

Employee's Retirement System
of the Government of the
Commonwealth of Puerto Rico
(A Pension Trust Fund of the Commonwealth of Puerto Rico)

Basic Financial Statements for the Year Ended
June 30, 2009, Required Supplementary
Information for the Year Ended June 30, 2009, and
Independent Auditors' Report

**EMPLOYEE'S RETIREMENT SYSTEM OF THE GOVERNMENT
OF THE COMMONWEALTH OF PUERTO RICO
(A Pension Trust Fund of the Commonwealth of Puerto Rico)**

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INDEPENDENT AUDITORS' REPORT

To the Board of Trustees of the
Employee's Retirement System of the Government of the
Commonwealth of Puerto Rico

We have audited the accompanying statement of plan net assets of the Employee's Retirement System of the Government of the Commonwealth of Puerto Rico (the "System"), a pension trust fund of the Commonwealth of Puerto Rico, as of June 30, 2009, and the related statement of change in plan net assets for the year then ended. These financial statements are the responsibility of the System's management. 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 of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets of the System as of June 30, 2009, and the change in its net assets for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis and the supplemental schedules listed in the table of contents are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the System's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and do not express an opinion on it.

As discussed in Note 1 to the basic financial statements, the System held investments valued at approximately \$948,544,000 (18.91% of total assets) as of June 30, 2009, whose fair values have been estimated in the absence of readily determinable fair values. This estimate is based on information provided by the underlying fund managers.

As discussed in Note 1 to the basic financial statements, the System's unfunded actuarial accrued liability and funded ratio as of June 30, 2009, were approximately \$17,101 million and 9.7%, respectively. In the opinion of management, based on information prepared by consulting actuaries, the System will not be able to fully fund pensions after the fiscal year 2020, if measures are not taken to reduce the unfunded actuarial accrued liability and increase the funded ratio of the System.

Deloitte & Touche LLP

April 26, 2010

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**EMPLOYEE'S RETIREMENT SYSTEM OF THE GOVERNMENT
OF THE COMMONWEALTH OF PUERTO RICO
(A Pension Trust Fund of the Commonwealth of Puerto Rico)**

**MANAGEMENT'S DISCUSSION AND ANALYSIS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2009**

Introduction

The Employee's Retirement System of the Government of the Commonwealth of Puerto Rico (the "System") administers retirement and other plan member benefits, such as personal, cultural and mortgages loans, occupational and non-occupational disability annuities and death benefits. The System is a pension trust fund of the Commonwealth of Puerto Rico (the "Commonwealth"). Pension trust resources are only held in trust to pay retirement benefits to plan members. The System presents in the Management's Discussion and Analysis an overview of the annual basic financial statements and provides a narrative discussion and analysis of the financial activities for the fiscal year ended June 30, 2009. 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

The Management's Discussion and Analysis introduces the System's basic financial statements. The basic financial statements include the following: (1) Statement of Plan Net Assets, (2) Statement of Changes in Plan Net Assets, and (3) Notes to the Basic Financial Statements. The System also includes additional information to supplement the basic financial statements.

Statement of Plan Net Assets and Statement of Change in Plan Net Assets

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

The statement of plan net assets includes all of the System's assets and liabilities, with the difference reported as net assets held in trust for pension benefits. Over time, increases or decreases in net assets 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 assets reports the change in the System's net assets held in trust for pension benefits during the year. All current year additions and deductions are included regardless of when cash is received or paid.

Notes to Basic Financial Statements

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

Required Supplementary Information

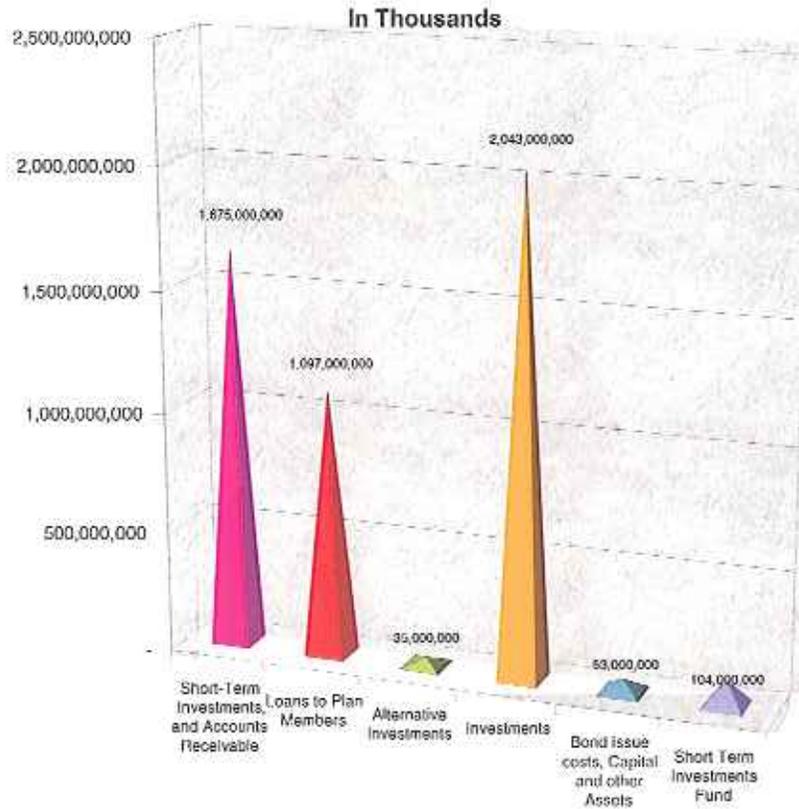
The required supplementary information consists of two schedules and related notes concerning the funded status of the pension plan administered by the System.

Financial Highlights

The System provides retirement benefits to employees of the Commonwealth. The System's total assets as of June 30, 2009 and 2008 amounted to \$5,007 million and \$5,772 million, respectively.

As of June 30, 2009, the System's total assets consist of the following:

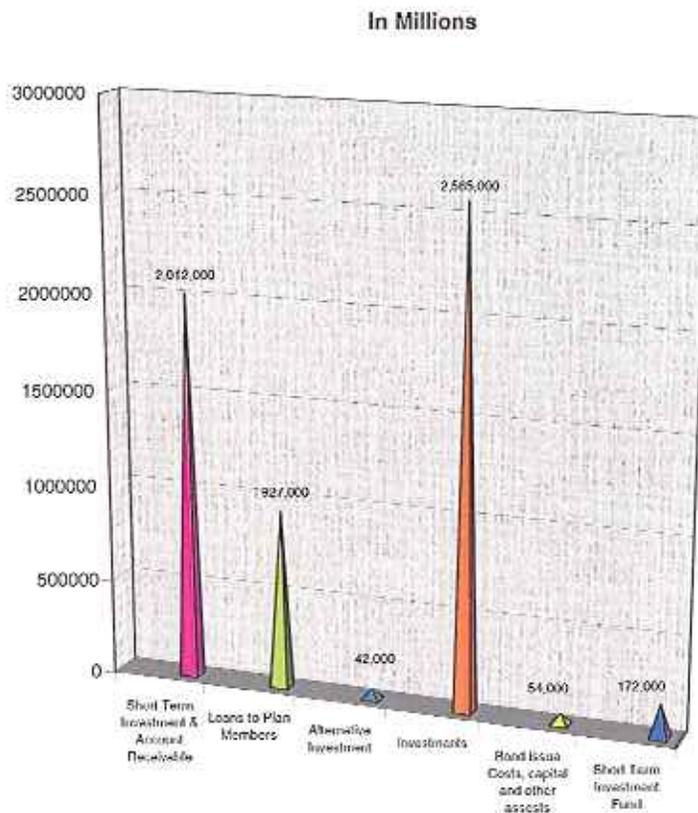
- \$1,675 million in cash and short-term investments, and accounts receivable, excluding an investment in a short-term investment fund
- \$1,097 million in loans and accrued interest receivable from plan members
- \$35 million in private equity investments
- \$2,043 million of investments in bonds and stocks
- \$53 million in bond issue costs, capital and other assets
- \$104 million in a short-term investment fund



As of June 30, 2008, the System's total assets consist of the following:

- \$2,012 million in cash and short-term investments, and accounts receivable, excluding an investment in a short-term investment fund
- \$927 million in loans to plan members
- \$42 million in private equity investments
- \$2,565 million of investments in bonds and stocks
- \$54 million in capital and other assets
- \$172 million in a short-term investment fund

The following provides a comparison of certain items within the financial statements:



The following schedules present comparative summary financial statements of the System's plan net assets and change in plan net assets for fiscal years 2009 and 2008:

Summary Comparative Statements of Plan Net Assets

	2009	2008	Total Dollar Change	Total Percentage Change
	(in thousands)			
Assets:				
Cash and short-term investments, and total accounts receivable	\$ 1,778,965	\$ 2,183,642	\$ (404,677)	-18.5%
Investments	2,078,233	2,607,798	(529,565)	-20.3%
Loans to plan members	1,097,444	926,831	170,613	18.4%
Capital assets and other	52,425	53,595	(1,170)	-2.2%
Total assets	<u>5,007,067</u>	<u>5,771,866</u>	<u>(764,799)</u>	<u>-13.3%</u>
Liabilities:				
Accounts payable and accrued liabilities	14,228	9,310	4,918	52.8%
Book overdraft	37,961		37,961	100.0%
Payables for securities lending	103,527	171,600	(68,073)	-39.7%
Bond interest payable	13,876	12,181	1,695	13.9%
Insurance reserve for loans to plan members and investment settlements	20,298	16,559	3,739	22.6%
Bond payable	2,961,359	2,942,184	19,175	0.7%
Other liabilities	13,675	12,946	729	5.6%
Total liabilities	<u>3,164,924</u>	<u>3,164,780</u>	<u>144</u>	<u>0.0%</u>
Total net assets held in trust for pension benefits	<u>\$ 1,842,143</u>	<u>\$ 2,607,086</u>	<u>\$ (764,943)</u>	<u>-29.3%</u>

Summary Comparative Statements of Change in Plan Net Assets

	2009	2008	Total Dollar Change	Total Percentage Change
	(in thousands)			
Additions:				
Contributions:				
Employers	\$ 400,405	\$ 380,833	\$ 19,572	5.1%
Participating employees	362,040	345,614	16,426	4.8%
Special laws	192,254	177,867	14,387	8.1%
Early retirement	47,146	141,724	(94,578)	-66.7%
Investment loss	(351,633)	(93,910)	(257,723)	274.4%
Other	35,878	31,007	4,871	15.7%
Total additions	<u>686,090</u>	<u>983,135</u>	<u>(297,045)</u>	<u>-30.2%</u>
Deductions:				
Retirement and other benefits	1,174,629	1,129,280	45,349	4.0%
Refunds of contributions	34,530	40,366	(5,836)	-14.5%
Interest on bonds payable	186,869	46,996	139,873	297.6%
General and administrative	32,590	31,610	980	3.1%
Other	22,415	19,298	3,117	16.2%
Total deductions	<u>1,451,033</u>	<u>1,267,550</u>	<u>183,483</u>	<u>14.5%</u>
Decrease in plan net assets	<u>\$ (764,943)</u>	<u>\$ (284,415)</u>	<u>\$ (480,528)</u>	<u>169.0%</u>

- The System total assets exceeded total liabilities by \$1,842 million (plan net assets) for the fiscal year reported compared to the prior year, for which assets exceeded liabilities by \$2,607 million.
- Based on the last actuarial valuation as of June 30, 2009, the System's funding ratio of the actuarial accrued liability is 9.7%.
- Loans to plan members amounted to \$1,097 million as of June 30, 2009, compared to \$927 million as of June 30, 2008.

The basic financial statements of the System for the fiscal year ended June 30, 2009 present a decrease in plan net assets of \$765 million as compared to the prior fiscal year. This was mostly the result of a decrease in cash and short-term investments of \$422 million and a decrease in investments of \$530 million, which was partially offset by an increase in loans and interest receivable from plan members of \$171 million and an increase in accounts receivable of \$17 million.

During fiscal year 2009, the plan member and employer contributions, including early retirement contributions, decreased by approximately \$58 million, from \$868 million during fiscal 2008 to \$810 million during fiscal year 2009. The System recognized a net depreciation in the fair value of investments of \$559 million during 2009, which represents an increase of \$346 million or 162% from the \$213 million recognized in 2008.

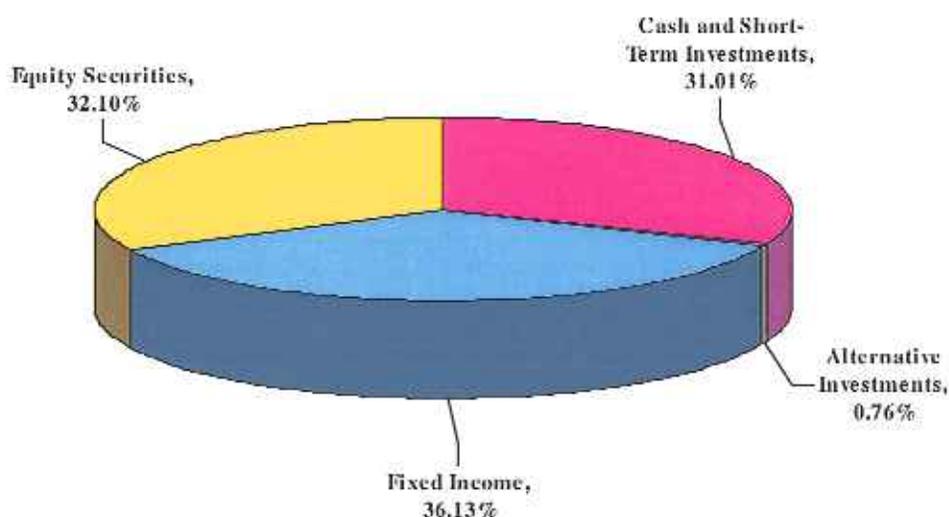
Issuance of Bonds Payable

During fiscal year 2007, the Board of Trustees approved the issuance of bonds payable to increase the funds currently available to pay pension benefits to certain of its beneficiaries and to reduce its unfunded accrued actuarial pension liability. As of June 30, 2009, bonds payable amounted to \$2,961 million.

Financial Analysis of the System

Facing an unstable market, in 2001 management identified the need for a portfolio restructuring. The System's portfolio moved from a very aggressive allocation of 75% toward equities to a controlled allocation of a maximum of 65% in equities. To enhance the expected annual return, the strategy concentrated in the allocation of a 28% of the total portfolio to the plan members' loans program with only 7% assigned to a core fixed income strategy. Those loans provide a higher return and lower risk in comparison to bonds, mostly because the System has the ability to increase the interest rates charged, the repayment comes from payroll deductions, and the loans are guaranteed by plan members' accumulated contributions.

The new asset allocation of the System's investment portfolio is the one that 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, 2009, the asset allocation of the System's investment portfolio is 36.13% in fixed-income investments, including loans receivable, 32.10% in equity securities, 31.01% in cash and short-term investments, and 0.76% in alternative investments as shown in the following chart:



Other Investments and Transactions

As of June 30, 2009 and 2008, the System held approximately \$1,097 million and \$927 million, respectively, in loans and interest receivable from plan members, which represents 35% and 26%, respectively of the total investment portfolio. As of June 30, 2009, loans and interest receivable from plan members consist of \$128 million in mortgage loans, \$911 million in personal loans, \$49 million in cultural trips loans, and \$20 million in accrued interest receivable, less \$10.5 million in allowance for adjustment and losses in realization. As of June 30, 2008, loans and interest receivable from plan members consist of \$116 million in mortgage loans, \$782 million in personal loans, \$37 million in cultural trips loans, and \$18 million in accrued interest receivable, less \$27 million in allowance for adjustment and losses in realization. As of June 30, 2009 and 2008, the fair value of the System's investment in limited partnerships amounted to \$34.9 and \$42.3 million, respectively, which represents approximately 1% of the investment portfolio for each year.

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 used the borrowed security to cover short sales and failed trades. The cash collateral received from the brokers is invested in a short-term investment fund in order to earn interest. For financial statements purposes, the amount of securities as of June 30, 2009 that was involved in the securities lending transactions was presented with the required disclosures, according to the current government accounting pronouncements. For the years ended June 30, 2009 and 2008, net income from the securities lending activity amounted to approximately \$247,000 and \$349,000, respectively.

Funding Status

The System was created by Act 447 of May 15, 1951, and since its inception it lacked proper planning and the levels of contributions were relatively low (and still remains low in comparison to the level of benefits). Besides, all retirement systems in place before 1951 were merged into the System, which then had to absorb all their unfunded liabilities. Afterwards, in 1973, the benefits structure was enhanced, however, without the appropriate increase in the contribution levels. As more people joined the government labor force and then retired under the new enhanced benefit structure, the gap between the assets available to pay benefits and the actuarial obligation started its steeping course.

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

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

Presently, the System consists of three different benefit structures, which are administrated according to their specifications in the Act. For all plan members, excluding System 2000 program participants, the level of contributions established by law is 8.275% of the employee salary. Under System 2000, employee's contributions range from 8.275% to 10% of the salary, as specified by the employee. Under all structures, employers' contributions are stated by law at 9.275% of the employee salary.

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

Market events plus the continuous increase in the actuarial liability had a negative effect over the System's actuarial unfunded liability. Based on the last actuarial valuation at June 30, 2009, the System's funded ratio is 9.5%, the actuarial obligation is \$18,944 million, total actuarial value of plan assets amounted to \$1,811 million, and the unfunded actuarial accrued liability amounted to \$17,132 million.

The bottom line is that the capital markets by themselves cannot solve the System's funding problem. Somehow capital contributions must be increased and/or the liabilities must be reduced. Management has come up with recommendations to improve the System's financial health. Among those, the increase in employees' and employers' contribution rates stands out.

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

Increase in Benefits for Retirees Established for 2009, 2008, and 2007

For the years 2009, 2008, and 2007, the Government of Puerto Rico granted several benefits to the System's retirees to help them cope with the increase in the cost of living, which consisted of:

- Increase in the minimum monthly pension benefit from \$300 to \$400, effective July 1, 2007.
- Increases of 3% in all pensions effective on July 1, 2007, but computed retroactively to January 1, 2007.
- Increase from \$500 to \$550 and to \$600 in the Christmas Bonus for the retiree, effective in December 2006 and 2007, respectively.
- Increases of 3% in all pensions lower than \$1,250 effective on July 1, 2008. This increase could not exceed the amount limit of \$1,250.

Following the requirements established by Act 1 of February 16, 1990, these benefits are financed through legislative appropriations from the Commonwealth with respect to Central Government retirees and financed by the municipalities and public corporations with respect to their corresponding retirees. There were no additional benefits granted for fiscal year 2009.

Capital Assets

The System's investment in capital assets as of June 30, 2009 and 2008 amounted to approximately \$9.2 million and \$9.8 million, respectively, net of accumulated depreciation. Capital assets include land, building and improvements, construction in progress, and equipment. The building and improvements consists of the facilities in which the System has its operations.

Requests for Information

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

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**EMPLOYEE'S RETIREMENT SYSTEM OF THE GOVERNMENT
OF THE COMMONWEALTH OF PUERTO RICO**
(A Pension Trust Fund of the Commonwealth of Puerto Rico)

STATEMENT OF PLAN NET ASSETS
JUNE 30, 2009
(In Thousands)

	2009
ASSETS:	
Cash and short-term investments:	
Deposits at commercial banks	\$ 21,792
Deposits with Government Development Bank of Puerto Rico:	
Unrestricted	79,500
Restricted	1,028,878
Deposits with Bank of New York	193,537
Short-term investment fund	<u>103,527</u>
Total cash and short-term investments	<u>1,427,234</u>
Investments:	
Bonds and notes	565,366
Stocks	1,477,945
Private equity investments	<u>34,922</u>
Total investments	<u>2,078,233</u>
Total cash and investments	<u>3,505,467</u>
Loans and interest receivable from plan members — net of allowance for adjustments and losses in realization	<u>1,097,444</u>
Accounts receivable:	
Employers -- net	289,427
Commonwealth of Puerto Rico	7,833
Duc from the Commonwealth of Puerto Rico Judiciary Retirement System	17,942
Investments sold	24,509
Accrued investment income	6,939
Other	<u>5,081</u>
Total accounts receivable	<u>351,731</u>
Capital assets — net	<u>9,171</u>
Bond issue costs	<u>34,362</u>
Other assets	<u>8,892</u>
Total assets	<u>5,007,067</u>

(Continued)

**EMPLOYEE'S RETIREMENT SYSTEM OF THE GOVERNMENT
OF THE COMMONWEALTH OF PUERTO RICO
(A Pension Trust Fund of the Commonwealth of Puerto Rico)**

**STATEMENT OF PLAN NET ASSETS
AS OF JUNE 30, 2009
(In Thousands)**

LIABILITIES:

Accounts payable and accrued liabilities, including book overdraft of \$37,961	\$ 52,189
Payables for securities lending	103,527
Investments purchased	13,926
Bonds interest payable	13,876
Funds of mortgage loans and guarantee insurance reserve for loans to plan members	6,372
Bonds payable	2,961,359
Other liabilities	<u>13,675</u>
 Total liabilities	 <u>3,164,924</u>

CONTINGENCIES (Note 12)

Net assets held in trust for pension benefits (Schedule of Funding Progress is presented on page 42)	<u>\$1,842,143</u>
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See notes to basic financial statements. (Concluded)

**EMPLOYEE'S RETIREMENT SYSTEM OF THE GOVERNMENT
OF THE COMMONWEALTH OF PUERTO RICO
(A Pension Trust Fund of the Commonwealth of Puerto Rico)**

**STATEMENT OF CHANGES IN PLAN NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2009
(In Thousands)**

ADDITIONS:	
Contributions:	
Employers	\$ 400,405
Participating employees	362,040
Early retirement	47,146
Special laws	192,254
Total contributions	<u>1,001,845</u>
Investment income (loss):	
Net depreciation of investments	(558,552)
Dividend income	15,774
Interest income	198,734
Total investment loss	<u>(344,044)</u>
Less investment expense	<u>7,589</u>
Net investment loss	<u>(351,633)</u>
Other income	<u>35,878</u>
Total additions	<u>686,090</u>
DEDUCTIONS:	
Annuities	970,843
Benefits under special laws	192,254
Death benefits	11,532
Refunds of contributions:	
Employers	2,013
Participating employees	32,517
Interest on bonds payable	186,869
General and administrative	32,590
Other expenses	22,415
Total deductions	<u>1,451,033</u>
NET DECREASE IN NET ASSETS HELD IN TRUST FOR PENSION BENEFITS	(764,943)
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS:	
Beginning of year	<u>2,607,086</u>
End of year	<u>\$1,842,143</u>

See notes to basic financial statements.

**EMPLOYEE'S RETIREMENT SYSTEM OF THE GOVERNMENT OF THE
COMMONWEALTH OF PUERTO RICO**
(A Pension Trust Fund of the Commonwealth of Puerto Rico)

**NOTES TO BASIC FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2009**

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Employee's Retirement System of the Government of the Commonwealth of Puerto Rico (the "System") is a defined benefit pension plan administered by the Puerto Rico Government Employees and Judiciary Retirement Systems Administration and was created by Act No. 447 on May 15, 1951. The System began operations on January 1, 1952, at which date, contributions by employers and participating employees commenced. The System is a pension trust fund of the Commonwealth of Puerto Rico (the "Commonwealth"). The System, as a governmental retirement plan, is excluded from the provisions of the Employee Retirement Income Security Act of 1974 (ERISA).

The responsibility for the proper operation and administration of the System is vested on the board of trustees, composed of two participating employees and one pensioner, who are appointed by the Governor of the Commonwealth. Also, there are four Commonwealth government agency representatives, which are the Secretary of the Treasury, the President of the Government Development Bank for Puerto Rico, the Executive Director of the Commonwealth's Human Resources Office, and the Municipal Affairs Commissioner.

As of June 30, 2009, the System has an unfunded actuarial accrued liability of approximately \$17,101 million, representing a 9.7% funding ratio. In the opinion of management and based on information prepared by consulting actuaries, if measures are not taken now to deal with this situation, the System will not be able to fully fund pensions in the fiscal years starting after 2020. This situation could have a direct negative effect on the Commonwealth's general fund, since most of the employers under the System are government agencies obligated to make actuarial contributions to fund the System.

To attend to these issues immediately, the Governor of the Commonwealth (the "Governor"), by Executive Order OE-2010-10 dated March 12, 2010, created the Special Commission on the Retirement Systems Reform (the "Commission"), as an instrument for its members to provide individual and/or group recommendations on actions that the executive and legislative branches can execute to provide immediate alternatives to ease the current crisis and long term solutions that will help the System.

The Administrator of the Puerto Rico Government Employees and Judiciary Retirement Systems Administration will provide technical support to the Commission and its members. After receiving all available data, the Commission must present a report to the Governor, no later than September 30, 2010, which must include specific recommendations addressing the current fiscal crisis and cash flow problems of the System.

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

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's contributions are recognized as additions in the period in which the employee services are rendered. Annuities, benefits, and refunds are recognized as deductions when due and payable in accordance with the terms of the plan.

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

Cash and Short-Term Investments — Cash and short-term investments consist of overnight deposits with the custodian bank, securities lending collateral, money market funds, and certificates of deposits in Government Development Bank for Puerto Rico (GDB) (a component unit of the Commonwealth) and a commercial bank. Restricted cash deposited with GDB consists of payments received from mortgage loan holders administered by the mortgage servicers in the servicing of loans (escrow accounts), expired checks not claimed by the plan members, restricted for repayments, and proceeds of the issuance of the Series A and B Bonds restricted for investment purchases.

Investments — Investments are carried at fair value. The fair value of investments is based on quoted prices, if available. The System has investments valued at approximately \$948,544,000 or 18.91% of total assets as of June 30, 2009, whose fair values have been estimated in the absence of readily determinable fair values. This estimate is based on information provided by the underlying fund managers. Such investments include private equity investments and nonexchange traded mutual funds.

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

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 granted to plan members for mortgage, personal, and cultural trip loans are \$100,000, \$15,000, and \$10,000, respectively.

The System services mortgage loans with aggregate principal balances of approximately \$8.6 million at June 30, 2009 related to certain mortgages loans sold to Federal National Mortgage Association (FNMA) for a fee of 0.25%. The income for 2009 amounted to \$21,484 and is recognized as interest income in the accompanying statement of change in plan net assets.

During 2009, the System repurchased approximately \$56,641 in mortgage loans that were sold during fiscal year 1998 to FNMA. The sale contract stipulates that the System must repurchase any loans with payments in arrears over 90 days.

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

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

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

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

The System evaluates capital assets under the provisions of GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, which establishes that, generally, an asset is considered impaired when its service utility has declined significantly and unexpectedly, and the event or change in circumstances is outside the normal life cycle of the asset. Management is then required to determine whether impairment of an asset has occurred. Impaired capital assets that will no longer be used by the System are reported at the lower of carrying value or fair value. Impairment losses on capital assets that will continue to be used by the System should be measured using the method that best reflects the diminished service utility of the capital asset. Impairment of capital assets with physical damage generally should be measured using a restoration cost approach, an approach that use the estimated cost to restore the capital asset to identify the portion of the historical cost of the capital asset that should be written off. During the year ended June 30, 2009, management assessed and determined that no impairment adjustment was deemed necessary.

Future Adoption of Accounting Pronouncements — The GASB has issued the following accounting standards that have effective dates after June 30, 2009:

- GASB Statement No. 51, *Accounting and Reporting for Intangible Assets*, which is effective for fiscal years beginning after June 15, 2009.
- GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, which is effective for fiscal years beginning after June 15, 2009.

The impact of these statements on the System's basic financial statements has not yet been determined.

2. PLAN DESCRIPTION

The System consists of different benefit structures pursuant to Act No. 447 of 1951, as amended, including a cost-sharing multi-employer contributory defined benefit program and a cash balance program, similar to a cash balance plan. The System is sponsored by the Commonwealth, public corporations, and municipalities of Puerto Rico. Substantially all full-time employees of the Commonwealth and its instrumentalities (Commonwealth Agencies, Municipalities, and Public Corporations, including the System) are covered by the System. All regular, appointed, and temporary employees of the Commonwealth at the date of employment become plan members of the System. The System is optional for Commonwealth officers appointed by the Governor and Head of Agencies.

At June 30, 2009, membership of the System consisted of the following

Retirees and beneficiaries currently receiving benefits	104,971
Current participating employees	<u>160,053</u>
Total membership	<u>265,024</u>

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

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

Policemen and Firefighters

50 with 25 years of credited service
58 with 10 years of credited service

Other Employees

55 with 25 years of credited service
58 with 10 years of credited service

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

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

Deferred Retirement Annuity — A participating employee who ceases to be an employee of the Commonwealth after having accumulated a minimum of 10 years of credited service qualifies for retirement benefits provided his/her contributions to the System are left within the System until attainment of 58 years of age.

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

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

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

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

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.

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

Death Benefits:

Occupational:

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

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

Nonoccupational —

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

Postretirement — Beneficiary with surviving spouse age 60 or over and child, age 18 or under, up to 50% (60%, if not covered under Title II of the Social Security Act) of retiree's pension or otherwise the excess, if any, of the accumulated contributions at the time of retirement over the total annuity benefits received before death, limited to a minimum of \$750.

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.

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

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

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

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

Other Benefits Granted — For fiscal years 2003 to 2007, the Commonwealth granted additional benefits to the System's retirees. As of June 30, 2009, these increases are being funded through special appropriations from the Commonwealth for the amount corresponding to the Commonwealth agencies and by contributions from the public corporations and municipalities.

Early Retirement Programs — During fiscal year 2001, the Commonwealth granted three additional retirement programs through Act No. 370 of December 31, 1999, Act No. 119 of July 13, 2000, and Act No. 174 of August 12, 2000. These acts applied to employees of the Municipality of San Juan, employees of the State Insurance Fund Corporation and the employees within the three branches of the Commonwealth, respectively. These early retirement programs ended in fiscal year 2006, at which time, these employees became fully beneficiaries of the System. In order to avoid any economic impact on the System, the employers were responsible for contributing to the System the amounts to cover the benefit payments and the employer and employee contributions with respect to the plan members covered until the attainment of the normal retirement age.

During fiscal year 2006, the Puerto Rico Industrial and Development Company (PRIDCO) implemented an early retirement program for its employees under Act No. 143, dated November 22, 2005. PRIDCO will reimburse the annuities and other benefits paid by the System during a five-year period, plus the employer and employee contributions with respect to the plan members covered until the attainment of the normal retirement age.

During fiscal year 2008, the Commonwealth issued Act No. 70, dated July 13, 2007, to implement an early retirement program for the employees of the Puerto Rico National Parks Company. The Municipality of San Juan issued the Resolution No. 41, dated May 5, 2008, which provided an early retirement program for the municipalities' employees. Also, GDB implemented an early retirement program for its employees under the Act No. 188 of December 12, 2007. The Puerto Rico National Parks Company has already made two payments and would reimburse the remaining balance on annuities and other benefits paid by the System in three installments on each July 31 starting on 2009 through 2011. The Municipality of San Juan will reimburse the annuities and other benefits paid by the System during a five-year period, plus the employer and employee contributions with respect to the plan members covered until they reach the normal retirement age.

The Land Authority of Puerto Rico (the "Land Authority") implemented an early retirement program for its employees under Law No. 59 of January 31, 2008. The Land Authority has already made the initial payment and would reimburse the remaining balance on annuities and other benefits paid by the System in four installments on each July 31 starting on 2009 through 2012.

The Right to Employment Administration (the "Administration") implemented an early retirement program for its employees under Law No. 275 of December 31, 2008. The Administration already made the initial payment and would reimburse the remaining balance on annuities and other benefits paid by the System in four installments on each July 31 starting on 2009 through 2012.

The Puerto Rico Environmental Quality Board (the "EQB") implemented an early retirement program for its employees under the Law 224 Act No. 7 dated August 9, 2008. The EQB already made the initial

payment and would reimburse the remaining balance on annuities and other benefits paid by the System in four installments on each July 31 starting on 2009 through 2012.

The Puerto Rico Department of Labor and Human Resources (the "Department of Labor") implemented an early retirement program for its employees under the Law 136 dated July 29, 2008. The Department of Labor already made the initial payment and would reimburse the remaining balance on annuities and other benefits paid by the System in four installments on each July 31 starting on 2009 through 2012.

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

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

The annuity benefits to participants is based on a formula which assumes that each year the employee's contribution (with a minimum of 8.275% of the employee's salary up to a maximum of 10%) will be invested as instructed by the employee in an account which either: (1) earns a fixed rate based on the two-year Constant Maturity Treasury Notes or, (2) earns a rate equal to 75% of the return of the System's investment portfolio (net of management fees), or (3) earns a combination of both alternatives. Plan members receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability benefits are not granted under System 2000 rather should be provided to those plan members that voluntarily elect to participate in a private insurance long-term disability program. The employers' contributions (9.275% of the employee's salary) with respect to employees under System 2000 will continue but will be used to fund the defined benefit plan. System 2000 reduced the retirement age from 65 years to 60 for those employees who joined the current plan on or after January 1, 2000.

At June 30, 2009, System 2000's membership consisted of 64,813 current participating employees.

3. FUNDING POLICY

The contribution requirement to the System is established by law and is not actuarially determined. Required employers' contributions consist of 9.275% of applicable payroll in the cases of municipalities, central government, and public corporations. Required employee contribution consists of 5.775% of the first \$550 of the monthly salary with the excess at 8.275% for the coordinated benefit structure and 8.275% of the total monthly salary for participating employee's contributions for the noncoordinated benefit structure. If necessary, additional non payroll related contributions from the Commonwealth should ultimately cover any deficiency between the participating employers' and employee's contributions and the System's pension benefit obligations and general and administrative deductions.

The System, besides the contributions received from plan members and employers, also receives legislative appropriations from special laws to cover additional benefits and the increase in benefits to retired employees. In the past years, there have been laws that granted additional benefits, such as, summer and Christmas bonuses, and various increases in cost of living allowances (3%), among others. Most of the funds used to cover these benefits are budgeted by the Commonwealth through legislative appropriations.

Actuarial Information — Calculations of the present value of benefits under the System were made by consulting actuaries as of June 30, 2009, using the projected unit credit cost method, with straight proration based on service to decrement. The significant assumptions underlying the actuarial computations include: (a) assumed rate of return on investments of 7.5%, except for System 2000, which is 4.5%, (b) assumed compound rate of wage increases of 3% per year, (c) assumed inflation rate of 2.5%, (d) assumed cost of living adjustment of 0.99% annual COLA to approximate 3% triennial increases, and (e) assumed mortality as follows:

- Preretirement Mortality — For general employees and mayors, RP-2000 Employee Mortality Rates, with white collar adjustments for males and females, projected on a generational basis using Scale AA. For members covered under Act No. 127, RP-2000 Employee Mortality Rates, with blue collar adjustments for males and females, projected on a generational basis using Scale AA.
- Postretirement Healthy Mortality — Gender-specific mortality rates were developed based on a study of the plan's experience from 2003-2007.
- Postretirement Disabled Mortality — RP-2000 disabled annuitant mortality rates, without projection.

As of June 30, 2009, the actuarial accrued liability and the unfunded actuarial accrued liability were approximately \$18,944 million and \$17,101 million, respectively.

The Legislature of the Commonwealth enacted Act No. 1 of February 16, 1990, to improve the solvency of the System for the next 50 years. Among other provisions, the legislation increased the level of contributions to the System, reduced the benefits for new participating employees, and increased the retirement age from 55 to 65 years. Further, through Act 305 of September 24, 1999, the original defined benefit structure was no longer available to new employees and System 2000 was created (as described in Note 2) for all plan members who started working for the Commonwealth effective January 1, 2000, or after.

As an employer, the System contributed \$1,734,000, which represented its contractually required contribution for the year ended June 30, 2009.

4. FUNDED STATUS AND FUNDING PROGRESS

The System's funded status as of June 30, 2009, the most recent actuarial valuation date, is as follows (in thousands):

Actuarial Valuation Date	Actuarial Value of Plan Assets	Actuarial Accrued Liability (AAL)	Unfunded Actuarial Accrued Liability (UAAL)	Funded Ratio	Annual Salary	UAAL as a Percentage of Annual Salary
June 30, 2009	\$1,842,143	\$18,943,586	\$17,101,443	9.7 %	\$4,292,552	398.4 %

The schedule of funding progress (see page 42), presented as required supplementary information (RSI) following the notes to the financial statements, present multilayer trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the AALs for benefits.

Additional information as of the latest actuarial valuation is as follows:

Valuation date	June 30, 2009
Actuarial cost method	Projected unit credit cost method, with straight proration based on service to decrement
Amortization method	30 years closed, level dollar
Remaining amortization period	28 years
Asset valuation method	Market value of assets
Actuarial assumptions:	
Investment rate of return	7.50%
Projected salary increases	3.00% (no increase in 2009-10 and 2010-11)
Projected payroll growth	2.5%
Inflation	2.5%
Mortality rate	Preretirement Mortality — For general employees and mayors, RP-2000 employee mortality rates, with white collar adjustments for males and females, projected on a generational basis using Scale AA. For members covered under Act No. 127, RP-2000 employee mortality rates, with blue collar adjustments for males and females, projected on a generational basis using Scale AA.
	Postretirement Healthy Mortality — Gender-specific mortality rates were developed based on a study of the plan's experience from 2003-2007.
	Postretirement Disabled Mortality — RP-2000 disabled annuitant mortality rates, without projection.
Cost of living adjustment	0.99% annual COLA to approximate 3% triennial increases.

5. CASH AND INVESTMENTS

Custodial Credit Risk Related to Deposits — Custodial credit risk is the risk that, in an event of a bank failure, the System's deposits might not be recovered. The Commonwealth requires that public funds deposited in Puerto Rico commercial banks must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of the Commonwealth. Deposits with GDB, Bank of New York, and with other non-Puerto Rico commercial banks are uninsured and uncollateralized, as these entities are exempt from compliance with the collateralization requirement.

As of June 30, 2009, depository bank balances of approximately \$1,428 million were uninsured and uncollateralized as follows (in thousands):

	Carrying Amount	Depository Bank Balance	Amount Uninsured and Uncollateralized
Deposits at commercial banks	\$ 21,792	\$ 21,792	\$ 21,792
Deposits with GDB	1,108,378	1,109,013	1,109,013
Deposits with Bank of New York	193,537	193,537	193,537
Short-term investments	103,527	103,527	103,527
Total	<u>\$ 1,427,234</u>	<u>\$ 1,427,869</u>	<u>\$ 1,427,869</u>

Investments — The fair value of investments in marketable securities held by the System as of June 30, 2009, is as follows (in thousands):

Bonds:		
U.S. government and sponsored agencies' securities		\$ 323,553
Municipal bonds		35,405
U.S. corporate bonds		<u>206,408</u>
Total bonds		<u>565,366</u>
Stocks:		
U.S. corporate stocks		564,323
Non-exchange traded mutual funds:		
U.S.		488,698
Non-U.S.		<u>424,924</u>
Total stocks		<u>1,477,945</u>
Private equity investments		<u>34,922</u>
Total investments		<u>\$2,078,233</u>

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, 2009:

Custodial Credit Risk Related to Investments — 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, 2009, securities investments were registered in the name of the System and were held in the possession of the System's custodian banks, State Street Bank and Trust and Bank of New York, except for securities lent.

Credit Risk — All fixed-income securities at the time of purchase must be of investment grade quality. All issuances shall be rated investment grade by at least two of the nationally recognized rating agencies. The portfolio is expected to maintain a minimum weighted-average credit quality of either “A” or better using either Standard and Poor’s or Moody’s Investor Service credit ratings.

The System’s U.S. government and sponsored agencies’ securities portfolio includes approximately \$83,024,000 of U.S. Treasury notes and approximately \$35,619,000 of mortgage-backed securities guaranteed by Government National Mortgage Association (GNMA), which carry the explicit guarantee of the U.S. government. The Moody’s ratings of bonds as of June 30, 2009, excluding U.S. Treasury notes and mortgage-backed securities guaranteed by GNMA are as follows (in thousands):

Moody’s Rating	Investment Type	Fair Value
Aaa	U.S. government and sponsored agencies securities	\$204,909
Aaa	U.S. corporate bonds	19,040
Aa1	U.S. corporate bonds	1,146
Aa2	U.S. corporate bonds	15,672
Aa3	U.S. corporate bonds	4,834
A1	U.S. corporate bonds	30,579
A2	U.S. corporate bonds	51,097
A3	U.S. corporate bonds	13,883
Baa1	U.S. corporate bonds	32,438
Baa2	U.S. corporate bonds	17,938
Baa3	U.S. corporate bonds	14,822
Ba3	U.S. corporate bonds	533
B1	U.S. corporate bonds	294
B3	U.S. corporate bonds	694
NR	U.S. corporate bonds	3,345
WR	U.S. corporate bonds	92
A3	Municipal bonds	1,679
Baa1	Municipal bonds	4,943
Baa2	Municipal bonds	6,553
Baa3	Municipal bonds	20,258
Ba1	Municipal bonds	1,974
	Total bonds	<u>\$446,723</u>

Concentration of Credit Risk — No investment in marketable securities in any organization represents 5% or more of the System’s net assets held in trust for pension benefits. The System owns shares in the State Street Bank and Trust Company S&P 500 Flagship Securities Lending Fund (the “S&P 500 Fund”). As of June 30, 2009, the fair value of the System’s investment in 2,648,352 shares of the S&P 500 Fund amounted to approximately \$488.7 million. The investment objective of the S&P 500 Fund is to match the return of the Standard & Poor’s 500 Index.

As of June 30, 2009, the investments underlying the S&P 500 Fund had the following sector allocations:

Sector	Percentage
Information technology	18.38 %
Health care	14.00
Financial	13.58
Energy	12.41
Consumer staples	11.99
Industrials	9.85
Consumer discretionary	8.96
Utilities	4.08
Telecommunication services	3.53
Materials	3.22

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

Investments in debt securities as of June 30, 2009, are as follows (in thousands):

	Maturity From	Investment Maturities (In Years)				
		Fair Value	Less Than 1	Between 1-5	Between 5-10	More Than 10
U.S. government and agencies securities	(2009-2039)	\$323,552	\$ 10,548	\$ 94,204	\$ 45,242	\$173,559
Corporate bonds	(2009-2044)	206,407	5,932	89,569	59,214	51,692
Municipal bonds	(2011-2032)	35,407	-	4,713	8,395	22,299
Total bonds		<u>\$565,366</u>	<u>\$ 16,480</u>	<u>\$188,486</u>	<u>\$112,851</u>	<u>\$247,550</u>

As of June 30, 2009, investment maturities as a percentage of total debt securities are as follows:

Maturity	Maximum Maturity
Less than one year	3 %
One to five years	33
More than five to ten years	20
More than ten years	44

Foreign Currency Risk — As of June 30, 2009, the System owned approximately \$371 million, in an international equity commingled fund under the custody of Morgan Stanley investment bank, which represented approximately 96.8% of the total commingled fund. Also, for the year ended June 30, 2009, the System owned approximately \$71 million, in an international equity commingled fund under the custody of Invesco International Equity Trust, which represented approximately 10.13% of the total commingled fund.

As of June 30, 2009, these pooled trusts had an asset mix and country allocation as shown in the following tables:

Morgan Stanley:

Assets Mix			Percent
Cash and equivalents			0.51 %
Future contracts			12.49
Equity securities			87.00
Total			100.00 %
Country Allocation	Currency	Currency Code	Portfolio %
Poland	Zlotych	PLN	0.48 %
Russia	Rubles	RUB	0.65
Eastern Europe			1.13
Austria	Euro	EUR	0.26
Belgium	Euro	EUR	0.38
Finland	Euro	EUR	1.15
France	Euro	EUR	8.39
Germany	Euro	EUR	7.82
Greece	Euro	EUR	0.36
Italy	Euro	EUR	2.22
Netherlands	Euro	EUR	2.24
Portugal	Euro	EUR	0.24
Spain	Euro	EUR	4.44
Euro Europe			27.50
India	Rupees	INR	1.08
Brazil	Real	BRL	1.35
Mexico	Pesos	MXN	0.14
Latin America			1.49
Turkey	Lira	TRY	0.84
Denmark	Kroner	DKK	0.58
Norway	Kroner	NOK	0.92
Sweden	Krona	SEK	2.17
Switzerland	Francs	CHF	6.26
United Kingdom	Pounds	GBP	18.79
Non-Euro Europe			28.72
Australia	Dollars	AUD	3.16
China	Yuan Renminbi	CNY	2.25
Hong Kong	Dollars	HKD	4.05
Indonesia	Rupiahs	IDR	0.64
Japan	Yen	JPY	25.61
Malaysia	Ringgits	MYR	0.02
New Zealand	Dollars	NZD	0.01
Singapore	Dollars	SGD	2.24
Taiwan	New Dollars	TWD	0.75
Pacific			38.73
Cash			0.51
Total			100.00 %

Invesco:

Assets Mix				Percent
Short-term investments				3.12 %
Foreign stock				<u>96.88</u>
Total				<u>100.00 %</u>
Country Allocation	Currency	Currency Code	Portfolio %	
Canada	Dollars	CAD	<u>2.69</u>	
Finland	Euro	EUR	1.98	
France	Euro	EUR	9.05	
Germany	Euro	EUR	4.27	
Netherlands	Euro	EUR	8.92	
Italy	Euro	EUR	2.25	
Spain	Euro	EUR	<u>3.82</u>	
Euro Europe			<u>30.29</u>	
Norway	Kroner	NOK	0.91	
Sweden	Krona	SEK	1.40	
Switzerland	Francs	CHF	6.63	
United Kingdom	Pounds	GBP	<u>19.85</u>	
Non-Euro Europe			<u>28.79</u>	
Australia			2.30	
Hong Kong	Dollars	HKD	4.08	
Japan	Yen	JPY	<u>22.24</u>	
Pacific			<u>28.62</u>	
Other Countries Invesco — Emerging Markets Equity Trust			<u>6.49</u>	
Total				<u>96.88 %</u>

Investments in Limited Partnerships — The fair value of investments in limited partnerships as of June 30, 2009, amounted to approximately \$34.9 million and is presented within private equity investments in the statements of plan net assets. The allocations of net gain and net loss to limited partners are based on certain percentages, as established in the limited partnership agreements. The investments in limited partnerships were as follows:

- During fiscal year 2009, approximately \$249,000 were invested in Guayacán Fund of Funds, L.P., a Delaware limited partnership, created by Grupo Guayacán, Inc. as General Partner in which the System has a total commitment of \$25 million. This fund has commitments to invest in fifteen (15) U.S. based and international venture partnerships and familiarizes the local pension funds with the private equity asset class without the risks inherent in geographically constrained investments.
- During fiscal year 2009, approximately \$142,000 were invested in Guayacán Fund of Funds II, L.P., a Delaware limited partnership created by Grupo Guayacán, Inc., as General Partner, in which the System has a total commitment of \$25 million. This fund seeks to provide investors with a superior investment return and extensive diversification by investing in nineteen (19) private equity

investment partnerships in the United States and Europe. This fund also invests a portion of its assets in a Puerto Rico based private equity investment entity.

- During fiscal year 2009, approximately \$238,000 were invested in Guayacán Private Equity Fund, L.P., a limited partnership organized pursuant to the laws of the State of Delaware and authorized to engage in business in the Commonwealth of Puerto Rico, in which the System has a total commitment of \$5 million. The purpose of this partnership is to make equity investments in privately held companies as established in its charter.
- During fiscal year 2009, approximately \$3 million were invested in Guayacán Private Equity Fund II, L.P., a limited partnership organized in April 2007, pursuant to the laws of the State of Delaware, in which the System has a total commitment of \$15 million. This partnership intends to seek out, invest in, and add value to companies, which will be based or operating in Puerto Rico or in companies whose products or services are targeted at the U.S.-Hispanic market, with specific interest in those companies where Advent-Morro's Equity Partners, Inc. Puerto Rico contact, know-how and track record can be leveraged to enhance investment selection and post-investment value-add. Guayacán Private Equity Fund II, L.P. will strive to have a balanced mix of portfolio investments primarily focusing on later stage opportunities such as: expansion financing, leveraged buyouts, management buyouts, and recapitalizations. This partnership may invest in de-novo companies that are being set up to enter established industries via market consolidation opportunities and/or internal growth.
- During fiscal year 2009, there were no additional contributions to Venture Capital Fund, Inc., a Puerto Rico corporation organized pursuant to Act No. 3 of October 6, 1987, as amended, known as the Puerto Rico Capital Investment Funds Act, which is managed by Advent-Morro Equity Partners (Advent-Morro), in which the System has a total commitment of \$800 thousand. Advent-Morro is a Puerto Rico based private equity firm. This fund was created to make private equity investments in operating companies, which are based, are operating, or a combination of both, in Puerto Rico. Since inception, the fund has invested in 25 companies some of which it continues to provide capital for their expansion.
- During fiscal year 2009, approximately \$389,000 were invested in GF Capital Private Equity Fund, L.P., a limited partnership organized under the laws of the State of Delaware, in which the System has a total commitment of \$25 million. The purpose of this partnership is to make private equity investments in a variety of industries, including media and entertainment, branded consumer products, and software for media and telecommunications applications. This partnership's initiatives are focused on companies capitalized at between \$20 to \$400 million with a representation of buy-outs, growth capital, and recapitalizations.
- During fiscal year 2009, approximately \$372,000 were invested in Chase Capital Partners Private Equity Fund of Funds Corporate Investors II, LTD, a limited partnership, organized by Chase as General Partner, in which the System has a total commitment of \$20 million. This fund's investment strategy is to capitalize on a globally diversified portfolio of private equity investment opportunities across various sectors, including buyouts, growth equity, venture capital, and other special situations through partnership and direct investments.
- The investment in Martincau Bay represents an investment in a hotel resort that filed under Chapter 11 of the United States Bankruptcy Code.

As of June 30, 2009, the date of commitment, total commitment, 2009 contributions, contributions to date at cost, and estimated value of investments in limited partnerships are as follows (in thousands):

	Date of Commitment	Total Commitment	FY 09 Contributions	Contributions to Date at Cost	Estimated Value
Grupo Guayacán, Inc.:					
Guayacán Fund of Funds, L.P.	Sept. 1996	\$ 25,000	\$ 249	\$23,637	\$ 3,178
Guayacán Fund of Funds II, L.P.	Aug. 1999	25,000	142	23,666	8,939
Advent-Morro Equity Partner, Inc.:					
Guayacán Private Equity Fund, L.P.	Jan. 1997	5,000	238	4,407	3,824
Guayacán Private Equity Fund II, L.P.	Apr. 2007	15,000	3,036	9,933	7,342
Venture Capital Fund, Inc.	Nov. 1995	800	-	800	721
GF Capital Management & Advisors, LLC —					
GF Capital Private Equity Fund I, P.	Dec. 2006	25,000	389	6,189	2,777
Chase Capital Partners Private:					
Equity Fund of Funds Corporate Investors II, LTD.	Jul. 2000	20,000	372	18,759	8,141
Martincou Bay Resort, s. en c. (s.e.)	Jul. 1998	<u>1,796</u>	<u>-</u>	<u>1,796</u>	<u>-</u>
Total alternative investments		<u>\$117,596</u>	<u>\$4,426</u>	<u>\$89,187</u>	<u>\$34,922</u>

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 equal to approximately 102% of the market value of the domestic securities on loan and 105% of the market value of the international securities on loan, with a simultaneous agreement to return the collateral for the same securities in the future. Collateral is marked to market daily and the agent places a request for additional collateral from brokers, if needed. The custodian bank is the agent for the securities lending program.

At the end of the year, there was no credit risk exposure to borrowers because the amounts the System owes the borrowers (the “collateral”) exceeded the amounts the borrowers owe the System (the “loaned securities”). At June 30, 2009, the collateral received represented 102.27% of the fair value of the domestic securities lent and 109.40% of the fair value of the international securities lent.

The securities on loan for which collateral was received as of June 30, 2009, consisted of the following:

Securities Lent	Fair Value
U.S. government and sponsored agencies’ securities	\$ 72,239
U.S. corporate stocks	20,109
U.S. corporate bonds	5,941
Non-exchange traded mutual funds:	
U.S.	2,266
Non-U.S.	<u>630</u>
Total	<u>\$ 101,185</u>

The underlying collateral for these securities had a fair value of approximately \$103,527,000 as of June 30, 2009. The collateral received was invested in a short-term investment fund sponsored by the custodian bank and is included as part of cash and short-term investments in the accompanying 2009 statement of plan net assets. As of June 30, 2009, the distribution of the short-term investment fund by investment type is as follows:

Investment type	Percentage
Securities bought under agreements to resell	53.67 %
Commercial paper	20.01
Certificates of deposit	15.50
Floating rate notes	8.05
Time deposits	2.77

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

6. LOANS AND INTEREST RECEIVABLE FROM PLAN MEMBERS

Loans receivable from plan members are guaranteed by the contributions of plan members and by other sources, including mortgage deeds and any unrestricted amount remaining in the escrow funds. In addition, collections on loans receivable are received through payroll withholdings. The maximum amounts that may be granted to plan members for personal and cultural trip loans are \$15,000 and \$10,000, respectively.

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

As of June 30, 2009, the composition of loans and interest receivable from plan members is summarized as follows (in thousands):

Loans receivable:	
Personal	\$ 910,704
Mortgage	128,366
Cultural trips	<u>48,983</u>
Total loans to plan members	1,088,053
Accrued interest receivable	<u>19,902</u>
Total loans and interest receivable from plan members	1,107,955
Less allowance for adjustments and losses in realization	<u>(10,511)</u>
Total loans and interest receivable from plan members — net	<u>\$ 1,097,444</u>

7. ACCOUNTS RECEIVABLE FROM EMPLOYERS

As of June 30, 2009, accounts receivable from employers consisted of the following (in thousands):

Early retirement programs	\$ 121,610
Special laws	92,709
Employer and employee contributions	76,688
Interest on late payments	<u>12,951</u>
Total accounts receivable from employers	303,958
Less allowance for doubtful accounts receivable	<u>(14,531)</u>
Accounts receivable from employers — net	<u>\$ 289,427</u>

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

The accounts receivable from employers related to special laws of \$92.7 million as of June 30, 2009, include approximately \$18.7 million, which were billed to employers during 2007. The System has entered into installment payment agreements with approximately 71% of these employers, while the remaining 29% of employers have not accepted or rejected the amounts billed by the System.

An allowance for doubtful accounts receivable of \$5.5 million has been established for the amounts billed to these employers, which as of end of fiscal year have not replied to the System, either accepting or rejecting the amount billed to them, including a \$3.4 million allowance on the amounts receivable from Medical Service Administration. It is the System's management understanding that the remaining receivable balances do not need an allowance for doubtful accounts since these employers have consistently showed an acceptable payment history toward the System.

As of June 30, 2009, accounts receivable from employers include accounts receivable from the Medical Service Administration (ASEM, by its Spanish acronym) of approximately \$45.2 million from as follows (in thousands):

Employer and employee contributions	\$ 32,419
Special laws	10,969
Early retirement program	5,160
Interest	<u>9,080</u>
Total accounts receivable from ASEM	57,628
Less allowance for doubtful accounts receivable	<u>(12,465)</u>
Accounts receivable from ASEM — net	<u>\$ 45,163</u>

ASEM has not paid the System the corresponding employer contributions, early retirement program contributions, special laws contributions, and contributions withheld from employees since fiscal year 2005. The System has made all the necessary efforts to collect the amounts owed by ASEM. These efforts include meetings with the Executive Officer of ASEM, the Legislature and the Senate of the Commonwealth, in order to establish a possible payment plan. Nevertheless, the System believes that eventually it will collect the majority of these receivables from ASEM or by legislative appropriations. As of June 30, 2009, the System has established an allowance for doubtful accounts receivable from ASEM of \$12.5 million.

8. CAPITAL ASSETS

Capital assets activity for the year ended June 30, 2009, was as follows (in thousands):

	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets, not being depreciated:				
Land	\$ 969	\$ -	\$ -	\$ 969
Construction in progress	<u>3,075</u>	<u>-</u>	<u>-</u>	<u>3,075</u>
Total capital assets, not being depreciated	<u>4,044</u>	<u>-</u>	<u>-</u>	<u>4,044</u>
Capital assets, being depreciated:				
Building and improvements	7,631	-	-	7,631
Equipment	<u>11,904</u>	<u>100</u>	<u>1,156</u>	<u>10,848</u>
Total capital assets, being depreciated	<u>19,535</u>	<u>100</u>	<u>1,156</u>	<u>18,479</u>
Less accumulated depreciation for:				
Building and improvements	3,568	113	-	3,681
Equipment	<u>10,171</u>	<u>1,075</u>	<u>1,575</u>	<u>9,671</u>
Total accumulated depreciation	<u>13,739</u>	<u>1,188</u>	<u>1,575</u>	<u>13,352</u>
Total capital assets being depreciated — net	<u>5,796</u>	<u>(1,088)</u>	<u>(419)</u>	<u>5,127</u>
Total capital assets — net	<u>\$ 9,840</u>	<u>\$ (1,088)</u>	<u>\$ (419)</u>	<u>\$ 9,171</u>

9. OTHER ASSETS

As of June 30, 2009, other assets consist of (in thousands):

Executed land	\$ 4,699
Repossessed and foreclosed properties	<u>4,193</u>
Total	<u>\$ 8,892</u>

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

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

As of June 30, 2009, a total of 14,618 square meters of land remained under the possession of the System. According to an independent appraisal performed as of June 8, 2005, the estimated market value of this land was approximately \$22.8 million.

10. BONDS PAYABLE

Senior Pension Funding Bonds — On February 27, 2007, the System's administration and GDB, acting as the System's fiscal agent (the "Fiscal Agent"), presented to the board of trustees, a financial transaction for the issuance of pension funding bonds in order to reduce the System's unfunded actuarial accrued liability. The System authorized the issuance of one or more series of bonds (the "Bonds") in order to increase the funds available to pay pension benefits to certain of its beneficiaries and reduce its unfunded accrued actuarial pension liability. The System pledged future employer contributions to the payment of the Bonds, invested the proceeds of the Bonds, and used these investments and the earnings thereon to provide pension benefits to its beneficiaries.

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

As of June 30, 2009, the outstanding balance of the Bonds is as follows (in thousands):

Description

Series A Bonds:

Capital Appreciation Bonds, maturing in 2028, bearing interest at 6.20%	\$ 49,105
Term Bonds, maturing in 2023, bearing interest at 5.85%	200,000
Term Bonds, maturing from 2031 through 2038, bearing interest at 6.15%	679,000
Term Bonds, maturing from 2039 through 2042, bearing interest at 6.20%	332,770
Term Bonds, maturing from 2055 through 2058, bearing interest at 6.45%	<u>332,000</u>

Total Series A Bonds outstanding 1,592,875

Series B Bonds:

Capital Appreciation Bonds, maturing from 2028 through 2030, bearing interest at 6.40%	151,006
Capital Appreciation Bonds, maturing from 2031 through 2034, bearing interest at 6.45%	108,668
Term Bonds, maturing in 2031, bearing interest at 6.25%	117,100
Term Bonds, maturing from 2036 through 2039, bearing interest at 6.30%	270,000
Term Bonds, maturing from 2055 through 2058, bearing interest at 6.55%	<u>429,000</u>

Total Series B Bonds outstanding 1,075,774

Series C Bonds:

Capital Appreciation Bonds, maturing in 2030, bearing interest at 6.50%	2,349
Term Bonds, maturing in 2028, bearing interest at 6.15%	110,000
Term Bonds, maturing in 2038, bearing interest at 6.25%	45,000
Term Bonds, maturing in 2043, bearing interest at 6.30%	<u>143,000</u>

Total Series C Bonds outstanding 300,349

Total bonds outstanding 2,968,998

Less bonds discount (7,639)

Bonds payable — net \$ 2,961,359

Series A Bonds — The aggregate principal amount of the Series A Bonds issued amounted to approximately \$1,589 million of which \$1,544 million were issued as term bonds (the “Series A Term Bonds”) and \$45 million were issued as capital appreciation bonds (the “Series A Capital Appreciation Bonds”). Interest on the Series A Bonds accrues, or compounds (in the case of the Series A Capital Appreciation Bonds), from their date of delivery. Interest in the Series A Term Bonds are payable monthly on the first day of each month, commencing on March 1, 2008. Interest on the Series A Capital Appreciation Bonds are not payable on a current basis, but are added to the principal of the Capital Appreciation Bonds on each January 1 and July 1, commencing on July 1, 2008 (“Compounding Dates”), and are treated as if accruing in equal daily amounts between Compounding Dates, until paid at maturity or upon redemption. Interest shall be computed on the basis of a 360-day year consisting of twelve 30-day months. The Series A Bonds are subject to redemption at the option of the System from any source, in whole or in part at any time on or after July 1, 2018, at a redemption price equal to the principal amount (in the case of Series A Capital Appreciation Bonds, the accreted amount) of the Series A Bonds, plus accrued interest to the redemption date, and without premium. The Series A Bonds have the following debt service requirements (in thousands):

Year ending June 30,	Principal	Interest
2010	\$ -	\$ 95,504
2011		95,504
2012		95,504
2013		95,504
2014		95,504
2015–2019		477,522
2020–2024	200,000	467,576
2025–2029	45,041	530,660
2030–2034	11,500	418,375
2035–2039	667,500	333,382
2040–2044	332,770	144,907
2045–2049		107,070
2050–2054		107,070
2055–2059	<u>332,000</u>	<u>74,278</u>
Principal outstanding and interest	1,588,811	3,138,360
Add (deduct) accreted value on bonds outstanding	<u>4,064</u>	<u>(4,064)</u>
Total Series B Bonds	<u>\$ 1,592,875</u>	<u>\$ 3,134,296</u>

Series B Bonds — The aggregate principal amount of the Series B Bonds amounted to approximately \$1,059 million of which \$816 million were issued as term bonds (the “Series B Term Bonds”) and \$243 million were issued as capital appreciation bonds (the “Series B Capital Appreciation Bonds”). Interest on the Series B Bonds accrues, or compounds (in the case of the Series B Capital Appreciation Bonds), from their date of delivery. Interest in the Series B Term Bonds are payable monthly on the first day of each month, commencing on July 1, 2008. Interest on the Series B Capital Appreciation Bonds are not payable on a current basis, but are added to the principal of the Series B Capital Appreciation Bonds on each January 1 and July 1, commencing on July 1, 2008 (“Compounding Dates”), and are treated as if accruing in equal daily amounts between Compounding Dates, until paid at maturity or upon redemption. Interest shall be computed on the basis of a 360-day year consisting of twelve 30-day months. The Series B Bonds are subject to redemption at the option of the System from any source, in whole or in part at any time on or after July 1, 2018, at a redemption price equal to the principal amount (in the case of Series B Capital Appreciation Bonds, the accreted amount) of the Series B Bonds, plus accrued interest to the redemption date, and without premium. The Series B Bonds have the following debt service requirements (in thousands):

Year ending June 30,	Principal	Interest
2010	\$ -	\$ 52,428
2011		52,428
2012		52,428
2013		52,428
2014		52,428
2015–2019		262,141
2020–2024		262,141
2025–2029	34,028	348,683
2030–2034	299,144	823,871
2035–2039	228,963	324,907
2040–2044	67,500	144,750
2045–2049		140,498
2050–2054		140,498
2055–2059	<u>429,000</u>	<u>102,671</u>
Principal outstanding and interest	1,058,635	2,812,301
Add (deduct) accreted value on bonds outstanding	<u>17,139</u>	<u>(17,139)</u>
Total Series B Bonds	<u>\$1,075,774</u>	<u>\$2,795,162</u>

Series C Bonds — The aggregate principal amount of the Series C Bonds amounted to approximately \$300 million of which \$298 million were issued as term bonds (the “Series C Term Bonds”) and \$2 million were issued as capital appreciation bonds (the “Series C Capital Appreciation Bonds”). Interest on the Series C Bonds accrues, or compounds (in the case of the Series C Capital Appreciation Bonds), from their date of delivery. Interest in the Series C Term Bonds are payable monthly on the first day of each month, commencing on August 1, 2008. Interest on the Series C Capital Appreciation Bonds are not payable on a current basis, but are added to the principal of the Series C Capital Appreciation Bonds on each January 1 and July 1, commencing on July 1, 2009 (“Compounding Dates”), and are treated as if accruing in equal daily amounts between Compounding Dates, until paid at maturity or upon redemption. Interest shall be computed on the basis of a 360-day year consisting of twelve 30-day months. The Series C Bonds are subject to redemption at the option of the System from any source, in whole or in part at any time on or after July 1, 2018, at a redemption price equal to the principal amount (in the case of Series C Capital Appreciation Bonds, the accreted amount) of the Series C Bonds, plus accrued interest to the redemption date, and without premium. The Series C Bonds have the following debt service requirements (in thousands):

Year ending June 30,	Principal	Interest
2010	\$ -	\$ 18,638
2011	-	18,587
2012	-	18,587
2013	-	18,587
2014	-	18,587
2015–2019	-	92,935
2020–2024	-	92,935
2025–2029	110,000	78,455
2030–2034	10,683	65,553
2035–2039	36,520	53,430
2040–2044	<u>143,000</u>	<u>27,026</u>
Principal outstanding and interest	300,203	503,320
Add (deduct) accreted value on bonds outstanding	<u>146</u>	<u>(146)</u>
Total Series C Bonds	<u>\$ 300,349</u>	<u>\$ 503,174</u>
Total bonds	<u>\$2,968,998</u>	<u>\$6,719,490</u>

Activity of bonds payable during the year ended June 30, 2009, is as follows:

	December 31, 2008	Issuances	Accretion	Payments	December 31, 2009	Current Portion
Series A Bonds:						
Capital appreciation bonds	\$ 46,197	\$ -	\$ 2,908	\$ -	\$ 49,105	\$ -
Term bonds	<u>1,543,770</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,543,770</u>	<u>-</u>
Total Series A Bonds	<u>1,589,967</u>	<u>-</u>	<u>2,908</u>	<u>-</u>	<u>1,592,875</u>	<u>-</u>
Series B Bonds:						
Capital appreciation bonds	243,771	-	15,903	-	259,674	-
Term bonds	<u>816,100</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>816,100</u>	<u>-</u>
Total Series B Bonds	<u>1,059,871</u>	<u>-</u>	<u>15,903</u>	<u>-</u>	<u>1,075,774</u>	<u>-</u>
Series C Bonds:						
Capital appreciation bonds	2,203	-	146	-	2,349	-
Term bonds	<u>298,000</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>298,000</u>	<u>-</u>
Total Series C Bonds	<u>300,203</u>	<u>-</u>	<u>146</u>	<u>-</u>	<u>300,349</u>	<u>-</u>
Total bonds outstanding	2,950,041	-	18,957	-	2,968,998	-
Less bond discounts	<u>(7,857)</u>	<u>-</u>	<u>218</u>	<u>-</u>	<u>(7,639)</u>	<u>-</u>
Total bonds payable — net	<u>\$ 2,942,184</u>	<u>\$ -</u>	<u>\$ 19,175</u>	<u>\$ -</u>	<u>\$ 2,961,359</u>	<u>\$ -</u>

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

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

11. GUARANTEE INSURANCE RESERVE FOR LOANS TO PLAN MEMBERS

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

12. CONTINGENCIES

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

Gain Contingency — The System, besides receiving contributions from participants and employers, also receives legislative appropriations from special laws to cover the increase in benefits to retirees. There have been several acts, which established an increase of 3% in pension annuities every three years for those members who meet the requirements outlined by these acts (Act No. 10 of May 21, 1992, Act No. 207 of August 13, 1995, Act No. 221 of August 9, 1998, Act No. 40 of June 13, 2001, and Act No. 157 of June 27, 2003). Also, there have been other laws that granted additional benefits, such as, summer and Christmas bonuses, and medical plan contributions, among others. Most of the funds needed to cover these benefits are budgeted by the Commonwealth through legislative appropriations. Nevertheless, the costs of pension benefits that increased from 1992 to 2004 were not received in full by the System from legislative appropriations. The System had to use approximately \$34.7 million from its resources that should have been received from legislative appropriations.

In June 30, 2007, the System filed a reimbursement claim with the Office of Management and Budget of the Commonwealth to collect the remaining unfunded special laws appropriations. The final outcome of this claim cannot be presently determined; therefore, no receivable has been recorded in the System's financial statements.

* * * * *

**REQUIRED SUPPLEMENTARY SCHEDULES OF EMPLOYERS'
CONTRIBUTIONS AND FUNDING PROGRESS**

**EMPLOYEE'S RETIREMENT SYSTEM OF THE GOVERNMENT
OF THE COMMONWEALTH OF PUERTO RICO**
(A Pension Trust Fund of the Commonwealth of Puerto Rico)

**SCHEDULE OF EMPLOYERS' CONTRIBUTIONS
AS OF JUNE 30, 2009
(In thousands)**

Years Ended June 30	Actual Employer Contributions	Annual Required Contributions	Percentage Contributed
2010*	\$ 590,742	\$ 1,459,774	40.47 %
2009	594,509	1,258,695	47.23
2008	581,285	1,191,275	48.80
2007	566,524	816,472	69.39
2006	559,198	816,472	68.49
2005	374,823	578,387	64.80
2004	330,336	578,387	57.11

* Actual employer contributions for the year ended June 30, 2010, assumes:
 Contribution of 9.275% of expected payroll for the basic system benefits, plus
 Contribution of \$149.9 million for special law pension benefits, plus
 Contribution of \$42.7 million for early retirement incentives.

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

See notes to supplementary schedule of employers' contributions and funding progress.

**EMPLOYEE'S RETIREMENT SYSTEM OF THE GOVERNMENT
OF THE COMMONWEALTH OF PUERTO RICO**
(A Pension Trust Fund of the Commonwealth of Puerto Rico)

**SCHEDULE OF FUNDING PROGRESS
AS OF JUNE 30, 2009
(In thousands)**

Actuarial Valuation Date	Actuarial Value of Plan Assets	Actuarial Accrued Liability Unit Credit (AAL)	Unfunded AAL (UAAL)	Funded Ratio	Annual Covered Payroll	UAAL as a Percentage Covered Payroll
June 30, 2009	\$ 1,842,143	\$ 18,943,586	\$ 17,101,443	9.7 %	\$ 4,292,552	398.4 %
June 30, 2008	2,607,086	Not determined	Not determined	Not determined	Not determined	Not determined
June 30, 2007	2,891,501	16,769,512	13,878,011	17.2	4,246,409	326.8
June 30, 2006	2,541,331	Not determined	Not determined	Not determined	Not determined	Not determined
June 30, 2005*	2,327,871	13,969,000	11,641,129	16.7	4,125,866	282.2
June 30, 2004	2,141,442	Not determined	Not determined	Not determined	Not determined	Not determined

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

See notes to supplementary schedule of employers' contributions and funding progress.

**EMPLOYEE'S RETIREMENT SYSTEM OF THE GOVERNMENT OF THE
COMMONWEALTH OF PUERTO RICO**
(A Pension Trust Fund of the Commonwealth of Puerto Rico)

**NOTES TO SUPPLEMENTARY SCHEDULES OF
EMPLOYERS' CONTRIBUTIONS AND FUNDING PROGRESS
AS OF JUNE 30, 2009**

1. SCHEDULE OF CONTRIBUTIONS

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

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

The information was obtained from the last actuarial report as of June 30, 2009.

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, 2009.

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