



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

Basic Financial Statements and Required Supplementary Information

June 30, 2013

(With Independent Auditors' Report Thereon)

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

Table of Contents

	Page(s)
Independent Auditors' Report	1-2
Management's Discussion and Analysis (Unaudited)	3-12
Basic Financial Statements:	
Statement of Plan Net Position	13
Statement of Changes in Plan Net Position	14
Notes to Basic Financial Statements	15-32
Required Supplementary Information (Unaudited):	
Schedule of Employer's Contributions	33
Schedule of Funding Progress	34
Notes to Required Supplementary Information	35



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San Juan, PR 00918-1819

Independent Auditors' Report

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

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

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

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



Emphasis of a Matter

As discussed in note 1 to the basic financial statements, the System’s unfunded actuarial accrued liability and funded ratio for pension benefits as of June 30, 2013 was approximately \$357.7 million and 14.2%, respectively. In the opinion of management, based on information prepared by consulting actuaries, the System’s net position will be exhausted by the fiscal year 2019 if measures are not taken to reduce the unfunded actuarial accrued liability and increase the funded ratio of the System.

Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles require that the information in the Management’s Discussion and Analysis, Schedule of Employer’s Contributions, and Schedule of Funding Progress on pages 3–12 and 33–35 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management’s responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

KPMG LLP

San Juan, Puerto Rico
June 30, 2014

Stamp No. E125998 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.

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

Management's Discussion and Analysis

June 30, 2013

(Unaudited)

Introduction

The Retirement System for the Judiciary of the Commonwealth of Puerto Rico (the System) administers retirement and other plan member benefits, such as personal, cultural, and mortgage loans, occupational and nonoccupational disability annuities, and death benefits for the judges of the judiciary branch of the Commonwealth of Puerto Rico (the Commonwealth). The System also administers postemployment healthcare benefits provided by the Commonwealth for its retired members. The System presents the annual basic financial statements and provides a narrative discussion and analysis of the financial activities for the fiscal year ended June 30, 2013. The financial performance of the System is discussed and analyzed within the context of the accompanying basic financial statements and disclosures.

Overview of the Basic Financial Statements

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

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

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

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

The statement of changes in plan net position reports changes in the System's assets and liabilities during the fiscal year. All current year additions and deductions are included, regardless of when the cash is received or paid.

Notes to the Basic Financial Statements

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

Required Supplementary Information

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

Financial Highlights

The System provides retirement benefits to the employees of the judiciary branch of the Commonwealth. As of June 30, 2013, the System has \$63.6 million in total assets, which consisted of the following:

- \$58.4 million in investments

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

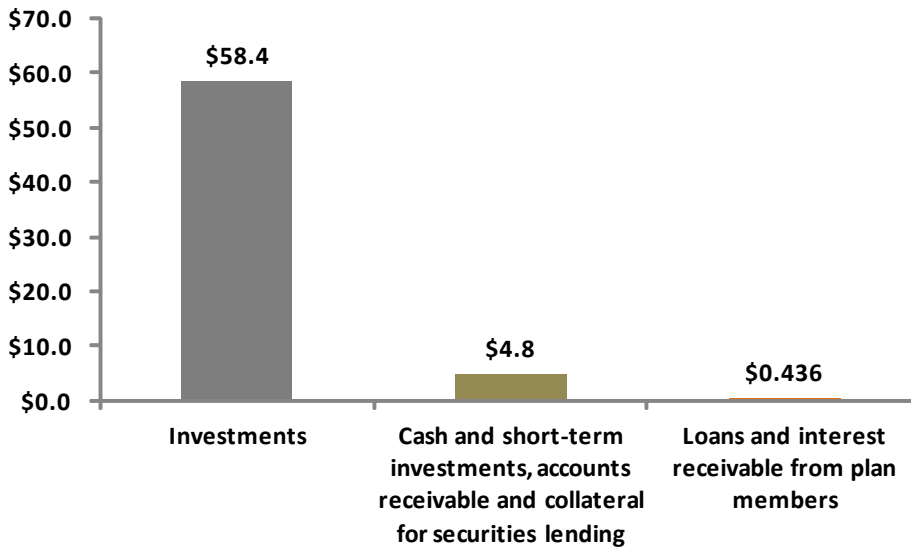
Management's Discussion and Analysis

June 30, 2013

(Unaudited)

- \$2.8 million in cash and short-term investments, and accounts receivable, plus \$2 million in collateral from securities lending transactions
- \$436,000 in loans and interest receivable from plan members

The total plan net position is presented in the following chart (in millions):



As of June 30, 2012, the System had \$62.9 million in total assets, which consisted of:

- \$48.7 million in investments
- \$12.6 million in cash and short-term investments, and accounts receivable, plus \$1.1 million in collateral from securities lending transactions
- \$471,000 in loans and interest receivable from plan members

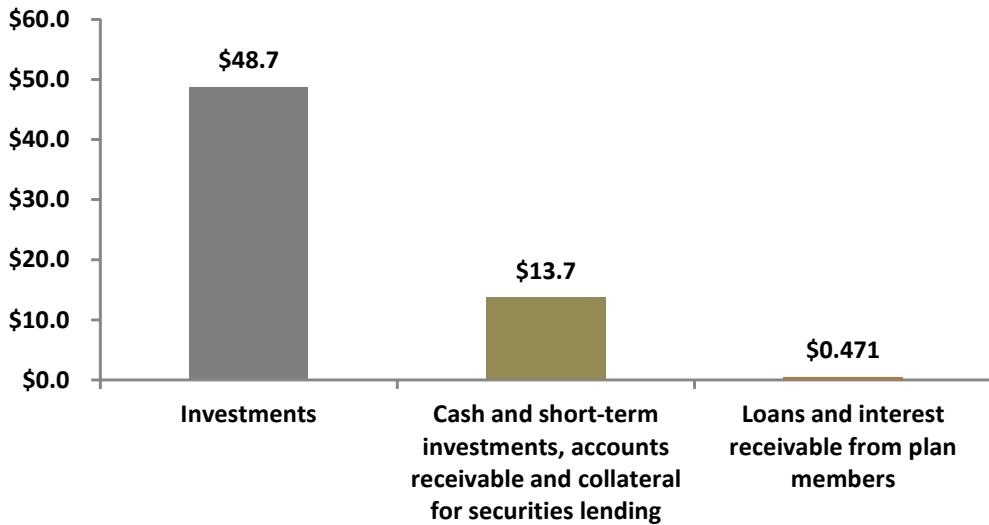
**RETIREMENT SYSTEM FOR THE JUDICIARY
OF THE COMMONWEALTH OF PUERTO RICO**
(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis

June 30, 2013

(Unaudited)

The total plan net position is presented in the following chart (in millions):



- The System's funded ratio of the actuarial accrued liability for pension benefits at June 30, 2013 was 14.2%, compared to 14.1% at June 30, 2012. The medical insurance plan contribution, which constitutes the other postemployment benefits, is financed by the Commonwealth on a pay-as-you-go basis and consequently is unfunded.

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

Management's Discussion and Analysis

June 30, 2013

(Unaudited)

The following schedules present comparative summary of the System's plan net position and changes in plan net position as of and for the years ended June 30, 2013 and 2012:

Comparative Summary of Plan Net Position – Pension Benefits

(Dollars in thousands)

	<u>2013</u>	<u>2012</u>	<u>Amount of change</u>	<u>Percentage change</u>
Assets:				
Cash and short-term investments, and total accounts receivable	\$ 4,799	\$ 13,658	\$ (8,859)	(64.9)%
Investments	58,354	48,730	9,624	19.7
Loans and interest receivable from plan members	436	471	(35)	(7.4)
Total assets	<u>63,589</u>	<u>62,859</u>	<u>730</u>	<u>1.2</u>
Liabilities:				
Due to the Employees' Retirement System of the Government of the Commonwealth of Puerto Rico	2,174	2,948	(774)	(26.3)
Escrow funds to plan members and guarantee insurance reserve for loans to plan members	65	65	—	—
Securities lending obligations	2,002	1,088	914	84.0
Other liabilities	336	170	166	97.6
Total liabilities	<u>4,577</u>	<u>4,271</u>	<u>306</u>	<u>7.2</u>
Total net position held in trust for pension benefits	<u>\$ 59,012</u>	<u>\$ 58,588</u>	<u>\$ 424</u>	<u>0.7%</u>

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

Management's Discussion and Analysis

June 30, 2013

(Unaudited)

Comparative Summary of Changes in Plan Net Position – Pension Benefits

(Dollars in thousands)

	<u>2013</u>	<u>2012</u>	<u>Amount of change</u>	<u>Percentage change</u>
Additions:				
Contributions:				
Employer	\$ 10,034	\$ 10,088	\$ (54)	(0.5)%
Special benefits	1,368	537	831	154.7
Participating employees	2,825	2,943	(118)	(4.0)
Net investment income	6,672	1,718	4,954	288.4
Other income	603	18	585	3,250.0
Total additions	<u>21,502</u>	<u>15,304</u>	<u>6,198</u>	<u>40.5</u>
Deductions:				
Retirement and other benefits	20,453	20,175	278	1.4
General and administrative expenses	625	516	109	21.1
Total deductions	<u>21,078</u>	<u>20,691</u>	<u>387</u>	<u>1.9</u>
Increase (decrease) in net position	<u>\$ 424</u>	<u>\$ (5,387)</u>	<u>\$ 5,811</u>	<u>(107.9)%</u>

- The System's total assets as of June 30, 2013 exceeded total liabilities by \$59 million (net position held in trust for pension benefits). As of June 30, 2012, total assets exceeded liabilities by \$58.6 million.
- The fair value of the System's investments, excluding loans to plan members, as of June 30, 2013 amounted to \$58.4 million compared to \$48.7 million as of June 30, 2012.
- Loans and interest receivable from plan members amounted to approximately \$436,000 as of June 30, 2013, compared to \$471,000 as of June 30, 2012.

Other Postemployment Healthcare Benefits

Other postemployment healthcare benefits paid during the fiscal year 2013 amounted to \$291,000, a decrease of 1% when compared to the \$294,000 paid during fiscal year 2012.

Financial Analysis of the System

The basic financial statements of the System for the fiscal year ended June 30, 2013 present a net increase in net position held in trust for pension benefits of approximately \$424,000 as compared to a decrease of \$5.4 million for the fiscal year ended June 30, 2012. This was mainly the result of an increase in total investments, at fair value, of \$9.6 million, partially offset by a decrease in cash and short-term investments of \$8.9 million. The increase in total liabilities consisted of an increase of approximately \$914,000 for securities lending and \$166,000 in other liabilities, which were partially offset by a decrease of approximately \$774,000 in accounts payable.

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

Management's Discussion and Analysis

June 30, 2013

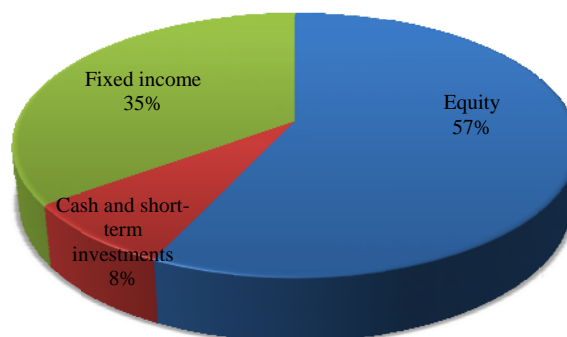
(Unaudited)

The System's additions in the statement of changes in plan net position include employer and plan member contributions, as well as investment income. For fiscal year 2013, employer and plan member contributions decreased by approximately \$659,000. The System recognized a net appreciation in the fair value of investments of \$5.8 million during 2013, which represents an increase of \$5.2 million from the net appreciation of \$516,000 recognized in 2012.

The System and the Employees' Retirement System of the Government of the Commonwealth of Puerto Rico (ERS), also a pension trust fund of the Commonwealth, are administered by the Puerto Rico Government Employees and Judiciary Retirement Systems Administration (the Administration). The Administration allocated 1.73% of its general and administrative expenses to the System. This percentage is based on total employer and participating employees' contributions to the System, divided by the aggregate total of employer and participants' contributions to the System and ERS, combined.

Investment Portfolio and Capital Markets Overview

The asset allocation of the System's investment portfolio fulfills the System's needs, and since it is more adequately balanced, it provides protection in case of a market downturn. As of June 30, 2013, the asset allocation of the System's investment portfolio is 35% in fixed income investments, including loans, 57% in equity securities, and 8% in cash and short-term investments as shown in the following chart:



Economy and Capital Markets Overview

The 2013 fiscal year started off strong due in large part to the deployment of monetary support from central banks across the globe. On the heels of a volatile spring and a steady flow of negative economic news, central banks took action. Notably, the Federal Reserve launched the much anticipated third round of quantitative easing (QE3) and the European Central Bank (ECB) initiated the Outright Monetary Transactions (OMT) program. The monetary stimulus drove global equity markets higher as relief set in that central bank support was present. However, the rally in the United States soon stalled as the positive sentiment gave way to concerns surrounding

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

Management's Discussion and Analysis

June 30, 2013

(Unaudited)

the U.S. presidential election and looming fiscal cliff. Meanwhile, international markets continued to rally into the second half of the fiscal year, as economic conditions improved and ECB President, Mario Draghi, committed to do "whatever it takes" to keep the Euro intact. In the United States, as the political uncertainty passed, equity markets surged to new all-time highs, even amongst increased taxes and threat of the budget sequester. Overseas, despite disappointing elections in Italy, the Cyprus bailout and a credit downgrade in the United Kingdom, markets continued their modest upward trend. The Bank of Japan launched its own unprecedented monetary and fiscal stimulus, providing another boost to investor confidence. The fiscal year ended with a spike in volatility due to comments from Ben Bernanke suggesting an easing of monetary support if economic conditions continued to improve. Global equities quickly retreated and bond yields spiked before investors were somewhat calmed after the Federal Reserve clarified that interest rates would remain low for the foreseeable future.

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

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

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

Management's Discussion and Analysis

June 30, 2013

(Unaudited)

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

Industry Indices Performance Overview

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

Total System's Investment Portfolio Performance

The System's portfolio generated a return of 11.0% during the 2012-2013 fiscal year, performing in line with its policy benchmark. The System's total investment portfolio, including loans, as of June 30, 2013 totaled \$60.7 million, composed of \$58.8 million in total investments and loans, \$191,000 in accrued interest receivable, and \$1.7 million in cash and cash equivalents.

U.S. Equity Overview for the Fiscal Year 2013

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

The System's domestic equity component generated a return of 20.2% during the fiscal year, performing in line with its benchmark, the Russell 3000 Index. Approximately \$3 million was redeemed from the SSgA S&P 500 Index Fund to meet the cash needs of the System. As of June 30, 2013, the System's domestic equity assets totaled \$25.9 million and represented approximately 42.7% of the System's total investments, including loans.

International Equity Overview for the Fiscal Year 2013

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

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

Management's Discussion and Analysis

June 30, 2013

(Unaudited)

During the fiscal year, the System's international equity component generated a return of 16.9%, outperforming the component's benchmark. The SSgA ACW MSCI Ex USA Fund performed in line with its benchmark. At the end of the fiscal year, the component had \$10.4 million in assets, representing 17.1% of the System's total investments, including loans.

U.S. Fixed Income Overview for the Fiscal Year 2013

The broad U.S. fixed income market, as measured by the Barclays Aggregate Bond Index, produced positive results for the first two quarters of the period only to reverse gains in the second half resulting in a loss of 0.7% during the fiscal year. All underlying sectors generated negative returns during the period, with the exception of corporate, asset-backed, and commercial mortgage-backed securities. Long-term government bonds experienced the largest decline, while shorter-term bonds produced modest positive results.

The System's fixed income component generated a return of 0.4% during the year ended June 30, 2013, underperforming the component's benchmark by 70 basis points. Taplin, Canida, & Habacht, contributed to outperformance while SSgA Intermediate Credit Index performed in line with its benchmark. At the end of the fiscal year, fixed income assets totaled \$23.4 million, consisting of approximately 38.6% of the System's total investments, including loans. Approximately \$12 million was redeemed from the component during the fiscal year as part of portfolio rebalancing and to meet the cash needs of the System.

Other Investments and Transactions

As of June 30, 2013 and 2012, the System held approximately \$436,000 and \$471,000, respectively, in loans and interest receivable from plan members. As of June 30, 2013, these loans consist of \$358,000 in personal loans, \$53,000 in cultural trip loans, and \$25,000 of accrued interest receivable applicable to the pool of loans. As of June 30, 2012, these loans consist of \$4,000 in mortgage loans, \$368,000 in personal loans, \$75,000 in cultural trip loans, and \$24,000 of accrued interest receivable applicable to the pool of loans.

The System earns additional investment income by lending investment securities to brokers via its custodian's securities lending program. The brokers provide collateral to the System and generally use the borrowed securities to cover short sales and failed trades. The cash collateral received from the brokers is invested in order to earn interest. For financial statements purposes, the amount of securities that was involved in securities lending transactions as of June 30, 2013 has been presented, along with the required disclosures, in accordance with current government accounting pronouncements. During fiscal years 2013 and 2012, income from the custodian securities lending activity amounted to approximately \$3,300 and \$4,600, respectively.

Funding Status

According to the actuarial valuation as of June 30, 2013, the System's unfunded actuarial accrued liability (UAAL) for pension benefits amounted to \$357.7 million with a funded ratio of 14.2%. The unfunded liability for postemployment healthcare benefits amounted to approximately \$6.7 million and was fully unfunded. In order to protect the System's financial health, the Commonwealth follows the practice of not allowing an increase in benefits unless an actuarial study is performed or the law provides the financing source.

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

Management's Discussion and Analysis

June 30, 2013

(Unaudited)

Recent Developments

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

Requests for Information

The financial report is designed to provide a general overview of the System's finances, comply with related laws and regulations, and demonstrate commitment to public accountability. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Commonwealth of Puerto Rico Government Employees and Judiciary Retirement Systems Administration, 437 Ponce de Leon Avenue, Hato Rey, Puerto Rico, 00918.

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

Statement of Plan Net Position

June 30, 2013

(In thousands)

	<u>Pension</u>	<u>Post employment healthcare benefits</u>	<u>Total</u>
Assets:			
Cash and short-term investments:			
Cash and cash equivalents	\$ 1,663	—	1,663
Deposits with Government Development Bank for Puerto Rico	916	—	916
Collateral from securities lending transactions	2,002	—	2,002
Total cash and short-term investments	<u>4,581</u>	<u>—</u>	<u>4,581</u>
Investments:			
Bonds and notes	18,693	—	18,693
Nonexchange commingled trust funds	39,661	—	39,661
Total investments	<u>58,354</u>	<u>—</u>	<u>58,354</u>
Loans and interest receivable from plan members	436	—	436
Accounts receivable:			
Accrued interest	191	—	191
Other	27	—	27
Total accounts receivable	<u>218</u>	<u>—</u>	<u>218</u>
Total assets	<u>63,589</u>	<u>—</u>	<u>63,589</u>
Liabilities:			
Securities lending obligations	2,002	—	2,002
Due to the Employees' Retirement System of the Government of the Commonwealth of Puerto Rico	2,174	—	2,174
Escrow funds to plan members and guarantee insurance reserve for loans to plan members	65	—	65
Other liabilities	336	—	336
Total liabilities	<u>4,577</u>	<u>—</u>	<u>4,577</u>
Net position held in trust for pension benefits	<u>\$ 59,012</u>	<u>—</u>	<u>59,012</u>

See accompanying notes to basic financial statements.

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

Statement of Changes in Plan Net Position

Year ended June 30, 2013

(In thousands)

	<u>Pension</u>	<u>Post employment healthcare benefits</u>	<u>Total</u>
Additions:			
Contributions:			
Employer:			
Basic benefits	\$ 10,034	—	10,034
Special benefits	1,368	291	1,659
Participating employees	2,825	—	2,825
Total contributions	<u>14,227</u>	<u>291</u>	<u>14,518</u>
Investment income:			
Net appreciation of investments	5,796	—	5,796
Interest income	948	—	948
Total investment income	<u>6,744</u>	<u>—</u>	<u>6,744</u>
Less investment expense	<u>72</u>	<u>—</u>	<u>72</u>
Net investment income	<u>6,672</u>	<u>—</u>	<u>6,672</u>
Other income	<u>603</u>	<u>—</u>	<u>603</u>
Total additions	<u>21,502</u>	<u>291</u>	<u>21,793</u>
Deductions:			
Annuities	18,509	—	18,509
Special benefits	1,944	291	2,235
General and administrative expenses	625	—	625
Total deductions	<u>21,078</u>	<u>291</u>	<u>21,369</u>
Net increase in net position held in trust for pension benefits	424	—	424
Net position held in trust for pension benefits:			
Beginning of year	<u>58,588</u>	<u>—</u>	<u>58,588</u>
End of year	<u>\$ 59,012</u>	<u>—</u>	<u>59,012</u>

See accompanying notes to basic financial statements.

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

Notes to Basic Financial Statements

June 30, 2013

(1) Organization and Summary of Significant Accounting Policies

The Retirement System for the Judiciary of the Commonwealth of Puerto Rico (the System) was created by Act No. 12 on October 19, 1954 (Act No. 12 of 1954). The System administers a single-employer defined-benefit pension plan (the pension plan). The System also administers postemployment healthcare benefits provided by the Commonwealth of Puerto Rico (the Commonwealth) to retired plan members (the Retirement System for the Judiciary of the Commonwealth of Puerto Rico Medical Insurance Plan Contribution - JRS MIPC), an unfunded, single-employer defined benefit other postemployment benefit plan. The System is considered an integral part of the financial reporting and is included in the Commonwealth's basic financial statements. The System, as a governmental retirement plan, is excluded from the provisions of the Employee Retirement Income Security Act of 1974 (ERISA).

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

As of June 30, 2013, the pension plan has an unfunded actuarial accrued liability (UAAL) for pension benefits of approximately \$357.7 million, representing a 14.2% funding ratio. In the opinion of management and based on information prepared by consulting actuaries, if measures are not taken soon to deal with this situation, the System's assets are estimated to be exhausted by the fiscal year 2019. The System's funding requirements, together with the funding requirements of the Employees' Retirement System of the Government of the Commonwealth of Puerto Rico and the Puerto Rico System of Annuities and Pensions for Teachers, could have a direct negative effect on the Commonwealth's General Fund, since the Commonwealth is the plan sponsor and is obligated to make contributions to fund each of the systems.

The Commonwealth has been facing a number of fiscal and economic challenges in recent years due, among other factors, to continued budget deficits, a prolonged economic recession, high unemployment, population decline, and high levels of debt and pension obligations. In recent months, the widening of credit spreads for the Commonwealth's public sector debt and the recent downgrading of the Commonwealth's credit ratings and those of many of its instrumentalities to noninvestment grade have put further strain on the Commonwealth's liquidity and may affect its access to both the capital markets and private sources of financing, as well as the borrowing cost of any such funding.

The estimate of when the System's assets would be exhausted is based on significant assumptions, including the rate of return on investments, the amount and timing of collections from the Commonwealth for the member and employer contributions, as well as the estimated participant benefits and the System's administrative expenses to be paid each year. If the Commonwealth's financial condition does not improve

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

Notes to Basic Financial Statements

June 30, 2013

as a result of fiscal and budgetary measures it is taking, its ability to repay its obligations, including its employer contributions to the pension plan for the upcoming years, may be adversely affected. Actual result could differ from this estimate.

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

Additionally, to help address the funded status situation, Act No. 162 of 2013 (Act No. 162) was enacted to amend certain provisions of the retirement system. However, as more fully described in the subsequent events footnote, many provisions of the Act were ruled unconstitutional or to apply only prospectively (note 8). The success of these measures cannot be assured, as it is dependent upon future events and circumstances whose outcome cannot be anticipated.

The System and the Employees' Retirement System of the Government of the Commonwealth of Puerto Rico (ERS), also pension and other employee benefit trust funds of the Commonwealth, are both administered by the Administration. The Administration allocated 1.73% of its general and administrative expenses to the System during the year ended June 30, 2013. The methodology used to determine the allocation of the Administration's expenses is based on total Employer and participating employees' contributions to the System, divided by the aggregate total of employer's and participants' contributions to the System and ERS, combined.

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

(a) Basis of Presentation

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

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

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

Notes to Basic Financial Statements

June 30, 2013

(b) Use of Estimates

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

(c) Cash and Short-term Investments

Cash and short-term investments consist of deposits with commercial banks, deposits in the GDB, and collateral from securities lending transactions.

(d) Investments

Investments are reported at fair value. The fair value of investments is based on quoted prices, if available. The System has investments in nonexchange commingled trust funds valued at approximately \$39.7 million as of June 30, 2013. Nonexchange commingled trust funds are reported at their net asset value (NAV). The NAV includes the market value of the securities in the fund plus any receivables, payables, and accrued fund expenses.

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

(e) Loans to Plan Members

Mortgage, personal, and cultural trip loans to plan members are stated at their outstanding principal balance. Maximum amounts that may be loaned to plan members for mortgage loans is \$100,000 and \$5,000 for personal and cultural trip loans. The carrying value of these loans approximates their fair value.

(f) Reserve for Life Insurance on Loans to Plan Members

Premiums collected and benefits claimed are recorded as additions and deductions of the guarantee insurance reserve for life insurance on loans to plan members, respectively.

(g) Allocation of Administrative Expenses

The Administration allocated 1.73% of its general and administrative expenses to the System, which amounted to approximately \$625,000 for the year ended June 30, 2013, and are included as part of general and administrative expenses in the accompanying statement of changes in plan net position.

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

Notes to Basic Financial Statements

June 30, 2013

(h) Future Adoption of Accounting Pronouncements

The GASB has issued the following Statements:

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

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

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

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

Notes to Basic Financial Statements

June 30, 2013

(2) Plan Description

Pension Benefits

All judges of the judiciary branch of the Commonwealth are members of the System.

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

Retirees and beneficiaries currently receiving benefits	430
Current participating employees	364
Terminated vested participants	59
Total membership	853

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

Plan members are eligible for the benefits described below:

Retirement Annuity – Plan members with 10 years of credited service are eligible for retirement upon reaching 60 years of age.

Plan members are eligible for monthly benefit payments determined by the application of a stipulated benefit to the plan member’s highest salary received as judge. The annuity for which a plan member is eligible is limited to a minimum of 25% and a maximum of 75% of the highest salary earned as judge.

Reversionary Annuity – A plan member, upon retirement, could elect to receive a reduced retirement annuity and to provide an annuity for his widow with the remainder of his equity as actuarially determined upon his death. The payments would start after the death of the retiree, for an amount not less than \$120 yearly or greater than the annuity payments being received by the retiree.

Occupational Disability Annuity – A participating employee, who as a direct result of the performance of his/her occupation is totally and permanently disabled, is eligible for a disability annuity of 50% of the compensation received at the time of the disability, payable as an annuity, reduced by any payments received from the state insurance fund under the Workmen’s Accident Compensation Act.

Nonoccupational Disability Annuity – A participating employee totally and permanently disabled for causes not related to his/her occupation, and with no less than 10 years of credited service, is eligible for annuity of 30% of the average compensation (the average of the 36 highest months of salary) of the first 10 years of credited service, increased by 1% for every additional year of credited service in excess of 10 years, up to a maximum of 50% of the average compensation.

Death Benefits:

Occupational:

- Surviving spouse – annuity equal to 50% of the participating employee’s salary at the date of the death.

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

Notes to Basic Financial Statements

June 30, 2013

- Children – \$10 per month for each child, minor or student, up to a maximum benefit per family of 75% of the participating employee’s salary at the date of the death. If no spouse survives or dies while receiving the annuity payments, each child, 18 or under, is eligible to receive an annuity of \$20 per month up to the attainment of 18 years of age or the completion of his/her studies.

Pre-retirement:

While in active service, the contributions and interest accumulated as of the date of the death, plus an amount equal to one year of compensation at the time of the death. While not in active service, the benefit equals a refund of accumulated contributions.

Post-retirement:

- 60% of the retiree’s pension, payable for life for a surviving spouse and/or disabled children and payable until age 18 or completion of studies, if later, for nondisabled children.
- When there is no relation as stated above the benefit is equal to the excess, if any, of the accumulated contributions at the time of retirement over the total annuity benefits received before death, in no case lower than \$1,000. The General Fund pays the difference, up to \$500, between the accumulated contributions less the annuities paid and \$1,000. The System pays for the rest.

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

Special Benefits:

Special benefits include the following:

- Christmas bonus – An annual bonus of \$600 for each retiree and disabled member paid each December. The System pays \$150 per retiree and disabled member and the remaining bonus is paid by the Commonwealth.
- Summer bonus – An annual bonus of \$100 for each retiree, beneficiary, and disabled member paid each July. This benefit is prorated if there are multiple beneficiaries and is funded by the Commonwealth.
- Medication bonus – An annual bonus of \$100 for each retiree, beneficiary, and disabled member paid each July to cover health costs. Evidence of coverage is not required. This benefit is funded by the Commonwealth.
- Cost-of-living adjustments (COLA) – Effective January 1, 2001, commencing January 1, 2002 and subsequently every three years thereafter, the annual benefit is increased by 3% for retirees and disabled members provided that the member had been receiving payments for at least three years (Section 236c). These COLAs are paid by the General Fund of the Commonwealth. In addition, an ad-hoc 3% COLA was granted effective January 1, 1999 and is paid by the System.

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

Notes to Basic Financial Statements

June 30, 2013

Other Postemployment Benefits (OPEB) - Healthcare Benefits

JRS MIPC is a cost-sharing, single-employer defined benefit other postemployment benefit plan sponsored by the Commonwealth. Its benefit covers a maximum of \$100 per month per retiree. JRS MIPC covers all judges of Judiciary Branch of the Commonwealth.

Plan members are eligible for benefits upon reaching the age of 60 with 10 years of service.

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

Retirees	430
Current participating employees	364
Terminated vested participants	59
Total membership	853

(3) Funding Policy

Pension Benefits

The contribution requirement to the System is established by law and is not actuarially determined. Required contributions consist of 30.34% of applicable payroll for the employer and 8% for the participating employees. Contributions from the Commonwealth should ultimately cover any deficiency between the employer's and employees' contributions and the System's pension benefit obligations and administrative costs.

The special benefits contributions of approximately \$1.4 million in 2013 represent contributions from the General Fund of the Commonwealth for the special benefits granted by special laws, as detailed in note 2. The funding of the special benefits is provided to the System through legislative appropriations each July 1. The legislative appropriations are considered estimates of the payments to be made by the System for the special benefits. Deficiencies in legislative appropriations are covered by the System's own funds until recovered through future legislative appropriations. Any surplus of legislative appropriations collected over special benefits paid is combined with the assets held in trust for the payment of other pension benefits.

Calculations of the present value of benefits under the System were made by consulting actuaries as of June 30, 2013. The significant assumptions underlying the actuarial computations are presented in note 4.

During the year ended June 30, 2013, the System increased the assumed rate of return from 6.1% in 2012 to 6.3% in 2013, which resulted in a decrease of approximately \$9 million in the actuarial accrued liability (AAL).

The AAL and the UAAL as of June 30, 2013 were \$416.7 million and \$357.7 million, respectively.

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

Notes to Basic Financial Statements

June 30, 2013

OPEB

The contribution requirement of JRS MIPC is established by Act No. 95 approved on June 29, 1963. This OPEB plan is financed by the Commonwealth on a pay-as-you-go basis. There is no contribution requirement from the plan member during active employment. Retirees contribute the amount of the healthcare insurance premium not covered by the Commonwealth contribution. As a result, these OPEB are 100% unfunded. During the year ended June 30, 2013, OPEB contributions amounted to \$291,000.

The funding of the healthcare benefits is provided to the System through legislative appropriations each July 1. The legislative appropriations are considered estimates of the payments to be made by the System for the healthcare benefits throughout the year. Deficiencies in legislative appropriations are covered by the System's own funds until recovered through future legislative appropriations. Any surplus of legislative appropriations collected over healthcare benefits paid is combined with the assets held in trust for the payment of other pension benefits.

(4) Funded Status and Funding Progress

The System's funded status as of June 30, 2013, the most recent actuarial valuation date, is as follows (in thousands):

	<u>Actuarial value Assets</u>	<u>AAL</u>	<u>UAAL</u>	<u>Funded ratio</u>	<u>Annual covered payroll</u>	<u>UAAL as a % of annual covered payroll</u>
Pension	\$ 59,012	\$ 416,734	\$ 357,722	14.2%	\$ 32,138	1,113.1%
OPEB	\$ —	\$ 6,705	\$ 6,705	—%	\$ 32,138	20.9%

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

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

Notes to Basic Financial Statements

June 30, 2013

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

Pension Benefits

Actuarial cost method	Projected unit credit cost method, with straight proration based on service to decrement
Amortization method	30 years closed, level percentage of payroll
Remaining amortization period	13 years
Asset valuation method	Market value of assets
Actuarial assumptions:	
Investment rate of return	6.3%
Projected salary increases	3%
Inflation	2.5%
Cost of living adjustment	0.99% annually to approximate 3% triennial increases.

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

OPEB

Actuarial cost method	Projected unit credit cost method, with straight proration based on service to decrement
Amortization method	30 years closed, level percentage of payroll
Remaining amortization period	13 years
Asset valuation method	Market value of assets
Actuarial assumptions:	
Investment rate of return	3.25%
Projected salary increases	Not applicable
Payroll growth	3%
Inflation	Not applicable
Cost of living adjustment	Not applicable

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

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

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

Notes to Basic Financial Statements

June 30, 2013

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

Mortality rate assumptions for both pension benefits and OPEB are:

- Pre-retirement Mortality – RP-2000 employee mortality rates with white collar adjustments for males and females, projected on a generational basis using Scale AA.
- Postretirement Healthy Mortality – RP-2000 healthy annuitant mortality rates, with white collar adjustments for males and females, projected on a generational basis using Scale AA.
- Postretirement Disabled Mortality – RP-2000 disabled annuitant mortality rates, without projection.

(5) Deposits and Investments

Deposits

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

As of June 30, 2013, the depository bank balance of approximately \$2.6 million was uninsured and uncollateralized. The bank balance of deposits with GDB, which amounted to approximately \$916,000, is uninsured and uncollateralized. Uninsured and uncollateralized cash and cash equivalents amounting to approximately \$1.7 million represent cash held by the System's custodian banks. These deposits are also exempt from compliance with the collateralization requirements.

Investments

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

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

Credit Risk – Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. All fixed-income securities at the time of purchase must be of investment-grade quality. The System's investment policy limits the investment in corporate debt securities to the top ratings issued by

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

Notes to Basic Financial Statements

June 30, 2013

nationally recognized statistical rating organizations. The policy requires the debt securities portfolio to maintain a minimum weighted average credit quality of either “A-” or better.

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

<u>Investment type</u>	<u>Rating (1)</u>					<u>Total</u>
	<u>AAA</u>	<u>AA+ to AA-</u>	<u>A+ to A-</u>	<u>BBB+ to BBB-</u>	<u>BB+ to BB-</u>	
Mortgage and asset-backed securities:						
Federal National Mortgage Association (FNMA)	\$ —	1,147	—	—	—	1,147
Federal Home Loan Mortgage Corporation (FHLMC)	—	1,786	—	—	—	1,786
U.S. corporate bonds and notes	—	1,286	2,682	4,493	192	8,653
Non U.S. corporate bonds	—	468	519	921	—	1,908
Total bonds and notes	—	4,687	3,201	5,414	192	13,494
Nonexchange commingled fixed income trust fund - SSgA Intermediate Fund	402	397	1,301	1,223	—	3,323
Total	\$ 402	5,084	4,502	6,637	192	16,817

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

Approximately \$5.2 million of the total system investments consist of U.S. government and Government National Mortgage Association (GNMA) mortgage-backed securities, which carry no risk, therefore, not included within the above table.

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

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of the System’s investment in a single issuer. As of June 30, 2013, there are no investments in any one issuer that represent 5% or more of the System’s net position.

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

Notes to Basic Financial Statements

June 30, 2013

As of June 30, 2013, the System owned shares in the SSgA S&P 500 Flagship Securities Lending Fund (the SSgA S&P 500 Fund), the SSgA MSCI ACWI Ex USA Non-Lending Fund (the SSgA MSCI ACWI Ex USA Fund), and the SSgA Intermediate Fund as follows (in thousands):

<u>Fund Name</u>	<u>Shares</u>	<u>Fair value</u>
SSgA S&P 500 Fund	74	\$ 25,937
SSgA MSCI ACWI Ex USA Fund	663	10,401
SSgA Intermediate Fund	122	3,323
Total nonexchange commingled trust funds		<u>\$ 39,661</u>

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

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

As of June 30, 2013, the investments underlying the SSgA S&P 500 Fund, SSgA MSCI ACWI Ex USA Fund, and the SSgA Intermediate Fund had the following sector allocations:

<u>Sector</u>	<u>SSgA S&P 500 Fund</u>	<u>SSgA MSCI ACWI Ex USA Fund</u>
Information technology	18%	7%
Healthcare	13	8
Financials	17	26
Energy	11	9
Consumer staples	10	11
Industrials	10	11
Consumer discretionary	12	10
Utilities	3	3
Telecommunication services	3	6
Materials	3	9
Total	<u>100%</u>	<u>100%</u>

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

Notes to Basic Financial Statements

June 30, 2013

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

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The System manages its exposure to declines in fair values by structuring the investment portfolio so that securities mature to meet cash requirements for benefit payments, thereby avoiding the need to sell securities on the open market prior to maturity. The System is expected to achieve capital preservation and income generation by investing in a diversified portfolio of marketable, investment-grade, intermediate credit fixed-income securities.

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

Notes to Basic Financial Statements

June 30, 2013

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

Investment type	Maturity (in years)				Total
	Within 1 year	After 1 to 5 years	After 5 to 10 years	After 10 years	
Bonds and notes:					
U.S. government securities:					
U.S. Treasury notes	\$ 1,532	—	—	—	1,532
U.S. Treasury Inflation-Protected Securities (TIPS)	—	607	1,603	—	2,210
Mortgage and asset-backed securities:					
GNMA	—	—	—	1,457	1,457
FNMA	—	13	—	1,134	1,147
FHLMC	—	—	—	1,786	1,786
U.S. corporate bonds and notes	850	2,368	2,171	3,264	8,653
Non-U.S. corporate bonds	426	—	784	698	1,908
Total bonds and notes	2,808	2,988	4,558	8,339	18,693
Nonexchange commingled fixed income trust fund (1) - SSgA Intermediate Fund:					
U.S.	—	2,215	—	—	2,215
Non-U.S.	—	1,108	—	—	1,108
Total bonds and notes and nonexchange commingled fixed income trust fund	2,808	6,311	4,558	8,339	22,016
Nonexchange commingled equity trust funds:					
U.S. – SSgA S&P 500 Fund					25,937
Non-U.S. – SSgA MSCI ACWI Ex USA Fund					10,401
Total stocks and nonexchange commingled equity trust funds					36,338
Total investments					\$ 58,354

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

Foreign Currency Risk

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

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

Notes to Basic Financial Statements

June 30, 2013

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

Country	SSgA MSCI ACWI Ex USA Fund
Japan	16%
United Kingdom	15
France	7
Switzerland	7
Canada	7
Other	7
Germany	6
Australia	6
China	4
Korea	3
Taiwan	3
Brazil	3
Spain	2
Netherlands	2
Sweden	2
Hong Kong	2
India	2
South Africa	2
Italy	1
Singapore	1
Mexico	1
Russia	1
Total	100%

Securities Lending Transactions

The System participates in a securities lending program, whereby securities are transferred to an independent broker or dealer in exchange for collateral in the form of cash, government securities, and/or irrevocable bank letters of credit with a simultaneous agreement to return the collateral for the same securities in the future. Collateral is marked to market daily, and the agent places a request for additional collateral from brokers, if needed. The custodian bank is the agent for the securities lending program.

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

Notes to Basic Financial Statements

June 30, 2013

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

Securities lent:

Description	Fair value of underlying securities
U.S. government securities:	
U.S. Treasury notes	\$ 510
U.S. Treasury Inflation- Protected Securities (TIPS)	580
U.S. corporate bonds and notes	863
Total	\$ 1,953

Collateral received:

Description	Fair value of underlying securities
Certificates of deposit	\$ 1,101
Commercial paper	901
Total	\$ 2,002

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

(6) Loans and Interest Receivable from Plan Members

Loans and interest receivable from plan members are substantially guaranteed by the contributions of plan members and by other sources, including mortgage deeds and any unrestricted amount remaining in the escrow funds. In addition, collections on loans receivable are received through payroll deductions. The maximum amount that may be loaned to plan members for mortgage loans is \$100,000 and \$5,000 for personal and cultural trip loans.

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

Notes to Basic Financial Statements

June 30, 2013

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

Loans receivable from plan members:			
Personal		\$	358
Cultural trips			53
Total loans receivable from plan members			411
Accrued interest receivable			25
Total loans and interest receivable from plan members		\$	436

(7) Guarantee Insurance Reserve for Loans to Plan Members

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

(8) Subsequent Event

On December 24, 2013, the Governor of Puerto Rico signed into law Act No. 162 of 2013 (Act No. 162), in order to implement a comprehensive reform plan to address the System's UAAL. The Act included various changes applicable to all participants and retirees; however, the constitutionality of Act No. 162 was challenged, and on February 21, 2014, the Puerto Rico Supreme Court ruled that the reform could only be applied as follows:

1. Active participants and retirees hired or retired prior to December 24, 2013 maintain the existing benefits.
2. Participants hired between December 24, 2013 and June 30, 2014 will accrue a maximum pension of 60% of salary, and will contribute 10% of salary, among other changes.
3. Participants hired on or after July 1, 2014 will participate in a new Hybrid Plan.
4. The ability to retire with existing benefits for participants already in the System until July 1, 2015 was declared unconstitutional.

Act No. 162 amends the provisions of the different benefit structures under the System for new participants (based on the Supreme Court ruling described above) through several measures, including the following:

1. A Hybrid Plan composed of a defined benefit and a defined contribution is established.
2. Creditable service will accrue in terms of time for the participant, only for time served as a judge. There will be no transfers of their contributions from other retirement systems.

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

Notes to Basic Financial Statements

June 30, 2013

3. Average compensation is based on the salary of the last five years of service.
4. Participant can receive a reimbursement of contributions if he/she is not vested (12 years of service and age 65).
5. New benefits for vested participants include (a) 1.5% of the average salary of the last five years of service multiplied by the number of years in service as a judge, plus (b) the balance of his/her accrued contributions divided by an actuarial factor determined by the board of trustees in consultation with the actuaries.
6. Early retirement for participants with 12 years of service, but between the ages of 55 and 65, would accrue the same benefits as #5 above, except that an actuarial reduction would be applied.
7. Disability benefits will not exceed 33% for participants with at least five years of service. The same formula as #5 is applied.
8. There will be a cost of living adjustment of 3% every three years.
9. Retired members can name spouse as beneficiary under a Joint and Survivor Annuity plan. However, if they do not have this plan, then the spouse would be reimbursed the deceased's contributions, not a pension benefit.
10. Employee contributions were increased for new participants from 8% to 12%, and employer contributions remain at 30.34%.
11. Various bonuses that were sponsored by special laws were eliminated: Christmas bonus of \$600, summer bonus of \$100, and medication bonus of \$100.
12. Medical Insurance Plan Contribution of \$100 per month continues to be in place.
13. The System shall commission an actuarial evaluation to determine an annual additional contribution by the government to maintain the assets of the trust fund at no less than \$20 million.

The Government of Puerto Rico and the System's management, together with the consulting actuary, are in the process of estimating the effects of Act No. 162 on the System's UAAL. However, as a result of the Supreme Court's ruling its effect will be significantly different than expected when Act No. 162 was enacted.

REQUIRED SUPPLEMENTARY INFORMATION

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

Schedule of Employer's Contributions

(Unaudited)

Dollars in thousands

<u>Plan</u>	<u>Year ended June 30</u>	<u>Annual required contribution</u>	<u>Actual employer's contribution</u>	<u>Percentage of contribution</u>
Pension *	2013	\$ 38,501	\$ 11,402	29.62%
	2012	33,544	11,466	34.18
	2011	29,684	11,012	37.10
	2010	28,127	11,045	39.27
	2009	22,195	11,132	50.16
	2008	19,803	7,262	36.67
	Other Postemployment Healthcare Benefits	2013	\$ 643	\$ 291
2012		554	294	53.05
2011		529	253	47.86
2010		488	256	52.42
2009		425	234	55.01
2008		408	226	55.33

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

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

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

Schedule of Funding Progress

(Unaudited)

(Dollars in thousands)

Plan	Year ended June 30	Actuarial value of plan assets	AAL	UAAL	Funded ratio	Annual covered payroll	UAAL as a % of annual covered payroll
Pension*	2013	\$ 59,012	\$ 416,734	\$ 357,722	14.2%	\$ 32,138	1,113.1%
	2012	58,588	416,340	357,752	14.1	33,066	1,081.9
	2011	63,975	382,776	318,801	16.7	31,811	1,002.2
	2010	55,410	338,195	282,785	16.4	32,061	882.0
	2009	50,566	323,928	273,362	15.6	30,587	893.7
	2008	69,311	N/D	N/D	N/D	N/D	N/D
Other Postemployment Healthcare Benefits	2013	\$ —	\$ 6,705	\$ 6,705	—%	\$ 32,138	20.9%
	2012	—	6,592	6,592	—	33,066	19.9
	2011	—	5,810	5,810	—	31,811	18.3
	2010	—	5,808	5,808	—	32,061	18.1
	2009	—	5,643	5,643	—	30,587	18.5
	2008	—	N/D	N/D	N/D	N/D	N/D

* The above liabilities are for basic System benefits and selected System-administered benefits.

N/D = Not determined.

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

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

Notes to Required Supplementary Information

(Unaudited)

June 30, 2013

(1) Schedule of Employer Contributions

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

The schedule of employer's contributions is based on total benefit and administration cost, net of member contributions; it includes both the Office of the Administration of Court Facilities' (the Employer) and participating employees' contributions. The Commonwealth's and Employer's contributions, ultimately, should cover any deficiency between the pension benefits and the System's administration costs, net of member contributions. The information was obtained from the last actuarial report as of June 30, 2013.

(2) Schedule of Funding Progress

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