>	<b>181,976,330</b>
Net increase in net position	<b>18,967,890</b>	<b>162,455,244</b>
Net position restricted for pensions:		
Beginning of year	<b>1,324,028,384</b>	1,161,573,140
End of year	<b>\$ 1,342,996,274</b>	\$ 1,324,028,384

*See accompanying notes.*

# University of Puerto Rico Retirement System

## Notes to Financial Statements

June 30, 2015 and 2014

### **1. Organization and Summary of Significant Accounting Policies**

#### **Organization**

The University of Puerto Rico Retirement System (the “System” or “Plan”) is the administrator of a single-employer defined benefit pension plan that was created by Act No. 135, approved on May 7, 1942. The System started operations on January 1, 1945, the date on which contributions by employees and the University of Puerto Rico (the “University”) commenced. Assets of the Plan are legally held in a Trust, separate from the assets of the University of Puerto Rico, and are held solely for the purpose of meeting the Plan’s obligations.

The responsibility for the proper operation and administration of the System is vested in the Executive Director of the System which in turn will report to the Finance and the System Committee of the Government Board of the University (the “Committee”). The Committee will then notify the Members of the University’s Government Board of any decisions made related to the System. The following are the significant accounting policies followed by the System in the preparation of its financial statements.

#### **Basis of Presentation**

The System’s financial statements and notes to the financial statements are prepared under the provisions of Governmental Accounting Standards Board (GASB) Statement No. 67, *Financial Reporting for Pension Plans*-an amendment of GASB Statement No. 25.

The accompanying financial statements have been prepared on the accrual basis of accounting. Participants and employer contributions are recognized in the period in which the contributions are due and the employer has made a formal commitment to provide the contributions. Benefits are recognized when due and payable in accordance with the terms of the Plan.

#### **Investments**

Investments are reported at fair value. Marketable securities are valued based on quotations obtained from national security exchanges. Dividend income is recognized when received.

The fair value of investments held in foreign currencies are translated to U.S. dollars generally using current rates of exchange and the related translation adjustments are included as an addition to the unrealized change in fair value of investments which is recorded in the statement of changes in fiduciary net position as net appreciation in fair value of the investments.

# University of Puerto Rico Retirement System

## Notes to Financial Statements (continued)

### 1. Organization and Summary of Significant Accounting Policies (continued)

#### Investments (continued)

The fair value of private equity fund investments is determined by the applicable fund manager.

#### Securities Lending

Cash received as collateral on securities lending transactions is used to purchase investments. These investments are reported as assets in the accompanying financial statements and are generally measured at fair value with the exception of repurchase agreements, which are reported at cost. A corresponding liability is also reported for the amount owed to the broker at the termination of the lending agreement. Additional disclosures about the Plan's securities lending transactions are provided in **Note 4**.

#### Loans to Plan Members

Loans to participants are carried at their unpaid principal balance, which approximates their fair value. Mortgage loans are collateralized by the participant's contribution to the pension plan and first mortgage liens on the underlying properties. These mortgages are valued on the basis of future principal and interest payments and are discounted at prevailing interest rates for similar instruments.

The System's Government Board granted certain participants the option to select a supplemental pension benefit by making a retroactive contribution to the System. The participants who accept this option have to make a lump-sum payment to cover the related benefits. The participants could obtain an interest-bearing loan from the System to fund their contributions.

As of June 30, 2015 and 2014, the balance of other loans consisted of the principal balance of such contributions, which amounted to approximately **\$15.5** million and \$16.9 million, respectively, net of allowance for uncollectible accounts.

# University of Puerto Rico Retirement System

## Notes to Financial Statements (continued)

### 1. Organization and Summary of Significant Accounting Policies (continued)

#### Capital Assets

Capital assets are recorded at cost. Depreciation is computed using the straight-line method based on the estimated useful lives of the depreciable property. Amounts exceeding \$1,000 and with a useful life of three years or more are capitalized.

Expenditures for maintenance and repairs are charged to operations, while those for renewals and betterments are capitalized. Depreciation expense charged to operations during the years ended June 30, 2015 and 2014 amounted to approximately **\$138,332** and \$44,416, respectively.

#### New Accounting Pronouncements

The GASB has issued the following Statements:

- GASB Statement No. 72, *Fair Value Measurement and Application* (GASB Statement No. 72), which is effective for reporting periods beginning after June 15, 2015. GASB Statement No. 72 requires the System to use valuation techniques which are appropriate under the circumstances and are either a market approach, a cost approach or an income approach. GASB Statement No. 72 establishes a hierarchy of inputs used to measure fair value consisting of three levels. Level 1 inputs are quoted prices in active markets for identical assets or liabilities. Level 2 inputs are inputs, other than quoted prices included within Level 1, which are observable for the asset or liability, either directly or indirectly. Level 3 inputs are unobservable inputs, such as management's assumption of the default rate among underlying mortgages of a mortgage-backed security. GASB Statement No. 72 also contains note disclosure requirements regarding the hierarchy of valuation inputs and valuation techniques that was used for the fair value measurements.

# University of Puerto Rico Retirement System

## Notes to Financial Statements (continued)

### 1. Organization and Summary of Significant Accounting Policies (continued)

#### New Accounting Pronouncements (continued)

- 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 (GASB Statement No. 73). The provisions of GASB Statement No. 73 that address accounting and financial reporting by employers and governmental nonemployer contributing entities for pensions that are not within the scope of GASB Statement No. 68, are effective for financial statements for fiscal years beginning after June 15, 2016, and the requirements of this statement that address financial reporting for assets accumulated for purposes of providing those pensions are effective for fiscal years beginning after June 15, 2015. The requirements of Statement No. 73 for pension plans that are within the scope of GASB Statement No. 67 or for pensions that are within the scope of GASB Statement No. 68 are effective for fiscal years beginning after June 15, 2015. GASB Statement No. 73 extends the approach to accounting and financial reporting established in GASB Statement No. 68 to all pensions to reflect that for accounting and financial reporting purposes, any assets accumulated for pensions that are provided through pension plans that are not administered through trusts that meet the criteria specified in GASB Statement No. 68 should not be considered pension plan assets. It also requires that information similar to that required by GASB Statement 68 be included in notes to financial statements and required supplementary information by all similarly situated employers and nonemployer contributing entities.
- GASB Statement No. 82 Pension Issues is to address certain issues that have been raised with respect to Statements No. 67, Financial Reporting for Pension Plans, No. 68, Accounting and Financial Reporting for Pensions, and 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. 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. The requirements of this Statement are effective for reporting periods beginning after June 15, 2016.

# University of Puerto Rico Retirement System

## Notes to Financial Statements (continued)

### **2. Financial Condition and Liquidity**

The discussion in the following paragraphs regarding the System's financial and liquidity risks provides the necessary background and support for management's evaluation as to whether there is substantial doubt about the System's ability to continue as a going concern for 12 months beyond the date of the financial statements or for an extended period if there is currently known information that may raise substantial doubt shortly thereafter. GASB Statement No. 56, Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards, establishes that the continuation of a legally separate governmental entity as a going concern is assumed in financial reporting in the absence of significant information to the contrary. Information that may significantly contradict the going concern assumption would relate to a governmental entity's inability to continue to meet its obligations as they become due without substantial disposition of assets outside the ordinary course of governmental operations, restructuring of debt, submission to the oversight of a separate fiscal assistance authority or financial review board, or similar actions. Indicators such as negative trends in operating losses and negative cash flows, possible financial difficulties such as nonpayment or default of debt and/or restructurings or noncompliance with capital or reserve requirements, and internal or external matters impacting the governmental entity's ability to meet its obligations as they become due, are factors that are considered in this evaluation. The System sponsor (the University) faces significant risks and uncertainties, including liquidity risk, which is the risk of not having sufficient liquid financial resources to meet obligations when they come due. We note that both the Commonwealth and the University have expressed substantial doubt about their respective ability to continue as going concerns in their most recently issued financial statements. The risks and uncertainties facing the University together with other factors further described below, have led management to conclude that there is substantial doubt as to the ability of the System to continue as a going concern in accordance with GASB Statement No. 56.

The Commonwealth has been facing a number of fiscal and economic challenges in recent years due to, among other factors, continued budget deficits, a prolonged economic recession, high unemployment, population decline, and high levels of debt and pension obligations. The Commonwealth and its affiliated entities, including the Government Development Bank for Puerto Rico ("GDB"), have experienced severe liquidity issues and are in default on significant amounts of debt. On June 30, 2016, the U.S. President signed the Puerto Rico Oversight, Management, and Economic Stability Act (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. On August 31, 2016, the U.S. President announced the appointment of seven members to the Oversight Board. It should be noted that this Oversight Board has broad powers that can be exercised in connection with addressing the financial condition of the Commonwealth and its affiliates.

# University of Puerto Rico Retirement System

## Notes to Financial Statements (continued)

### **2. Financial Condition and Liquidity (continued)**

On June 30, 2016, the Governor of the Commonwealth signed EO 31, declaring the University in a state of emergency pursuant to Act No. 21. In compliance with EO 31, the University suspended the monthly payments to the trustee of the Trust Agreement that govern the University System Revenue Bonds and the monthly payments of the Lease Agreement with DUI in July 2016.

The University is highly reliant on the Commonwealth for operating revenues and for governance coupled with reliance on the Government Development Bank for Puerto Rico (“GDB”), a component unit of the Commonwealth, for liquidity and financial management support.

As economic conditions worsened, the Commonwealth’s revenues and funding sources from GDB have been reduced, which could further reduce the University’s revenues from the Commonwealth’s appropriations and the University’s liquidity, having have an adverse effect on the University’s financial position or changes in its net position. We note that both the Commonwealth and the University have expressed substantial doubt about their respective ability to continue as going concerns in their most recently issued financial statements.

The System has evaluated the current market and University situation and considered several facts to establish a mitigation action plan as follows:

- **Trust Regulations:**  
The System is the administrator of a single-employer defined benefit pension plan that was created by Act No. 135, approved on May 7, 1942. The System started operations on January 1, 1945, the date on which contributions by employees and the Employer commenced.
- **Fund administration:**  
The Retirement System implemented a separate Retirement Fund located in JP Morgan Chase New York in 1989. This Retirement Fund was created to exclusively receive income, hold monies, and make disbursements on behalf of the Trust.
- **Investments Return:**  
As of June 30, 2015, the returns of the Retirement fund have presented positive results above market. In the last quarter of fiscal year 2014-2015, the market closed at -.20% and the System’s closed with a return of .40%. Also, the funding ratio increased from 40.8% to 43.9% in June 30, 2014, and from 2014 to 2015 the funding ratio increased to 46.60%.

# University of Puerto Rico Retirement System

## Notes to Financial Statements (continued)

### 2. Financial Condition and Liquidity (continued)

- Contributions:

As stated in the plan document, the Retirement fund will not be used for disbursements, withdrawals, and transfer of any assets other than the exclusive use of funds for both pension and administrative expenses. Its securities, notes or other evidences of loans are clearly marked to indicate ownership by the System and are registered in the name of the System.

Its administration is separated from the administration of the University as established in Cert. 53 (1989-1990).

The System is qualified and exempt from Puerto Rico and United States income taxes like other peer governmental plans. There is uncertainty as to what actions the Oversight Board and the Commonwealth will take, if any, and the effects they may have on the Plan. PROMESA requires that any fiscal plan developed by the Commonwealth or any of its affiliates shall “provide for the adequate funding for public pension systems.” In addition, pursuant to the Trust Deed, the System’s assets remain completely autonomous and separate of the assets of the University, the Trustee and its members and continue to be exempt from the individual or collective action of their respective creditors.

The assets of the Retirement Fund have been well maintained over \$1.2 billion. Given the precarious scenarios in Puerto Rico, the Retirement Funds are likely not sufficient to sustain necessary withdrawals as projected over the life of the Plan, without further contributions by the University. However, we believe the Retirement funds can sustain withdrawals for approximately 15 years, assuming a constant rate of return of 7.75% and liabilities as currently projected. This analysis only includes the individual contributions that are part of the University automatic payroll deductions. The employer has stated clearly that payroll is a priority under the current scenario, and has asserted a commitment to fund the unfunded liability for the next 40 years to the extent it is able.

- Plan Regulatory Changes:

As a result of intensive research work made by the System administration and several meetings by the Retirement Board & the Government Board, retirement system regulatory changes have been approved for the current and next fiscal year. These measures emerged as initiatives implemented towards improving sustainability of the current defined benefit system. The System amendments are described in detail in notes 3 and 10.

# University of Puerto Rico Retirement System

## Notes to Financial Statements (continued)

### 3. Description of the System

#### General

The System is a single-employer defined benefit pension plan that covers all employees of the University with the exception of hourly, temporary, part-time, contract and substitute employees, and visiting professors. It is qualified and exempt from Puerto Rico and United States income taxes.

Participants consisted of the following as of June 30:

	<u>2015</u>	<u>2014</u>
Retirees and beneficiaries receiving benefits	<b>8,247</b>	8,082
Terminated plan participants entitled to but not yet receiving benefits	<b>443</b>	476
Terminated non-vested plan participants entitled to return of their contributions	<b>7,985</b>	7,941
Active plan participants	<b>10,644</b>	10,728
Total	<b><u>27,319</u></b>	<u>27,227</u>

#### Plan Amendments

Effective July 1, 2007, the Plan was amended by Certification No. 12. This certification was superseded by Certification No. 70 2013-2014 in which the automatic 3% increase in pension benefits was terminated.

Effective July 1, 2014, the compensation limit for Certification 139 was frozen at \$69,556.44. Effective January 1, 2015, the formula for Non-Occupational Disability was amended to increase vesting from 10 years to 15 years and benefit paid would be based on 90% of what their merit pension will be.

# University of Puerto Rico Retirement System

## Notes to Financial Statements (continued)

### 3. Description of the System (continued)

#### Plan Amendments (continued)

Effective July 1, 2002, the Plan was amended, by establishing Certification 139, to offer participants an increase from \$50,000 to \$60,000 in the maximum salary subject to withholding contribution. The participants who elect this benefit may pay retroactively to their first day of employment the differences in withholding contributions for prior year salaries exceeding \$50,000 and up to a maximum of \$60,000 plus 8% interest.

Effective July 1, 1998, the Plan was amended by establishing Certification 9, to offer participants an increase from \$35,000 to \$50,000 in the maximum salary subject to withholding contributions. The participants who elect this benefit may pay retroactively to their first day of employment the differences in withholding contributions for prior year salaries exceeding \$35,000 and up to a maximum of \$50,000 plus 8% interest. Effective July 1, 1998, all new participants will have the option to contribute 9% of their salary up to \$50,000 or 11% of their salary up to \$69,556.44.

In addition, the maximum annual compensation for those participants who had not completed 20 years of service by July 1, 1979 is \$35,000. Also, the minimum pension is \$250 a month. Finally, the reduction for commencement of pension benefits prior to age 65 is 1/3% per month for participants who had not completed 20 years of service by July 1, 1979, and elected Certification 55, and for participants hired on or after January 1, 1990.

#### Contributions and Funding Policy

The contribution requirements of participants and the University are established and may be amended by the Board of Trustees. Participants are required to contribute as follows:

Participants who elect Certification No. 139: 11% of monthly compensation up to \$5,796.37

Participants who have not completed 20 years of service by July 1, 1979:

- If full supplement is elected: 7% of monthly compensation up to \$2,916.67
- If full supplement is not elected: 5% of monthly compensation up to \$2,916.67
- If Certification 94 is elected: 9% of monthly compensation up to \$4,166.67

## University of Puerto Rico Retirement System

### Notes to Financial Statements (continued)

#### 3. Description of the System (continued)

##### Contributions and Funding Policy (continued)

###### Participants who have completed 20 years of service by July 1, 1979:

- If full supplement is elected: 7% of monthly compensation
- If full supplement is not elected: 4% of monthly compensation up to \$350.00, plus 6.5% of the excess

###### Participants who have not completed 20 years of service by July 1, 1979 and elect Certification 55:

- If full supplement is elected: 7% of monthly compensation up to \$2,916.67
- If full supplement is not elected: 4% of monthly compensation up to \$350.00, plus 6.5% of the excess up to \$2,916.67
- If certification 94 is elected: 9% of monthly compensation up to \$4,166.67
- If certification 139 is elected: 11% of monthly compensation up to \$5,796.37

###### Participants who are hired between January 1, 1990 and June 30, 1998:

- 8% of monthly compensation up to \$2,916.67 or,
- If Certification 94 is elected: 9% of monthly compensation up to \$4,166.67
- If certification 139 is elected: 11% of monthly compensation up to \$5,796.37

###### Participants who are hired on or after July 1, 1998:

- 9% of monthly compensation up to \$4,166.67
- 11% of monthly compensation up to \$5,796.37

###### Participants who are hired on or after April 1, 2015:

- 11% of monthly compensation up to \$5,796.37 fully supplemented

The University contributes at an actuarially determined rate; the rate as of June 30, 2015 and 2014 was **17.29%** and 15.16%, respectively, of annual covered payroll. The actuarially determined employer contribution rate takes into account payment of administrative expenses. Administrative expenses are paid out of the trust fund.

# University of Puerto Rico Retirement System

## Notes to Financial Statements (continued)

### 3. Description of the System (continued)

#### Contributions and Funding Policy (continued)

The contributions of the University were originally designed to fund, together with the contributions of the participants, the current service cost on a current basis and the estimated accrued benefit cost attributable to qualifying service prior to the establishment of the System over a Certification 146, 2014-2015, 40-year period, but as a result of increasing benefits without a correlative increase in employer's contributions, they fall short of accomplishing the necessary funding.

#### Retirement Benefits

The System provides retirement, disability and death benefits to participants and beneficiaries.

Participants who have completed 20 years of service by July 1, 1979 are entitled to annual retirement benefits at any age after 30 years of service. Otherwise, participants are entitled to annual retirement benefits at age 55 after 30 years of service. Participants may elect to receive their retirement benefits at age 58 after 10 years of service, or at age 55 after 25 years of service.

The amount of service retirement annuity is as follows:

- For all participants except those who have completed 20 years of service by July 1, 1979:
  - Before age 65 – for participants with at least 30 years of service: 75% of average compensation. Amount is reduced by .5% for each month the member is under age 58 (Certification 37) and 55 (Certification 55), at time annuity begins.
  - Before age 65 – for participants with less than 30 years of service: 1.5% of average compensation per year of service for the participants with 20 or fewer years. Percentage increases by .05% for each year in excess of 20 years up to a maximum of 1.95% per year. Amount is reduced by .5% for each month the participant is under age 58 at time annuity begins.

# University of Puerto Rico Retirement System

## Notes to Financial Statements (continued)

### 3. Description of the System (continued)

#### Retirement Benefits (continued)

- After age 65 – if the member elected full supplement, the annuity is the same as before age 65. Otherwise, the annuity is reduced by .5% of average compensation not in excess of Social Security wage base in effect at retirement for each year of service. If the participants had less than 30 years of service and was under age 58 at the beginning date, adjustment is made before application of .5% reduction per month under age 58.
- For those members who have completed 20 years of service by July 1, 1979:
  - Before age 65 – for participants with at least 30 years of service: 75% of average compensation if age 55 at beginning date; 65% if under age 55. If the member completed 30 years of service before July 1973, the annuity is increased by 2% of average compensation for each year of service beyond 30 and before July 1973, but to no more than 85% of average compensation.
  - Before age 65 – for participants with less than 30 years of service: 1.5% of average compensation per year of service for participants with 20 or fewer years. Percentage increases by .05% for each year in excess of 20 years up to maximum of 1.95% per year. Amount is reduced by .5% for each month the participant is under age 58 at the time the annuity begins.
  - At age 65 – if participants elected full supplement, the annuity is the same as before age 65. Otherwise, the annuity is reduced by .5% of first \$350 of average compensation for each year of service but not by more than primary Social Security benefit. If the participants had less than 30 years of service and was under age 58 at beginning date, adjustment is made before application of .5% reduction per month under age 58.
- For all participants who have not completed 20 years of service by July 1, 1979 and elect Certification 55, and for those hired on or after January 1, 1990:
  - Before age 65 – for participants with less than 30 years of service: 1.5% of average compensation per year of service for participants with 20 or fewer years. Percentage increases by .05% for each year in excess of 20 years up to a maximum of 1.95% per year.

## University of Puerto Rico Retirement System

### Notes to Financial Statements (continued)

#### 3. Description of the System (continued)

##### Retirement Benefits (continued)

- Before age 65 – for participants with at least 30 years of service: 75% of average compensation for participants with at least 55 years of age at retirement date. Amount reduced by .5% for each month the participant is under age 55 at time annuity begins.
- After Age 65 – if participants elected full supplement, annuity is the same as before age 65. Otherwise, annuity is reduced by .5% of average compensation at time of retirement multiplied by years of service.
- Minimum Annuity – \$250 per month - if a participant terminates before rendering 10 years of service, the right to receive the portion of his accumulated plan benefits attributable to the University's contributions is forfeited. However, the employee is entitled to receive, in a lump-sum payment, the value of his accumulated contributions.
- If a participant terminates after rendering 10 years of service, and does not withdraw his contributions, the participant receives a retirement annuity payable beginning at age 60 based on the applicable benefit formula.
- Refund may also be obtained after 10 years of service, but the vested benefit is lost.

##### Disability Benefits

- Employees who become disabled receive annual disability benefits regardless of service if disability is due to occupational causes or after 15 years of service if disability is due to non-occupational causes. If the employee is also eligible for a retirement annuity, the benefit payable is the higher of the two. Disability benefits are paid as follows:
  - Before age 65 – if service related 50% of final salary. If not services related, 30% of average compensation plus additional 1% for each year of service over 10.
  - After age 65 – reduced to amount payable as retirement annuity, if that amount is less than disability retirement annuity, but reduced annuity plus primary Social Security benefit may not be less than original disability annuity.

# University of Puerto Rico Retirement System

## Notes to Financial Statements (continued)

### 3. Description of the System (continued)

#### Disability Benefits (continued)

Effective December 15, 2014, (Certification 51, 2014-2015) non-occupational disability benefits regulation was amended. A disability due to non-occupational causes will be payable upon 15 years of service, the benefit payable will be 90% of the member's retirement benefit payable if the participant was to retire based on years of service. If the participant is eligible for a service retirement, benefit payable will be the higher of the two.

#### Death Benefits

- Pre-retirement death benefit – if the death of an employee is service related, a death benefit equal to 50% of the final annual salary plus \$120 (\$240 if widow not receiving benefit) per year for each child under age 18 (21 if at school) is paid to the employee's beneficiaries. Maximum family benefit is 75% of the employee's final annual salary. If death is non-service related, a lump-sum is paid equal to the employee's contributions plus one year's final salary, but not less than \$6,000.
- Post retirement death benefits – employee's contributions are refunded if they do not exceed retirement payments already made, unless reverse annuity was elected. Minimum payment is \$600. In addition, an annuity is payable to surviving spouse until death or remarriage or until they become eligible for Social Security benefits. Minimum annuity, \$75 per month, maximum annuity, \$150 per month.

#### Christmas Bonus

- A \$400 annual bonus is given to all retired participants.

### 4. Cash and Cash Equivalents

Cash and cash equivalents as of June 30, is as follows:

	<u>2015</u>	<u>2014</u>
Cash	\$ 22,329,050	\$11,197,229
Cash equivalents	–	28,787,394
	<u>\$ 22,329,050</u>	<u>\$39,984,623</u>

## University of Puerto Rico Retirement System

### Notes to Financial Statements (continued)

#### 4. Cash and Cash Equivalents (continued)

Pursuant to present statutes, deposits of financial institutions, other than with Government Development Bank of Puerto Rico (GDB), shall be in banks designated by the Puerto Rico Secretary of the Treasury as depository institutions of public funds.

#### 5. Investments

The following table presents the fair value of investments of marketable securities as of June 30, 2015 and 2014:

	<u>2015</u>	<u>2014</u>
Marketable securities:		
U.S. Government obligations	\$ 3,047,688	\$ 2,573,335
U.S. Government agencies' obligations	35,269,162	53,868,115
Foreign bonds	20,583,349	20,289,189
Corporate bonds and other debentures	82,303,666	150,774,923
Foreign common stock	169,081,850	137,950,172
Common stock	189,333,039	765,352,688
Mortgage-backed securities	66,801,132	62,677,909
Municipal bonds	1,708,469	1,871,750
Commingled Fund Equity	661,866,148	-
Sovereign debt	359,190	309,573
Total	<u>\$1,230,353,693</u>	<u>\$1,195,667,654</u>

No more than 5% of any debt issue may be purchased as an investment, with the exception of the U.S. government securities or its agencies. No more than 10% of the assets at cost may be invested in the securities of a single issuer, with the exception of the U.S. government securities or its agencies.

# University of Puerto Rico Retirement System

## Notes to Financial Statements (continued)

### 5. Investments (continued)

The custody of these investments is held by the trust department of a commercial bank in the name of the System and the portfolio is managed by Investment Management Organization.

The UPR's Government Board has adopted the following strategic asset allocation:

<b>Asset Class</b>	<b>% Allocated</b>	<b>Range</b>
Domestic Large Cap Equity	40%	+/-5%
Domestic Small/Mid Cap	10%	+/-3%
International Equity	10%	+/-3%
Fixed Income	28%	+/-5%
Loans and Mortgages	12%	+/-3%

The overall investment fund does not have a strategic asset allocation to cash but individual managers will hold varying amounts of cash within their respective portfolios as part of the normal course of managing the assets.

From time to time, when the operating cash flow has excess disbursements the Executive Director is authorized to sell securities on behalf of the Retirement System not exceeding \$6,500,000.00 (Certification No. 97, 2013-2014). This will be executed according to market fluctuations and rebalancing requirements of the portfolio without diverging from the Investment Policy.

The overall investment fund does not have a strategic allocation to private equity. However, the overall investment fund may, from time to time, examine private equity investments that it deems acceptable. If an allocation to private equity is made it will be funded from the domestic equity asset class. At no time, will the allocation exceed 5% of total fund assets.

University of Puerto Rico Retirement System

Notes to Financial Statements (continued)

**5. Investments (continued)**

Private equity funds include the following at June 30, 2015 and 2014:

	<b>30-Jun-15</b>			
	<b>Total Commitment</b>	<b>Contributions</b>	<b>Distribution</b>	<b>Fair Value</b>
<b>Grupo Guayacán, Inc.:</b>				
Guayacán Fund of Funds I, LP	\$ 5,000,000	\$ 4,764,049	\$ 8,121,850	\$ –
Guayacán Fund of Funds II, LP	6,000,000	5,683,539	7,240,144	489,805
Guayacán Fund of Funds III, LP	5,000,000	4,149,981	1,505,666	3,727,634
Guayacán Fund of Funds IV, LP	–	350,000	–	326,064
<b>Advent -Morro Equity Partners Inc.:</b>				
Guayacán Private Equity Fund I, LP	2,500,000	2,322,582	4,058,236	1,107,133
Guayacán Private Equity Fund II, LP	5,000,000	4,270,187	797,101	4,416,518
McCoy Investment Fund 2	15,000,000	9,554,326	4,193,613	8,586,215
<b>Total</b>	<b>\$ 38,500,000</b>	<b>\$ 31,094,664</b>	<b>\$ 25,916,610</b>	<b>\$ 18,653,369</b>

	<b>30-Jun-14</b>			
	<b>Total Commitment</b>	<b>Contributions</b>	<b>Distribution</b>	<b>Fair Value</b>
<b>Grupo Guayacán, Inc.:</b>				
Guayacán Fund of Funds I, LP	\$ 5,000,000	\$ 4,764,049	\$ 8,113,357	\$ 10,412
Guayacán Fund of Funds II, LP	6,000,000	5,683,539	7,010,711	697,532
Guayacán Fund of Funds III, LP	5,000,000	3,482,763	630,468	3,535,692
<b>Advent -Morro Equity Partners Inc.:</b>				
Guayacán Private Equity Fund I, LP	2,500,000	2,322,582	4,058,236	1,758,157
Guayacán Private Equity Fund II, LP	5,000,000	3,984,473	797,101	4,037,610
DCC Growth Fun, LP	2,000,000	2,000,000	–	–
McCoy Investment Fund 2	15,000,000	7,454,755	2,498,906	6,562,740
<b>Total</b>	<b>\$ 40,500,000</b>	<b>\$ 29,692,161</b>	<b>\$ 23,108,779</b>	<b>\$ 16,602,143</b>

University of Puerto Rico Retirement System

Notes to Financial Statements (continued)

**5. Investments (continued)**

**Credit Risk**

Issuer credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Investments issued or explicitly guaranteed by the United States government are excluded. The System's policy requires and limits investments in debt securities to only those in the top investment grade ratings issued by a nationally recognized statistical rating organization. As of June 30, 2015, the System's credit quality distribution for securities was as follows:

	<b>2015</b>	
	<b>Carrying Value</b>	<b>Rating</b>
Foreign bonds	<b>\$ 20,583,348</b>	<b>Aaa to BB+</b>
Corporate bonds and other debentures	<b>82,303,666</b>	<b>Aaa to BB-</b>
Mortgage backed securities	<b>66,801,132</b>	<b>Aaa to D</b>
Municipal bonds	<b>1,708,469</b>	<b>Aaa to BBB</b>

**Custodial Risk**

The custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the System will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custody of the commingled fund is located at another financial institution. Investments of the System, which are under custody of a depository finance institution, are as follows:

University of Puerto Rico Retirement System

Notes to Financial Statements (continued)

**5. Investments (continued)**

**Custodial Risk (continued)**

Security Type	June 30	
	2015	2014
	Carrying Value	Carrying Value
Mortgage backed securities	\$ 66,801,132	\$ 62,677,909
Corporate bonds and other debentures	82,303,666	150,774,923
Common stocks	189,333,039	765,352,688
U.S. Government obligation	3,047,688	2,573,335
Treasury bonds and notes	35,269,162	53,868,115
Foreign common stocks	169,081,850	137,950,172
Foreign corporate bonds	16,719,879	14,964,282
Foreign government bonds	3,863,470	5,324,907
Commingled Fund Equity	661,866,148	-
Sovereign Debt	359,190	309,573
Municipal Bonds	1,708,469	1,871,750
Total	<u>\$1,230,353,693</u>	<u>\$1,195,667,654</u>

**Security Lending**

The System has a Security Lending Agreement (the Agreement) with its investment custodian (the Custodian). In this Agreement, the University agrees to lend certain securities upon request of a borrower. The Custodian is the managing agent in this agreement where upon request of a borrower, the Custodian lends, as mentioned before, securities in exchange for collateral. Collateral may consist of cash, other approved securities and/or letter of credit from the borrower. The Custodian has the unrestricted right to invest any cash collateral; also, the Custodian may commingle any approved securities held as collateral with any other securities held under custody on behalf of the University. Under the Agreement, the borrower is compelled to return the securities loaned by the University upon termination of the loan term.

## University of Puerto Rico Retirement System

### Notes to Financial Statements (continued)

#### **5. Investments (continued)**

##### **Security Lending (continued)**

Under the Agreement as disclosed above, the System had a cash collateral of **\$59,665,343** and \$88,785,830 at June 30, 2015 and 2014, respectively. This cash collateral has been reinvested, in accordance with the Agreement, in fixed income investments that are exposed to custodial credit risk as disclosed in the executed agreement.

During fiscal year 2008-2009, there was a default in a Lehman Brothers and Sigma floating rate note in which securities lending collateral had been invested. These funds are invested into a collective investment trust fund, and are included on the Statement Fiduciary of Net Position. The purpose of the separate account is to provide a reserve account to offset expected losses. The purpose of the separate account is to provide a reserve account to offset expected losses. At 2015 and 2014, the Plan had an unrealized loss in the Securities Lending Collateral pool of **\$60,326** and \$1,341,986, respectively, and had accrued an obligation of **\$60,946,003** and \$90,126,816, respectively, in the separate account.

##### **Concentration of Credit Risk**

Concentration of credit risk is the risk of loss attributable to the magnitude of investment in a single issuer. Information regarding investment in any one issuer that represents five percent or more of the System's total investments must be disclosed under GASB No. 40, excluding investments issued or explicitly guaranteed by the United States government. The System's portfolio is not exposed to concentration of credit risk since the investment policies do not allow the System to invest in any single issuer more than 5% of the total portfolio, except for Government securities.

University of Puerto Rico Retirement System

Notes to Financial Statements (continued)

**5. Investments (continued)**

**Interest-Rate Risk**

Interest-rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value is to changes in market interest rates. As of June 30, 2015 and 2014, the weighted average maturity by investment type in each fund follows:

<b>Investment Type</b>	<b>Weighted Average (Years)</b>	<b>Fair Value</b>	
		<b>2015</b>	<b>2014</b>
Corporate Bonds	3.1079	\$ 82,303,666	\$ 64,214,954
Mortgage Backed Securities	4.3833	66,801,132	62,677,909
Municipal Bonds	0.0756	1,708,469	1,871,750
Foreign Bonds	0.1512	20,583,348	20,289,189
US Government agency obligations	2.0347	38,676,040	56,751,023
		<b>\$ 210,072,655</b>	<b>\$ 205,804,826</b>

University of Puerto Rico Retirement System

Notes to Financial Statements (continued)

**5. Investments (continued)**

A System's exposure to foreign currency risk derives from its positions in foreign currency denominated equities and fixed income investments. The System's investment policy permits it to invest up to 15% of total investments in foreign currency denominated investments. The following is a listing of foreign assets included in the Statement of Fiduciary Net Position as of June 30, 2015:

**Foreign Currency Risk**

Security Type	Currency	Maturity	Fair Value
Common Stocks	Australia	Not Applicable	\$4,548,387
Common Stocks	Bermuda	Not Applicable	3,469,033
Common Stocks	Brazil	Not Applicable	2
Common Stocks	Cayman Islands	Not Applicable	3,342,582
Common Stocks	Canada	Not Applicable	5,208,715
Common Stocks	Channel Island	Not Applicable	682,375
Common Stocks	China	Not Applicable	3,339,296
Common Stocks	Denmark	Not Applicable	2,328,215
Common Stocks	France	Not Applicable	12,690,873
Common Stocks	Germany	Not Applicable	15,857,405
Common Stocks	Hong Kong	Not Applicable	1,224,794
Common Stocks	India	Not Applicable	3,737,302
Common Stocks	Indonesia	Not Applicable	829,016
Common Stocks	Ireland	Not Applicable	3,205,674
Common Stocks	Italy	Not Applicable	399,063
Common Stocks	Japan	Not Applicable	37,208,348
Common Stocks	Korea	Not Applicable	664,632
Common Stocks	Mexico	Not Applicable	1,707,688
Common Stocks	Netherlands	Not Applicable	7,053,474
Common Stocks	Norway	Not Applicable	2,933,478

(Continued)

University of Puerto Rico Retirement System

Notes to Financial Statements (continued)

**5. Investments (continued)**

**Foreign Currency Risk (continued)**

<b>Security Type</b>	<b>Currency</b>	<b>Maturity</b>	<b>Fair Value</b>
Common Stocks	Panama	Not Applicable	677,238
Common Stocks	Singapore	Not Applicable	1,954,475
Common Stocks	Spain	Not Applicable	2,426,664
Common Stocks	Sweden	Not Applicable	3,038,597
Common Stocks	Switzerland	Not Applicable	20,343,990
Common Stocks	Taiwan	Not Applicable	1,850,933
Common Stocks	United Kingdom	Not Applicable	28,359,598
Corporate Bonds	Australia	7/17/2015	940,320
Corporate Bonds	Austria	7/6/2015	790,000
Corporate Bonds	Brazil	11/6/2017-03/17/2024	319,927
Corporate Bonds	Canada	07/29/2015 - 06/15/2035	4,419,455
Corporate Bonds	Cayman Islands	01/27/2016 - 12/15/2021	613,784
Corporate Bonds	Colombia	1/16/2025	100,512
Corporate Bonds	France	06/10/2020 - 10/22/2023	460,661
Corporate Bonds	Germany	02/13/2018-05/30/2024	293,486
Corporate Bonds	Japan	3/17/2017	261,765
Corporate Bonds	Luxembourg	03/12/2018 - 03/15/2045	1,107,892
Corporate Bonds	Mexico	05/03/2019-06/02/2041	594,548
Corporate Bonds	Neth. Antilles	03/07/2017 - 09/25/2023	106,261
Corporate Bonds	Netherlands	3/7/2017 - 09/25/2023	1,351,300
Corporate Bonds	Norway	01/15/2024-03/01/2024	431,983

*Continued*

University of Puerto Rico Retirement System

Notes to Financial Statements (continued)

**5. Investments (continued)**

**Foreign Currency Risk (continued)**

Security Type	Currency	Maturity	Fair Value
Corporate Bonds	Sweden	4/4/2019-03/04/2020	456,066
Corporate Bonds	Switzerland	03/24/2017-04/27/2018	1,817,816
Corporate Bonds	United Kingdom	05/10/2017-05/11/2045	2,596,123
Governmental Bonds	Brazil	1/22/2021	313,500
Governmental Bonds	Canada	2/27/2019	141,274
Governmental Bonds	Colombia	2/26/2024	248,750
Governmental Bonds	Germany	4/8/2016-9/05/2017	1,202,099
Governmental Bonds	Mexico	01/21/2021 - 01/23/2046	78,250
Governmental Bonds	New Turkish Lira	3/22/2024	541,250
Governmental Bonds	Norway	10/31/2016	646,349
Governmental Bonds	Supranational	10/18/2016	490,998
Total			<u><u>\$189,665,199</u></u>

**Risk and Uncertainty**

The Retirement Fund invests in various marketable securities. These are exposed to various risks; due to the level of risk inherent in securities it is possible that changes in the values of these securities could occur in the near term and that such changes could materially affect the amounts reported in the Statement.

University of Puerto Rico Retirement System

Notes to Financial Statements (continued)

**6. Capital Assets**

Capital Assets additions are recorded at cost. Depreciation is provided using the straight-line method over the useful life of the asset. For the years ended June 30, 2015 and 2014, changes in Capital Assets, consisted of the following:

	<b>Beginning Balance at 1-July-14</b>	<b>Additions</b>	<b>Retirements</b>	<b>Ending Balance at 30-Jun-15</b>
Building	\$3,811,940	\$ –	\$ –	\$3,811,940
Equipment	279,113	15,426	(1,900)	292,639
Foreclosure Homes	460,093	–	(687)	459,406
	<b>4,551,146</b>	<b>15,426</b>	<b>(2,587)</b>	<b>4,563,985</b>
Less accumulated depreciation	(876,894)	–	(138,331)	(1,015,225)
	<b>\$3,674,252</b>	<b>\$15,426</b>	<b>\$(140,918)</b>	<b>\$3,548,760</b>

	<b>Beginning Balance at 1-July-2013</b>	<b>Additions</b>	<b>Retirements</b>	<b>Ending Balance at 30-Jun-2014</b>
Building	\$3,811,940	\$ –	\$ –	\$3,811,940
Equipment	465,606	–	(186,492)	279,113
Foreclosure Homes	277,627	226,404	(43,939)	460,093
	<b>4,555,173</b>	<b>226,404</b>	<b>(230,431)</b>	<b>4,551,146</b>
Less accumulated depreciation	(921,310)	–	44,416	(876,894)
	<b>\$3,633,863</b>	<b>\$226,404</b>	<b>\$(186,015)</b>	<b>\$3,674,252</b>

# University of Puerto Rico Retirement System

## Notes to Financial Statements (continued)

### 7. Medical Insurance

The System reimbursed each retiree up to a maximum of \$125 monthly for medical plan expenses. For the years ended June 30, 2015 and 2014, the medical plan expenses amounted to **\$11,403,965** and \$8,247,730, respectively. Medical expenses are paid by the retiree and reimbursed by the University of Puerto Rico.

### 8. Related Party Transactions

All employer contributions of the System are received from the University. In addition, the University reimburses the System for certain medical insurance expenses.

### 9. Net Pension Liability of the University of Puerto Rico

The components of the net pension liability of the University of Puerto Rico at June 30, 2015 and 2014, were as follows (in thousands):

	<u>2015</u>	<u>2014</u>
Total pension liability	<b>\$ 3,139,723</b>	\$ 3,428,068
Plan fiduciary net position	<b>(1,342,996)</b>	(1,324,028)
University of Puerto Rico's net pension liability	<b>\$ 1,796,727</b>	\$ 2,104,040
Plan fiduciary net position as a percentage of the total pension liability	<b>42.77%</b>	38.62%

### Actuarial Assumptions

The total pension liability at June 30, 2015, was determined by an actuarial valuation as of June 30, 2014, using the following actuarial assumptions, applied to all periods included in the measurement. The result was rolled forward using standard actuarial techniques to the measurement date of June 30, 2015:

Inflation	3.00%
Salary increases	3.75% average, including inflation
Investment rate of return	7.75%, net of pension plan investment expense, including inflation

# University of Puerto Rico Retirement System

## Notes to Financial Statements (continued)

### 9. Net Pension Liability of the University of Puerto Rico (continued)

#### Actuarial Assumptions (continued)

The rates of mortality for the period after service retirement are according to the RP-2000 Healthy Annuitant Mortality Table for ages 50 and greater and the RP-2000 Combined Mortality Table for ages less than 50, projected to 2020 using Scale BB, set back 5 years for males and set forward 1 year for females. Rates of mortality for the period after disability retirement are according to the RP-2000 Disability Mortality Table projected to 2020 using Scale BB set back 5 years for males and set forward 2 years for females.

The total pension liability was determined by an actuarial valuation as of June 30, 2013, using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.5 percent
Salary increases	5.0 percent average, including inflation
Investment rate of return	8.0 percent, net of pension plan investment expense, including inflation

Mortality rates were based on the RP-2000 Healthy Annuitant Mortality Table, projected to 2018, as appropriate, with adjustments for mortality improvements based on Scale AA.

The actuarial assumptions used in the June 30, 2013, valuation were based on the results of an actuarial experience of the System. The result was rolled forward using standard actuarial techniques to the measurement date as of June 30, 2014.

The long-term expected rate of return on pension plan investments was determined using a log-normal distribution analysis 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. The target asset allocation and best estimates of arithmetic real rates of return for each major asset class provided by the System's investment consultant Callan are summarized in the following table:

University of Puerto Rico Retirement System

Notes to Financial Statements (continued)

**9. Net Pension Liability of the University of Puerto Rico (continued)**

**Actuarial Assumptions (continued)**

Asset Class	Target Allocation	2015 Long-Term Expected Real Rate of Return	2014 Long-Term Expected Real Rate of Return
Domestic large cap equity	40%	6.65%	6.5%
International equity	10%	7.00%	7.0%
Domestic small/mid cap equity	10%	7.90%	7.9%
Fixed income	28%	0.80%	0.8%
Loan and mortgages	12%	5.70%	5.7%
Total	<u>100%</u>		

**Discount Rate**

Discount rate. The discount rate used to measure the total pension liability at June 30, 2015, was 6.37%. The projection of cash flows used to determine the discount rate assumed that plan member contributions will be made at the current contribution rates and that Employer contributions will be made at rates equal to the difference between actuarially determined contribution rates and the member rate. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members until the plan year ending June 30, 2043. Therefore, the long-term expected rate of return on pension plan investments of 7.75% was applied to all periods of projected benefit payments through June 30, 2043 and the applicable municipal bond index rate of 3.82%, based on the Bond Buyer General Obligation 20-year Municipal Bond Index published monthly by the Board of Governors of the Federal Reserve System as of June 30, 2015, was applied to all periods of projected benefit payments after June 30, 2043. The Single Equivalent Interest Rate (SEIR) of 6.37% that discounts the entire projected benefit stream to the same amount as the sum of the present values of the two separate benefit payments streams was used to determine the total pension liability as of June 30, 2015. The SEIR at the beginning of the measurement period was 5.31% based on the long-term expected rate of return on pension plan investments of 8% applied to all periods of projected benefit payments through June 30, 2027 and the applicable municipal bond index rate of 4.35% as of June 30, 2014 applied to all periods of projected benefit payments after June 30, 2027.

# University of Puerto Rico Retirement System

## Notes to Financial Statements (continued)

### **9. Net Pension Liability of the University of Puerto Rico (continued)**

#### **Discount Rate (continued)**

Beginning June 30, 2015 the contribution rates reflect amortization of the System's unfunded actuarial accrued liability over a closed 40 – year period as adopted by the University's Board of Governors. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members until the plan year ending June 30, 2044. Therefore, the long-term expected rate of return on pension plan investments of 7.75% was applied to all periods of projected benefit payments through June 30, 2044 and the applicable municipal bond index rate of 3.82%, based on the Bond Buyer General Obligation 20-year Municipal Bond Index published monthly by the Board of Governors of the Federal Reserve System as of June 30, 2015, was applied to all periods of projected benefit payments after June 30, 2044. The Single Equivalent Interest Rate (SEIR) of 7.45% that discounts the entire projected benefit stream to the same amount as the sum of the present values of the two separate benefit payments streams was used to determine the total pension liability as of June 30, 2015.

The discount rate used to measure the total pension liability was 5.31 percent at June 30, 2014. The projection of cash flows used to determine the discount rate assumed that plan member contributions will be made at the current contribution rate and that the Plan contributions will be made at rates equal to the difference between actuarially determined contribution rates and the member rate.

Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members until the plan year ending June 30, 2027. Therefore, the long-term expected rate of return on pension plan investments of 8% was applied to all periods of projected benefit payments through June 30, 2027 and the applicable municipal bond index rate of 4.35%, based on the Bond Buyer General Obligation 20-year Municipal Bond Index published monthly by the Board of Governors of the Federal Reserve System as of June 30, 2014, was applied to all periods of projected benefit payments after June 30, 2027. The Single Equivalent Interest Rate (SEIR) of 5.31% that discounts the entire projected benefit stream to the same amount as the sum of the present values of the two separate benefit payments streams was used to determine the total pension liability as of June 30, 2014.

# University of Puerto Rico Retirement System

## Notes to Financial Statements (continued)

### 9. Net Pension Liability of the University of Puerto Rico (continued)

#### Discount Rate (continued)

The SEIR at the beginning of the measurement period was 5.31% and 5.24% for prior period, based on the long-term expected rate of return on pension plan investments of 8% for both periods applied to all periods of projected benefit payments through June 30, 2027. The applicable municipal bond index rate of 4.35% and 4.27% as of June 30, 2015 and 2014, respectively, applied to all periods of projected benefit payments after June 30, 2027.

#### Sensitivity of the Net Pension Liability of Changes in the Discount Rate

The following presents the net pension liability of the University of Puerto Rico, at June 30, 2015, calculated using the SEIR discount rate of 6.37%, as well as what the University of Puerto Rico's net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (5.37%) or 1-percentage-point higher (7.37%) than the current rate (\$ thousands):

	<b>1% Decrease (5.37%)</b>	<b>Current Discount Rate (6.37%)</b>	<b>1% Increase (7.37%)</b>
University of Puerto Rico's net pension liability	\$2,144,842	\$1,796,727	\$1,501,031

## University of Puerto Rico Retirement System

### Notes to Financial Statements (continued)

#### 9. Net Pension Liability of the University of Puerto Rico (continued)

##### Sensitivity of the Net Pension Liability of Changes in the Discount Rate (continued)

For June 30, 2014, the net pension liability of the University of Puerto Rico, calculated using the discount rate of 5.31 percent, as well as the University of Puerto Rico's net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (4.31 percent) or 1-percentage-point higher (6.31 percent) than the current rate:

	<b>1% Decrease (4.31%)</b>	<b>Current Discount Rate (5.31%)</b>	<b>1% Increase (6.31%)</b>
Net pension liability	\$2,247,062	\$2,104,040	\$1,788,340

#### 10. Subsequent Events

##### Retirement System Regulatory changes

As a result of intensive research work made by the Retirement System Administration and several meetings by the Retirement System Board & the Government Board, effective July 1, 2015 subsequent retirement system regulatory changes will occur. These measures emerge as initiatives implemented towards improving sustainability of the current defined benefit system.

Effective July 1, 2015, participation rules change for all participants with less than 25 years of service. Retirement age eligibility and payroll contribution requirements were modified for participants under 25 years of credited services as of June 30, 2015 (*Governing Board Certification number 140, 2014-2015*).

- For participants with less than 25 years of service as of June 30, 2015, the eligible retirement age change from 55 to 58 years and the individual contribution increases an additional one percent (1%) over the one currently being deducted as of June 30, 2015. This increase in contribution does not represent changes in the employee current pension salary ceiling certification nor in the Social Security supplementation. Participants retain their right to exercise the option to change to Social Security supplementation and / or to change to another pension salary ceiling certificate in accordance with established rules and regulations for these changes.

## University of Puerto Rico Retirement System

### Notes to Financial Statements (continued)

#### **10. Subsequent Events (continued)**

##### **Retirement System Regulatory Changes (continued)**

- Participants who enter for the first time on July 1, 2015 and thereafter will contribute 12% of their salary to a maximum of \$69,556 salary ceiling supplemented with Social Security. These new participants will automatically fall into the provisions for Annuities Service Certification 55 (1989-1990) of the Higher Education Council, as amended.

##### **Commonwealth of Puerto Rico Regulatory Changes**

On June 30, 2016, the U.S. President signed the Puerto Rico Oversight, Management, and Economic Stability Act (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. On August 31, 2016, the U.S. President announced the appointment of seven members to the Oversight Board.

On June 30, 2016, the Governor of the Commonwealth signed EO 31, declaring the University in a state of emergency pursuant to Act No. 21. In compliance with EO 31, the University suspended the monthly payments to the trustee of the Trust Agreement that govern the University System Revenue Bonds and the monthly payments of the Lease Agreement with DUI in July 2016.

Required Supplementary Information  
*(Unaudited)*

University of Puerto Rico Retirement System

Schedule 1 – Schedule of Changes in the University of Puerto Rico's  
Net Pension Liability

Last 10 fiscal years  
(In thousands) (Unaudited)

	2015	2014
<b>Total Pension Liability:</b>		
Service cost	\$ 48,107	\$ 49,499
Interest	177,334	173,630
Changes in benefit terms	(45,209)	–
Differences between expected and actual experience	(323,974)	(24,034)
Changes in assumptions	32,269	–
Benefit payments, including refunds of member contributions	(176,872)	(169,163)
Net change in total pension liability	(288,345)	29,932
Total pension liability, beginning	3,428,068	3,398,136
Total pension liability, ending (a)	\$ 3,139,723	\$ 3,428,068
 <b>Plan Fiduciary Net Position:</b>		
Contributions - employer	\$ 88,251	\$ 91,689
Contributions - member	35,594	37,900
Net investment income	76,684	206,595
Benefit payments	(176,872)	(169,163)
Administrative expenses	(4,689)	(4,566)
Net change in plan net position	18,968	162,455
Plan fiduciary net position, beginning	1,324,028	1,161,573
Plan fiduciary net position, ending (b)	\$ 1,342,996	\$ 1,324,028
<b>University of Puerto Rico's Net Pension Liability - Ending (a) - (b)</b>	<b>\$ 1,796,727</b>	<b>\$ 2,104,040</b>

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

*See notes to required supplementary information.*

University of Puerto Rico Retirement System

Schedule 2 – Schedule of the University of Puerto Rico's Net Pension Liability

Last 10 fiscal years

(In thousands) (Unaudited)

(1) University of Puerto Rico Total Pension Liability	(2) Plan Fiduciary Net Position	(3) University of Puerto Rico's Net Pension Liability (1) - (2)	(4) Plan Fiduciary Net Position as a % of the Total Pension Liability (2)/(1)	(5) Covered Employee Payroll	(6) University of Puerto Rico Net Pension Liability as a % of Covered Payroll (3)/(5)
\$ 3,139,723	\$ 1,342,996	\$ 1,796,727	42.77%	\$ 516,226	348.05%
3,428,068	1,324,028	2,104,040	38.62%	515,856	407.87%

Data comes from GASB Statement No. 67

Schedule is intended to show information for 10 years. Additional years will be displayed as they become

See notes to required supplementary information.

University of Puerto Rico Retirement System

Schedule 3 – Schedule of the University of Puerto Rico's Contributions

Last 10 Years

(Dollar values expressed in thousands) (Unaudited)

<b>Year Ended June 30</b>	<b>Actuarial Determined Contribution (ADC)</b>	<b>Contributions in Relation to the Actuarial Determined Contribution</b>	<b>Contribution Deficiency (Excess)</b>	<b>Covered Employee Payroll</b>	<b>Contributions as a Percentage of Covered Employee Payroll (1)</b>	<b>Contribution as a Percentage of General Employee Payroll (2)</b>
2015	\$ 89,255	\$ 88,251	\$ 1,004	\$ 516,226	17.10%	17.29%
2014	78,204	91,689	(13,485)	515,856	17.77%	15.16%
2013	77,772	78,481	(709)	491,291	15.97%	15.80%
2012	72,186	75,140	(2,954)	491,063	15.30%	14.70%
2011	68,487	70,761	(2,274)	526,820	13.43%	13.00%
2010	63,722	71,177	(7,455)	558,961	12.73%	11.40%
2009	64,072	72,605	(8,533)	577,227	12.58%	11.10%
2008	59,246	81,553	(22,307)	543,538	15.00%	10.90%
2007	57,524	78,311	(20,787)	518,237	15.11%	11.10%
2006	55,400	73,658	(18,258)	490,263	15.02%	11.30%

(1) ADC Rate for each fiscal year comes from actuarial valuation at start of that fiscal year (e.g., the June 30, 2014)

(2) Required Contribution was established in the June 30, 2014 actuarial valuation

(3) Fiscal year ended June 30, 2014 GASB Statement No. 67 implemented

(4) The Government Board approved with the recommendation of the Retirement Board (Certification 146 fiscal year 2014-2015) a 40 year closed amortization beginning on July 1, 2015.

See notes to required supplementary information.

University of Puerto Rico Retirement System

Schedule 4 – Schedule of Investment Returns

Last 10 years

*(Unaudited)*

	<b>Year ended June 30,</b>	
	<b>2015</b>	<b>2014</b>
<b>Annual Money-Weighted Rate of Return, net of investment expense:</b>	<b>5.61%</b>	<b>17.80%</b>

Includes loans and private equities

Schedule is intended to show information for 10 years. Additional years will be displayed as they become available.

*See notes to required supplementary information.*

# University of Puerto Rico Retirement System

## Notes to Required Supplementary Information

June 30, 2015

### **1. Factors that Significantly Affect Trends in Amounts Reported**

For the periods presented, there were changes of benefit terms, however no changes in the size or composition of the population covered by the benefit terms. Also, the System had changes of assumptions which significantly affect trends in the amounts reported.

#### **Changes of Benefit Terms**

Effective July 1, 2014, the compensation limit for Certification 139 was frozen at \$69,556.44.

#### **Changes of Assumption:**

- Change assumed rates of termination from age-based to service-based rates
- Reduce assumed rates of retirement
- Reduce assumed rates of disability retirement
- Update mortality to RP-2000 projected to 2020
- Reduce assumed salary increases to 3.75%
- Reduce assumed rate of investment return to 7.75%
- Reduce price inflation assumption to 3.0%
- Reduce wage inflation assumption to 3.75%
- Reduce payroll growth assumption to 3.0%
- Increase administrative expense load to 0.70% of payroll
- Change amortization method from 30 year open to 30 year closed

University of Puerto Rico Retirement System

Notes to Required Supplementary Information (continued)

June 30, 2015

**2. Method and Assumptions Used in Calculations of Actuarially Determined Contributions**

The actuarially determined contribution rates in the Schedule of Employer's Contributions are calculated as of June 30, for the fiscal year beginning on that date. The following actuarial methods and assumptions were used to determine contribution rates reported in that schedule:

<b>Plan</b>	<b>Plan Employees</b>
Valuation date	30-Jun-15
Actuarial cost method	Entry age normal
Amortization method	Level percentage of payroll, closed
Remaining amortization period	30 years
Asset valuation method	5-year smoothed market
Inflation	3.0%
Salary increase	3.75%, including inflation
Actuarial assumptions:	
Investment rate of return	7.75%

Based on the funding policy adopted by the University's Board of Governors, employer contributions for years beginning June 30, 2015 reflect amortization of the System's unfunded actuarial accrued liability over a closed 40-year period from that date.

To determine contributions the System uses the RP-2000 mortality table projected to 2020.

**Report of Independent Auditors on Internal Control  
Over Financial Reporting and on Compliance and Other Matters  
Based on an Audit of the Financial Statements  
Performed in Accordance with *Government Auditing Standards***

The Government Board of the University of Puerto Rico Retirement System

We have audited, in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of University of Puerto Rico Retirement System (the System), which comprise the statement of fiduciary net position, as of June 30, 2015, and the related statement of changes in fiduciary net position for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated January 25, 2017.

***Internal Control over Financial Reporting***

In planning and performing our audit of the financial statements, we considered the System's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control. Accordingly, we do not express an opinion on the effectiveness of the System's internal control.

*A deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal controls that is less secure than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weakness may exist that have not been identified.

### ***Compliance and Other Matters***

As part of obtaining reasonable assurance about whether the System's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

### ***Purpose of this Report***

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*Ernst + Young LLP*

January 25, 2017

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the original  
of this report.

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