Financial Section

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Report of Independent Public Accountants

The Board of Trustees of
Pennsylvania Public School Employees' Retirement System
Harrisburg, Pennsylvania

Report on the Financial Statements

We have audited the accompanying basic financial statements of the Commonwealth of Pennsylvania Public School Employees' Retirement System (PSERS), as of June 30, 2015 and 2014, and for the years then ended, and the related notes to the financial statements, which collectively comprise PSERS' basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on the basic financial statements based on our audits. We conducted our audits 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 basic financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the respective financial position of PSERS, as of June 30, 2015 and 2014, and the respective changes in its financial position thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America (GAAP).

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Other Matters

Adoption of GASB 68

As discussed in Note 2 to the financial statements, PSERS has changed its method of accounting for measuring and recognizing liabilities, deferred outflows of resources, and expenditures related to the proportionate share of the Pennsylvania State Employees' Retirement System's net pension liability, due to the adoption of GASB Statement No. 68. The beginning net position restricted for pension and postemployment healthcare benefits for the fiscal year ended June 30, 2015 was restated by $(41,543,000). Our opinion is not modified with respect to this matter.

Required Supplementary information

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

Other Supplementary Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise PSERS' basic financial statements. The Schedule of Operating Expenses, Summary of Investment Expenses, Schedule of Payments to Non-Investment Consultants and Schedule of Employer Contributions are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements as a whole.

The Introductory, Investment, Actuarial, and Statistical Sections as listed in the table of contents have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on them.

Hunt Valley, Maryland
September 24, 2015

SB & Company, LLC

Management's Discussion and Analysis

Management's Discussion and Analysis (MD&A) of the Commonwealth of Pennsylvania Public School Employees' Retirement System (PSERS, System, Fund) for the fiscal year ended June 30, 2015 (FY 2015) provides a narrative summary of PSERS' financial position and performance, including highlights and comparative data. The MD&A is presented as required supplementary information to the financial statements and should be read in conjunction with the financial statements, the notes to financial statements, and the supplementary schedules.

Overview of Financial Statements

PSERS is primarily responsible for administering a defined benefit pension plan for public school employees in the Commonwealth of Pennsylvania. PSERS also administers two voluntary postemployment healthcare programs, the Health Insurance Premium Assistance Program (Premium Assistance) and the Health Options Program (HOP), for its annuitants. As part of the HOP, PSERS has an Employer/Union Direct Contract with the Centers for Medicare and Medicaid Services (CMS) to provide a Medicare Part D Prescription Drug Plan to participants. The financial statements present the financial position and activities for the pension plan and the two postemployment healthcare programs.

The ***Statements of Fiduciary Net Position*** provide a snapshot of the financial position of PSERS at June 30, 2015, including comparative amounts for the prior year.

The ***Statements of Changes in Fiduciary Net Position*** summarize PSERS' financial activities that occurred during the fiscal period from July 1, 2014 to June 30, 2015, including comparative amounts for the prior year.

The ***Notes to Financial Statements*** provide additional information that is essential for a full understanding of the financial statements. The notes are an integral part of the financial statements and include detailed information not readily evident in the basic financial statements such as accounting policies, plan membership and benefits, and summary disclosures of selected financial data.

The ***Required Supplementary Schedules*** immediately following the notes to financial statements provide five schedules illustrating the Changes in the Employer Net Pension Liability, Employer Net Pension Liability, Employer Contributions, Investment Returns, and Funding Progress.

The remaining supplementary schedules provide additional detailed information concerning the operating expenses, investment expenses, payments to non-investment consultants, and the employer contributions. These schedules emphasize the long-term nature of the pension and premium assistance plans and show the progress of PSERS in accumulating assets sufficient to pay benefits when due. All of this supplementary information is considered useful in understanding and evaluating the financial activities of PSERS.

Financial Highlights

- The time-weighted rate of return on investments was 3.04% for FY 2015, 14.91% for the fiscal year ended June 30, 2014 (FY 2014), and 7.96% for the fiscal year ended June 30, 2013 (FY 2013). A time-weighted rate of return considers investment performance of a hypothetical dollar invested from the beginning of an investment period to the period's end. The annualized rate of return for the three years ended June 30, 2015 was 8.52%, which exceeded the 7.5% actuarial investment rate of return assumption. Unless otherwise noted, all rates of return are net of fees.
- PSERS' total net position decreased by $1.4 billion from $53.3 billion at June 30, 2014 to $51.9 billion at June 30, 2015. This decrease was due in large part to deductions for benefits and administrative expenses exceeding net investment income plus member and employer contributions. The change in total net position from June 30, 2013 to June 30, 2014 was an increase of $4.0 billion from $49.3 billion at June 30, 2013 to $53.3 billion at June 30, 2014. This increase was due in large part to net investment income plus member and employer contributions exceeding deductions for benefits and administrative expenses.
- Total member pension contributions increased from $966.9 million in FY 2014 to $984.6 million in FY 2015. The increase was mainly due to a $12.7 million increase in member contributions from active member payroll. The portion of participant premiums for the HOP grew due to increased participation as well as ongoing health insurance rate increases.
- Total employer contributions increased from $2.1 billion in FY 2014 to $2.7 billion in FY 2015. This increase was primarily attributable to an increase in the total employer contribution rate from 16.93% in FY 2014 to 21.40% in FY 2015 in accordance with Act 120 of 2010. There was also a slight increase in active member payroll which contributed to the increase in employer contributions. Total employer contributions increased from $1.6 billion in FY 2013 to $2.1 billion in FY 2014. This increase was primarily attributable to an increase in the total employer contribution rate from 12.36% in FY 2013 to 16.93% in FY 2014. This rate increase was partially offset by a slight reduction in active member payroll.

Management's Discussion and Analysis (continued)

- Total PSERS' benefit expense increased slightly from $6.4 billion in FY 2014 to $6.6 billion in FY 2015. The average monthly benefit and the number of members receiving benefits increased in FY 2015. New retirements during FY 2015 increased by approximately 9% from FY 2014. Total PSERS' benefit expense was steady at $6.4 billion in FY 2013 and FY 2014. The average monthly benefit and the number of members receiving benefits increased in FY 2014. These increases were offset by a decrease in lump sum payments to new retirees. New retirements during FY 2014 decreased by approximately 21% from FY 2013.

GASB Standards

In June 2012, the Governmental Accounting Standards Board (GASB) approved a Statement that reflects substantial changes to the accounting and financial reporting of pension plans. Statement No. 67, *Financial Reporting for Pension Plans*, addresses financial reporting for state and local government pension plans. Statement No. 67 replaces the requirements of Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, for most public employee pension plans and replaces the requirements of Statement No. 50, *Pension Disclosures*, for those governments and public pension plans. Under Statement No. 67, an emphasis is put on accounting for pension plans whereas Statement No. 25 dealt more with funding pension plans.

A key change from Statement No. 25 to Statement No. 67 is the measurement of the liability. GASB 25 subtracts the Actuarial Value of Assets from the Actuarial Accrued Liability to achieve the Unfunded Actuarial Accrued Liability. GASB 67 subtracts the Fiduciary Net Position from the Total Pension Liability (TPL) to attain the Net Pension Liability (NPL). The major difference in the measurements is that GASB 25 allows for asset smoothing, whereas, GASB 67 uses the fair value of assets as of the

Analysis of Fiduciary Net Position

(Dollar Amounts in Thousands)

Summary of Fiduciary Net Position	**FY 2015**	Increase (Decrease)	FY 2014	Increase (Decrease)	FY 2013
Assets:					
Receivables	**$ 2,335,917**	$ 929,888	$ 1,406,029	$ 232,428	$ 1,173,601
Investments	**50,579,031**	(2,349,076)	52,928,107	3,393,700	49,534,407
Securities lending collateral pool	**1,207,170**	610,234	596,936	(18,223)	615,159
Capital assets	**22,814**	(37)	22,851	447	22,404
Total Assets	**54,144,932**	(808,991)	54,953,923	3,608,352	51,345,571
Deferred outflows of resources	**3,895**	3,895	-	-	-
Liabilities:					
Payables and other liabilities	**1,056,539**	(38,524)	1,095,063	(359,652)	1,454,715
Obligations under securities lending	**1,207,170**	610,234	596,936	(18,223)	615,159
Total Liabilities	**2,263,709**	571,710	1,691,999	(377,875)	2,069,874
Deferred inflows of resources	**44**	44	-	-	-
Net Position	**$ 51,885,074**	$ (1,376,850)	$ 53,261,924	$ 3,986,227	$ 49,275,697
Summary of Changes in Fiduciary Net Position					
Additions:					
Contributions	**$ 3,698,173**	$ 621,295	$ 3,076,878	$ 530,713	$ 2,546,165
Participant premiums and CMS	**324,291**	28,792	295,499	20,285	275,214
Net investment income	**1,328,883**	(5,769,139)	7,098,022	2,971,684	4,126,338
Total Additions	**5,351,347**	(5,119,052)	10,470,399	3,522,682	6,947,717
Deductions:					
Benefit expense	**6,614,154**	196,699	6,417,455	44,092	6,373,363
Administrative expenses	**72,500**	5,783	66,717	4,481	62,236
Total Deductions	**6,686,654**	202,482	6,484,172	48,573	6,435,599
Changes in Net Position	**$ (1,335,307)**	$ (5,321,534)	$ 3,986,227	$ 3,474,109	$ 512,118

Management's Discussion and Analysis (continued)

As of June 30, 2014

GASB 67 - Accounting Method			GASB 25 - Funding Method		
Total Pension Liability (TPL)	$	92,560,832	Actuarial Accrued Liability (AAL)	$	92,352,983
Fiduciary Net Position		52,980,115	Actuarial Value of Assets		57,231,799
Net Pension Liability (NPL)		39,580,717	Unfunded Actuarial Accrued Liability (UAAL)		35,121,184
Ratio - Fiduciary Net Position/TPL		57.2%	Funded Ratio		62.0%

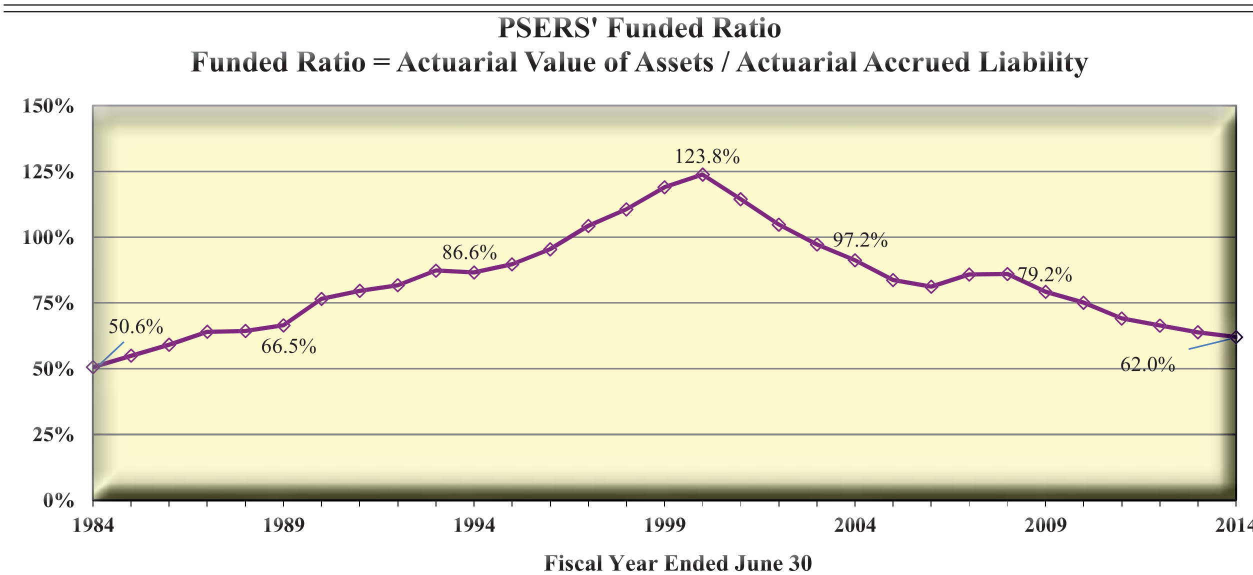
measurement date. A chart illustrating the difference between the liability measurements as of June 30, 2014, the last measurement date GASB 25 information is available, is at the top of this page.

- Under GASB 25, PSERS' funded ratio for the pension plan decreased from 63.8% at June 30, 2013 to 62.0% as of the latest actuarial valuation dated June 30, 2014. This decrease was primarily due to experience losses on investment assets and employer contributions that were less than the normal cost plus interest on the unfunded liability. This ratio is less volatile, as smoothing of the assets is used in the measurement.
- Under GASB 67, PSERS' pension plan ratio of fiduciary net position to total pension liability, increased from 54.5% as of June 30, 2013 to 57.2% as of June 30, 2014. This increase is due to the increase in investment assets outpacing the increase in the TPL from benefits earned. This ratio is more susceptible to volatility, as the fair value of assets is used in the measurement.
- The NPL is larger than the Unfunded Actuarial Accrued Liability (UAAL) since the Actuarial Value of Assets, which is smoothed, is larger than the Fiduciary Net Position. The Actuarial Value of Assets is larger as the impact of the FY 2009 Great Recession losses is not fully recognized. For funding purposes, PSERS smooths asset gains and losses over a 10-year period to reduce volatility.
- GASB 67 separates the accounting for pensions from the funding provisions used for the actuarial valuation. GASB 67 has no impact on how pension plans are funded. The assumptions and methods used in the actuarial valuation to establish the employer contribution rate did not change as a result of its implementation.

At June 30, 2015, the NPL increased $3.7 billion from $39.6 billion at June 30, 2014 to $43.3 billion due to a $2.3 billion growth in the TPL from benefits earned and a $1.4 billion decrease in the fiduciary net position due to benefit payments exceeding contributions and investment income. As a result, the ratio of fiduciary net position to TPL also decreased from 57.2% at June 30, 2014 to 54.4% at June 30, 2015.

Funded Status

PSERS uses an actuarial reserve type of funding that is financed by member contributions, employer contributions, and earnings from invested assets. A thirty-year history of PSERS' funded status is shown at the bottom of this page. An independent actuarial valuation of PSERS' actuarial assets and liabilities is performed annually. As part of this valuation, the progress toward funding pension obligations of PSERS is measured by comparing the actuarial value of assets to the actuarial accrued liability. This measurement is referred to as the funded ratio or funded status. The most recent actuarial valuation reports that PSERS' pension



Management's Discussion and Analysis (continued)

is 62.0% funded as of June 30, 2014. The funded ratio decreased from 63.8% as of June 30, 2013 due to a decrease in the actuarial value of assets, which is based on a ten-year smoothing period, employer contributions below the actuarially recommended level, and an increase in the actuarial accrued liability.

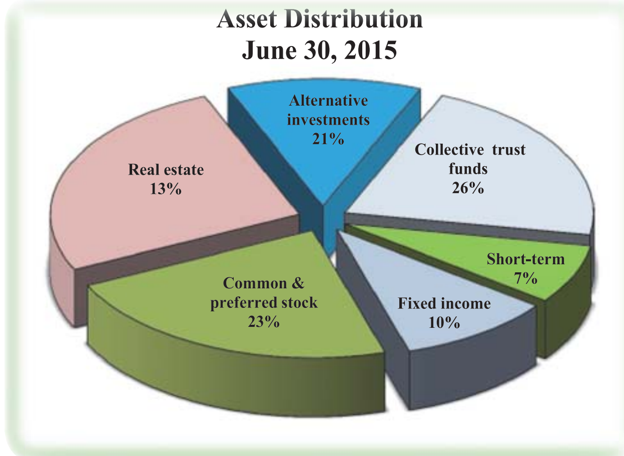
The results of operations for FY 2015 will be reflected in the actuarial valuation for the year ended June 30, 2015. Due to the normal lag time for completion of the actuarial valuation, the resulting funded status will be available at the end of the 2015 calendar year and will be reported in the financial statements for the fiscal year ending June 30, 2016 (FY 2016). Based on the investment performance for the ten-year period ended June 30, 2015, which is below the investment rate of return assumption during that time period, and employer contributions below the actuarially recommended level, the funded ratio at June 30, 2015 is expected to decrease. FY 2015 is the final year of a five-year transition from five-year to ten-year smoothing of actuarial assets.

PSERS' State Accumulation Account deficit increased from June 30, 2014 to June 30, 2015 (See Note 3). One-year investment returns below the return assumption and employer contributions below the normal cost plus interest contributed to the deficit increase. Increased employer contributions, as mandated by Act 120, and investment earnings will be used to reduce the deficit in this account in the future.

Investments

PSERS is a long-term investor and manages the pension fund with long-term objectives in mind. A primary element of PSERS' investment philosophy is diversification among various asset classes, which is the best way to achieve its goals. PSERS makes estimates of future long-term market returns and establishes an asset allocation plan taking into account the risk associated with each asset class as well as the financial objectives of the Fund.

Economically, this past fiscal year was a mixed year to be invested in higher risk assets with modestly positive returns to equities (in currency hedged terms) while commodity and commodity-related securities struggled. The fiscal year was marked by falling global growth and inflation expectations coupled with a modest increase in risk premiums. The global economy is still burdened by high debt levels which has the effect of constraining growth and is generally deflationary. Global monetary conditions have been very accommodative with most countries easing this past year, including implementation of quantitative easing programs by central banks in Europe and Japan. A notable exception was the U.S. which has ended quantitative easing during the past fiscal year and is contemplating increasing interest rates later in 2015. Domestically, the past fiscal year generated positive but tepid results given the low interest rates and amount of monetary stimulus injected into the economy through quantitative easing by the Federal Reserve (Fed). The U.S. real Gross Domestic Product (GDP) increased in each of the four quarters for the fiscal year ended June 30, 2015. The U.S. Core Consumer Price Index (CPI) was 2.1% year over year as of June 2014 and decreased to 0.1% as of June 2015. Housing during the past fiscal year has continued to show improvement, up 4.5% as measured by the S&P Case-Shiller 20-City Home Price Index after being up 8.1% last fiscal year. Globally, the Chinese economy remained one of the stronger economies in the world, increasing by 7.0% or more in each of the four quarters ended June 30, 2015. However, subsequent to the fiscal year end, China has shown notable signs that its economy is weakening as they try to rebalance their economy from a more investment driven economy to a more consumer oriented economy. The Japanese real GDP increased in three of the four quarters for the fiscal year ended June 30, 2015. The Eurozone economy, during the past year, remained very weak and on the verge of recession. The Eurozone real GDP increased by 0.2%, 0.4%, 0.4% and 0.3% in the third quarter 2014, fourth quarter 2014, first quarter 2015, and second quarter 2015, respectively.



For FY 2015, PSERS' time-weighted rate of return on investments was 3.04% which exceeded PSERS' total fund Policy Index of 2.02% for the same time period. The Policy Index is a custom benchmark, which is based on the Board-established asset allocation structure, that seeks to generate a return that meets the actuarial rate of return assumption. Net investment income of $1.3 billion in FY 2015 decreased from a net investment income of $7.1 billion in FY 2014.

The time-weighted annualized rate of return over the past three- and five-year periods ended June 30, 2015 was 8.52% and 9.73%, respectively. The time-weighted returns for the three- and five-year periods exceeded the total fund Policy

Management's Discussion and Analysis (continued)

Index returns for those periods by 228 and 246 basis points, respectively. The annualized time-weighted rate of return for the ten- and twenty-five-year periods ended June 30, 2015 was 6.31% and 8.45%, respectively.

PSERS' long-term actuarial investment rate of return assumption was 7.5% at June 30, 2015.

The asset distribution of PSERS' investment portfolio at June 30, 2015, 2014 and 2013, at fair value, and including postemployment healthcare assets, is presented in the chart on the top of the previous page and the table at the bottom of this page.

Short-term investments (cash and cash equivalents) decreased by $0.5 billion from $4.3 billion at June 30, 2014 to $3.8 billion at June 30, 2015. Due to a reallocation of exposure from other asset classes, PSERS decreased its short-term investments during FY 2015. ***Fixed income investments*** decreased by $0.4 billion from $5.5 billion at June 30, 2014 to $5.1 billion at June 30, 2015 mostly due to manager terminations and reallocation of exposure to other asset classes during FY 2015. ***Common and preferred stock investments*** increased by $0.5 billion from $10.9 billion at June 30, 2014 to $11.4 billion at June 30, 2015. The rise in this asset category was mainly the result of strong returns for domestic equity, international equity, and master limited partnerships, as well as the continual reallocation of exposure from other asset classes to master limited partnerships. ***Collective trust funds*** rose by $1.3 billion from $11.8 billion at June 30, 2014 to $13.1 billion at June 30, 2015 mostly due to reallocation of exposure from other asset classes. ***Real estate investments*** decreased by $0.8 billion from $7.2 billion at June 30, 2014 to $6.4 billion at June 30, 2015 due to significant partnership distributions which exceeded contributions to new and existing partnerships combined with valuation increases in partnership portfolio holdings. ***Alternative investments*** decreased by $2.4 billion from $13.2 billion at June 30, 2014 to $10.8 billion at June 30, 2015 partially due to the sale of limited partnership interests to third parties and to significant partnership distributions which exceeded contributions to new and existing partnerships combined with valuation increases in partnership portfolio holdings.

Short-term investments (cash and cash equivalents) increased by $1.1 billion from $3.2 billion at June 30, 2013 to $4.3 billion at June 30, 2014. Due to a reallocation of exposure from other asset classes, PSERS increased its short-term investments during FY 2014. ***Fixed income investments*** decreased by $0.3 billion from $5.8 billion at June 30, 2013 to $5.5 billion at June 30, 2014 mostly due to manager terminations and reallocation of exposure to other asset classes during FY 2014. ***Common and preferred stock investments*** increased by $1.1 billion from $9.8 billion at June 30, 2013 to $10.9 billion at June 30, 2014. The rise in this asset category was mainly the result of strong returns for domestic equity, international equity, and master limited partnerships, as well as the continual reallocation of exposure from other asset classes to master limited partnerships. ***Collective trust funds*** rose by $0.5 billion from $11.3 billion at June 30, 2013 to $11.8 billion at June 30, 2014 mostly due to strong investment performance. ***Real estate investments*** increased by $0.4 billion from $6.8 billion at June 30, 2013 to $7.2 billion at June 30, 2014 due to contributions to new and existing partnerships combined with valuation increases in partnership portfolio holdings which exceeded significant partnership distributions. ***Alternative investments*** increased by $0.6 billion from $12.6 billion at June 30, 2013 to $13.2 billion at June 30, 2014 due to contributions to new and existing partnerships combined with valuation increases in partnership portfolio holdings which exceeded significant partnership distributions.

Securities Lending

The System experienced a significant decrease in net income from securities lending activities from $18.6 million in FY 2014 to $9.0 million in FY 2015 due to a recovery from the lending agent of specific losses incurred during the market downturn in 2008 received in FY 2014.

Contributions

Employer contributions increased from $2.1 billion in FY 2014 to $2.7 billion in FY 2015 due to the increase in the total employer contribution rate from 16.93% in FY 2014 to 21.40% in FY 2015.

(Dollar Amounts in Thousands)

Asset Class	2015	%	2014	%	2013	%
Short-term	**$ 3,780,778**	**7.5**	$ 4,331,188	8.2	$ 3,242,139	6.5
Fixed income	**5,085,921**	**10.0**	5,532,214	10.4	5,828,418	11.8
Common and preferred stock	**11,420,135**	**22.6**	10,851,457	20.5	9,762,527	19.7
Collective trust funds	**13,102,950**	**25.9**	11,795,390	22.3	11,280,497	22.8
Real estate	**6,386,295**	**12.6**	7,230,493	13.7	6,797,535	13.7
Alternative investments	**10,802,952**	**21.4**	13,187,365	24.9	12,623,291	25.5
Total	**$ 50,579,031**	**100.0**	$ 52,928,107	100.0	$ 49,534,407	100.0

Management's Discussion and Analysis (continued)

Total member contributions increased from $966.9 million in FY 2014 to $984.6 million in FY 2015. The increase was mainly due to a $12.7 million increase in member contributions from active member payroll. Additionally, there was a $5.0 million rise in purchase of service contributions. Total member contributions decreased from $991.1 million in FY 2013 to $966.9 million in FY 2014 due to a $22.6 million decrease in purchase of service contributions and a slight decrease in active member payroll. These decreases were partially offset by a small increase in the average member contribution rate. The average member contribution rate for pension increased from 7.40% in FY 2013 to 7.43% in FY 2014.

As a result of an increase in member purchase of service contributions and an increase in the receivables of member contributions from active member payroll, in the last quarter of FY 2014 to the last quarter of FY 2015, member contribution receivables increased from $314.7 million at June 30, 2014 to $329.2 million at June 30, 2015. The increase in the employer contribution rate from FY 2014 to FY 2015, resulted in the employer contribution receivables rising from $624.3 million at June 30, 2014 to $785.0 million at June 30, 2015.

Progress of Act 120

On November 23, 2010, the Governor signed HB 2497 into law. The legislation is now known as Act 120 of 2010. Act 120 preserves the benefits of existing members and includes a series of actuarial and funding changes to PSERS and benefit reductions for individuals who become new members of PSERS on or after July 1, 2011. The Act created two new membership classes, T-E and T-F. T-E and T-F members are "shared-risk," meaning that their employee contributions can increase or decrease due to investment performance.

Act 120 addressed the pending employer contribution rate spike projected for FY 2013 by smoothing the projected rate increases over a five- to nine-year time period. Instead of a large rate spike in one year, under Act 120, the employer contribution rate has increased steadily each year from the 5.64% in effect when Act 120 became law to the 21.40% rate in the FY 2015. During that time, PSERS' Annual Required Contribution (ARC) percentage under GASB standards increased from 27% to 69% and is projected to continue to improve until the ARC reaches 100%.

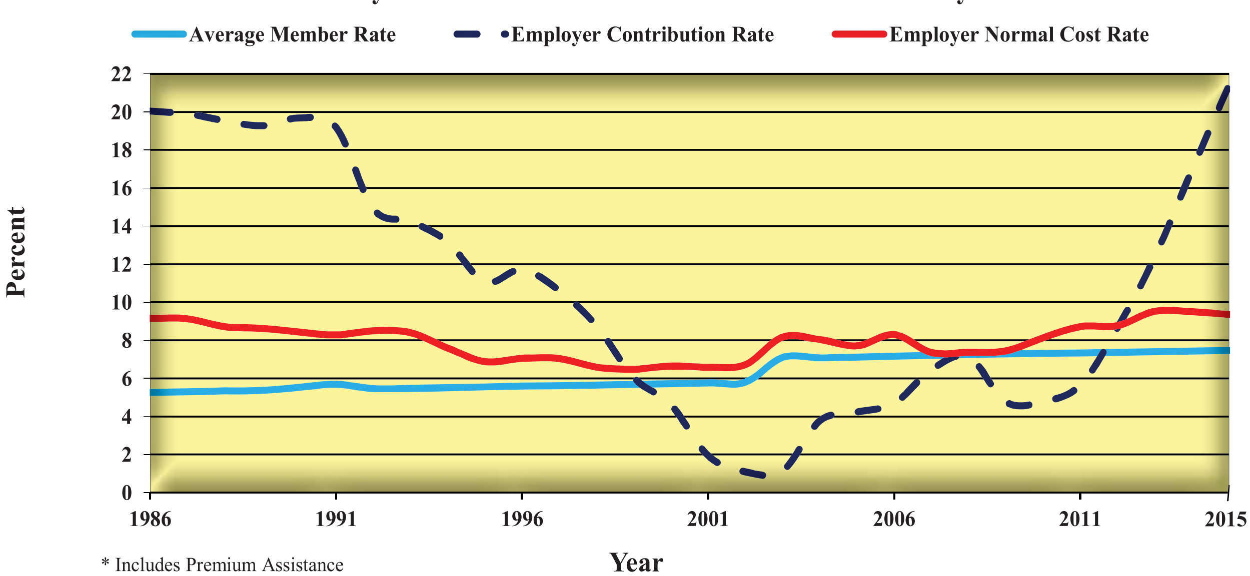
At June 30, 2015, there were an estimated 48,000 T-E and T-F active members representing approximately 18% of all active members. The employer normal cost of Act 120 members is less than 3% of payroll which is over 65% less than the normal cost for pre-Act 120 members. As the percentage of T-E and T-F membership grows, the annual cost of benefits continues to decline steadily.

Investment Income

Net investment income decreased from $7.1 billion in FY 2014 to $1.3 billion in FY 2015, which is consistent with the decrease in the time-weighted investment rate of return from 14.91% for FY 2014 to 3.04% for FY 2015. Net investment income increased from $4.1 billion in FY 2013 to $7.1 billion in FY 2014, which is consistent with the increase in the time-weighted investment rate of return from 7.96% for FY 2013 to 14.91% for FY 2014. As depicted in the following chart, investment earnings provided 69%

Below is a thirty-year history of PSERS' contribution rates:

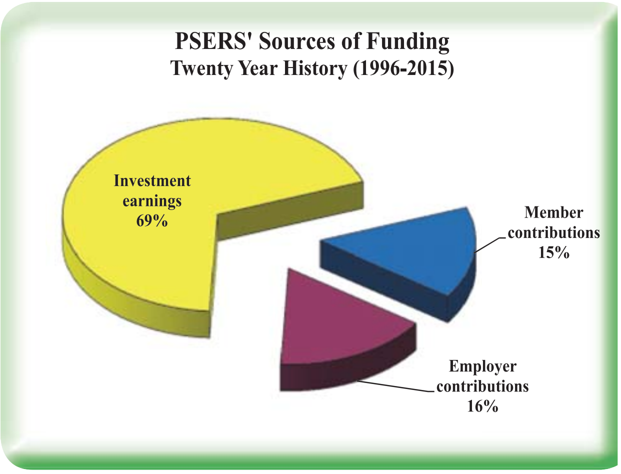
History of PSERS' Contribution Rates as a Percent of Payroll*



* Includes Premium Assistance

Management's Discussion and Analysis (continued)

of PSERS' funding over the past 20 years. Net investment income also includes investment expenses as a deduction. The "Total PSERS' Benefits and Expenses" section that follows includes an analysis of investment expenses.



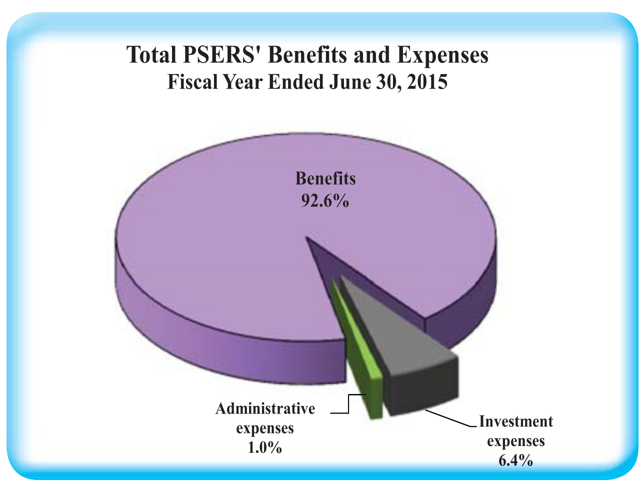
Total PSERS' Benefits and Expenses

The primary source of expense during FY 2015 was for the payment of benefits approximating $6.6 billion. The breakdown consisted of $6.2 billion for Pension, $106.3 million for Premium Assistance, and $287.3 million for HOP benefits. The chart at the end of this page illustrates the significant portion of expenses attributable to benefit payments.

Total PSERS' benefit expense increased from $6.4 billion in FY 2014 to $6.6 billion in FY 2015. The increase is attributable to an ongoing increase to the average monthly benefit and an increase in the number of members receiving benefits. Pension benefits payable increased from $531.6 million at June 30, 2014 compared to $560.3 million at June 30, 2015. This increase was due to the payment of the federal withholding tax earlier in FY 2014. This was partially offset by lower fourth quarter retirements in FY 2015 as compared to the same period in FY 2014. New retirements during FY 2015 increased by approximately 9% from FY 2014. Benefit expense increased from $6.3 billion in FY 2013 to $6.4 billion in FY 2014. The increase is attributable to an ongoing increase to the average monthly benefit and an increase in the number of members receiving benefits. Fourth quarter retirements in FY 2014 were lower compared to the same period in FY 2013, resulting in a lower pension benefits payable figure at June 30, 2014 of $531.6 million compared to $747.6 million at June 30, 2013. New retirements during FY 2014 decreased by approximately 21% from FY 2013.

Investment expenses decreased by $27.0 million from $482.2 million in FY 2014 to $455.2 million in FY 2015 mainly due to a decrease in management fees in the collective trust fund and alternative investment asset classes. As a percentage of total benefits and expenses, investment expense has decreased from 8.2% in FY 2013 to 6.4% in FY 2015. These decreases were slightly offset by an increase in management fees in the fixed income asset class and consultant and legal fees. The fee decrease in the collective trust fund asset class is mainly attributable to higher performance fees due to the stronger performance this asset class had for FY 2014. The decrease in the alternative investment class is partially attributable to the sale of certain limited partnership interests and to changes in fee structure brought on by partnerships maturing. Investment expenses decreased by $75.4 million from $557.6 million in FY 2013 to $482.2 million in FY 2014 mainly due to a decrease in management fees in the collective trust fund and alternative investment asset classes. The fee decrease in the collective trust fund asset class is mainly attributable to higher performance fees due to the stronger performance this asset class had for FY 2013. The decrease in the alternative investment class is attributable to changes in fee structure brought on by partnerships maturing.

Administrative expenses increased by $5.8 million from $66.7 million during FY 2014 compared to $72.5 million during FY 2015. This rise was mainly attributable to the implementation of GASB 68, as discussed in Note 7 of the Notes to the Financial Statements. A contributing factor was the increase in administrative costs for HOP due to increased membership. Administrative expenses increased by $4.5 million from $62.2 million during FY 2013 compared to $66.7 million during FY 2014 mainly due to a rise in the administrative costs attributable to increased membership in the HOP.



Management's Discussion and Analysis (continued)

Postemployment Healthcare

PSERS administers two postemployment healthcare programs, the Health Insurance Premium Assistance Program (Premium Assistance) and the Health Options Program (HOP), for its annuitants. The following paragraphs and summary financial data provide supplementary information to the financial statements which contain the financial position and activities for the two postemployment healthcare programs.

Health Insurance Premium Assistance Program (Premium Assistance)

Financial Highlights

- Total net position increased by $8.6 million in FY 2015 due to an increase in employer contributions driven by the increase in active member payroll. This increase was slightly offset by a decrease in the contribution rate from 0.93% for FY 2014 to 0.90% for the FY 2015. The change from June 30, 2013 to June 30, 2014 was an increase of $11.7 million due to an increase in employer contributions driven by the increase in the contribution rate from 0.86% for FY 2013 to 0.93% for the FY 2014.
- Total receivables decreased from $48.5 million at June 30, 2014 to $35.9 million at June 30, 2015 mostly due to a decrease in interfund receivables from pension and employer receivables.
- Investments increased from $64.1 million at June 30, 2014 to $86.0 million at June 30, 2015 mainly due to the decrease in the interfund receivables combined with the increase in net position.

Contributions

Total employer contributions for Premium Assistance decreased from $117.9 million in FY 2014 to $116.8 million in FY 2015 due to the decrease in the employer contribution rate from FY 2014 to FY 2015. The contribution rate decreased from 0.93% in FY 2014 to 0.90% in FY 2015. This decrease was moderately offset by an increase in active member payroll.

Investment Income

Total investment income for Premium Assistance increased slightly from $0.1 million for FY 2014 to $0.2 for FY 2015.

Benefits and Expenses

Overall expenses for Premium Assistance increased from $106.2 million in FY 2014 to $108.4 million in FY 2015. This increase is primarily due to the increase in number of members receiving premium assistance benefits.

Health Options Program (HOP)

Financial Highlights

- Total net position increased by $9.2 million in FY 2015 primarily due to the rise in premiums that outpaced the rise in expenses. The change from June 30, 2013 to June 30, 2014 is also primarily due to the rise in premiums that outpaced the rise in expenses.
- Total receivables increased from $27.9 million at June 30, 2014 to $39.1 million at June 30, 2015. The increase is tied primarily to higher premiums due to an increase in participation in the HOP.
- Investments decreased slightly from $187.4 million at June 30, 2014 to $186.3 million at June 30, 2015.
- Total liabilities increased 2.0% from $45.5 million at June 30, 2014 to $46.4 million at June 30, 2015. The increase is due to increased participation in the program and an increase in claims payable.

Participant and CMS Premiums

Total participant Centers for Medicare and Medicaid Services (CMS) premiums for HOP increased from $295.5 million in FY 2014 to $324.3 million in FY 2015. This increase is representative of the 7.5% increase in plan participation.

Investment Income

Investment income for HOP remained at $0.2 million for FY 2014 and FY 2015 due to a continued period of low short-term interest rates.

Benefits and Expenses

Overall expenses for HOP increased from $285.7 million in FY 2014 to $315.3 million in FY 2015. This increase is primarily due to the increase in number of members enrolled in the HOP combined with an increase in the administrative costs.

Management's Discussion and Analysis (continued)

Premium Assistance

Summary of Fiduciary Net Position

(Dollar Amounts in Thousands)

Assets:	**FY 2015**	Increase (Decrease)	FY 2014	Increase (Decrease)	FY 2013
Receivables	**$ 35,858**	$ (12,644)	$ 48,502	$ 10,292	$ 38,210
Investments	**85,995**	21,896	64,099	1,522	62,577
Total Assets	**121,853**	9,252	112,601	11,814	100,787
Liabilities:					
Payables and other liabilities	**1,210**	669	541	103	438
Total Liabilities	**1,210**	669	541	103	438
Net Position	**$ 120,643**	$ 8,583	$ 112,060	$ 11,711	$ 100,349

Summary of Changes in Fiduciary Net Position

Additions:	**FY 2015**	Increase (Decrease)	FY 2014	Increase (Decrease)	FY 2013
Contributions	**$ 116,808**	$ (1,060)	$ 117,868	$ 9,192	$ 108,676
Net investment income	**215**	145	70	(40)	110
Total Additions	**117,023**	(915)	117,938	9,152	108,786
Deductions:					
Benefit expenses	**106,298**	2,101	104,197	4,119	100,078
Administrative expenses	**2,142**	112	2,030	(82)	2,112
Total Deductions	**108,440**	2,213	106,227	4,037	102,190
Changes in Net Position	**$ 8,583**	$ (3,128)	$ 11,711	$ 5,115	$ 6,596

Health Options Program

Summary of Fiduciary Net Position

(Dollar Amounts in Thousands)

Assets:	**FY 2015**	Increase (Decrease)	FY 2014	Increase (Decrease)	FY 2013
Receivables	**$ 39,066**	$ 11,202	$ 27,864	$ 4,821	$ 23,043
Investments	**186,292**	(1,111)	187,403	11,713	175,690
Total Assets	**225,358**	10,091	215,267	16,534	198,733
Liabilities:					
Payables and other liabilities	**46,448**	930	45,518	6,572	38,946
Total Liabilities	**46,448**	930	45,518	6,572	38,946
Net Position	**$ 178,910**	$ 9,161	$ 169,749	$ 9,962	$ 159,787

Summary of Changes in Fiduciary Net Position

Additions:	**FY 2015**	Increase (Decrease)	FY 2014	Increase (Decrease)	FY 2013
Participant and CMS premiums	**$ 324,291**	$ 28,792	$ 295,499	$ 20,285	$ 275,214
Net investment income	**152**	(39)	191	(35)	226
Total Additions	**324,443**	28,753	295,690	20,250	275,440
Deductions:					
Benefit expenses	**287,255**	27,502	259,753	30,714	229,039
Administrative expenses	**28,027**	2,052	25,975	3,331	22,644
Total Deductions	**315,282**	29,554	285,728	34,045	251,683
Changes in Net Position	**$ 9,161**	$ (801)	$ 9,962	$ (13,795)	$ 23,757

Statements of Fiduciary Net Position
June 30, 2015 and 2014
(Dollar Amounts in Thousands)

	2015			
		Postemployment Healthcare		
	Pension	Premium Assistance	Health Options Program	Totals
Assets:				
Receivables:				
Members	$ 325,285	$ 3,852	$ 35	$ 329,172
Employers	754,873	30,163	-	785,036
Investment income	149,175	41	18	149,234
Investment proceeds	1,031,297	-	-	1,031,297
CMS Part D and prescriptions	-	-	38,938	38,938
Interfund	-	929	-	929
Miscellaneous	363	873	75	1,311
Total Receivables	2,260,993	35,858	39,066	2,335,917
Investments, at fair value:				
Short-term	3,508,491	85,995	186,292	3,780,778
Fixed income	5,085,921	-	-	5,085,921
Common and preferred stock	11,420,135	-	-	11,420,135
Collective trust funds	13,102,950	-	-	13,102,950
Real estate	6,386,295	-	-	6,386,295
Alternative investments	10,802,952	-	-	10,802,952
Total Investments	50,306,744	85,995	186,292	50,579,031
Securities lending collateral pool	1,207,170	-	-	1,207,170
Capital assets (net of accumulated depreciation $26,153)	22,814	-	-	22,814
Total Assets	53,797,721	121,853	225,358	54,144,932
Deferred outflows of resources	3,895	-	-	3,895
Liabilities:				
Accounts payable and accrued expenses	147,235	319	1,700	149,254
Benefits payable	560,319	191	20,308	580,818
Participant premium advances	-	-	24,440	24,440
Investment purchases and other liabilities	300,398	700	-	301,098
Obligations under securities lending	1,207,170	-	-	1,207,170
Interfund payable	929	-	-	929
Total Liabilities	2,216,051	1,210	46,448	2,263,709
Deferred inflows of resources	44	-	-	44
Net position restricted for pension and postemployment healthcare benefits	$ 51,585,521	$ 120,643	$ 178,910	$ 51,885,074

The accompanying notes are an integral part of the financial statements.

Statements of Fiduciary Net Position
June 30, 2015 and 2014
(Dollar Amounts in Thousands)

	2014			
		Postemployment Healthcare		
	Pension	Premium Assistance	Health Options Program	Totals
Assets:				
Receivables:				
Members	$ 310,305	$ 4,395	$ 31	$ 314,731
Employers	590,953	33,352	-	624,305
Investment income	238,202	65	12	238,279
Investment proceeds	189,746	-	-	189,746
CMS Part D and prescriptions	-	-	27,793	27,793
Interfund	-	9,917	-	9,917
Miscellaneous	457	773	28	1,258
Total Receivables	1,329,663	48,502	27,864	1,406,029
Investments, at fair value:				
Short-term	4,079,686	64,099	187,403	4,331,188
Fixed income	5,532,214	-	-	5,532,214
Common and preferred stock	10,851,457	-	-	10,851,457
Collective trust funds	11,795,390	-	-	11,795,390
Real estate	7,230,493	-	-	7,230,493
Alternative investments	13,187,365	-	-	13,187,365
Total Investments	52,676,605	64,099	187,403	52,928,107
Securities lending collateral pool	596,936	-	-	596,936
Capital assets (net of accumulated depreciation $24,080)	22,851	-	-	22,851
Total Assets	54,626,055	112,601	215,267	54,953,923
Deferred outflows of resources	-	-	-	-
Liabilities:				
Accounts payable and accrued expenses	86,328	355	1,725	88,408
Benefits payable	531,621	186	21,531	553,338
Participant premium advances	-	-	22,262	22,262
Investment purchases and other liabilities	421,138	-	-	421,138
Obligations under securities lending	596,936	-	-	596,936
Interfund payable	9,917	-	-	9,917
Total Liabilities	1,645,940	541	45,518	1,691,999
Deferred inflows of resources	-	-	-	-
Net position restricted for pension and postemployment healthcare benefits	$ 52,980,115	$ 112,060	$ 169,749	$ 53,261,924

The accompanying notes are an integral part of the financial statements.

Statements of Changes in Fiduciary Net Position
Years Ended June 30, 2015 and 2014
(Dollar Amounts in Thousands)

	2015			
		Postemployment Healthcare		
	Pension	Premium Assistance	Health Options Program	Totals
Additions:				
Contributions:				
Members	$ 984,634	$ -	$ -	$ 984,634
Employers	2,596,731	116,808	-	2,713,539
Total contributions	3,581,365	116,808	-	3,698,173
Participant premiums	-	-	281,855	281,855
Centers for Medicare & Medicaid Services premiums	-	-	42,436	42,436
Investment income:				
From investing activities:				
Net appreciation (depreciation) in fair value of investments	511,997	(128)	-	511,869
Short-term	8,940	376	186	9,502
Fixed income	167,788	-	-	167,788
Common and preferred stock	279,940	-	-	279,940
Collective trust funds	2,117	-	-	2,117
Real estate	345,250	-	-	345,250
Alternative investments	458,658	-	-	458,658
Total investment activity income	1,774,690	248	186	1,775,124
Investment expenses	(455,140)	(33)	(34)	(455,207)
Net income from investing activities	1,319,550	215	152	1,319,917
From securities lending activities:				
Securities lending income	9,934	-	-	9,934
Securities lending expense	(968)	-	-	(968)
Net income from securities lending activities	8,966	-	-	8,966
Total net investment income	1,328,516	215	152	1,328,883
Total Additions	4,909,881	117,023	324,443	5,351,347
Deductions:				
Benefits	6,199,681	106,298	287,255	6,593,234
Refunds of contributions	20,920	-	-	20,920
Administrative expenses	42,331	2,142	28,027	72,500
Total Deductions	6,262,932	108,440	315,282	6,686,654
Net increase (decrease)	(1,353,051)	8,583	9,161	(1,335,307)
Net position restricted for pension and postemployment healthcare benefits:				
Balance, beginning of year	52,980,115	112,060	169,749	53,261,924
Effect of change in accounting principle	(41,543)	-	-	(41,543)
Balance, beginning, as restated	52,938,572	112,060	169,749	53,220,381
Balance, end of year	$ 51,585,521	$ 120,643	$ 178,910	$ 51,885,074

The accompanying notes are an integral part of the financial statements.

Statements of Changes in Fiduciary Net Position
Years Ended June 30, 2015 and 2014
(Dollar Amounts in Thousands)

	2014			
		Postemployment Healthcare		
	Pension	Premium Assistance	Health Options Program	Totals
Additions:				
Contributions:				
Members	$ 966,926	$ -	$ -	$ 966,926
Employers	1,992,084	117,868	-	2,109,952
Total contributions	2,959,010	117,868	-	3,076,878
Participant premiums	-	-	257,740	257,740
Centers for Medicare & Medicaid Services premiums	-	-	37,759	37,759
Investment income:				
From investing activities:				
Net appreciation (depreciation) in fair value of investments	6,024,512	(651)	-	6,023,861
Short-term	7,695	816	191	8,702
Fixed income	220,447	-	-	220,447
Common and preferred stock	284,808	-	-	284,808
Collective trust funds	7,069	-	-	7,069
Real estate	374,076	-	-	374,076
Alternative investments	642,727	-	-	642,727
Total investment activity income	7,561,334	165	191	7,561,690
Investment expenses	(482,141)	(95)	-	(482,236)
Net income from investing activities	7,079,193	70	191	7,079,454
From securities lending activities:				
Securities lending income	19,859	-	-	19,859
Securities lending expense	(1,291)	-	-	(1,291)
Net income from securities lending activities	18,568	-	-	18,568
Total net investment income	7,097,761	70	191	7,098,022
Total Additions	10,056,771	117,938	295,690	10,470,399
Deductions:				
Benefits	6,030,682	104,197	259,753	6,394,632
Refunds of contributions	22,823	-	-	22,823
Administrative expenses	38,712	2,030	25,975	66,717
Total Deductions	6,092,217	106,227	285,728	6,484,172
Net increase	3,964,554	11,711	9,962	3,986,227
Net position restricted for pension and postemployment healthcare benefits:				
Balance, beginning of year	49,015,561	100,349	159,787	49,275,697
Balance, end of year	$ 52,980,115	$ 112,060	$ 169,749	$ 53,261,924

The accompanying notes are an integral part of the financial statements.

Notes to Financial Statements
Years Ended June 30, 2015 and 2014

1. Organization and Description of the System

(A) Organization

The System was established on July 18, 1917, under the provisions of Pamphlet Law 1043, No. 343 as a governmental cost-sharing, multiple-employer plan that provides retirement allowances and other benefits to its members. Membership in the System is mandatory for nearly all qualifying public school employees in the Commonwealth of Pennsylvania (Commonwealth). As of June 30, 2015, there were 784 participating employers, generally school districts. Membership as of June 30, 2014, the most recent year for which actual amounts are available, is presented in the table at the bottom of this page.

The Public School Employees' Retirement Board (Board) is established by state law as an independent administrative board of the Commonwealth. The Board exercises control and management of the System, including the investment of its assets. The Board has fifteen members including the Commonwealth's Secretary of Education, the State Treasurer, the Executive Director of the Pennsylvania School Boards Association, two members appointed by the Governor, six elected members (three from among the System's certified members, one from among the System's noncertified members, one from among the System's annuitants, and one from among school board members in Pennsylvania), two members from the Senate, and two members from the House of Representatives.

The State Treasurer is the custodian of the System's fund. The retirement plan of the System is a contributory defined benefit plan for which the benefit payments to members and contribution provisions by employers and employees are specified in the Pennsylvania Public School Employees' Retirement Code (Code). Changes in benefit and contribution provisions for the retirement plan must be made by legislation. Pursuant to state law, all legislative bills and amendments proposing to change the System's retirement plan are to be accompanied with an actuarial note prepared by an enrolled pension actuary from the Public Employee Retirement Commission providing an estimate of the cost and actuarial effect of the proposed change.

Based upon criterion of financial accountability as defined by governmental accounting standards, the System is considered a component unit of the Commonwealth of Pennsylvania financial reporting entity and is included in the Comprehensive Annual Financial Report of the Commonwealth of Pennsylvania.

(B) Pension Plan

i. Pension Benefits

Under the provisions of the 1975 revision of the Code by the Pennsylvania General Assembly, members are eligible for monthly retirement benefits upon reaching (a) age 62 with at least 1 year of credited service; (b) age 60 with 30 or more years of credited service; or (c) 35 or more years of service regardless of age. Act 120 of 2010 (Act 120) preserves the benefits of existing members and introduced benefit reductions for individuals who become new members on or after July 1, 2011. Act 120 created two new membership classes, Membership Class T-E (Class T-E) and Membership Class T-F (Class T-F). To qualify for normal retirement, Class T-E and Class T-F members must work until age 65 with a minimum of 3 years of service or attain a total combination of age and service that is equal to or greater than 92 with a minimum of 35 years of service. The Internal Revenue Code (IRC) limitation on the annual benefits for a defined benefit plan was $210,000 for 2015 and $210,000 for 2014.

Benefits are generally equal to 2% or 2.5%, depending upon membership class, of the member's final average salary (as defined in the Code) multiplied by the number of years of credited service. For members whose membership started prior to July 1, 2011, after completion of five years of service, a member's right to the defined benefits is vested and early retirement benefits may be elected. For Class T-E and Class T-F members, the right to benefits is vested after ten years of service. Active members may purchase

Membership as of June 30, 2014

Currently employed members:		
Vested	194,585	
Nonvested	68,727	
Total currently employed members		**263,312**
Retirees and beneficiaries currently receiving benefits	213,900	
Inactive members and vestees entitled to but not receiving benefits*	20,467	
Total retirees and other members		**234,367**
Total number of members		**497,679**

*Does not include 112,097 inactive members who are no longer participating.

Notes to Financial Statements (continued)

The contribution rates based on qualified member compensation for virtually all members are presented below:

PSERS members whose membership started prior to July 1, 2011:		
Membership Class T-C	Active Members hired before July 22, 1983	5.25%
Membership Class T-C	Active Members hired on or after July 22, 1983	6.25%
Membership Class T-D	Active Members hired before July 22, 1983	6.50%
Membership Class T-D	Active Members hired on or after July 22, 1983	7.50%
PSERS members whose membership started on or after July 1, 2011 (Act 120 members):		
Membership Class T-E*		7.50%
Membership Class T-F**		10.30%

* Shared risk program could cause future contribution rates to fluctuate between 7.5% and 9.5%

** Shared risk program could cause future contribution rates to fluctuate between 10.3% and 12.3%

credit for various types of school and non-school service on a lump-sum, installment purchase basis, or through an actuarially calculated benefit reduction. Class T-E and Class T-F members must purchase Non Qualifying Part Time service and most other types of non-school or non-state service credit at full actuarial cost. Class T-E and Class T-F members must purchase credit for Non Qualifying Part Time service within 365 days of enrollment in the system.

In addition to regular retirement benefits, the System also provides for disability retirement benefits and death benefits. Participants are eligible for disability retirement benefits after completion of five years of credited service. Such benefits are generally equal to 2% or 2.5%, depending upon membership class, of the member's final average salary (as defined in the Code) multiplied by the number of years of credited service, but not less than one-third of such salary nor greater than the benefit the member would have had at normal retirement age. Members over normal retirement age may apply for disability benefits.

Death benefits are payable upon the death of an active member who has reached age 62 with at least one year of credited service (age 65 with at least three years of credited service for Class T-E and Class T-F members) or who has at least five years of credited service (ten years for Class T-E and Class T-F members). Such benefits are actuarially equivalent to the benefit that would have been effective if the member had retired on the day before death.

Members with credited service in the Commonwealth of Pennsylvania State Employees' Retirement System (SERS) may elect to transfer service to the Public School Employees' Retirement System upon commencement of employment in the public school system. Similarly, a member with credited service in the System may transfer such service to SERS upon becoming a member of that system.

All members are fully vested in their individual balance in the Members' Savings Account which is described in Note 3. All non-vested members may receive a refund of their individual balance of member contributions and interest from the Members' Savings Account upon termination of public school employment. Vested members who enrolled prior to July 1, 2011 may elect to receive a return of their accumulated contributions and interest upon their retirement which results in a reduced monthly annuity. Vested Class T-E and Class T-F members cannot withdraw their accumulated contributions and interest from the Members' Savings Account upon their retirement.

ii. Contributions

The contribution policy is set by the Code and requires contributions by active members, employers, and the Commonwealth. The System's funding policy provides for periodic employer and Commonwealth contributions at actuarially determined rates, expressed as a percentage of annual covered payroll, such that they, along with employee contributions and an actuarially determined rate of investment return, are adequate to accumulate assets to pay retirement benefits when due. Level percentage of payroll employer contribution rates are determined using the entry age normal actuarial funding method. This method determines the amount of contributions necessary to (1) fully fund all current costs, (also known as normal cost), which represents the estimated amount necessary to pay for the benefits earned by the employees during the current service year; and (2) liquidate the prior service cost for service earned prior to the current service year and subsequent benefit increases, which represents the amount necessary to fund accrued liabilities over the appropriate amortization periods.

Contribution rates for active members are set by law (redefined with the provisions of Act 9 of 2001 and Act 120) and are dependent upon membership class. The IRC limitation on the annual compensation for a defined benefit plan was $260,000 for 2014 and $265,000 for 2015.

Active members who enrolled between July 1, 2001, the effective date of Act 9, and June 30, 2011 are Membership

Notes to Financial Statements (continued)

Class T-D (Class T-D). The contribution rates for all members in Class T-D were effective January 1, 2002. For Act 120 members, all new members automatically become Class T-E members. New members, however, have a one-time opportunity to elect Class T-F within 45 days of receiving written notification from PSERS. Failure to elect Class T-F at time of original eligibility will make the member ineligible for Class T-F forever. Act 120 introduced a shared risk program that could affect Class T-E and Class T-F members' contribution rates in future fiscal years. With the shared risk program Class T-E and Class T-F members benefit when investments of the fund are doing well and share some of the risk when investments underperform. The member contribution rate will stay within the specified range allotted for Class T-E or Class T-F; but could increase or decrease by 0.5% every three years starting July 1, 2015, dependent on investment performance of PSERS. The member contribution rate will never go below the base rate of 7.5% for Class T-E and 10.3% for Class T-F members, or above 9.5% for Class T-E and 12.3% for Class T-F members.

The total contribution rate for the employers and the Commonwealth was 21.40% and 16.93% (20.50% and 16.00% for pension component) of qualified compensation for the years ended June 30, 2015 and 2014, respectively.

Act 120 suppresses the employer contribution rate by using rate caps in future years to keep the rate from rising too high, too fast for budgetary purposes.

The rate caps limit the amount the pension component of the employer contribution rate can increase over the prior year's rate. For FY 2014 and thereafter, the rate can increase no more than 4.5% plus the premium assistance contribution rate.

The rate cap remains at 4.5% until the rate cap no longer applies, i.e., the rise in the employer contribution rate is less than the rate cap in effect at that time. Once the rate caps no longer apply, the employer normal cost becomes the contribution rate floor.

According to requirements established in Act 29 of 1994, the Commonwealth reimburses school entity employers a portion of the employer contributions paid to the System. All school entity employers are reimbursed by the Commonwealth at least 50% of the total employer contributions based on the total contribution rate. The Commonwealth reimburses certain school entity employers at a rate greater than 50% based upon non-pension criteria which stipulate that the entity must have a Commonwealth Department of Education calculated Market Value / Personal Income Aid Ratio in excess of .5000. The Commonwealth remits 50% of the total employer contributions for employers other than school entities directly to the System. All contributions from employers and the Commonwealth are shown as employer contributions on the Statements of Changes in Fiduciary Net Position.

(C) Postemployment Healthcare Plans

i. Health Insurance Premium Assistance Program

(a) Premium Assistance Benefits

The System provides a Health Insurance Premium Assistance Program (Premium Assistance) for all eligible annuitants who qualify and elect to participate. Under this program, employer contribution rates for Premium Assistance are established to provide reserves in the Health Insurance Account that are sufficient for the payment of Premium Assistance benefits for each succeeding year. Effective January 1, 2002, under the provisions of Act 9 of 2001, participating eligible annuitants are entitled to receive premium assistance payments equal to the lesser of $100 per month or their out-of-pocket monthly health insurance premium. To receive premium assistance, eligible annuitants must obtain their health insurance through either their school employer or the PSERS' Health Options Program. As of June 30, 2015 there were no assumed future benefit increases to participating eligible annuitants in the Premium Assistance program.

(b) Contributions

A portion of each employer and Commonwealth contribution to the System is set aside for the funding of Premium Assistance. The Premium Assistance contribution rate is set at a level necessary to establish reserves sufficient to provide Premium Assistance payments for all participating eligible members for the subsequent fiscal year. The portion of the total contribution rate for employers and the Commonwealth used to fund Premium Assistance was 0.90% and 0.93% for the years ended June 30, 2015 and 2014, respectively.

(c) Funding Status and Annual Required Contributions (ARC)

As of June 30, 2014, the most recent actuarial valuation, the plan was 8.2% funded. The actuarial accrued liability for benefits was $1.374 billion, and the actuarial value of assets was $112.1 million, resulting in an unfunded accrued liability of $1.262 billion. The covered payroll of active members was $12.6 billion and the ratio of the unfunded actuarial accrued liability to the covered payroll was 10.0%.

For fiscal year ended June 30, 2015, the ARC was $127.6 million. The actual employer contributions for fiscal year

Notes to Financial Statements (continued)

ended June 30, 2015 was $116.0 million resulting in a 91% contributed rate. The ratio of assets to Actuarial Accrued Liabilities (AAL) was 8.2%, 7.2%, and 6.9% for fiscal years ended June 30, 2014, 2013, and 2012, respectively. Assets have increased in relation to AAL from fiscal year ended June 30, 2012 to 2013 and increased from fiscal year ended June 30, 2013 to 2014.

The Schedule of Funding Progress and the Schedule of Employer Contributions included as Required Supplementary Information following the notes to the financial statements provide multiple year presentations about whether the actuarial value of plan assets is increasing or decreasing relative to the actuarial accrued liability for benefits over time.

(d) Actuarial Assumptions and Methods

The health insurance liability and funding provisions of the PSERS Code differ from the GASB disclosure requirements. As a result, there are different determinations of actuarial liability and contribution requirements for GASB accounting purposes and for Commonwealth funding purposes. For purposes of funding, the actuarial liability equals the assets in the Premium Assistance account, and the contribution required is the amount necessary to establish reserves sufficient to provide Premium Assistance payments to all participating eligible annuitants during the fiscal year that immediately follows the year the employer contribution is made. For GASB accounting purposes, the actuarial liability has been determined under the entry age normal actuarial cost method, and the ARC is equal to the entry age normal cost for health insurance plus an amount that will amortize the entry age unfunded actuarial liability for health insurance over a period of 30 years using level dollar open amortization. The entry age actuarial cost method was selected for this calculation because it meets the GASB parameters for determining actuarial liability and normal cost, and is the cost method specified by the PSERS Code for the PSERS pension plan.

Each annual actuarial valuation for Premium Assistance includes calculations that are based on the Premium Assistance benefits provided under the terms of the substantive plan in effect at the time of each valuation. The valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. The actuarial calculations for Premium Assistance reflect a long-term perspective. Actuarially determined amounts are subject to continual revision as results are compared to past expectations and new estimates are made about the future. Other significant actuarial assumptions employed by the actuary as of June 30, 2014, the date of the most recent actuarial valuation were:

- Investment return - 7.50%, includes inflation at 3.00%
- Salary increases - 5.50%, which reflects an allowance for inflation of 3.00%, real wage growth of 1%, and merit or seniority increases of 1.50%
- Multiple decrement tables - mortality, vesting, retirement age, and withdrawal estimates are based upon tables provided by the actuary

ii. Health Options Program

The Health Options Program (HOP) is a PSERS-sponsored voluntary health insurance program for the sole benefit of annuitants of PSERS, spouses of annuitants, survivor annuitants and their dependents who participate in HOP. The HOP is funded exclusively by the premiums paid by its participants for the benefit coverage they elect. HOP offers several health plans. Participants may select among a self-funded Medicare supplement plan, two Medicare Rx plans, and multiple Medicare Advantage plans for those eligible for Medicare. Participants not eligible for Medicare have a choice of a self-funded high deductible indemnity plan and multiple managed care plans. Medicare Advantage and managed care plans are available to retirees residing in the plan's service area. The Medicare Advantage and managed care plans are provided by private insurance companies or managed care organizations and benefits are fully insured. The Medicare supplement and high deductible plans are self-funded and claims are adjudicated by a third party administrator. The Medicare Rx Options and the prescription drug benefit of the high deductible plan for those not eligible for Medicare are also self-funded. HOP uses a pharmacy benefits manager to administer the benefits. Effective January 1, 2006, PSERS entered into an Employer/Union Entity contract with the Centers for Medicare and Medicaid Services (CMS) to operate a voluntary Medicare Prescription Drug Plan (PDP). Monthly premiums are received from CMS covering the 69,035 participants in the PDP. An independent actuarial consulting firm sets the rates for the self-funded benefits. The HOP maintains reserves for claims that are Incurred But Not Reported (IBNR) and for claim fluctuation for the self-funded benefit plans. At June 30, 2015 and 2014, PSERS recorded $13,571,000 and $16,308,000, respectively, in IBNR. The IBNR is included in benefits payable. The PSERS pension fund assets are not available to fund or satisfy obligations of the HOP.

Notes to Financial Statements (continued)

2. Summary of Significant Accounting Policies

(A) Basis of Accounting

The financial statements of the System are prepared on the accrual basis of accounting under which expenses are recorded when the liability is incurred, revenues are recorded in the accounting period in which they are earned and become measurable, and investment purchases and sales are recorded as of their trade date. Member and employer contributions are recognized in the period for which employees' salaries are reported. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

The accounting and reporting policies of the System conform to accounting principles generally accepted in the United States of America (GAAP). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of additions and deductions in fiduciary net position during the reporting period. Actual results could differ from those estimates.

(B) Investments

The System's investments are reported at fair value. Fair value is the amount that the System can reasonably expect to receive for an investment in a current sale between a willing buyer and a willing seller, that is, other than in a forced or liquidation sale. Short-term securities are carried at cost, which approximates fair value, unless they have published market prices or quotations from national securities exchanges or securities pricing services, in which case they are valued at the published market price. Fixed income securities and common and preferred stocks are generally valued based on published market prices and quotations from national securities exchanges or securities pricing services. Securities which are not traded on a national securities exchange are valued by the respective fund manager or other third parties based on similar sales.

Directly-owned real estate investments are primarily valued based on appraisals performed by independent appraisers and, for properties not appraised, the present value of the projected future net income stream is used. Real estate owned investments are reported net of related debt borrowed against the market value of the property. As of June 30, 2015 and 2014, $132,000,000 in line of credit advances were netted against the related property valuation. The line of credit balance is due on March 4, 2016. The line is payable at an interest rate equivalent to the lender's commercial paper rate plus 75 basis points and is collateralized by certain fixed income investments of the System.

For alternative investments, which include private equity, private debt, venture capital and equity real estate investments where no readily ascertainable market value exists, management, in consultation with the general partner and investment advisors, has determined the fair values for the individual investments based upon the partnership's most recent available financial information. Futures contracts, foreign exchange contracts, and options are marked-to-market daily based on published market prices and quotations from national securities exchanges or securities pricing services. The changes in market value are recognized as part of net appreciation/depreciation in the fair value of investments. Initial margin requirements for such financial instruments are provided by investment securities pledged as collateral or by cash.

Collective trust fund investments (CTF) consist primarily of domestic and international institutional funds. The funds generally do not pay interest or dividends to shareholders and reinvest all income earned on securities held by the fund. The fair value of CTF is based on the reported share value of the respective fund. CTF are managed by state chartered banks for which various state banking departments have regulatory oversight and investment advisors for which regulatory agencies such as the Securities and Exchange Commission have regulatory oversight. Investments that are not subject to this oversight are subject to annual independent audits.

In accordance with PSERS' investment guidelines, cash collateral from securities loaned is invested in a short-term collateral investment pool. The pool is invested entirely in overnight repurchase agreements carried at amortized cost which approximates fair value.

Investment expenses consist of investment manager fees and those administrative expenses directly related to the System's investment operations. Investment proceeds receivable generally includes unsettled investment sales and unsettled investment purchases are included in investment purchases and other liabilities. At June 30, 2015, investment proceeds receivable also includes $771,000,000 in receivables due to the sale of limited partnership interests during FY 2015.

(C) Capital Assets

Capital assets consist primarily of data processing equipment, software, and internally developed computer software recognized as intangible assets. Capital assets are depreciated using the straight-line method over an estimated useful life of five years. Intangible assets are amortized

Notes to Financial Statements (continued)

using the straight-line method over an estimated useful life of twenty years for assets purchased prior to July 1, 2012 and 5 years for assets purchased after June 30, 2012.

(D) Benefits Payable

Benefits payable identifies the obligations of the System, on an accrual basis, at the end of the fiscal year. It includes the estimated retirement and death benefits payable, premium assistance benefits payable, and the HOP IBNR claims for its participants.

(E) Pensions for Employees of the System

For purposes of measuring the net pension liability, deferred outflows of resources, deferred inflows of resources, and pension expense, information about the fiduciary net position of the Pennsylvania State Employees' Retirement System (SERS) and additions to/deductions from SERS' fiduciary net position have been determined on the same basis as they are reported by SERS, please refer to Note 7 for additional information regarding SERS. PSERS' net pension liability for its employees to SERS is reported in Accounts payable and accrued expenses. The pension expense is reported in Administrative expenses and is detailed on the Schedule of Operating Expenses Supplementary Schedule.

(F) Compensated Absences

The System uses the accrual basis of accounting for measuring vacation leave, sick leave, and other compensated absences liabilities. Employees of the System are paid for accumulated vacation leave upon termination or retirement. Retiring employees of the System that meet service, age, or disability requirements are paid between 30% and 100% of sick days available at retirement, up to 161 maximum days paid. As of June 30, 2015 and 2014, $3,647,000 and $3,649,000, respectively, were accrued for unused vacation and sick leave for the System's employees and are included in "Accounts payable and accrued expenses" on the Statements of Fiduciary Net Position.

(G) Participant Premium Advances

Premium advances in the fiscal years ended June 30, 2015 and 2014 are for HOP premiums related to health care coverage to be provided in calendar year 2015 and 2014, respectively.

(H) Federal Income Taxes

The Internal Revenue Service (IRS) issued a determination letter dated September 30, 2013 which stated that the plan and its underlying trust qualify under the provisions of Section 501(a) of the Internal Revenue Code (IRC) and therefore are exempt from federal income taxes.

(I) Risk Management

The System is exposed to various liabilities and risks of loss, including, without limitation, the ordinary risks of investment losses, risks related to theft or destruction of assets, liabilities resulting from injuries to employees, and liabilities resulting from court challenges to fiduciary decisions. As an administrative agency of the Commonwealth of Pennsylvania, the System is accorded sovereign immunity. For claims not shielded by sovereign immunity, the System participates in certain Commonwealth pooled insurance programs and requires asset managers to carry certain insurance coverage for the protection of the System. The System has implemented a self-insurance program for fiduciary and director and officer liability coverage. During the past three fiscal years, insurance settlements did not exceed insurance coverage.

(J) Reclassifications

Certain 2014 amounts have been reclassified in conformity with the 2015 presentation. These reclassifications had no effect on net position restricted for pension benefits or the change in fiduciary net position.

(K) Members Receivables

Members receivables include an amount for members' obligations to the System for the purchase of service credit. Members have a variety of options to remit purchase of service payments:

- Remit a lump sum payment.
- Request an installment plan from one to seven years where the member's employer establishes a payroll

The following is a summary of the members receivables at June 30, 2015 and 2014:

	(Dollar Amounts in Thousands)	
	2015	2014
Pension:		
Member contributions	$ **74,488**	$ 69,874
Purchase of service	**245,180**	234,727
Other	**5,617**	5,704
Total Members Receivables	**$ 325,285**	$ 310,305

Notes to Financial Statements (continued)

deduction process. The member's employer then forwards monthly payments of the withheld amounts to PSERS.

- Accept an actuarial reduction debt through which the amount of the purchase plus accumulated interest will reduce the member's retirement or death benefit.
- Rollover funds from an eligible distribution.

(L) Interfund Transactions and Balances

Interfund transfers of assets take place on a regular recurring basis between Pension and Premium Assistance. The transfers occur upon receipt of employer contributions and payment of benefits or expenses. The interfund receivables and payables related to interfund activity are classified under receivables and liabilities on the financial statements.

(M) Adoption of New Accounting Standards

During the fiscal year ended June 30, 2015, the System adopted GASB Statement No. 68, *Accounting and Financial Reporting for Pensions* which replaces the requirements of GASB Statement Nos. 25 and 50 related to pension plans that are administered through trusts or equivalent arrangements.

During the fiscal year ended June 30, 2015, the System adopted GASB Statement No. 69, *Government Combinations and disposals of Government Operations*. Upon examination of GASB 69, it was determined to have no current impact on PSERS.

During the fiscal year ended June 30, 2015, the System adopted GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date* which is to be applied simultaneously with the provisions of GASB Statement No. 68.

During the fiscal year ended June 30, 2014, the System adopted GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. This Statement specifies items that were previously reported as assets and liabilities that should now be reported as deferred outflows of resources or deferred inflow of resources.

During the fiscal year ended June 30, 2014, the System adopted GASB Statement No. 67 which addresses accounting and financial reporting requirements for pension plans. The requirements for GASB No. 67 require changes in presentation of the financial statements, notes to the financial statements, and required supplementary information. Significant changes include an actuarial calculation of total and net pension liability. It also includes comprehensive footnote disclosure regarding the pension liability, the sensitivity of the net pension liability to the discount rate, and increased investment activity disclosures.

During the fiscal year ended June 30, 2014, the System adopted GASB Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*. This Statement establishes accounting and financial reporting standards for situations where a state or local government, as a guarantor, agrees to indemnify a third-party obligation holder under specified conditions. Upon examination of GASB 70, it was determined to have no current impact on PSERS.

(N) Change in Accounting Principle

Due to the implementation of GASB Statement No. 68, the beginning net position restricted for pension and postemployment healthcare benefits has been restated by $(41,543,000) . The purpose of the restatement was to record the beginning net pension liability of $(42,989,000) and the beginning deferred outflows of resources for contributions subsequent to the measurement date of $1,446,000 to SERS.

3. Description of Accounts

The Code requires the System to maintain the following accounts which represent reserves held for future and current benefit payments as follows and as illustrated in the table at the top of the following page.

(A) State Accumulation Account

The State Accumulation Account is credited with contributions from the Commonwealth and the employers. Additionally, interest earnings of the System (after crediting the Members' Savings Account with 4% interest and the reserve for retirement with 5.50% statutory interest) are credited to this account. Each year, the necessary amounts, as determined by the actuary for the payment of retirement, disabilities, and death benefits, are transferred from the State Accumulation Account to the Annuity Reserve Account increasing the reserve credit to the 7.50% valuation assumption rate determined by the actuary. All administrative expenses necessary for the operation of the System, except for Premium Assistance and HOP expenses, are paid from the State Accumulation Account.

(B) Members' Savings Account

The Members' Savings Account is credited with all contributions made by active members of the System. Interest is added to the member's individual account at an annual rate of 4%.

Notes to Financial Statements (continued)

	(Dollar Amounts in Thousands) 2015	2014
Pension:		
State Accumulation Account	**$ (15,751,974)**	$ (13,136,437)
Members' Savings Account	**14,079,658**	13,554,229
Annuity Reserve Account	**53,257,837**	52,562,323
	$ 51,585,521	$ 52,980,115
Postemployment Healthcare:		
Health Insurance Account	**$ 120,643**	$ 112,060
Health Insurance Program Account	**178,910**	169,749
	$ 299,553	$ 281,809

Upon death or retirement of a member, the accumulated contributions plus interest are transferred to the Annuity Reserve Account for subsequent payment of benefits.

(C) Annuity Reserve Account

The Annuity Reserve Account represents the amounts transferred from the Members' Savings and State Accumulation Accounts, plus additional contributions made by the Commonwealth and employers for the payment of supplemental annuities and cost-of-living increases. All death, disability, and retirement benefits are paid from this account. Annual interest of 5.50% is credited to the Annuity Reserve Account.

(D) Health Insurance Account

The Health Insurance Account is credited with contributions from the Commonwealth and the employers for Premium Assistance. Effective January 1, 2002, under the provisions of Act 9 of 2001, participating eligible annuitants are entitled to receive premium assistance payments equal to the lesser of $100 per month or their out-of-pocket monthly health insurance premium. The Health Insurance Account pays all administrative expenses necessary to operate the Premium Assistance.

(E) Health Insurance Program Account

The Health Insurance Program Account is credited with premiums from members of the HOP and from CMS. All benefits related to the HOP (premium payments to the insurance companies and self-funded benefits) are paid from this account. The Health Insurance Program Account pays all administrative expenses necessary to operate the HOP.

4. Investments

(A) Summary of Investments

The Board has the responsibility to invest and reinvest available funds of the System in accordance with the guidelines and limitations set forth in the Code and other applicable state law. The Board accomplishes the daily management of the System's investments through investment advisors who act as agents for the System and through internal investment managers.

The Board invests the funds of the System using the Prudent Investor Standard, as articulated in the Code, which means "the exercise of that degree of judgment, skill and care under the circumstances then prevailing which persons of prudence, discretion and intelligence who are familiar with such matters exercise in the management of their own affairs not in regard to speculation, but in regard to the permanent disposition of the fund, considering the probable income to be derived therefrom as well as the probable safety of their capital." The Board has adopted its investment policy to formally document investment objectives and responsibilities. This policy, as well as applicable state law, establishes guidelines for permissible investments of the System. See the summary of investments table on the following page.

(B) Deposit and Investment Risk Disclosures

i. Deposits

Custodial credit risk for deposits is the risk that, in the event of a financial institution failure, the System would not be able to recover the value of the deposits. The Commonwealth's Treasury Department is the custodian of the System's funds. Commonwealth Treasury Department deposits must be held in insured depositories approved by the Commonwealth's Board of Finance and Revenue and must be fully collateralized.

The System, through its third party administrator, maintains certain bank deposits for the operation of its voluntary HOP. These deposits are not required to be collateralized by statute or policy. These deposits totaled $97,483,000 and $98,774,000 at June 30, 2015 and 2014, respectively, and are under the custody of M&T Bank which has an A- rating by Standard and Poor's (S&P) and an A3 rating by Moody's Investor Services (Moody's).

Notes to Financial Statements (continued)

A summary of the fair value of investments at June 30, 2015 and 2014 follows:

	(Dollar Amounts in Thousands)	
	2015	2014
Pension investments:		
Short-term:		
PSERS Short-Term Investment Fund	$ **3,250,700**	$ 3,730,820
Other domestic short-term	**82,214**	216,570
International short-term	**175,577**	132,296
	3,508,491	4,079,686
Fixed income:		
Domestic asset-backed and mortgage-backed securities	**1,269,736**	1,739,734
U.S. government and agency obligations	**1,399,117**	1,523,266
Domestic corporate and taxable municipal bonds	**1,594,524**	1,103,634
International fixed income	**822,544**	1,165,580
	5,085,921	5,532,214
Common and preferred stock:		
Domestic common and preferred stock	**5,216,388**	6,675,218
International common and preferred stock	**6,203,747**	4,176,239
	11,420,135	10,851,457
Collective trust funds	**13,102,950**	11,795,390
Real estate:		
Equity real estate	**6,073,946**	6,944,983
Directly-owned real estate	**312,349**	285,510
	6,386,295	7,230,493
Alternative investments:		
Private equity	**6,055,821**	8,748,284
Private debt	**3,791,320**	3,471,149
Venture capital	**955,811**	967,932
	10,802,952	13,187,365
Pension investments at fair value	$ **50,306,744**	$ 52,676,605
Postemployment healthcare investments:		
Premium Assistance:		
PSERS Short-Term Investment Fund	$ **71,106**	$ 53,052
Other domestic short-term	**14,889**	11,047
	85,995	64,099
Health Options Program:		
PSERS Short-Term Investment Fund	**88,809**	88,629
Other domestic short-term	**97,483**	98,774
	186,292	187,403
Postemployment healthcare investments at fair value	$ **272,287**	$ 251,502

Notes to Financial Statements (continued)

ii. Investment Risks

The System's investments, including derivatives and other similar investments, may be subject to various risks. Among these risks are concentration of credit risk, custodial credit risk, credit risk, interest rate risk, and foreign currency risk. The policies addressing each one of these risks, discussed in more detail below, are contained within the Investment Policy Statement, Objectives, and Guidelines reviewed and approved annually by the Board. Due to the level of risk associated with certain investments, it is possible that changes in the values of investments may occur in the near term and that such changes could materially affect the amounts reported in the Statements of Fiduciary Net Position.

(a) Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of the System's investment in a single issuer. As of June 30, 2015 and 2014, the System had no single issuer that exceeded 5% of total investments. Investments issued or explicitly guaranteed by the U.S. government and investments in mutual funds, external investment pools, and other pooled investments were excluded.

(b) Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the System would not be able to recover the value of investment or collateral securities that are in the possession of an outside party. In accordance with a contractual relationship between the Commonwealth's Treasury Department and its custodial agent, substantially all investments, where securities are used as evidence of the investment, are held by the custodian in book-entry form in the System's name. Those investments are defined as insured or registered investments for which the securities are held by the System or its agent and, therefore, have a very minimal level of custodial credit risk. The remaining investments, which do not have securities that are used as evidence of the investment, are primarily in collective trust funds and limited partnerships, which include real estate and alternative investments.

(c) Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The credit risk of a debt instrument is measured by nationally recognized statistical rating organizations (NRSRO) such as Fitch Investor Services (Fitch), Moody's, and S&P. Annually, the Board establishes an asset allocation plan. This plan manages the overall credit risk of the fixed income asset class through a clearly defined long-term asset allocation policy. This policy establishes a long-term target allocation of the fixed income asset class at 23.0% of the investment portfolio. The fixed income target allocation consists of:

- An allocation of 5.0% of the portfolio has been made to the U.S. core plus segment of the fixed income asset class benchmarked to the Barclays Capital U.S. Aggregate Index. The U.S. core plus allocation is composed of primarily investment grade, relatively liquid, public domestic bonds with an overall weighted-average NRSRO credit rating of A or better.

- An allocation of 6.0% of the portfolio has been made to the high yield segment of the fixed income asset class benchmarked to the Barclays Capital U.S. High Yield Index. The high yield allocation is composed of less liquid public non-investment grade fixed income securities with an overall weighted-average NRSRO credit rating of B- or better.

- An allocation of 6.0% of the portfolio has been made to the Treasury Inflation-Protected Securities (TIPS) segment of the fixed income asset class benchmarked to the Barclays Capital U.S. TIPS Index and composed of primarily government issued TIPS with an overall weighted-average NRSRO credit rating of AA or better. The portfolio manager is permitted to leverage the portfolio using TIPS total return swaps up to 3:1.

- An allocation of 1.0% of the portfolio has been made to the non-U.S. developed markets fixed income asset class benchmarked to the Barclays Capital Global Aggregate GDP-weighted Developed Market ex-U.S. (Unhedged) Index composed of primarily investment grade, relatively liquid non-U.S. public bonds with an overall weighted-average NRSRO credit rating of A or better.

- An allocation of 2.0% of the portfolio has been made to the emerging markets fixed income asset class benchmarked to the Barclays Capital EM Local Currency-Government-MV Weighted (Unhedged) -10% Country Cap Index composed of primarily investment grade, relatively liquid non-U.S. public bonds with an overall weighted-average NRSRO credit rating of BB- or better.

- An allocation of 3.0% of the portfolio has been made to cash benchmarked to the Merrill Lynch U.S. Treasury Bill 0-3 Months Index composed of primarily investment grade, relatively liquid U.S. and non-U.S. public bonds with an overall weighted-average NRSRO credit rating of AA or better.

Notes to Financial Statements (continued)

The following table discloses aggregate market value by credit quality rating category. Many securities have ratings from more than one NRSRO and sometimes those ratings differ from one NRSRO to another. The data listed below uses the rating (expressed as S&P equivalent) available from Fitch, Moody's and/or S&P that indicates the lowest credit quality at June 30, 2015 and 2014.

	(Dollar Amounts in Thousands)	
	2015	2014
Quality Rating	**Fair Value**	Fair Value
AAA	**$ 624,399**	$ 533,518
AA	**417,854**	613,511
A	**398,294**	460,003
BBB	**693,513**	648,371
BB and Below	**309,954**	362,024
NR*	**13,638,198**	13,249,826
Total Exposed to Credit Risk	**16,082,212**	15,867,253
US Government Guaranteed**	**1,578,899**	2,189,602
Total Fixed Income and Short-Term Investments	**$ 17,661,111**	$ 18,056,855

* Not Rated securities include $8,794,411 and $8,194,002 in collective trust funds at June 30, 2015 and 2014 respectively.

** Comprised of U.S. government and agency obligations explicitly guaranteed by the U.S. government and not considered to have credit risk.

For derivatives exposed to credit risk, the table below presents aggregate market value by the least favorable credit rating provided by NRSROs at June 30, 2015 and 2014.

	(Dollar Amounts in Thousands)	
	2015	2014
Quality Rating	**Fair Value**	Fair Value
A	**$ (15,821)**	$ 87,881
BBB	**(2,179)**	-
Total Swaps-Total Return	**$ (18,000)**	$ 87,881

(d) Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of a fixed income investment. The System manages its interest rate risk by diversifying the fixed income portfolio and maintaining the fixed income portfolio at a Board-approved effective duration range of the benchmark index.

Duration is a measure of the approximate sensitivity of a bond's value to interest rate changes. The higher the duration, the greater the changes in fair value when interest rates change. For example, a duration of 4.0 would mean that, given a 100-basis point change up/down in rates, a bond's price would move down/up approximately 4.0%. PSERS measures interest rate risk using option-adjusted duration, which recognizes the fact that yield changes may change the expected cash flows due to embedded options.

(e) Foreign Currency Risk

Foreign currency risk is the risk that fluctuations in exchange rates will adversely affect the fair value of an investment. As part of the System's program to manage risk and enhance returns, the System invests in non-U.S. markets. Investment managers in non-U.S. equity and global fixed income may hedge their non-U.S. foreign currency exposure back to U.S. dollars. During FY 2014, the System adopted an 8% total fund-level currency hedge on foreign currency exposure to developed market currencies which include, but are not limited to, the Australian dollar, Swiss franc, Euro, British pound sterling, Hong Kong dollar, and Japanese yen.

(C) Securities Lending

During the year ended June 30, 2015, the System entered into a securities lending program with a third party agent. Under this program, the lending agent loans securities (equities, fixed income and money market instruments) to independent brokers and dealers in exchange for U.S. dollar cash collateral in an amount not less than 102% of the fair value of any securities loaned except for non-U.S. corporations for which 105% of the fair value is required. Collateral is marked-to-market daily. If the fair value of the collateral held falls below the minimum guidelines for securities loaned, additional collateral is obtained. The lending agent invests the cash collateral in accordance with reinvestment guidelines approved by the System.

As of June 30, 2015 and 2014, the System had no credit risk exposure to borrowers because the amounts the System owed the borrowers exceeded the amounts the borrowers owed the System. Under the securities lending program, the lending agent provides indemnification to the System if a borrower fails to return borrowed securities (and the collateral is inadequate to replace the loaned securities) or fails to pay income distributions on them. The lending agent also provides indemnification to the System if investment of cash collateral results in investment loss. There were no losses during the fiscal years ended June 30, 2015 and 2014 resulting from a default of the borrowers or the lending agent.

All securities loans can be terminated on demand by either the System or the borrower, although the average term of the loan is one day. There were no term loans as of June 30, 2015 and 2014.

Notes to Financial Statements (continued)

At June 30, 2015 and 2014, the System's fixed income portfolio had the following option-adjusted durations by fixed income sector:

(Dollar Amounts in Thousands)

Investment Type	2015 Option-Adjusted Duration	2015 Fair Value	2014 Option-Adjusted Duration	2014 Fair Value
Domestic asset-backed and mortgage-backed securities	**1.0**	**$ 1,269,736**	1.3	$ 1,739,734
U.S. government and agency obligations	**6.7**	**1,399,117**	7.6	1,523,266
Domestic corporate and taxable municipal bonds	**2.9**	**1,594,524**	3.3	1,103,634
International fixed income	**5.5**	**822,544**	5.3	1,165,580
Collective trust funds	**3.7**	**8,794,411**	4.1	8,194,002
PSERS Short-Term Investment Fund	**0.1**	**3,410,615**	0.1	3,872,501
Total	3.0*	**$ 17,290,947**	3.3*	$ 17,598,717

* Fixed income investment managers enter into futures contracts to adjust the durations of their portfolios as a whole rather than any particular investment type within the portfolio. In total, the futures contracts have adjusted PSERS' total portfolio duration upward by 0.1 at June 30, 2015 and 2014. The total portfolio option-adjusted duration is calculated by weighting each investment type by fair value.

Cash collateral is invested in a short-term collateral investment pool that is managed by the lending agent, is segregated from all other clients of the lending agent, and is not subject to custodial credit risk. The System's income from securities lending represents its pro-rata share from participating in the program. The weighted-average maturity of the investments in the pool was one day at June 30, 2015 and 2014. During the fiscal years ended June 30, 2015 and 2014, the mismatch between the maturities of the investments made with cash collateral and the maturities of the securities loans may have posed some interest rate risk to the System. In the event of a default, the lending agent may use the collateral to replace the loaned securities.

As of June 30, 2015, the fair value of loaned securities was $1,179,064,000. The fair value of the associated collateral was $1,207,170,000, all of which was cash. As of June 30, 2014, the fair value of loaned securities was $2,305,109,000, which includes $1,722,457,000 of loaned securities which are collateralized by securities and irrevocable letters of credit that are not included in the Statements of Fiduciary Net Position. The fair value of the associated collateral was $2,476,587,000 of which $596,936,000 was cash.

5. Derivative and Other Similar Investments

The System enters into a variety of financial contracts, which include options and futures. The System also enters into foreign exchange positions, such as forward and spot contracts to obtain or hedge foreign currency exposure; swap agreements to gain exposure to certain sectors of the equity and fixed income markets; collateralized mortgage obligations (CMOs); other forward contracts, and U.S. Treasury strips. The System is not a dealer, but an end-user of these instruments. The contracts are used primarily to enhance performance and reduce the volatility of the

At June 30, 2015 and 2014, the System had the following foreign currency exposures for its derivatives (except for foreign exchange contracts which are included in Note 5):

(Dollar Amounts in Thousands)

Currency	2015 Notional Value	2014 Notional Value
Japanese yen	**$ 136,159**	$ 501,484
Euro	**212,058**	144,193
British pound sterling	**140,441**	118,565
Canadian dollar	**45,424**	40,219
Australian dollar	**41,481**	29,941
Hong Kong dollar	**4,056**	1,640
Total Futures Contracts and Total Return Swaps	**$ 579,619**	$ 836,042

Notes to Financial Statements (continued)

Non-U.S. currency exposures at June 30, 2015 and 2014:

2015

(Dollar Amounts in Thousands)

Currency	Equity	Fixed Income	Alternative Investments & Real Estate	Short-Term*	Currency Hedge	Total Fair Value
Euro	$ 1,134,258	$ 106,466	$ 2,163,559	$ 32,433	$ (2,069,019)	**$ 1,367,697**
South Korean won	123,179	37,570	-	241	(5,305)	**155,685**
British pound sterling	1,137,744	35,406	60,984	45,979	(1,154,757)	**125,356**
Taiwan new dollar	107,355	-	-	(2)	(1,188)	**106,165**
South African rand	59,842	40,085	-	262	(1,757)	**98,432**
Mexican new peso	23,208	49,808	-	9,664	75	**82,755**
Indian rupee	69,658	7,933	-	-	-	**77,591**
Brazil real	26,411	65,829	-	952	(18,192)	**75,000**
Hong Kong dollar	237,528	-	-	2,549	(176,248)	**63,829**
Other non-U.S. currencies	2,861,729	277,629	38	77,944	(3,130,990)	**86,350**
Total	**$ 5,780,912**	**$ 620,726**	**$ 2,224,581**	**$ 170,022**	**(6,557,381)**	**$ 2,238,860**

2014

(Dollar Amounts in Thousands)

Currency	Equity	Fixed Income	Alternative Investments & Real Estate	Short-Term*	Currency Hedge	Total Fair Value
Euro	$ 676,095	$ 211,282	$ 2,991,462	$ 50,951	$ (1,941,107)	**$ 1,988,683**
British pound sterling	702,457	54,218	56,465	51,156	49,029	**913,325**
Canadian dollar	270,360	27,266	48	6,681	(87,043)	**217,312**
Japanese yen	629,041	57,363	-	46,142	(535,133)	**197,413**
Australian dollar	213,541	20,878	-	5,992	(60,118)	**180,293**
South Korean won	114,168	43,328	-	542	2,719	**160,757**
Hong Kong dollar	144,030	-	-	1,806	177	**146,013**
Swedish krona	128,351	2,572	-	154	(9,108)	**121,969**
Taiwan new dollar	100,911	-	-	587	(386)	**101,112**
Other non-U.S. currencies	759,979	469,532	-	20,031	(180,847)	**1,068,695**
Total	**$ 3,738,933**	**$ 886,439**	**$ 3,047,975**	**$ 184,042**	**(2,761,817)**	**$ 5,095,572**

* Includes investment receivables and payables

Notes to Financial Statements (continued)

portfolio. The System is exposed to credit risk in the event of non-performance by counterparties to financial instruments. The System generally enters into transactions only with high quality institutions. Legal risk is mitigated through selection of executing brokers and review of all documentation. The System is exposed to market risk, the risk that future changes in market conditions may make an instrument less valuable. Exposure to market risk is managed in accordance with risk limits set by senior management, through buying or selling instruments or entering into offsetting positions.

The notional or contractual amounts of derivatives indicate the extent of the System's involvement in the various types and uses of derivative financial instruments and do not measure the System's exposure to credit or market risks and do not necessarily represent amounts exchanged by the parties. The amounts exchanged are determined by reference to the notional amounts and the other terms of the derivatives.

Futures contracts are contracts in which the buyer agrees to purchase and the seller agrees to make delivery of a specific financial instrument at a predetermined date and price. Gains and losses on futures contracts are settled daily based on a notional (underlying) principal value and do not involve an actual transfer of the specific instrument. Futures contracts are standardized and are traded on exchanges. The exchange assumes the risk that a counterparty will not pay and generally requires margin payments to minimize such risk. In addition, the System enters into short sales, sales of securities it does not presently own, to neutralize the market risk of certain equity positions. Initial margin requirements on futures contracts and collateral for short sales are provided by investment securities pledged as collateral and by cash held by various brokers. Although the System has the right to access individual pledged securities, it must maintain the amount pledged by substituting other securities for those accessed. The value of securities pledged and the amount of cash held at June 30, 2015 and 2014 represent a restriction on the amount of assets available as of year-end for other purposes.

Option contracts provide the option purchaser with the right, but not the obligation, to buy or sell the underlying security at a set price during a period or at a specified date. The option writer is obligated to buy or sell the underlying security if the option purchaser chooses to exercise the option. The System generally uses exchange listed currency, index, stock, and futures options. The System held no option positions at June 30, 2015 and 2014.

Foreign exchange contracts involve an agreement to exchange the currency of one country for the currency of another country at an agreed-upon price and settlement date. To reduce the risk of counterparty non-performance, the investment managers generally enter into these contracts with institutions regarded as meeting high standards of credit worthiness. The contracts reported below primarily include forwards. The $8,302,553,000 of foreign currency contracts outstanding at June 30, 2015 consist of "buy" contracts, which represent the U.S. dollar equivalents of commitments to purchase foreign currencies of $906,950,000 and "sell" contracts, which represent U.S. dollar equivalents of commitments to sell foreign currencies of $7,395,603,000. The $5,644,996,000 of foreign currency contracts outstanding at June 30, 2014 consist of "buy" contracts

The table presented below summarizes the aggregate notional or contractual amounts for the System's derivative financial instruments at June 30, 2015 and 2014.

	(Dollar Amounts in Thousands)	
	2015	2014
Futures contracts - long:		
Treasury futures	**$ 1,835,560**	$ 1,724,904
U.S. equity futures	**1,096,741**	605,732
Non-U.S. equity futures	**488,995**	748,268
Commodity futures	**381,855**	815,786
Non-U.S. bond futures	**128,229**	102,093
Futures contracts - short:		
Treasury futures	**27,541**	105,342
U.S. equity futures	**24,008**	94,272
Commodity futures	-	26,553
Non-U.S. bond futures	-	7,087
Foreign exchange forward and spot contracts, gross	**8,302,553**	5,644,996
Swaps - total return type	**4,224,789**	3,203,881

Notes to Financial Statements (continued)

of $1,465,116,000 and “sell” contracts of $4,179,880,000. The unrealized loss on contracts of $(24,982,000) and $(32,195,000) at June 30, 2015 and 2014, respectively, is included in the Statements of Fiduciary Net Position and represents the fair value of the contracts.

Swap agreements provide for periodic payments at predetermined future dates between parties based on the change in value of underlying securities, indexes, or interest rates. During the year ended June 30, 2015 and 2014, the System entered into total return type swaps. Under the total return type swap arrangements, the System receives the net return of certain equity securities or indexes in exchange for a short-term rate minus a spread or a predetermined fixed charge. The receivable (payable) on the total return type swap contracts of $(18,000,000) and $87,881,000 at June 30, 2015 and 2014, respectively, is included in the Statements of Fiduciary Net Position and represents the fair value of the contracts. The contracts have varying maturity dates ranging from July 6, 2015 to July 5, 2016.

The System also invests in mortgage-backed securities (MBS) such as CMOs and MBS forwards to maximize yields. These securities are sensitive to prepayments of mortgages, which may result from a drop in interest rates. The MBS forwards are subject to credit risk in the event of nonperformance by counterparties. The fair value of CMOs at June 30, 2015 and 2014 is $663,492,000 and $990,794,000, respectively.

The System invests in U.S. Treasury strips which essentially act as zero coupon bonds and are subject to market volatility from a rise or drop in interest rates.

Through certain collective trust funds, the System also indirectly holds various derivative financial instruments. The collective trust funds invest in futures and options thereon; forward foreign currency contracts; options; interest rate, currency, equity, index, and total return swaps; interest-only strips; and CMOs, to enhance the performance and/or reduce the volatility of their portfolios.

The fair values of derivative instruments outstanding at June 30, 2015 and 2014 are classified by type and by the changes in fair value of the derivative instrument in the table below.

(Dollar Amounts in Thousands)

	Change in Fair Value Gain/(Loss) FY 2015		**Fair Value at June 30, 2015**	
Investment Derivative Type	**Classification**	**Amount**	**Classification**	**Amount**
Futures	Investment income	**$ (52,839)**	Receivable/(Payable)	**$ (52,839)**
Total return type swaps	Investment income	**(18,000)**	Receivable/(Payable)	**(18,000)**
Foreign exchange contracts	Investment income	**(24,982)**	Receivable/(Payable)	**(24,982)**
Total		**$ (95,821)**		**$ (95,821)**

	Change in Fair Value Gain/(Loss) FY 2014		Fair Value at June 30, 2014	
Investment Derivative Type	Classification	Amount	Classification	Amount
Futures	Investment income	$ 21,549	Receivable/(Payable)	$ 21,549
Total return type swaps	Investment income	87,881	Receivable/(Payable)	87,881
Foreign exchange contracts	Investment income	(32,195)	Receivable/(Payable)	(32,195)
Total		$ 77,235		$ 77,235

Notes to Financial Statements (continued)

The following table summarizes the System's foreign exchange contracts by currency at June 30, 2015 and 2014:

2015
(Dollar Amounts in Thousands)

Currency	Buys	Unrealized Gain/(Loss)	Sells	Unrealized Gain/(Loss)
Euro	$ 251,588	$ (906)	$ 2,289,025	$ 26,764
British pound sterling	152,820	912	1,307,577	(34,253)
Japanese yen	111,106	425	1,396,701	(23,285)
Australian dollar	109,548	(1,376)	473,944	(2,207)
Canadian dollar	96,932	(1,084)	637,493	2,994
New Zealand dollar	39,460	(1,303)	81,090	4,048
Swedish krona	37,599	(197)	187,052	215
Brazilian real	32,138	245	50,330	(68)
Polish zloty	20,668	(409)	11,252	129
Norwegian krone	12,187	(20)	50,613	666
Romanian leu	6,909	(6)	-	-
Philippine dollar	6,526	(76)	83	-
Swiss franc	5,535	24	483,605	3,211
Russian ruble	5,348	(273)	13,168	727
Singapore dollar	1,358	11	85,102	(549)
South Korean won	44	-	5,349	(15)
Hong Kong dollar	29	-	176,277	(7)
Danish krone	-	-	95,058	1,441
Israeli shekel	-	-	34,999	(567)
Turkish lira	-	-	5,517	(98)
Other non-US currencies	17,155	(84)	11,368	(11)
Total	**$ 906,950**	**$ (4,117)**	**$ 7,395,603**	**$ (20,865)**

2014
(Dollar Amounts in Thousands)

Currency	Buys	Unrealized Gain/(Loss)	Sells	Unrealized Gain/(Loss)
British pound sterling	$ 487,597	$ 3,772	$ 438,568	$ (7,071)
Japanese yen	249,459	750	784,593	(7,534)
Euro	235,252	1,433	2,144,922	(15,155)
Australian dollar	194,925	1,508	255,045	(4,251)
Canadian dollar	128,865	1,836	215,908	(3,933)
New Zealand dollar	32,404	70	54,237	(839)
Swedish krona	28,814	86	25,512	(56)
Norwegian krone	24,614	(417)	17,420	456
Swiss franc	22,514	(2)	214,648	(2,716)
Philippine dollar	14,670	69	1,990	(7)
Brazilian real	8,287	38	10,875	(130)
Polish zloty	5,944	8	5,960	(48)
Malaysian ringgit	5,483	47	2,003	1
Other non-US currencies	26,288	(101)	8,199	(9)
Total	**$ 1,465,116**	**$ 9,097**	**$ 4,179,880**	**$ (41,292)**

Notes to Financial Statements (continued)

6. Net Pension Liability of Participating Employers

The components of the net pension liability of the participating employers at June 30, 2015 were as follows:

(Dollar amounts in thousands)		
Total pension liability	$	94,900,830
Plan fiduciary net position		(51,585,521)
Employer net pension liability	$	43,315,309
Plan fiduciary net position as a percentage of the total pension liability		54.36%

Actuarial Assumptions

The total pension liability as of June 30, 2015 was determined by rolling forward the System's total pension liability as of June 30, 2014 to June 30, 2015 using the following actuarial assumptions, applied to all periods included in the measurement:

- Actuarial cost method - Entry Age Normal - level % of pay
- Investment return - 7.50%, includes inflation at 3.00%
- Salary increases - Effective average of 5.50%, comprised of inflation of 3.00%, real wage growth of 1%, and merit or seniority increases of 1.50%
- Mortality rates were based on the RP-2000 Combined Healthy Annuitant Tables (male and female) with age set back 3 years for both males and females. For disabled annuitants the RP-2000 Combined Disabled Tables (male and female) with age set back 7 years for males and 3 years for females.

Investments

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

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

For the year ended June 30, 2015, the annual money-weighted rate of return on pension plan investments, net of pension plan investment expense, was 3.08%. The money-weighted rate of return expresses investment performance, net of investment expense, adjusted for the changing amounts actually invested. The above was the Board's adopted asset allocation policy and best estimates of geometric real rates of return for each major asset class as of June 30, 2015.

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
Public markets global equity	22.5%	4.8%
Private markets (equity)	15.0%	6.6%
Private real estate	12.0%	4.5%
Global fixed income	7.5%	2.4%
U.S. long treasuries	3.0%	1.4%
TIPS	12.0%	1.1%
High yield bonds	6.0%	3.3%
Cash	3.0%	0.7%
Absolute return	10.0%	4.9%
Risk parity	10.0%	3.7%
MLPs/Infrastructure	5.0%	5.2%
Commodities	8.0%	3.1%
Financing (LIBOR)	(14.0%)	1.1%
	100.0%	

Discount Rate

The discount rate used to measure the total pension liability was 7.50%. The projection of cash flows used to determine the discount rate assumed that contributions from plan members will be made at the current contribution rate and that contributions from employers will be made at contractually required rates, actuarially determined. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of the Net Pension Liability

The following presents the net pension liability, calculated using the discount rate of 7.50%, as well as what the net pension liability would be if it were calculated using a discount rate that is 1-percentage point lower (6.50%) or 1-percentage point higher (8.50%) than the current rate:

(Dollar amounts in thousands)	1% Decrease 6.50%	Current Discount Rate 7.50%	1% Increase 8.50%
Net pension liability	$ 53,390,292	$ 43,315,309	$ 34,847,279

Notes to Financial Statements (continued)

7. Pension Plan for Employees of the System

(A) SERS' Plan Description

The System contributes to SERS, a cost-sharing multiple-employer defined benefit pension plan established by the Commonwealth to provide pension benefits for employees of state government and certain independent agencies. SERS is a component unit of the Commonwealth and is included in the Commonwealth's financial report as a pension trust fund.

Membership in SERS is mandatory for most state employees. SERS provides retirement, death, and disability benefits. Article II of the Commonwealth's constitution assigns the authority to establish and amend the benefit provision of the plan to the General Assembly.

(B) SERS' Benefits Provided to Employees of the System

SERS member retirement benefits are generally determined by taking years of credited service times final average salary times 2% or 2.5%, depending on date of hire. The normal retirement age ranges from 50 - 65, depending on the membership class.

According to the State Employees' Retirement Code (SERC), all obligations of SERS will be assumed by the Commonwealth should SERS terminate.

(C) Contributions to SERS

The contribution requirements of SERS plan members is mandated by Commonwealth statute. The member contribution rate for the majority of SERS' members is 6.25%.

Employer rates are calculated based on SERS full year ended December 31 and applied to the Commonwealth based on its fiscal year end of June 30; therefore, the employer contribution rates, in effect for SERS full year ended December 31, reflect a blended average of calculated rates. As of December 31, 2014 and 2013, the blended contribution rates were 18.29% and 13.82%, respectively. Contributions to SERS from PSERS were $3.6 million for the year ended June 30, 2015.

(D) Proportionate Share of Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources from SERS

At June 30, 2015, PSERS reported a liability of $47.3 million for its proportionate share of the net pension liability for the SERS plan in Accounts payable and accrued expenses on the Statement of Fiduciary Net Position. The net pension liability was measured as of December 31, 2014, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of December 31, 2014. The discount rate for SERS used to measure the total pension liability was 7.50%. PSERS' proportion of the net pension liability was calculated utilizing a projected-contribution method. This methodology applies the most recent calculated contribution rates for Commonwealth fiscal year 2015-2016, from the December 31, 2014 funding valuation, to the expected funding payroll for the allocation of the 2014 amounts, and the contribution rates for fiscal year 2014-2015 from the December 31, 2013 funding valuation to the expected funding payroll for the allocation of the 2013 net pension liability. At December 31, 2014, PSERS' proportion was 0.31817394 percent, which was an increase of 0.00354436 from its proportion measured as of June 30, 2013.

For the year ended June 30, 2015, PSERS recognized pension expense of $5.5 million in Administrative expenses on the Statement of Fiduciary Net Position. At June 30, 2015, PSERS reported $3.9 million of deferred outflows of resources and $.04 million of deferred inflows of resources. Of the $3.9 million of deferred outflows of resources, PSERS recorded $1.9 million for contributions subsequent to the measurement date which will be recognized as a reduction of the net pension liability in the year ended June 30, 2016. The other amounts reported as deferred outflows of resources and deferred inflows of resources will be recognized over a 5 and 5.6 year closed amortization periods, dependent on the type of deferral.

(E) Sensitivity of PSERS' Proportionate Share of the Net Pension Liability from SERS to Changes in the Discount Rate

If SERS' net pension liability were calculated using a discount rate that is 1-percentage point lower (6.50%), PSERS' proportionate share would result in a net pension liability of $60.5 million. If SERS' net pension liability were calculated using a discount rate 1-percentage point higher (8.50%), PSERS' proportionate share would result in a lower net pension liability of $35.9 million.

(F) SERS' Pension Plan Fiduciary Net Position

Detailed information about SERS' fiduciary net position is available in SERS' Comprehensive Annual Financial Report which can be found on SERS' website at www.SERS.pa.gov.

Notes to Financial Statements (continued)

8. Postemployment Healthcare Plan for Employees of the System

The System participates in the Commonwealth's Retired Employees Health Program (REHP). The REHP is a single-employer plan and provides certain healthcare benefits to qualifying individuals meeting specified age and/or service requirements. The Commonwealth's Office of Administration (OA), in its sole discretion, determines available REHP benefits on an ongoing basis. The Pennsylvania Employees Benefit Trust Fund (PEBTF) is a third-party administrator for the REHP under the provisions of an Administration Agreement between OA and PEBTF.

Employer costs for retiree healthcare benefits are charged as a component of payroll expenditures on a 'pay-as-you-go' basis. REHP funding is arranged between OA and the Governor's Budget Office. FY 2015 employer costs were charged at the rate of $334/employee/bi-weekly pay period. Plan members who retired after June 30, 2005 contribute to the plan based on a percentage of their final annual gross base salary at the time of retirement. Plan member contribution rates vary based on their REHP enrollment date.

In September 2014, the Commonwealth released an Actuarial Valuation of its Post-Retirement Medical Plan with calculations made as of July 1, 2014 using census data collected as of December 2013 and health care claims costs for calendar 2013. This valuation provided Other Postemployment Benefits (OPEB) reporting that was used for both FY 2013 and FY 2014. For FY 2014, the valuation indicated overall Annual OPEB Cost (AOC) of $898.3 million with the System's allocated AOC of $4.1 million. Based on the aggregate REHP qualifying contributions for FY 2014, the net OPEB liability for the System was $0.9 million for that fiscal year. For FY 2015, the valuation indicated overall AOC of $1.1 billion with the System's allocated AOC of $5.2 million. Based on the aggregate REHP qualifying contributions for FY 2015, the net OPEB liability for the System was $1.5 million for that fiscal year. The ARC/AOCs and OPEB for fiscal years 2015, 2014, and 2013 are illustrated in the following table:

(Dollar Amounts in Thousands)

Fiscal Year	Commonwealth ARC/AOC	PSERS' ARC/ AOC	PSERS' Net OPEB
2015	$ 1,136,817	$ 5,157	$ 1,547
2014	898,330	4,099	948
2013	869,100	3,966	1,166

9. Litigation and Contingencies

The System is subject to various threatened and pending lawsuits. These lawsuits include issues related to benefit calculations and eligibility. It is the opinion of management that the ultimate liability arising from such threatened and pending litigation will not have a material effect on the financial position of the System. The System is exposed to various other liabilities and risks related to fiduciary responsibilities of directors and officers.

10. Commitments

As of June 30, 2015, PSERS had commitments for the future purchase of investments in alternative investments of $6.5 billion and real estate of $2.6 billion.

11. Subsequent Events

The System has performed an evaluation of subsequent events through September 24, 2015, the date the basic financial statements were available to be issued. No material events were identified by the System.

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Required Supplementary Schedule 1
Schedule of Changes in the Employer Net Pension Liability
(Unaudited – See Accompanying Auditor's Report)
(Dollar Amounts in Thousands)

	2015	2014
Total pension liability		
Service cost	$ 1,926,539	$ 2,139,037
Interest	6,857,497	6,523,484
Changes of benefit terms	-	-
Differences between expected and actual experience	(223,437)	-
Changes of assumptions	-	-
Benefit payments	(6,220,601)	(6,053,505)
Net change in total pension liability	2,339,998	2,609,016
Total pension liability - beginning	92,560,832	89,951,816
Total pension liability - ending (a)	$ 94,900,830	$ 92,560,832
Plan fiduciary net position		
Contributions - employer	$ 2,596,731	$ 1,992,084
Contributions - member	984,634	966,926
Net investment income	1,328,516	7,097,761
Benefit payments	(6,220,601)	(6,053,505)
Administrative expense	(42,331)	(38,712)
Other	-	-
Net Change in plan fiduciary net position	(1,353,051)	3,964,554
Plan fiduciary net position - beginning	52,980,115	49,015,561
Effect of change in accounting principle	(41,543)	-
Plan fiduciary net position - beginning, as restated	52,938,572	-
Plan fiduciary net position - ending (b)	$ 51,585,521	$ 52,980,115
Employer net pension liability - ending (a) - (b)	$ 43,315,309	$ 39,580,717

Required Supplementary Schedule 2
Schedule of Employer Net Pension Liability
(Unaudited – See Accompanying Auditor's Report)
(Dollar Amounts in Thousands)

	2015	2014
Total pension liability	$ 94,900,830	$ 92,560,832
Plan fiduciary net position	(51,585,521)	(52,980,115)
Employer net pension liability	$ 43,315,309	$ 39,580,717
Plan fiduciary net position as a percentage of the total pension liability	54.36%	57.24%
Covered payroll	$ 12,866,473	$ 12,760,785
Employer net pension liability as a percentage of covered payroll	336.65%	310.17%

Required Supplementary Schedule 3
Schedule of Employer Contributions
(Unaudited – See Accompanying Auditor's Report)
(Dollar Amounts in Thousands)

Pension

	2015	2014
Actuarially determined contribution	$ 3,289,615	$ 2,965,715
Contractually required contribution*	2,582,114	1,992,084
Contributions in relation to the actuarially determined contribution*	2,582,114	1,992,084
Contribution deficiency	$ 707,501	$ 973,631
Covered payroll	$ 12,866,473	$ 12,760,785
Contributions as a percentage of covered payroll	20.07%	15.61%

*Amounts for 2015 exclude purchase of service contributions.

Premium Assistance

Year Ended June 30	Annual Required Contributions	Actual Employer Contributions	Percentage Contributed
2015	$ 127,576	$ 115,978	91%
2014	121,260	117,471	97%
2013	113,016	107,993	96%

Required Supplementary Schedule 4
Schedule of Investment Returns
(Unaudited – See Accompanying Auditor's Report)

	2015	2014
Annual money-weighted rate of return, net of investment expense	3.08%	14.98%

Required Supplementary Schedule 5
Schedule of Funding Progress*
(Unaudited – See Accompanying Auditor's Report)
(Dollar Amounts in Millions)

Premium Assistance

Valuation as of June 30	(1) Actuarial Accrued Liabilities (AAL)	(2) Actuarial Value of Assets	(3) Unfunded Actuarial Accrued Liabilities UAAL (1) - (2)	(4) Ratio of Assets to AAL (2) / (1)	(5) Annualized Salaries	(6) UAAL as a Percentage of Covered Payroll (3) / (5)
2014	$ 1,374.1	$ 112.1	$ 1,262.0	8.2%	$ 12,620.9	10.0%
2013	1,385.0	100.3	1,284.7	7.2%	12,577.1	10.2%
2012	1,364.7	93.8	1,270.9	6.9%	12,714.4	10.0%
2011	1,339.4	111.3	1,228.2	8.3%	12,910.0	9.5%

* The amounts reported above in the Schedule of Funding Progress do not include assets or liabilities for the HOP.

Notes to Required Supplementary Information for the Year Ended June 30, 2015

Changes in benefit terms

None

Changes in assumptions

None

Method and assumptions used in calculations of actuarially determined contributions

The actuarially determined contributions are calculated as of the June 30 preceding the fiscal year in which contributions are made. That is, the contribution calculated as of the June 30, 2014 actuarial valuation will be made during the fiscal year ended June 30, 2016. The following actuarial methods and assumptions were used to determine contribution rates reported in that schedule:

- Investment return - 7.50%, includes inflation at 3.00%
- Salary increases - Effective average of 5.50%, which reflects an allowance for inflation of 3.00%, real wage growth of 1%, and merit or seniority increases of 1.50%
- Benefit payments - no postretirement benefit increases assumed in the future
- Multiple decrement tables - mortality, vesting, retirement age, and withdrawal estimates are based upon tables provided by the actuary

10-year reporting requirements

Required Supplementary Schedules 1 - 4, as related to pensions, are intended to show information for 10 years. Additional years will be displayed as they become available.

Supplementary Schedule 1
Schedule of Operating Expenses
Year Ended June 30, 2015
(Dollar Amounts in Thousands)

	Administrative Expenses (1)	Investment Expenses (2)	Total
Personnel costs:			
Salaries and wages	$ 14,758	$ 4,617	**$ 19,375**
Employee benefits	6,842	996	**7,838**
Total personnel costs	21,600	5,613	**27,213**
Operating costs:			
Investment managers' fees	-	432,189	**432,189**
Custodian fees	-	2,383	**2,383**
Specialized services	30,597	886	**31,483**
Rental of real estate, electricity	2,104	236	**2,340**
Consultant and legal fees	1,227	11,446	**12,673**
Treasury and other Commonwealth services	1,528	388	**1,916**
Postage	1,145	-	**1,145**
Contracted maintenance and repair services	1,162	-	**1,162**
Office supplies	155	10	**165**
Rental of equipment and software	3,815	344	**4,159**
Printing	209	-	**209**
Travel and training	139	21	**160**
Telecommunications	365	-	**365**
Equipment (non-capital assets)	367	-	**367**
Miscellaneous expenses	487	1,691	**2,178**
Total operating costs	43,300	449,594	**492,894**
Other charges:			
Pension expense	5,527	-	**5,527**
Depreciation	2,073	-	**2,073**
Total other charges	7,600	-	**7,600**
Total operating expenses	$ 72,500	$ 455,207	**$ 527,707**

(1)Includes administrative expenses of $2,142 related to Postemployment Healthcare Premium Assistance and $28,027 related to Postemployment Healthcare Health Options Program for the fiscal year ended June 30, 2015.

(2)Includes investment expenses of $33 related to Postemployment Healthcare Premium Assistance and $34 related to Health Options Program for the fiscal year ended June 30, 2015 and does not include $6,481 in capitalized broker commissions for the fiscal year ended June 30, 2015.

Supplementary Schedule 2
Summary of Investment Expenses*
Year Ended June 30, 2015
(Dollar Amounts in Thousands)

	Investment Management							
	Base		Performance		Other Expenses		Total	
External management:								
Domestic equity	$	2,097	$	555	$	-	**$**	**2,652**
International equity		18,058		5,752		-		**23,810**
Fixed income		76,505		7,784		-		**84,289**
Real estate		68,955		-		-		**68,955**
Alternative investments		102,190		-		-		**102,190**
Absolute return		83,278		33,958		-		**117,236**
Commodities		7,963		272		-		**8,235**
Master limited partnership		8,502		3,407		-		**11,909**
Risk parity		12,913		-		-		**12,913**
Total external management		380,461		51,728		-		**432,189**
Total internal management		-		-		9,189		**9,189**
Total investment management		380,461		51,728		9,189		**441,378**
Custodian fees		-		-		2,383		**2,383**
Consultant and legal fees		-		-		11,446		**11,446**
Total investment expenses	$	380,461	$	51,728	$	23,018	**$**	**455,207**

* External investment management fees classified on an asset allocation basis

Supplementary Schedule 3
Schedule of Payments to Non-Investment Consultants
Year Ended June 30, 2015
(Dollar Amounts Greater than $100,000)

Consultant	Fees	Services Provided
CoreSource Inc.	$ 20,942,589	Postemployment healthcare benefits administration and claims adjudication
ViTech Systems Group Inc.	5,500,000	Pension administration system services
Rx Solutions, Inc.	5,335,571	Administration of postemployment healthcare benefits and prescription drug plan
The Segal Company, Inc.	2,840,288	Actuarial services and consulting for HOP and prescription drug plan
Buck Consultants LLC	604,766	Pension benefit actuarial services
Independent Pharmaceutical Consultants, Inc.	542,877	Pharmacy benefit consulting services
Healthways, Inc.	317,355	Administration of the Silver Sneakers Fitness Program

Supplementary Schedule 4
Schedule of Employer Contributions
(Unaudited – See Accompanying Auditor's Report)
(Dollar Amounts in Thousands)

Pension

Year Ended June 30	Annual Required Contributions	Actual Employer Contributions*	Percentage Contributed
2015	$ 3,760,827	$ 2,582,114	69%
2014	3,410,373	1,986,384	58%
2013	3,110,429	1,434,815	46%
2012	2,629,244	1,001,140	38%
2011	2,436,602	646,560	27%
2010	1,928,278	527,212	27%

*Amounts exclude purchase of service contributions.

The schedule above and information below is not required by current GASB standards. PSERS is voluntarily providing this information for historical perspective as PSERS transitions to GASB Statement No. 67.

The Board adopted all contribution rates as recommended by the Board's actuary pursuant to the prevailing provisions of the Retirement Code for each year, with the exception of the year ended June 30, 2011. Act 46 required the Board to recertify the employer contribution rate from 8.22% to 5.64%, allocating 5% to the pension component and .64% to the premium assistance component.

Funding Status and Annual Required Contributions (ARC)

As of June 30, 2014, the most recent actuarial valuation, the plan was 62.0% funded. The actuarial accrued liability for pension benefits was $92.4 billion, and the actuarial value of pension assets was $57.2 billion, resulting in an unfunded accrued liability of $35.1 billion. The covered payroll of active members was $12.6 billion and the ratio of the unfunded actuarial accrued liability to the covered payroll was 278.3%.

For fiscal year ended June 30, 2015, the ARC was $3.8 billion. The actual employer contributions, net of purchase of service contributions, for fiscal year ended June 30, 2015 was $2.6 billion resulting in a 69% contributed rate.

The Schedule of Funding Progress and the Schedule of Employer Contributions included as Required Supplementary Information following the notes to the financial statements provide multiyear presentations of funding status and ARC to illustrate their trends over time.

Actuarial Assumptions and Methods

(A) Funding Method

For purposes of determining pension contributions under the PSERS Code, the entry-age normal actuarial cost method is used in determining benefit liabilities and normal cost. Act 120 modified the funding method. The outstanding balance of the unfunded accrued liability as of June 30, 2010 was re-amortized over a 24-year period with amortization payments based on level percentage of pay. Future valuation experience gains or losses, and changes in the unfunded accrued liability resulting from changes in actuarial assumptions and methods, are amortized over a 24-year period as a level percent of pay. Future increases in accrued liability enacted by legislation after June 30, 2010 will be funded over a 10-year period as a level percent of pay.

(B) Asset Valuation Method

For actuarial purposes, Act 120 extended the asset smoothing from five years to ten years. Assets are valued using a ten-year moving market average value that will recognize the actuarial expected investment return immediately and spread the difference between actual and expected investment return beginning with fiscal year ended June 30, 2010 over a period of ten years (the averaging period is being phased-in from fiscal year 2006). Previously, PSERS recognized the actuarial expected return immediately and spread the difference between actual and expected investment return over a period of five years.

(C) Actuarial Assumptions

Significant actuarial assumptions employed by the actuary for funding purposes as of June 30, 2014, the date of the most recent actuarial valuation, include:

- Investment return - 7.50%, includes inflation at 3.00%
- Salary increases - Effective average of 5.50%, which reflects an allowance for inflation of 3.00%, real wage growth of 1%, and merit or seniority increases of 1.50%
- Benefit payments - no postretirement benefit increases assumed in the future
- Multiple decrement tables - mortality, vesting, retirement age, and withdrawal estimates are based upon tables provided by the actuary

The System's actuarial liabilities are calculated separately for retirees and beneficiaries and for active and inactive members. The actuarial present value of benefits to be paid to retirees and beneficiaries currently receiving benefits and deferred survivor beneficiaries, whose benefits have been determined, is calculated using the assumptions noted above. The Annuity Reserve Account with interest credited thereon at an annual rate of 5.50% is compared to the actuarial accrued liability for the remaining lifetimes of the retirees and beneficiaries and any deficiency is then funded by a transfer from the State Accumulation Account.

The actuarial accrued liability for active and inactive members is calculated on the projected benefit basis using the entry-age normal actuarial cost method under which the present value of each member's expected benefit payable at retirement or death is determined. The assets of the Members' Savings Account, State Accumulation Account and the fair value adjustment are subtracted from this present value to arrive at the funded or unfunded actuarial accrued liability.