

Texas Treasury Safekeeping Trust Company

(A Component Unit of the State of Texas)

Basic Financial Statements
August 31, 2018

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RSM US LLP

Independent Auditor's Report

To the Honorable Glenn Hegar
Comptroller of Public Accounts of the State of Texas
Texas Treasury Safekeeping Trust Company

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities and aggregate remaining fund information of the Texas Treasury Safekeeping Trust Company (Texas Trust), a component unit of the State of Texas, as of and for the year ended August 31, 2018 and the related notes to the financial statements, which collectively comprise the Texas Trust's basic financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

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 opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities and the aggregate remaining fund information of Texas Trust, as of August 31, 2018 and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

As described in Note 1 to the financial statements, these financial statements present only the financial statements of Texas Trust and do not purport to, and do not, present fairly the financial position of the State of Texas as of August 31, 2018, and the changes in financial position for the year then ended, in accordance with accounting principles generally accepted in the United States of America. Our opinions are not modified with respect to this matter.

As discussed in Note 8 to the financial statements, effective September 1, 2017, the Texas Trust implemented Governmental Accounting Standards Board Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions (OPEB)*, which restated beginning net position. Our opinion is not modified with respect to this matter.

Other Matter—Required Supplementary Information

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

Other Matter—Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise Texas Trust's basic financial statements. The accompanying supplementary information as listed in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. The supplementary 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. Such 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 supplementary information is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated December 12, 2018, on our consideration of Texas Trust's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Texas Trust's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Texas Trust's internal control over financial reporting and compliance.

RSM US LLP

Austin, Texas
December 12, 2018

Texas Treasury Safekeeping Trust Company

Management's Discussion and Analysis August 31, 2018

This section of the Texas Treasury Safekeeping Trust Company's (Texas Trust) annual financial report presents discussion and analysis of its financial performance during the fiscal year ended August 31, 2018, and should be read in conjunction with Texas Trust's financial statements, which follow this section.

Financial Highlights

- Texas Trust's total managed funds, including pooled funds, exceeded sixty-four (64) billion dollars at August 31, 2018.
- Texas Trust had fees for services in fiscal year 2018 of \$29,549,413 and net non-operating revenues of \$472,670 (interest income less non-operating expenses). Operating expenses were \$30,954,037.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to Texas Trust's financial statements. The financial statements include statements for each of the following funds: Proprietary Fund and Fiduciary Fund.

Proprietary Fund

The proprietary fund financial statements presented herein include the operations of the Texas Trust using the approach as prescribed by the Governmental Accounting Standards Board (GASB) in its publication *Codification of Governmental Accounting and Financial Reporting Standards*. They present the financial statements of the Texas Trust from the economic resources measurement focus using the accrual basis of accounting.

The Texas Trust Enterprise Fund is used to report any activity for which a fee is charged to users for services such as investment management and custodial services. The pricing policies of the activity establish fees and charges designed to recover its costs, including capital costs. The Texas Trust accounts for its daily operations using an enterprise fund. The enterprise fund, which represents Texas Trust's operating funds, is reported as a proprietary component unit of the State of Texas, and as such is accounted for using the flow of economic resources measurement focus and accrual basis of accounting. Accordingly, revenues are recognized when earned and expenses are recognized when the liability is incurred regardless of the timing of the related cash flow, similar to private sector companies.

The following statements are presented as part of the enterprise fund:

- The Statement of Net Position presents information on all of the Texas Trust's assets, deferred outflows of resources, liabilities and deferred inflows of resources, with the difference reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the Texas Trust is improving or deteriorating. Additionally, certain eliminations have occurred in regards to interfund activity, payables and receivables.
- The Statement of Revenues, Expenses and Changes in Net Position presents information showing how the Texas Trust's net position changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the time of related cash flows. Thus, revenues and expenses are reported for some items that will only result in cash flows in future fiscal periods. The business-type activities of Texas Trust include providing investment management and custody services. Management fees charged to customers support these activities.

Texas Treasury Safekeeping Trust Company

Management's Discussion and Analysis

August 31, 2018

- The Statement of Cash Flows – This statement reports the cash receipts and payments of Texas Trust according to whether they stem from operating, noncapital financing, capital and related financing, or investing activities.

Fiduciary Funds

Fiduciary funds are used to account for resources that a government holds as a trustee or agent on behalf of an outside party that cannot be used to support the government's own programs. The Texas Trust performs custodial and investment services for entities in two fund categories for a fee designed on a cost recovery basis. The two fund categories used under fiduciary fund types are:

Investment Trust Funds

Investment Trust Funds are used to report the external portion of investment pools reported by the sponsoring government. The Texas Trust accounts for monies constituting the Texas Local Government Investment Pool and the Texas Local Government Investment Pool Prime in an investment trust fund.

Agency Funds

Agency Funds are used to report resources held by the reporting government in a purely custodial capacity. Agency funds typically involve only the receipt, temporary investment and remittance of fiduciary resources to individuals, private organizations, or other governments. The Texas Trust accounts for monies held for certain state agencies including the Treasury Pool, Tobacco Settlement Permanent Trust Fund, State Water Implementation Fund (SWIFT), Texas Economic Stabilization Investment Fund (TESTIF) and securities held on behalf of their owners or beneficiaries in agency funds. Those agencies contract with the Texas Trust for investment management and custodial services.

Texas Treasury Safekeeping Trust Company

Management's Discussion and Analysis
August 31, 2018

Condensed Financial Information for 2018 and 2017 (in 000's)

	Business-Type Activities	
	2018	2017
Assets:		
Current assets	\$ 74,109	\$ 36,423
Capital assets	1,811	2,068
Noncurrent assets	-	34,599
Total assets	75,920	73,090
Deferred outflow of resources:		
Deferred outflow for ERS pension liability	5,762	6,747
Deferred outflow for ERS OPEB liability	94	-
Total deferred outflows of resources	5,856	6,747
Liabilities:		
Current liabilities	6,475	5,627
Noncurrent liabilities	28,167	21,819
Total liabilities	34,642	27,446
Deferred inflows of resources:		
Deferred inflow for ERS pension liability	285	1,549
Deferred inflow for ERS OPEB liability	715	-
Total deferred inflows of resources	1,000	1,549
Net position:		
Invested in capital assets	1,811	2,068
Unrestricted	44,323	48,774
Total net position	\$ 46,134	\$ 50,842

Texas Treasury Safekeeping Trust Company

Management's Discussion and Analysis August 31, 2018

Condensed Financial Information for 2018 and 2017 (in 000's) (Continued)

	Business-Type Activities	
	2018	2017
Changes in Net Position:		
Charges for service:		
Endowments	\$ 11,235	\$ 11,174
Treasury Pool	9,196	7,636
SWIFT	3,543	3,657
TESTIF	2,259	2,070
Emerging Technology Fund	1,500	1,500
Investment Trust Fund	1,158	1,006
Agencies	658	925
Total charges for service	<u>29,549</u>	<u>27,968</u>
Net nonoperating revenues	<u>473</u>	<u>215</u>
Total revenues	30,022	28,183
Total expenses	<u>30,954</u>	<u>30,343</u>
Change in net position	<u>\$ (932)</u>	<u>\$ (2,160)</u>

Overall Financial Analysis

Business-type activities: The Texas Trust earns a fee based upon the assets under management for each client; consequently, revenue is directly related to the total assets under management by Texas Trust. Average balances under management for Endowments, TESTIF, Treasury Pool and the Investment Trust Funds increased during FY 2018, while average balances for the State Water Implementation Fund for Texas and other state agencies funds decreased in FY 2018. Business-type activities generated revenue of \$29.5 million, an increase of \$1.6 million during FY 2018. Total expenses for business-type activities were \$30.9 million, an increase of \$0.6 million during FY 2018.

The Texas Trust is required to have a fee schedule to maintain operations, being a self-supporting entity. A Capital Reserves Requirement policy exists in order to identify required reserves and other reserves necessary to support operations. This policy is reviewed periodically by executive management. If there are excess reserves at the end of the fiscal year, fees are waived or refunded until the excess is eliminated.

Texas Treasury Safekeeping Trust Company

Management's Discussion and Analysis August 31, 2018

The fee schedule for the various funds managed by the Texas Trust is as follows:

Account	Fees in Basis Points
Charges for service:	
Endowments	30
SWIFT	20
TESTIF	10
Treasury Pool	3
TexPool and TexPool Prime	0.5
Other Agency Funds	Range from 2-6 Basis Points plus certain itemized charges for services

The Texas Trust reports in the Enterprise Fund its proportionate share of net pension liability, deferred outflows of resources, and deferred inflows of resources and related pension expenses of the Employee Retirement System of Texas Plan (ERS Plan). The proportionate share is an actuarial calculation based on ERS records of actual contributions from the Texas Trust as a percentage of total contributions from all other plan participants. Texas Trust's proportionate share of net pension liability at August 31, 2018 is \$24.6 million, an increase of \$3.2 million from August 31, 2017. See Notes to the Financial Statements for additional detail information.

Beginning in fiscal year 2018, the Texas Trust reports in the Enterprise Fund its proportionate share of Other Postemployment Benefits (OPEB) liability, deferred outflows of resources, and deferred inflows of resources and related OPEB expenses of the ERS Plan. The proportionate share is an actuarial calculation based on ERS records of actual contributions from the Texas Trust as a percentage of total contributions from all other plan participants. Texas Trust's proportionate share of OPEB liability at August 31, 2018 is \$3.2 million. See Notes to the Financial Statements for additional information.

Individual Fund Financial Analysis

Investment trust fund: The fund balance includes the Texas Local Government Investment Pool (TexPool) and the Texas Local Government Investment Pool Prime (TexPool Prime) that are operated for the benefit of local governments.

The net position in the fund at August 31, 2018 totals \$22.0 billion and the net increase in fiduciary net position for FY 2018 is \$1.9 billion.

Agency Fund: This fund includes assets held by the Texas Trust on behalf of various agencies and special accounts. The balance of funds held for others at August 31, 2018 is \$42.3 billion. There is no change in fund balance as Texas Trust holds these amounts as custodial assets only.

Capital assets and long-term debt: The Texas Trust's investment in capital assets for its business type activities as of August 31, 2018 amounts to \$1,811,610 (net of accumulated depreciation). This investment in capital assets includes leasehold improvements, furniture, equipment and software.

Texas Trust has no long-term debt and only short-term trade payables.

Texas Treasury Safekeeping Trust Company

Management's Discussion and Analysis
August 31, 2018

Contacting Texas Trust's Financial Management

This financial report is designed to provide Texas Trust customers, business partners and creditors with a general overview of its finances. Questions about this report can be directed to Texas Trust's Finance Department at (512) 463-4300.

Basic Financial Statements

Texas Treasury Safekeeping Trust Company

Statement of Net Position

August 31, 2018

Assets:

Current assets:

Cash and cash equivalents:

Cash in bank	\$ 34,052,432
Cash in State Treasury	1,165,832
Restricted cash in bank	97,026
Investments in repurchase agreements	31,537,320
Restricted investments	347,246

Receivables, net from:

Management fees	5,620,194
Interest	1,952
Other	11,691

Prepaid expenses	1,274,998
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Total current assets	74,108,691
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Noncurrent assets:

Capital assets:

Depreciable:

Software (net)	130,133
Building and building improvements (net)	1,219,131
Furniture and equipment (net)	462,346

Total noncurrent assets	1,811,610
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Total assets	75,920,301
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Deferred outflows of resources:

Deferred outflow for ERS pension liability	5,762,141
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Deferred outflow for ERS OPEB liability	93,787
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Total deferred outflows of resources	5,855,928
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See notes to financial statements

Texas Treasury Safekeeping Trust Company

Statement of Net Position (Continued)

August 31, 2018

Liabilities:

Current liabilities:

Accounts payable	\$ 1,736,634
Payroll payable	4,120,973
Employee's compensable leave	617,378
Total current liabilities	6,474,985

Noncurrent liabilities:

Employees' compensable leave	367,493
Net pension liability	24,564,998
OPEB liability	3,234,380
Total noncurrent liabilities	28,166,871

Total liabilities	34,641,856
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Deferred inflow of resources:

Deferred inflow for ERS pension liability	285,085
Deferred inflow for ERS OPEB liability	715,137
Total deferred inflows of resources	1,000,222

Net position:

Invested in capital assets	1,811,610
Unrestricted	44,322,541
Total net position	\$ 46,134,151

Texas Treasury Safekeeping Trust Company

**Statement of Revenues, Expenses and Changes in Net Position
Year Ended August 31, 2018**

Operating revenue—management fees	\$ 29,549,413
Operating expenses:	
Salaries and wages	10,625,503
Payroll related costs	1,304,249
Pension and other postemployment expense	3,857,655
Professional fees and services	8,115,526
Travel	159,834
Materials and supplies	2,793,631
Communication and utilities	1,438,699
Repairs and maintenance	1,476,730
Rentals and leases	22,383
Printing and reproduction	5,960
Depreciation and amortization	391,476
Other operating expenses	762,391
Total operating expenses	<u>30,954,037</u>
Operating loss	<u>(1,404,624)</u>
Nonoperating revenue (expenses):	
Investment income	480,898
Settlement of claims	(8,228)
Net nonoperating revenues	<u>472,670</u>
Change in net position	(931,954)
Total net position at beginning of year, as previously reported	<u>50,841,574</u>
Restatement required by GASB Statement No. 75 (Note 8)	<u>(3,775,469)</u>
Total net position at beginning of year, as restated	<u>47,066,105</u>
Total net position at end of year	<u>\$ 46,134,151</u>

See notes to financial statements

Texas Treasury Safekeeping Trust Company

Statement of Cash Flows
Year Ended August 31, 2018

Cash flows from operating activities:	
Proceeds from management fees	\$ 29,351,895
Payments to employees	(11,324,526)
Payments for pension and other postemployment benefits	(939,417)
Payments for operating expenses	(14,820,854)
Net cash provided by operating activities	<u>2,267,098</u>
Cash flows from capital and related financing activities:	
Payments for additions to capital assets	(135,162)
Net cash used for capital and related financing activities	<u>(135,162)</u>
Cash flows from investing activities:	
Purchases of investments	(45,577)
Proceeds from interest and investment income	480,221
Net cash provided by investing activities	<u>434,644</u>
Net increase in cash and cash equivalents	2,566,580
Cash and cash equivalents at beginning of year	<u>64,286,030</u>
Cash and cash equivalents at end of year	<u>\$ 66,852,610</u>
Reconciliation of operating loss to net cash provided by operating activities:	
Operating loss	\$ (1,404,624)
Adjustments to reconcile operating loss to net cash provided by operating activities	
Classification differences	(8,228)
Depreciation expense	391,476
Changes in assets/liabilities:	
Receivables	(197,518)
Prepaid expenses	(276,971)
Deferred outflows/inflows	342,281
Benefits payables	2,575,957
Payables	844,725
Net cash provided by operating activities	<u>\$ 2,267,098</u>
Displayed as:	
Cash in bank	\$ 34,052,432
Cash in State Treasury	1,165,832
Restricted cash in bank	97,026
Investments in repurchase agreements	31,537,320
Total cash and cash equivalents	<u>\$ 66,852,610</u>

See notes to financial statements

Texas Treasury Safekeeping Trust Company

**Statement of Fiduciary Net Position—Fiduciary Funds
August 31, 2018**

	Investment Trust Fund	Agency Fund
Assets:		
Cash in State Treasury	\$ -	\$ 1,119,375,657
Cash in bank	20,053	85,704,724
Deposits	-	599,073,500
Investments	22,205,566,013	40,381,791,403
Swaps at fair value	-	163,364
Other asset	-	64,612,272
Accrued interest receivable	13,023,027	36,004,863
	<hr/>	<hr/>
Total assets	\$ 22,218,609,093	\$ 42,286,725,783
	<hr/> <hr/>	<hr/> <hr/>
Liabilities:		
Accounts payable and accrued expenses	\$ 29,484	\$ 4,559,729
Interest payable	-	534
Amounts payable to participants	38,054,424	-
Trades pending settlement	138,772,500	198,090
Futures at fair value	-	2,436,008
Swaps at fair value	-	449,776
Management fees reserved for operating expenses	281,900	-
Obligations under reverse repurchase agreements	-	24,115,546
Funds held for others	-	42,254,966,100
	<hr/>	<hr/>
Total liabilities	\$ 177,138,308	\$ 42,286,725,783
	<hr/> <hr/>	<hr/> <hr/>
Net Position:		
Held in trust for pool participants	<u>\$ 22,041,470,785</u>	

See notes to financial statements

Texas Treasury Safekeeping Trust Company

**Statement of Changes in Fiduciary Net Position—Fiduciary Funds
Year Ended August 31, 2018**

	Investment Trust Fund
<hr/>	
Additions:	
Investment income:	
Interest income	\$ 364,996,930
Expenses:	
Management fees and expenses	<u>(11,011,357)</u>
Net investment income	<u>353,985,573</u>
Deductions:	
Earnings paid to investors from net investment income	(354,036,600)
Net change in management fees reserved for operating expenses	51,027
Net increase in participant investments	<u>1,912,872,879</u>
Net increase in net position	1,912,872,879
Net position at beginning of year	<u>20,128,597,906</u>
Net position at end of year	<u><u>\$22,041,470,785</u></u>

See notes to financial statements

Notes to Financial Statements

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements

August 31, 2018

Note 1. Summary of Significant Accounting Policies

Reporting entity: In 1986, the 69th Texas Legislature authorized the incorporation of the Texas Treasury Safekeeping Trust Company (Texas Trust) to give the Treasurer of the State of Texas access to the Federal Reserve System. The 77th Legislature amended the Texas Trust statute and the Texas Trust began operations as a separate State entity on September 1, 2001. The Comptroller of Public Accounts (Comptroller) is the single shareholder of the Texas Trust and is charged with managing the Texas Trust. Texas Trust is reported as a blended, proprietary component unit of the State of Texas.

The Texas Trust is authorized to manage, disburse, transfer, safekeep and invest funds and securities provided by statute or belonging to state and local entities and gives the Comptroller direct access to services provided by the Federal Reserve System. The enabling legislation also provides for:

- Specifically exempting the Texas Trust from other state laws regulating or limiting state purchasing or a purchasing decision if it is determined the purchase or decision relates to its fiduciary duties.
- The Texas Trust to enter into contracts, trust agreements, or other fiduciary instruments with the Comptroller, the Federal Reserve System, the Depository Trust Company and other third parties.
- The Comptroller appointing an investment advisory board to advise the Comptroller with respect to managing the assets held by the Texas Trust.
- The Comptroller appointing a person to serve as Chief Executive Officer in managing the Texas Trust and carrying out its duties.
- The development of a fee schedule in the amount necessary to recover costs of service and to retain adequate reserves to support the operations of the Texas Trust.

The Texas Trust is exempt from federal income taxation as a governmental entity under Internal Revenue Code Section 115. The accompanying financial statements present the activities and operations of the Texas Trust. The primary business functions provided by the Texas Trust are investment management and custodial services and therefore, the majority of the funds accounted for by the Texas Trust are fiduciary in nature. Separate audited financial statements are available for the Texas Local Government Investment Pool (TexPool), the Texas Local Government Investment Pool Prime (TexPool Prime), the Tobacco Settlement Permanent Trust Fund (Tobacco Trust) and the State Water Implementation Fund for Texas (SWIFT) and may be obtained from the Comptroller's Office by writing:

Texas Comptroller of Public Accounts
Post Office Box 13528
Austin, Texas 78711-3528

Financial statements: The Texas Trust financial statements report information on all of the non-fiduciary activities of the Texas Trust. Separate financial statements are provided for Texas Trust's proprietary fund and fiduciary funds. All capital asset depreciation is reported as a direct expense of the proprietary fund. Operating revenues include charges for services relating to assets under management.

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2018

Note 1. Summary of Significant Accounting Policies (Continued)

Measurement focus, basis of accounting and financial statement presentation: The Texas Trust financial statements include financial statements for each of the following fund classifications: a proprietary fund and fiduciary funds consisting of an investment trust fund and multiple agency funds. The proprietary and investment trust funds are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. The agency funds have no measurement focus but utilize the accrual basis of accounting for reporting its assets and liabilities.

The Texas Trust accounts for its daily operations using an enterprise fund. Operating revenues result from exchange transactions associated with the principal activity of the fund. Exchange transactions are those in which each party receives and gives up essentially equal values. Nonoperating revenues, such as investment earnings, result from nonexchange transactions or ancillary activities. Operating expenses include the cost of services, administrative expenses and depreciation of capital assets.

The Texas Trust reports the following fiduciary funds.

Investment Trust Fund: Investment trust funds are used to report the external portion of investment pools reported by the sponsoring government. The Texas Trust accounts for monies constituting TexPool and TexPool Prime in an investment trust fund.

Agency Fund: Agency funds are used to report resources held by the reporting government in a purely custodial capacity. Agency funds typically involve only the receipt, temporary investment and remittance of fiduciary resources to individuals, private organizations or other governments. The Texas Trust accounts for monies for individual state agencies contracting with the Texas Trust for investment management and custodial services in agency funds.

Cash and cash equivalents: For purposes of the statement of cash flows, demand deposits and short-term highly liquid investments in the business type activities with an original maturity of three months or less are considered cash equivalents. For purposes of the statement of net position presentation, investments in repurchase agreements and cash in state treasury and cash with the Federal Reserve are included in cash and cash equivalents.

Restricted cash and cash equivalents: The Texas Trust maintains an account with the Depository Trust Company (DTC). In accordance with the agreement between DTC and the Texas Trust, \$97,026 in cash was held at DTC as of August 31, 2018, in order to maintain the account.

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2018

Note 1. Summary of Significant Accounting Policies (Continued)

Deposits and investments: Fair value is the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. Investments, other than money market instruments are reported at fair value based upon quoted market prices, or when quoted market prices are not readily determinable, other observable significant inputs including, but not limited to, quoted prices for similar securities, interest rates, net asset values of underlying securities and fixed income pricing models. Money market instruments and repurchase agreements are reported at amortized cost.

The Texas Trust manages the fiduciary funds and enterprise fund investments in accordance with the Comptroller's Investment Policy and Government Code Section 404.024. The portfolio of investments may include:

1. Direct security repurchase agreements;
2. Reverse security repurchase agreements;
3. Obligations of the United States or its agencies and instrumentalities, other than mortgage-backed securities interest only and principal only strips;
4. Bankers' acceptances that:
 - a. do not exceed 270 days to maturity; and
 - b. are issued by a bank that has received the highest short-term credit rating by a nationally recognized investment rating firm;
5. Commercial paper that:
 - a. does not exceed 270 days to maturity; and
 - b. except as provided by Subsection (i) of Government Code Section 404.024, has received the highest short-term credit rating by a nationally recognized investment rating firm;
6. Contracts written by the treasury in which the treasury grants the purchaser the right to purchase securities in the treasury's marketable securities portfolio at a specified price over a specified period and for which the treasury is paid a fee and specifically prohibits naked-option or uncovered option trading;
7. Direct obligations of or obligations guaranteed by the Inter-American Development Bank, the International Bank for Reconstruction and Development (the World Bank), the African Development Bank, the Asian Development Bank and the International Finance Corporation that have received the highest credit rating by a nationally recognized investment rating firm (collectively referred to herein as Supranationals);
8. Bonds issued, assumed, or guaranteed by the State of Israel;

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2018

Note 1. Summary of Significant Accounting Policies (Continued)

9. Obligations of a state or an agency, county, city, or other political subdivision of a state that have received at least a single A rating or its equivalent by a nationally recognized investment rating firm as provided for by Government Code Section 404.024, Subsection (i);
10. Mutual funds secured by obligations that are described by Subdivisions (1) through (6);
11. Foreign currency for the sole purpose of facilitating investment by state agencies that have the authority to invest in foreign securities; and
12. Such other investments as may be authorized by Government Code Section 404.024.

Fiduciary funds are managed in accordance with the respective entities' investment policies and governing statutes.

Security transactions are recorded on a trade date basis.

In connection with transactions in repurchase agreements, it is the Texas Trust's policy to hold the underlying collateral securities in their account at the Federal Reserve Bank of Dallas, San Antonio branch, in the name of the Texas Trust. The fair value of the underlying collateral securities exceeds the principal amount of the repurchase transaction, including accrued interest, at all times. Where tri-party agreements have been executed, the Texas Trust may enter into repurchase agreements whereby a third party custodian holds the collateral in a segregated account in Texas Trust's name. As of August 31, 2018, the Texas Trust had no tri-party agreements outstanding. If the seller defaults, and the fair value of the collateral declines, realization of the collateral held by the Texas Trust may be delayed or limited. Repurchase agreements may be entered into only with State or National banks doing business in Texas or with primary dealers approved by the Federal Reserve System.

Government Code Section 404.024 provides for the use of reverse repurchase agreements by the Comptroller. In connection with transactions in reverse repurchase agreements (reverse), it is the Texas Trust's policy, consistent with Government Code Section 404.024, to match the maturity of the reverse with the maturity of securities purchased with the proceeds from the reverse. Further, proceeds from reverses are used to purchase securities. At August 31, 2018, the Agency Fund had \$24,115,546 in reverse repurchase agreements.

In accordance with Government Code Section 404.021 and the State Depository Handbook, the Texas Trust may deposit state funds with approved national and state banks, savings and loan associations and credit unions doing business in Texas through a main office or one or more branches. Any entity where total deposits are in excess of \$237,500 requires acceptable collateral in an amount not less than 105% of the total deposit balance held in the Texas Trust's account at the Federal Reserve. Collateralization of 125% is required for any securities pledged that have a declining principal balance.

Receivables and payables: All trade receivables are shown net of an allowance for uncollectible amounts. The allowance as of August 31, 2018, was \$3,440. The liabilities are for the value of assets or services received at or before year-end for which payment was not made as of year-end.

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2018

Note 1. Summary of Significant Accounting Policies (Continued)

Capital assets: Assets with an initial, individual cost of more than \$5,000 and an estimated useful life in excess of one year are capitalized. Assets are capitalized at cost when acquired. Donated assets are reported at acquisition value on the acquisition date. All capital assets are depreciated using the straight-line method over the following estimated useful lives:

Asset Class	Estimated Useful Lives
Software	3 years
Office equipment	5 years
Computer equipment	5 years
Building improvements	10 years

Compensable leave: A state employee is entitled to be paid for all unused vacation time accrued, in the event of the employee's resignation, dismissal or separation from state employment, provided the employee has had continuous employment with the state for six months. Therefore, the liability for unused vacation time has been recorded. No liability is recorded for non-vesting accumulating rights to receive sick pay benefits.

Common stock: One share of common stock issued and outstanding at August 31, 2018, is held by the Comptroller with a par value of \$1,000,000. This amount is reflected in the Statement of Net Position within the unrestricted net position balance.

Use of estimates: The preparation of the Texas Trust financial statements, in conformity with accounting principles generally accepted in the United States of America, requires management to make estimates and assumptions that affect the financial statements and related notes. Actual results could differ from those estimates.

Risk management: The Texas Trust provides investment management and custodial services. Investments are managed for other State agencies in accordance with their applicable investment guidelines. Although every effort is made to preserve principal, the Texas Trust does not provide any guarantee or insurance against loss.

Pensions: The fiduciary net position of the Employees Retirement System of Texas Plan (ERS) has been determined using the flow of economic resources measurement focus and the accrual basis of accounting. This includes the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, pension expense and information about assets, liabilities and additions to/deductions from ERS's fiduciary net position. Benefit payments by ERS (including refunds of employee contributions) are recognized when due and payable in accordance with the terms of the plan. Investments of ERS are reported at fair value.

Other Post-Employment Benefits: The fiduciary net position of the ERS has been determined using the flow of economic resources measurement focus and the accrual basis of accounting. This includes the net OPEB liability, deferred outflows of resources and deferred inflows of resources related to OPEB, OPEB expense and information about assets, liabilities and additions to/deductions from ERS's fiduciary net position. Benefit payments by ERS are recognized when due and payable in accordance with the terms of the plan. Investments of ERS are reported at fair value.

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2018

Note 2. Deposits and Investments

Deposits: Cash deposits are made in state or national banks, savings and loan associations, or credit unions doing business in Texas through a main office or one or more branches. Single direct placements of deposits less than Deposit Insurance levels made with any qualifying institution are fully insured by the Federal Deposit Insurance Corporation (FDIC) or the National Credit Union Share Insurance Fund (NCUSIF). Deposits made in any single financial institution, which are in excess of its Deposit Insurance levels, may be made only if fully collateralized in accordance with the State Depository Handbook. Collateral is held by a qualifying institution. Cash in State Treasury is not considered a deposit with a financial institution for Texas Trust reporting purposes since the State Treasury is not a bank.

Securities pledged as collateral on August 31, 2018, were categorized under the Political Subdivision Securities or U.S. Government Securities as U.S. Treasury Bills or U.S. Treasury Notes and Bonds.

All bank balances were either insured or collateralized with securities held by the Texas Trust.

Bank balance	<u><u>\$ 719,750,209</u></u>
Carrying amount	<u><u>\$ 718,947,735</u></u>
Proprietary cash at bank	\$ 34,052,432
Proprietary Funds restricted cash at bank	97,026
Investment Trust Fund cash at bank	20,053
Agency Fund cash at bank	85,704,724
Agency Funds deposits	<u>599,073,500</u>
Total deposits carrying amount	<u><u>\$ 718,947,735</u></u>

Investment risks addressed by Texas Trust's investment policy, including custodial credit risk, credit risk, interest rate risk, concentration risk and foreign currency risk are disclosed below by investment type, if applicable.

Investments—custodial credit risk: For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Texas Trust would not be able to recover the loss of its investments or collateral securities that are in possession of an outside entity. Investment securities are exposed to custodial credit risk if the securities are uninsured, are not held in the name of the Texas Trust and are held by the counterparty, its trust or agent but not in the name of the Texas Trust. The Texas Trust's investments are not exposed to custodial credit risk since they are insured or registered or the securities are held by the Texas Trust or its agent in the Texas Trust's name.

The Texas Trust categorizes its fair value measurement disclosures within the fair value hierarchy established by generally accepted accounting principles. The hierarchy prioritizes valuation inputs used to measure the fair value of the asset or liability in three broad categories. Levels 1, 2 and 3 (lowest priority level) of the fair value hierarchy are defined as follows.

Level 1: Inputs using unadjusted quoted prices in active markets or exchanges for identical assets or liabilities.

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2018

Note 2. Deposits and Investments (Continued)

Level 2: Significant other observable inputs, which may include, quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in nonactive markets; and inputs other than quoted prices that are observable for the assets or liabilities, either directly or indirectly.

Level 3: Valuations for which one or more significant inputs are unobservable and may include situations where there is minimal, if any, market activity for the asset or liability.

If the fair value is measured using inputs from different levels in the fair value hierarchy, the measurement is categorized based on the lowest priority level input that is significant to the valuation. The Texas Trust's assessment of significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the investment. Investments measured at fair value using NAV per share (or equivalent) as a practical expedient to fair value are not classified in the fair value hierarchy.

Business Type Activities: Investments for the Enterprise Fund, as of August 31, 2018, are as follows:

Investments by Fair Value Level	Fair Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Equity securities	\$ 347,246	\$ -	\$ 347,246	\$ -
Total investments at fair value	\$ 347,246	\$ -	\$ 347,246	\$ -
Investments measured at amortized cost:	Carrying Value			
Repurchase agreements	\$ 31,537,320			
Total investments at amortized cost	\$ 31,537,320			
Total investments	\$ 31,884,566			

Equity securities classified as Level 2 of the fair value hierarchy are valued using other observable significant inputs including but not limited to quoted prices for similar securities.

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligation. Pursuant to Government Code section 404.024 (a) and (b), treasury funds may be invested in fully collateralized repurchase agreements secured by obligations of the U.S., its agencies, or Government Sponsored Enterprises (GSEs), or cash. The Enterprise Fund invests in the Repurchase Agreement Pool which the Texas Trust administers. The underlying securities in the various repurchase agreement pools are rated AA+ by Standard & Poor's and Aaa by Moody's.

Concentration of credit risk is the risk of loss attributable to the magnitude of the investment in a single issuer. The Enterprise Fund's investments are not exposed to concentration risk as of August 31, 2018.

Interest rate is the risk that changes in interest rates will adversely affect the fair value of an investment. The maximum maturity of direct repurchase agreements will not exceed 180 days. All Texas Trust repurchase agreement pools are in overnight repurchase agreements as of August 31, 2018. The weighted average maturity of the repurchase agreement pools are 4 days.

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2018

Note 2. Deposits and Investments (Continued)

TexPool and TexPool Prime Investment Trust Fund: Investments for TexPool and TexPool Prime, as of August 31, 2018, are as follows:

Investments by Fair Value Level	Principal Value	Carrying Value	Fair Value	Fair Value Measurements Using		
				Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Debt securities:						
Repurchase agreements	\$ 5,675,281,886	\$ 5,675,281,886	\$ 5,675,281,886	\$ -	\$ 5,675,281,886	\$ -
Commercial paper	3,087,290,000	3,081,573,703	3,082,396,790	-	3,082,396,790	-
United States government treasuries	1,960,000,000	1,950,450,244	1,950,726,899	-	1,950,726,899	-
United States government agencies	10,143,650,000	10,134,047,077	10,134,123,105	-	10,134,123,105	-
Money market mutual funds	1,364,165,108	1,364,213,103	1,364,165,108	1,364,165,108	-	-
Total investments	\$ 22,230,386,994	\$ 22,205,566,013	\$ 22,206,693,788	\$ 1,364,165,108	\$ 20,842,528,680	\$ -

Debt securities classified as Level 2 of the fair value hierarchy are valued using other observable significant inputs including, but not limited to, quoted prices for similar securities, interest rates, and a fixed-income pricing model. Money market mutual funds classified as Level 1 of the fair value hierarchy are valued using a published net asset value per share of \$1.

The following table provides additional information about TexPool's portfolio:

	August 31, 2018	
	Ranges of	
	Interest Rates	Maturity Dates
Securities purchased under agreement to resell	1.950% to 1.970%	09/04/2018 - 09/05/2018
United States government agency securities	0.000% to 2.213%	09/04/2018 - 03/05/2019
United States treasuries	0.010% to 2.124%	09/06/2018 - 02/07/2019
Money market mutual funds	1.850% to 1.855%	09/03/2018 - 09/04/2018

The following table provides additional information about TexPool Prime's portfolio:

	Ranges of	
	Interest Rates	Maturity Dates
	Securities purchased under agreement to resell	1.95% to 1.97%
Commercial paper	0.00% to 2.54%	09/03/2018 - 04/26/2019
United States government agency securities	0.00% to 0.00%	09/24/2018
United States treasuries	0.01% to 0.01%	09/20/2018 - 12/20/2018
Money market mutual funds	1.85% to 2.09%	09/04/2018

Credit risk: TexPool and TexPool Prime portfolios are designed and managed to ensure that they maintain an AAAM rating (or the equivalent) by a nationally recognized statistical rating organization (NRSRO). As of August 31, 2018, TexPool and TexPool Prime's investments in United States government securities, commercial paper and the underlying securities of the Repurchase Agreements were A-1 by Standard and Poor's, P-1 by Moody's and F-1 by Fitch. Money market mutual funds were rated AAA by Standard and Poor's, A by Moody's and AAA by Fitch ratings as of August 31, 2018.

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2018

Note 2. Deposits and Investments (Continued)

Concentration of credit risk: Concentration of credit risk is the risk of loss attributable to the magnitude of the investment in a single issuer. TexPool's investment policy has no limit on the amount it may invest in any single Governmental Sponsored Enterprise (GSE). As of August 31, 2018, TexPool had more than 5.0% of the pool's investments in the following GSEs: 40.2% with the Federal Home Loan Bank, 11.4% with the Federal Farm Credit Bank and 5.8% with the Federal Home Loan Mortgage Corporation. TexPool Prime's investment policy limits commercial paper investments to less than 25% in a single industry or business sector, provided that this limitation does not apply to securities issued or guaranteed by companies in the financial services industry. No more than 5.0% of TexPool Prime assets at the time of purchase may be invested in a single corporate entity. As of August 31, 2018, commercial paper investments per issuer and government agencies were less than 5.0% of the pool's investments.

Interest rate risk: The weighted average maturity of the portfolio is limited to 60 days calculated using the reset date for variable rate notes (VRNs) and 90 days or fewer using the final maturity date for VRNs, with the maximum maturity for any individual security in the portfolio not exceeding 397 days for fixed rate securities and 24 months for VRNs. The following schedule reflects the weighted average maturity by investment type and as a whole:

Investment Type	Weighted Average Maturity (Days)	
	TexPool	TexPool Prime
Repurchase agreements	4	4
Commercial paper	-	36
Money market mutual funds	4	4
United States government agency securities	31	24
United States government treasury securities	91	47
Weighted average maturity	28	27

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2018

Note 2. Deposits and Investments (Continued)

Treasury Pool: Investments for the Treasury Pool, an agency fund, as of August 31, 2018, are as follows:

Investments by Fair Value Level	Carrying Value	Fair Value	Fair Value Measurements Using		
			Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Debt securities:					
United States government agencies	\$ 1,195,133,000	\$ 1,195,133,000	\$ -	\$ 1,195,133,000	\$ -
United States government treasuries	4,917,667,803	4,918,096,500	-	4,918,096,500	-
Treasury Inflation-Protected Securities	313,543,534	313,543,534	-	313,543,534	-
Agency commercial backed securities	255,389,702	255,389,702	-	255,389,702	-
Government mortgage-backed securities	1,899,214,208	1,899,214,208	-	1,899,214,208	-
Commercial paper	9,787,311,437	9,787,311,437	-	9,787,311,437	-
Supranational	2,501,031,100	2,501,031,100	-	2,501,031,100	-
Corporate obligations	1,854,591,607	1,854,591,607	-	1,854,591,607	-
Asset backed securities	2,903,029,309	2,903,029,309	-	2,903,029,309	-
Small business administration	18,882,489	18,882,489	-	18,882,489	-
Stock in Texas Trust	1,000,000	1,000,000	-	-	1,000,000
Money market mutual funds	1,614,000,000	1,614,000,000	1,614,000,000	-	-
United States government agencies—Refco	309,311,204	309,311,204	-	309,311,204	-
United States government agencies—Lottery Treasury Strips	203,372,282	203,372,282	-	203,372,282	-
Total investments at fair value	<u>\$ 27,773,477,675</u>	<u>\$ 27,773,906,372</u>	<u>\$ 1,614,000,000</u>	<u>\$ 26,158,906,372</u>	<u>\$ 1,000,000</u>
Investments Measured at amortized cost:					
Repurchase agreements	<u>\$ 2,375,000,000</u>				
Total investments at amortized cost	<u>\$ 2,375,000,000</u>				
Total investments	<u>\$ 30,148,477,675</u>				

Debt securities classified as Level 2 of the fair value hierarchy are valued using other observable significant inputs including but not limited to quoted prices for similar securities, interest rates, and fixed income pricing models. Stock classified as Level 3 of the fair value hierarchy is valued using a market comparable companies technique. There was no change in the Level 3 stock in Texas Trust between 2017 and 2018. Money market funds are valued based upon their published NAV.

Credit risk: The risk that an issuer or other counterparty to an investment will not fulfill its obligation. Pursuant to Government Code section 404.024(a) and (b), treasury funds may be invested in fully collateralized repurchase agreements secured by obligations of the U.S., its agencies, or Government Sponsored Enterprises (GSEs), including mortgage-backed securities of such agencies and GSEs, as set out in section 404.001 of the Government Code. The Comptroller may purchase direct obligations of or obligations, the principal and interest of which are guaranteed by the U.S.; and direct obligations of, or obligations guaranteed by U.S. agencies or GSEs. Mortgage-backed securities are eligible for purchase except those specifically prohibited by section 404.024 (e) of the Government Code. Treasury funds may invest in commercial paper that has received the highest short-term credit rating by a nationally recognized investment rating organization or "NRSRO." "Highest short-term credit rating" includes at least one of the following short-term credit ratings, Moody's (P-1), Standard & Poor's (A-1), or Fitch, Inc. (F-1).

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2018

Note 2. Deposits and Investments (Continued)

Money market funds must be rated AAAM by a NRSRO. The asset backed securities that are not rated, are issued by Government Sponsored Enterprises that are rated AA+. The mutual fund that is not rated by Standard & Poor's is rated Aaa by Moody's. The Treasury portfolio is rated AAAs by Standard & Poor's.

The following table lists Standard & Poor's credit rating by investment type at fair value for the Treasury Pool securities that are subject to credit risk.

Investment Type	AAA	AA	A	A-1	Not Rated
U.S. government agencies	\$ -	\$ 1,195,133,000	\$ -	\$ -	\$ -
Agency commercial backed securities	12,933,450	242,456,252	-	-	-
Government mortgage-backed securities	-	1,899,214,208	-	-	-
Commercial paper	-	-	-	9,787,311,437	-
Corporate obligations	340,453,980	1,315,437,440	198,700,187	-	-
Asset-backed securities	2,786,215,932	-	-	-	116,813,377
Supranational	2,441,172,500	-	59,858,600	-	-
Mutual funds (2A 7-Like)	1,009,000,000	-	-	-	605,000,000

Concentration of credit risk: The Comptroller places no limit on the amount the Treasury Pool may invest in any one issuer. More than 5.0% of the Treasury Pool investments are with the International Bank for Reconstruction. These investments are 8.1% of the Treasury Pool at August 31, 2018.

Interest rate risk: In accordance with its investment policy, the Treasury Pool manages its exposure to interest rate risk by maintaining an overall weighted-average maturity of no more than two (2) years. The following schedule reflects the average modified duration (a measure of the price sensitivity of a bond to interest rate movements) of the Treasury Pool by investment type and as a whole:

Investment Type	Modified Duration (Years)
United States government agencies	3.732
United States government treasuries	0.639
Government mortgaged-backed securities	3.504
Commercial paper	0.247
Corporate obligations	1.235
Asset-backed securities	1.249
Repurchase agreements	0.011
Small Business Administration	13.726
Supranational	1.780
Treasury inflation protected securities	4.408
Agency commercial backed securities	1.371
U.S. government agencies—REFCO	3.526
U.S. government agencies—Lottery treasury strips	7.707
Treasury portfolio modified duration	1.023

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2018

Note 2. Deposits and Investments (Continued)

Reverse repurchase agreements: The Treasury Pool may enter into reverse repurchase agreements for up to 35% of the pool's assets. The Treasury Pool's aggregate amount of reverse repurchase agreement obligations at August 31, 2018, was \$24,116,080 including accrued interest. The aggregate fair value of the securities underlying those agreements, including accrued interest, was \$24,194,548. There was no credit exposure at year-end.

Endowment Funds: Investments for the Endowment Funds, an agency fund, as of August 31, 2018, are as follows:

Investments by Fair Value Level	Carrying Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Money market mutual funds	\$ 322,355,701	\$ 322,355,701	\$ -	\$ -
Mutual Funds—Global Fixed Income	10,261,750	10,261,750	-	-
Mutual Funds—Global Equities	275,927,420	275,927,420	-	-
Total investments at fair value	<u>\$ 608,544,871</u>	<u>\$ 608,544,871</u>	<u>\$ -</u>	<u>\$ -</u>

Investments Measured at NAV	Carrying Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Hedge funds—fund of funds	\$ 136,330,865	N/A	Daily, Monthly, Quarterly, Annually	1-95 days
Hedge funds—direct funds—fixed income	702,439,735	N/A	Daily, Monthly, Quarterly, Annually	2-92 days
Hedge funds—direct funds—equities	1,211,337,907	N/A	Daily, Monthly, Quarterly, Semi-Annually	1-120 days
Hedge funds—direct funds—all asset strategies	36,604,914	N/A	Annually	45 days
Hedge funds—direct funds—real assets	43,414,148	N/A	Monthly	30 days
Domestic alternative—private debt	435,746,665	\$ 248,173,463	N/A	N/A
Domestic alternative—private equity	377,180,653	328,455,065	N/A	N/A
Domestic alternative—real assets	504,116,000	350,118,409	N/A	N/A
International alternative—private debt	64,073	891,455	N/A	N/A
International alternative—private equity	42,363,955	15,405,419	N/A	N/A
International alternative—real assets	26,103,878	13,200,748	N/A	N/A
Total investments at NAV	<u>\$ 3,515,702,793</u>	<u>\$ 956,244,559</u>		
Total investments	<u>\$ 4,124,247,664</u>			

Mutual funds are valued daily or monthly, as appropriate, at a published NAV per share. Hedge Funds are valued monthly at NAV using the current monthly account statements from the funds. If a current monthly account statement is unavailable, the value is calculated by the custodian using the estimated monthly return from the fund. Once a statement is received, the value is adjusted to reflect the NAV from the statement adjusted for cash flows that occur after the statement date. Domestic and international alternative investments are valued monthly at NAV using the latest account statements from the funds. NAV is adjusted for cash flows that occur after the date of the statements through the month-end date.

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2018

Note 2. Deposits and Investments (Continued)

Fixed income strategies are expected to generate relatively consistent positive returns with lower correlation to the public equity markets. Strategies selected are intended to provide positive returns during most economic and capital market environments.

Equity strategies include public and private equities and asset classes that are correlated to global equity markets. Historically, global equity investments have provided returns in excess of the total fund return objective. The equity portfolio consists of traditional long-only, hedged and private strategies whose portfolios are predominantly invested in the equity of corporations.

Real asset strategies are intended to serve primarily as inflation hedges and provide diversification benefits of low correlation with other investment strategies. A significant majority of the portfolio is exposed to real assets such as high quality real estate, timber, infrastructure assets, industrial and precious metals, energy, livestock and grains.

All asset strategies include exposures across equity, fixed income and real asset classes. The all asset portfolio may consist of long-only, hedged and private strategies whose portfolios are diversified across a broad range of asset types.

Credit risk: Corporate obligations must be rated investment grade by at least one NRSRO and not rated below investment grade by any NRSRO. Short-term securities must be rated in the highest rating category by an NRSRO. The average quality rating of the high-yield fixed income portfolio shall be B1/B+ or higher. All high-yield securities when purchased must be rated at least CCC. The following schedule lists Standard & Poor's credit rating by investment type for the Endowment Fund securities that are subject to credit risk. The high-yield securities not rated by Standard & Poor's are rated Ba or B by Moody's.

Standard & Poor's Credit Ratings	Mutual Funds— Global Fixed Income	Money Market Funds
AAA	\$ -	\$ 322,355,701
Not rated	275,927,420	-
Total	<u>\$ 275,927,420</u>	<u>\$ 322,355,701</u>

Concentration risk: Excluding securities issued or guaranteed by the U.S. Government, its agencies, instrumentalities, and GSEs, no more than 5% of the portfolio at the time of purchase, shall be invested in securities of one issuer. As of August 31, 2018, no more than 5% of the portfolio was invested in securities of one issuer.

Texas Treasury Safekeeping Trust Company

**Notes to Financial Statements
August 31, 2018**

Note 2. Deposits and Investments (Continued)

Interest rate risk: The endowment funds do not have a formal investment policy that limits investment maturities. The following schedule reflects the average effective duration of the endowment funds by investment type. The investments in the short-term investment fund use a weighted average maturity to reflect the interest rate risk.

Investment Type	Effective Duration (Years)
Mutual funds—global fixed income	2.30
	Weighted- Average Maturity
Money market mutual fund	21 days

Foreign currency risk: The endowment funds do not have a formal investment policy that limits foreign currencies. The endowment funds exposure to foreign currency risk derives from its position in foreign currency-denominated investment in alternative investments.

Currency	Cash	International Alternative Investments	Total
Euros	\$ 732,976	\$ 68,531,906	\$ 69,264,882

Derivatives: Derivatives are financial instruments whose value is derived, in whole or part, from the value of any one of more underlying securities or assets, or index of securities or assets, such as stocks, bonds, commodities or currencies. The Endowment funds use derivatives as part of the hedging and overlays program. The objective of the program is to facilitate risk management and provide efficiency in the implementation of various investment strategies. Permitted applications of the portfolio hedging and overlays program are: to implement strategies in a low cost and efficient manner; to hedge and control risks; to alter the Endowment funds' market (systemic) exposure without trading the underlying cash market securities and; to construct portfolios with risk and return characteristics that could not be created with cash market securities or to facilitate transition trading.

Through the use of derivatives, the risks that are bound together in traditional cash market investments can be separated and managed independently. The primary intent of the Endowment Fund's investment in derivative instruments is to manage and implement investment strategies more effectively and at a lower cost than would be possible in the cash market. All of the Endowment funds' derivative instruments are considered investment derivatives and therefore are measured and reported at fair value.

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2018

Note 2. Deposits and Investments (Continued)

The fair value, changes in fair value, and notional value of the Endowment funds derivatives investments, classified by derivative type, are displayed in the following table as of August 31, 2018.

	Fair Value	Changes in Fair Value	Notional Value
Futures			
Commodities futures	\$ (2,436,008)	\$ (845,876)	\$ 109,300,740
Equity index futures	-	3,439,250	-
Total futures	\$ (2,436,008)	\$ 2,593,374	\$ 109,300,740
Swaps			
Total Return Swap - Fixed Income	\$ 163,364	\$ 195,623	\$ 75,840,967
Total Return Swap - Equity	(449,776)	2,675,466	153,414,040
Total swaps	\$ (286,412)	\$ 2,871,089	\$ 229,255,007
Total derivatives	\$ (2,722,420)	\$ 5,464,463	\$ 338,555,747

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2018

Note 2. Deposits and Investments (Continued)

State Water Implementation Fund for Texas: Investments for the SWIFT, an agency fund, as of August 31, 2018, are as follows:

Investments by Fair Value Level	Carrying Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Debt Securities				
Money market mutual funds	\$ 80,259,504	\$ 80,259,504	\$ -	\$ -
Mutual Funds—Global Fixed Income	164,422,175	164,422,175	-	-
Mutual Funds—Global Equities	64,251,605	64,251,605	-	-
Total investments by fair value level	<u>\$ 308,933,284</u>	<u>\$ 308,933,284</u>	<u>\$ -</u>	<u>\$ -</u>
Investments Measured at NAV	Carrying Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Hedge Funds—Fund of Funds	\$ 58,541,368	N/A	Monthly, Quarterly	26 - 95 days
Hedge Funds—Direct Funds—Fixed Income	318,317,984	N/A	Daily, Monthly, Quarterly	2 - 65 days
Hedge Funds—Direct Funds—Equities	379,369,595	N/A	Monthly, Quarterly, Semi-Annually, Anniversary	30 - 120 days
Hedge Funds—Direct Funds—All Asset Strategies	80,636,343	N/A	Annually	45 days
Domestic Alternative—Private Debt	238,298,641	\$ 157,617,304	N/A	N/A
Domestic Alternative—Private Equity	2,500,000	100,000,000	N/A	N/A
Domestic Alternative—Real Assets	265,204,609	74,858,393	N/A	N/A
Total investments measured at NAV	<u>\$ 1,342,868,540</u>	<u>\$ 332,475,697</u>		
Total investments	<u>\$ 1,651,801,824</u>			

Mutual funds are valued daily or monthly, as appropriate, at a published NAV per share. Hedge Funds are valued monthly at NAV using the current monthly account statements from the funds. If a current monthly account statement is unavailable, the value is calculated by the custodian using the estimated monthly return from the fund. Once a statement is received, the value is adjusted to reflect the NAV from the statement adjusted for cash flows that occur after the statement date. Domestic alternative investments are valued monthly at NAV using the latest account statements from the funds. NAV is adjusted for cash flows that occur after the date of the statements through the month-end date.

Fixed Income strategies, which consists of global fixed income mutual funds, are expected to generate relatively consistent positive returns with lower correlation to the public markets. Strategies selected are intended to provide positive returns during most economic and capital market environments.

Alternative Fixed Income strategies, which consists of fixed income hedge funds, are intended to preserve investment capital by achieving consistent positive real returns and maximizing long-term total returns, within prudent levels of risk, through the use of diversified portfolios of complementary strategies.

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2018

Note 2. Deposits and Investments (Continued)

Private Debt strategies will be primarily focused on debt and credit oriented strategies ranging from senior secured credit to distressed credit, but at times may include exposures across the entire corporate capital structure. Private debt strategies are intended to take advantage of illiquidity premiums available in the debt markets. Portfolios may take an extended period to be realized.

Equity strategies (Directional Equity and Hedged Equity) are intended to provide for portfolio growth and inflation protection and help the fund achieve its performance expectations over time. Due to the inherent volatility of the asset class, hedged strategies may be emphasized over directional strategies.

Real Asset strategies (Core Real Estate and Commodities) are intended to serve primarily as inflation hedges and provide diversification benefits through low correlation with other investment strategies. Real Asset strategies may include investments in high quality real estate, timber, infrastructure assets, industrial and precious metals, energy, livestock and grains.

All Asset Strategies include exposures across equity, fixed income and real asset classes. All Asset portfolios may consist of long-only, hedged and private strategies whose portfolios are diversified across a broad range of asset types.

Credit risk: The SWIFT investment policy does not limit credit risk. The following schedule lists Standard & Poor's credit rating by investment type for those investments subject to credit risk.

Standard & Poor's Credit Ratings	Mutual Funds— Global Fixed Income	Money Market Funds
AAA	\$ -	\$ 80,259,504
Not rated	164,422,175	-
Total	<u>\$ 164,422,175</u>	<u>\$ 80,259,504</u>

Concentration risk: Excluding passive strategies, exposure to any investment firm will generally be limited to no more than 25% of fund assets. Fund investments will generally not exceed more than 25% of any firms' total assets under management. As of August 31, 2018, no more than 5% of the portfolio was invested in securities of one issuer.

Interest rate risk: The SWIFT investment policy does not limit investment maturities. The following schedule reflects the average effective duration of the funds by investment type. The investments in the short-term investment fund use a weighted average maturity to reflect the interest rate risk.

Investment Type	Effective Duration (Years)
Mutual funds—global fixed income	2.99 years
	<u>Weighted- Average Maturity</u>
Money market mutual funds	21 days

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2018

Note 2. Deposits and Investments (Continued)

Texas Economic Stabilization Investment Fund of Texas (TESTIF): Investments for the TESTIF, an agency fund, as of August 31, 2017 are as follows:

Investments by Fair Value Level	Carrying Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Debt securities:				
Money market mutual funds	\$ 137,598,245	\$ 137,598,245	\$ -	\$ -
Mutual Funds—Global Fixed Income	1,810,010,681	1,810,010,681	-	-
Total investments by fair value level	<u>\$ 1,947,608,926</u>	<u>\$ 1,947,608,926</u>	<u>\$ -</u>	<u>\$ -</u>

Investments measured at NAV	Carrying Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Domestic Alternative—Private Debt	<u>\$ 393,379,770</u>	<u>\$ -</u>	N/A	N/A
Total investments	<u>\$ 2,340,988,696</u>			

Mutual funds are valued daily or monthly, as appropriate, at a published NAV per share. Domestic alternative investments are valued monthly at NAV using the latest account statements from the funds. NAV is adjusted for cash flows that occur after the date of the statements through the month-end date.

Fixed Income strategies are expected to generate relatively consistent positive returns with lower correlation to the public markets. Strategies selected are intended to provide positive returns during most economic and capital market environments.

Credit risk: The TESTIF investment policy does not limit credit risk. The following schedule lists Standard & Poor's credit rating by investment type for those investments subject to credit risk.

Standard & Poor's Credit Ratings	Mutual Funds—Global Fixed Income	Money Market Funds
AAA	\$ -	\$ 137,598,245
Not rated	1,810,010,681	-
Total	<u>\$ 1,810,010,681</u>	<u>\$ 137,598,245</u>

Concentration risk: Exposure to any investment firm will generally be limited to no more than 25% of the fund's assets. Fund investments will generally not exceed more than 25% of any firm's total assets under management. As of August 31, 2018, no more than 5% of the portfolio was invested in securities of one issuer.

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2018

Note 2. Deposits and Investments (Continued)

Interest rate risk: The TESTIF investment policy does not limit investment maturities. The following schedule reflects the average effective duration of the funds by investment type. The investments in the short-term investment fund use a weighted average maturity to reflect the interest rate risk.

<u>Investment Type</u>	<u>Effective Duration (Years)</u>
Mutual funds—global fixed income	2.37 years
	<u>Weighted- Average Maturity</u>
Money market mutual funds	21 days

Repurchase Agreement Pool, an agency fund: The Texas Trust operates a Repurchase Agreement Pool (Pool) in which state entities may invest non-appropriated funds. Investments for the Pool, as of August 31, 2018, consist of repurchase agreements carried at amortized cost.

Credit risk: Is the risk that an issuer or other counterparty to an investment will not fulfill its obligation. Pursuant to Government Code section 404.024 (a) and (b), treasury funds may be invested in fully collateralized repurchase agreements secured by obligations of the U.S., its agencies, or GSEs, or cash. The Repurchase Agreement Pool is administered by the Texas Trust. The underlying securities in the various repurchase agreement pools are rated AA+ by Standard & Poor's.

Interest rate risk: The maximum maturity of direct repurchase agreements will not exceed 180 days. All repurchase agreement pools are in overnight repurchase agreements. The weighted average maturity of the Repurchase Agreement Pool is 4 days.

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2018

Note 2. Deposits and Investments (Continued)

Other trust activities, an agency fund: The Texas Trust functions as a custodian and/or depository to several state agencies. The functions are strictly fiduciary. Credit risk, interest rate risk, and concentration risk are not significantly different from the risks of similar investments disclosed above. Each respective state agency performs their own investment management activities within the parameters of their own respective investment policies.

Investments for these other trust activities, as of August 31, 2018, are as follows:

Investments by Fair Value Level	Carrying Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Debt securities:				
Mutual Funds	\$ 2,465,827	\$ 2,465,827	\$ -	\$ -
Commercial paper	223,558,376	223,558,376	-	-
Corporate obligations	9,744,998	-	9,744,998	-
Government sponsored enterprises	303,249,431	-	303,249,431	-
Government mortgage-backed securities	3,715,442	-	3,715,442	-
Investment in guaranteed investment contracts	28,454,615	28,454,615	-	-
Non agency collateralized mortgage obligations	6,290	-	6,290	-
Political subdivision bonds	57,540,854	-	57,540,854	-
United States government treasuries	129,244,968	-	129,244,968	-
Total debt securities	<u>757,980,801</u>	<u>254,478,818</u>	<u>503,501,983</u>	<u>-</u>
Equity securities:				
Common and preferred stock	176,840,540	176,840,540	-	-
Investment in real estate trust fund	3,921,477	-	3,921,477	-
Warrants	37,852	-	37,852	-
Total equity securities	<u>180,799,869</u>	<u>176,840,540</u>	<u>3,959,329</u>	<u>-</u>
Total investments at fair value	<u>\$ 938,780,670</u>	<u>\$ 431,319,358</u>	<u>\$ 507,461,312</u>	<u>\$ -</u>
Investments measured at amortized cost:				
Repurchase agreements	<u>\$ 474,671,657</u>			
Total investments measured at amortized cost	<u>\$ 474,671,657</u>			
Total investments	<u>\$ 1,413,452,327</u>			

Debt securities classified as Level 1 of the fair value hierarchy are valued using prices quoted in active markets for those securities. Debt securities classified as Level 2 of the fair value hierarchy are valued using other observable significant inputs including but not limited to quoted prices for similar securities, interest rates, and fixed income pricing models.

Equity securities classified as Level 1 of the fair value hierarchy are valued using prices quoted in active markets for those securities. Equity securities classified as Level 2 of the fair value hierarchy are valued using other observable significant inputs including but not limited to quoted prices for similar securities.

Mutual funds are valued daily or monthly, as appropriate, at a published NAV per share.

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2018

Note 3. Capital Assets

Capital asset activity for the year ended August 31, 2018, was as follows:

Business-Type Activities	Balance September 1, 2017	Additions	Deletions	Balance at August 31, 2018
Depreciable assets:				
Buildings and building improvements	\$ 1,587,186	\$ 135,162	\$ -	\$ 1,722,348
Furniture and equipment	1,366,386	-	-	1,366,386
Total depreciable assets at historical cost	<u>2,953,572</u>	<u>135,162</u>	<u>-</u>	<u>3,088,734</u>
Less accumulated depreciation for:				
Buildings and building improvements	(417,589)	(85,628)	-	(503,217)
Furniture and equipment	(824,624)	(79,416)	-	(904,040)
Total accumulated depreciation	<u>(1,242,213)</u>	<u>(165,044)</u>	<u>-</u>	<u>(1,407,257)</u>
Total depreciable assets, net	<u>1,711,359</u>	<u>(29,882)</u>	<u>-</u>	<u>1,681,477</u>
Amortizable assets-intangible:				
Computer software	2,910,356	-	-	2,910,356
Total amortizable assets-intangible	<u>2,910,356</u>	<u>-</u>	<u>-</u>	<u>2,910,356</u>
Less Accumulated amortization for:				
Computer software	(2,553,791)	(226,432)	-	(2,780,223)
Total accumulated amortization	<u>(2,553,791)</u>	<u>(226,432)</u>	<u>-</u>	<u>(2,780,223)</u>
Amortizable assets—intangible, net	<u>356,565</u>	<u>(226,432)</u>	<u>-</u>	<u>130,133</u>
Business-type activities—capital assets, net	<u>\$ 2,067,924</u>	<u>\$ (256,314)</u>	<u>\$ -</u>	<u>\$ 1,811,610</u>

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2018

Note 4. Pension Plan

Texas Trust employees participate in the Employees Retirement System of Texas Plan (ERS Plan) which is one of the three retirement systems of the state of Texas. The ERS Plan is administered through a trust.

ERS Plan: The Board of Trustees of ERS is the administrator of four pension plans that provide a standard monthly benefit in a life annuity at retirement and death and disability benefits for members. In addition to the state of Texas, the employers of the ERS plan include various component units of the state. The Employees Retirement System and the Texas Trust, which are blended component units, and the State Bar of Texas, which is a discrete component unit, are also employers of the ERS plan. The ERS Plan is considered a single employer defined benefit plan under GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*. For financial reporting purposes, ERS is treated as a cost-sharing plan, since each participating employer has an obligation to contribute.

ERS Plan covers members in employee and elected classes. Employee class includes employees and appointed officers of the agencies of the state of Texas except those who included in the coverage of Teacher Retirement System of Texas, Judicial Retirement System Plan I (JRS 1) and Plan II (JRS II). Elected class includes elected state officials not included in the coverage of JRS 1 and JRS II, and members of the Legislature and district and criminal district attorneys.

The benefit and contribution provisions of the ERS Plan are authorized by state law and may be amended by the Legislature. The monthly benefit may vary by membership class:

The monthly standard annuity of the employee class is determined by a statutory percentage of 2.3% of a member's average monthly compensation multiplied by number of years of service credit. The average monthly compensation of the employee class may vary depending on the hire date. For members hired on or before August 31, 2009, the average monthly compensation is the average of the highest 36 months of compensation. For members hired on or after September 1, 2009 and before September 1, 2013, the average monthly compensation is the average of the highest 48 months of compensation. For members hired on or after September 1, 2013, the average monthly compensation is the average of highest 60 months of compensation.

The monthly standard annuity of the elected class equals the statutory percentage of 2.3% of the current state salary of a district judge multiplied by the number of years of service credit. Retirement benefits are automatically adjusted as state judicial salaries change.

Texas Treasury Safekeeping Trust Company

**Notes to Financial Statements
August 31, 2018**

Note 4. Pension Plan (Continued)

The contribution rates for the state and the members for the ERS Plan for the measurement period of August 31, 2017 are presented in the table below:

Required Contribution Rates—ERS Plan					
Employer			Members		
Employee Class	Elected Class— Legislators	Elected Class— Other	Employee Class	Elected Class— Legislators	Elected Class— Other
10.00%	10.00%	10.00%	9.50%	9.50%	9.50%

The amount of Texas Trust's contributions recognized by the ERS Plan for the measurement period of August 31, 2017 was \$786,614. The amount of Texas Trust's fiscal year 2018 contributions was \$846,589.

The total pension liability is determined by an annual actuarial valuation. The methods and assumptions applied, except discount rate, in the actuarial valuation were based on an experience study covering the five-year period from September 1, 2011, through August 31, 2016. The table below presents the actuarial methods and assumptions used to measure the total pension liability as of the August 31, 2017:

Actuarial Methods and Assumptions	
ERS Plan	
Actuarial valuation date	August 31, 2017
Actuarial cost method	Entry Age Normal
Amortization method	Level Percent of Payroll, Open
Actuarial assumptions:	
Discount rate	5.36%
Investment rate of return	7.50%
Inflation	2.50%
Salary increase	2.50% to 9.30%
Mortality	The mortality rates for active member and disability retirees are based on the RP-2014 Active Member Mortality Tables with generational mortality improvements projected from the year 2014, which is based on the most recent Ultimate MP scale. The mortality rates for service retirees and beneficiaries are based on the 2017 State Retirees of Texas Mortality Tables with generational mortality improvements projected from the year 2017, which is based on the most recent Ultimate MP scale. Rates for male law enforcement and custodial officers are set forward one year.
Cost-of-living adjustments	None—Employee 3.5%—Elected

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2018

Note 4. Pension Plan (Continued)

A blended discount rate of 5.36% was applied to measure the total pension liability. The 5.36% discount rate incorporated a 7.5% long-term expected rate of return on pension plan investments and 3.42% 20-year municipal bond rate based on Fidelity Index's "20-Year Municipal GO AA Index." The long-term expected investment rate of return was applied to projected benefit payments through fiscal 2047 and the municipal bond rate was applied to all benefit payments thereafter.

The projections of cash flows used to determine this blended discount rate assumed that plan member and employer contributions will be made at the current statutory levels and remain a level percentage of payroll. The projected cash flows from the employers are based on contributions for the most recent five year period, modified on consideration of subsequent events. The legislature passed House Bill No. 9 in the 84th legislative session during fiscal 2015 to increase the state contribution rates for fiscal 2016 and 2017 and maintained the changes made by the 83rd legislature session in Senate Bill No. 1459, which established proportional decreases to the employee contribution if the state contribution was decreased. The passage of this bill is an indicator that the legislature is committed to increase the funding levels for the pension funds. Projected employer contributions are based on fiscal year 2017 funding levels.

The long-term expected rate of return on plan investments was developed using a building-block method in which best estimated 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 weighing the expected future real rates of return by the target asset allocation percentage and by adding expected inflation.

The target allocation and best estimates of arithmetic real rates of return for each major asset class for the plan's investment portfolio are presented below:

Asset Class	Target Allocation	Long-Term Expected Arithmetic Real Rate of Return
Global Equity	55%	4.57%
Global Credit	10%	0.29%
Intermediate Treasuries	15%	0.33%
Real Estate	10%	0.53%
Infrastructure	4%	0.29%
Hedge Funds	5%	0.40%
Cash	1%	0.00%
Total	<u>100%</u>	

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements

August 31, 2018

Note 4. Pension Plan (Continued)

Sensitivity analysis was performed on the impact of changes in the discount rate on the proportionate share of Texas Trust's net pension liability. The result of the analysis is presented in the table below:

	1% Decrease	Current Discount Rate	1% Increase
	4.36%	5.36%	6.36%
Texas Trust's proportionate share of the net pension liability	\$ 32,016,592	\$ 24,564,998	\$ 17,945,517

The pension plan's fiduciary net position is determined using economic resources measurement focus and the accrual basis of accounting, which is the same basis used by Employees Retirement System. Benefits and refunds of contributions are recognized when due and payable in accordance with the terms of the plan. Investments of the pension trust fund are reported at fair value in accordance with GASB Statements No. 31 and 67. The fair value of investments is based on published market prices and quotations from major investment brokers at available current exchange rates. However, corporate bonds in general are valued based on currently available yields of comparable securities by issuers with similar credit ratings. Employees Retirement System issues stand-alone audited Comprehensive Annual Financial Report (CAFR). More detailed information on the plan's investment valuation, investment policy, assets and fiduciary net position may be obtained from ERS' fiscal 2017 CAFR:

Employees Retirement System of Texas
P. O. Box 13207
Austin, Texas 78711-3207

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2018

Note 4. Pension Plan (Continued)

At August 31, 2018, the Texas Trust reported a liability of \$24,564,998 for its proportionate share of the net pension liability. The net pension liability was measured as of August 31, 2017, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The Texas Trust's proportion of the net pension liability was based on a projection of the Texas Trust's long-term share of contributions to the pension plan relative to the projected contributions of all participating governments, actuarially determined.

There were no changes to benefit terms. The change of discount rate and a slight change in the assumption of the withdraw rate of member contributions at termination are the only assumption changes during the current measurement period. There have been no changes to the benefit terms of the plan since the prior measurement date. The Texas Trust's proportion of the entire ERS Plan was 0.112350550% in fiscal year 2018 as compared with the 0.10855888% in the prior fiscal year.

For the fiscal year ending August 31, 2018, Texas Trust recognized pension expense of \$3,684,565. At August 31, 2018, Texas Trust reported deferred outflows of resources and deferred inflows of resources from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference between expected and actual experience	\$ 146,833	\$ 21,858
Changes of assumptions	3,990,109	263,227
Net difference between projected and actual investment return	119,670	-
Change in proportion and contribution difference	658,940	-
Contributions subsequent to the measurement date	846,589	-
Total	<u>\$ 5,762,141</u>	<u>\$ 285,085</u>

The \$846,589 reported as deferred outflows of resources resulting from contributions subsequent to the measurement date will be recognized as a reduction in the net pension liability for the year ending August 31, 2019.

Amounts reported as deferred outflows and inflows of resources related to pensions will be recognized in pension expense in the following years:

Year ended August 31:	
2019	\$ 2,842,828
2020	1,830,639
2021	162,028
2022	(205,028)
	<u>\$ 4,630,467</u>

The deferred outflows and inflows resulting from the difference between projected and actual earnings on pension plan investments will be recognized as a reduction of pension expense over five years. The other deferred inflows and outflows will be recognized in pension expense using the average expected remaining service lives of all members.

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2018

Note 5. Other Post-Employment Benefit Plan (OPEB)

In addition to the pension benefits described in Note 4, the Employees Retirement System of Texas (ERS) provides postemployment health care, life and dental insurance benefits through the Group Benefits Program in accordance with Chapter 1551, Texas Insurance Code. This program is governed by the same Board of Trustees who is responsible for the defined benefit pension plans.

Texas Trust employees participate in the State Retiree Health Plan (SRHP) administered by ERS. The SRHP is a cost-sharing multiple-employer postemployment health care plan with a special funding situation. This plan covers retired employees of the State, and other entities as specified by the State legislature. Benefit and contribution provisions of the State Retiree Health Plan are authorized by state law and may be amended by the Texas Legislature. Retirees must meet certain age and service requirements and have at least 10 years of service at retirement to participate in the plan. The principal participating employer is the state of Texas. State agencies and universities employ 185,760, or 80.7%, or the employees covered by the SRHP. Participating entities are as follows:

State Agencies	116
Universities	27
Junior and Community Colleges	50
Other Entities	8
Total participating entities	<u>201</u>

The maximum monthly employer contributions toward eligible retirees' health and basic life premium are summarized as follows:

Retiree Only	\$ 617.30
Retiree and Spouse	970.98
Retiree and Children	854.10
Retiree and Family	1,207.78

Retirees pay any premium over and above the employer contribution. The employer does not contribute toward dental or optional life insurance. Surviving spouses and their dependents do not receive any employer contribution. As the non-employer contributing entity, the State of Texas pays part of the premiums for the junior and community college.

For the measurement period ending August 31, 2017, the amount of Texas Trust's contributions recognized by SHRP was \$88,968. Fiscal year 2018 contributions were \$92,829.

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2018

Note 5. Other Post-Employment Benefit Plan (OPEB) (Continued)

The total OPEB liability is determined by an actuarial valuation. The methods and assumptions applied in the actuarial valuation were based on an experience study covering the five-year period from September 1, 2011 through August 31, 2016 for state agency members and for the period September 1, 2010 through August 31, 2014 for higher education members. The table below presents the actuarial methods and assumptions used to measure the total OPEB liability as of the August 31, 2017:

Actuarial Methods and Assumptions	
ERS Plan	
Actuarial valuation date	August 31, 2017
Actuarial cost method	Entry Age
Amortization method	Level Percent of Payroll, Open
Amortization period	30 years
Actuarial assumptions:	
Discount rate	3.51%
Inflation	2.50%
Salary increase	2.50% to 9.50%, including inflation
Annual healthcare trend rate	8.50% for fiscal year 2019, decreasing 0.5% per year to 4.50% for fiscal year 2027 and later
Aggregate payroll growth	3.00%
Retirement age	Experience based tables of rates that are specific to employee class
Mortality	
State Agency Members	
Service Retirees, Survivors and Other Inactive Members	2017 State Retirees of Texas Mortality table with a 1 year set forward for male CPO/CO members and Ultimate MP Projection Scale projected from the year 2017
Disabled Retirees	RP-2014 Disabled Retiree Mortality with Ultimate MP Projection Scale projected from the year 2014
Active Members	RP-2014 Active Member Mortality tables with Ultimate MP Projection Scale from the year 2014
Higher Education Members	
Service Retirees, Survivors and Other Inactive Members	Tables based on TRS experience with full generational projection using Scale BB from Base Year 2014
Disabled Retirees	Tables based on TRS experience with full generational projection using Scale BB from Base Year 2014 using a 3-year set forward and minimum mortality rates of four per 100 male members and two per 100 female members
Active Members	Sex Distinct RP-2014 Employee Mortality multiplied by 90% with full generational projection using Scale BB
Ad hoc postemployment benefit changes	None

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2018

Note 5. Other Post-Employment Benefit Plan (OPEB) (Continued)

The following benefit revisions have been adopted since the prior valuation for retirees and dependents for whom Medicare is not primary:

- a. Increase in the out-of-pocket cost applicable to services obtained at a free standing emergency facility,
- b. Elimination of the copayment for virtual visits,
- c. Copay reduction for Airrosti and for out of state participants, and
- d. Elimination of the deductible for in-network services and application of a copayment rather than coinsurance to certain services like primary care and specialist visits.

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

The discount rate that was used to measure the total OPEB liability is the municipal bond rate of 3.51% for the measurement date ending August 31, 2017 as compared to a discount rate of 2.84% as of the beginning of the measurement period. The source of the municipal bond rate is the Bond Buyer Index of general obligation bonds with 20 years to maturity and mixed credit quality. The bonds' average credit quality is roughly equivalent to Moody's Investors Service's Aa2 rating and Standard & Poor's AA. Projected cash flows into the plan are equal to projected benefit payments out of the plan. As the plan operates on a pay as you go basis and is not intended to accumulate assets, there is no long-term expected rate of return. ERS' board of trustees adopted an amendment to the investment policy in August 2017 to require that all funds in this plan be invested in short-term fixed income securities and specify that the expected rate of return on these investments be at least 2.4%. The investment rate of return used to calculate the projected earnings on OPEB plan investments was 2.84%.

Sensitivity analysis was performed on the impact of changes in the discount rate on the proportionate share of Texas Trust's total OPEB liability. The result of the analysis is presented in the table below:

	1% Decrease	Current Discount Rate	1% Increase
	2.51%	3.51%	4.51%
Texas Trust's proportionate share of the total OPEB liability	\$ 3,860,905	\$ 3,234,380	\$ 2,749,081

The initial healthcare trend rate is 8.50% and the ultimate rate is 4.50%. The sensitivity of the net OPEB liability to changes in the discount rate and healthcare trend rate is summarized below:

	1% Decrease (7.50%, Decreasing to 3.50%)	Current Healthcare Cost Trend Rates (8.50%, Decreasing to 4.50%)	1% Increase (9.50%, Decreasing to 5.50%)
Texas Trust's proportionate share of the total OPEB liability	\$ 2,720,945	\$ 3,234,380	\$ 3,903,056

Texas Treasury Safekeeping Trust Company

**Notes to Financial Statements
August 31, 2018**

Note 5. Other Post-Employment Benefit Plan (OPEB) (Continued)

The OPEB plan's fiduciary net position is determined using economic resources measurement focus and the accrual basis of accounting, which is the same basis used by Employees Retirement System. Benefits and refunds of contributions are recognized when due and payable in accordance with the terms of the plan. Investments of the OPEB trust fund are reported at fair value in accordance with GASB Statements No. 72. The fair value of investments is based on published market prices and quotations from major investment brokers at available current exchange rates. However, corporate bonds in general are valued based on currently available yields of comparable securities by issuers with similar credit ratings. Employees Retirement System issues stand-alone audited Comprehensive Annual Financial Report (CAFR). More detailed information on the plan's investment valuation, investment policy, assets and fiduciary net position may be obtained from ERS' fiscal 2017 CAFR:

Employees Retirement System of Texas
P. O. Box 13207
Austin, Texas 78711-3207

At August 31, 2018, the Texas Trust recognized a net OPEB liability of \$3,234,380 for its proportionate share of the collective total OPEB liability. The Texas Trust's proportionate share of the total OPEB liability was 0.0094925% and was based on contributions to the OPEB plan relative to the contributions of all employers and the non-employer contributing entity for the period.

For the year ending August 31, 2018, Texas Trust recognized OPEB expense of \$173,090. At August 31, 2018, Texas Trust reported deferred outflows of resources and deferred inflows of resources from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference between expected and actual experience	\$ -	\$ 38,867
Changes of assumptions	-	676,270
Net difference between projected and actual investment return	958	-
Contributions subsequent to the measurement date	92,829	-
Total	\$ 93,787	\$ 715,137

The \$92,829 reported as deferred outflows of resources resulting from contributions subsequent to the measurement date will be recognized as a reduction in the total OPEB liability for the year ending August 31, 2019.

Amounts reported as deferred outflows and inflows of resources related to OPEB will be recognized in OPEB expense in the following years:

Year ended August 31:	
2019	\$ (160,828)
2020	(160,828)
2021	(160,828)
2022	(160,828)
2023	(70,867)
	\$ (714,179)

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2018

Note 6. Related-Party Transactions

The Texas Trust has entered into a services agreement with the Comptroller of Public Accounts (CPA). The agreement provides for specified rates based on hours of utilization. For the fiscal year ended August 31, 2017, the Texas Trust paid CPA \$72,552 for services provided. At August 31, 2018, the Texas Trust had accrued \$20,156 for services provided by CPA and this amount is included in accounts payable.

The Texas Trust utilizes the CPA Payroll Department to service its payroll. Prior to the end of each month, the approximate amount of the Texas Trust's monthly payroll is transferred from the Texas Trust to the Comptroller's Office. At August 31, 2018, the Comptroller held \$1,165,832 to pay for the Texas Trust's September 1, 2018 payroll.

Note 7. Changes in Long-Term Liabilities

During the year ended August 31, 2018, the following changes occurred in long-term liabilities:

	Balance September 1, 2017	Additions	Reductions	Balance August 31, 2018	Amounts Due Within One Year
Compensable leave	\$ 1,019,434	\$ 916,311	\$ (950,874)	\$ 984,871	\$ 617,378
Net pension liability	21,447,953	3,117,045	-	24,564,998	-
OPEB liability	-	3,234,380	-	3,234,380	-
Total	<u>\$ 22,467,387</u>	<u>\$ 7,267,736</u>	<u>\$ (950,874)</u>	<u>\$ 28,784,249</u>	<u>\$ 617,378</u>

Note 8. Restatement

Effective September 1, 2017, the Texas Trust implemented GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other than Pensions* (Statement No. 75). Statement No. 75 addresses the accounting and financial reporting for postemployment benefits other than pensions (OPEB). Upon adoption, OPEB liability, deferred inflows and outflows and OPEB expense are now reflected in the financial statements in accordance with the guidance provided for within the standard. The implementation resulted in a restatement of the beginning net position in fiscal year 2018, the fiscal year in which the provisions of Statement No. 75 were adopted. The adoption decreased beginning net position by \$3,775,469.

	Total
Net position at beginning of year—as previously reported	\$ 50,841,574
Implementation of GASB Statement No. 75	(3,775,469)
Net position at beginning of year—as restated	<u>\$ 47,066,105</u>

**Required Supplementary Information
(Unaudited)**

Texas Treasury Safekeeping Trust Company

**Schedule of Changes in Proportionate Share of the Net Pension Liability
Last Four Fiscal Years**

	2018	2017	2016	2015
Texas Trust's proportionate share of the collective plan net pension liability	0.11235055%	0.10855888%	0.10548924%	0.09956829%
Texas Trust's proportionate share of the collective plan net pension liability	\$ 24,564,998	\$ 21,447,953	\$ 13,994,671	\$ 14,398,372
Texas Trust's covered payroll	\$ 7,706,918	\$ 7,319,190	\$ 6,487,794	\$ 5,929,750
Texas Trust's proportionate share of the net pension liability as a percentage of its covered payroll	318.74%	293.04%	215.71%	242.82%
Plan fiduciary net position as a percentage of total pension liability	54.67%	55.32%	64.40%	63.40%

The information disclosed for each fiscal year is reported as of the measurement date of the net position liability which is August 31 of the preceding fiscal year.

Only four years of data is presented in accordance with GASB Statement No. 68, Paragraph 138. The information for all periods for the ten-year schedules that are required to be presented as required supplementary information is not available. During this transition period, the information will be presented for as many years as are available.

See notes to required supplementary information.

Texas Treasury Safekeeping Trust Company

**Schedule of Contributions—Net Pension Liability
Last Four Fiscal Years**

Fiscal Years Ending August, 31	Actuarially Determined Contributions	Contributions in Relation to the Actuarially Determined Contributions	Contribution Deficiency (Excess)	Covered Payroll	Contributions as a Percentage of Covered Payroll
2015	\$ 777,573	\$ 527,863	\$ 249,710	\$ 6,487,794	8.14%
2016	737,990	745,626	(7,636)	7,319,190	10.19%
2017	801,652	786,614	15,038	7,706,918	10.21%
2018	786,542	846,589	(60,047)	8,667,871	9.77%

The information disclosed for each fiscal year is reported as of the fiscal year-end date.

Only four years of data is presented in accordance with GASB Statement No. 68. The information for all periods for the ten-year schedules that are required to be presented as required supplementary information is not available. During this transition period, the information will be presented for as many years as are available.

See notes to required supplementary information.

Texas Treasury Safekeeping Trust Company

**Schedule of Changes in Proportionate Share of the Net OPEB Liability
August 31, 2018**

	2018
Texas Trust's proportionate share of the collective net OPEB liability	0.0094925%
Texas Trust's proportionate share of the collective net OPEB liability	\$ 3,234,380
Texas Trust's covered payroll	\$ 7,706,918
Texas Trust's proportionate share of the net OPEB liability as a percentage of its covered payroll	41.97%
Plan fiduciary net position as a percentage of total OPEB liability	2.04%

The information disclosed for each fiscal year is reported as of the measurement date of the net OPEB liability which is August 31 of the preceding fiscal year.

Only one year of data is presented in accordance with GASB Statement No. 75. The information for all periods for the ten-year schedules that are required to be presented as required supplementary information is not available. During this transition period, the information will be presented for as many years as are available.

See notes to required supplementary information.

Texas Treasury Safekeeping Trust Company

**Schedule of Contributions—Net OPEB Liability
August 31, 2018**

Fiscal Years Ending August, 31	Statutorily Required Contributions	Contributions in Relation to the Statutorily Required Contributions	Contribution Deficiency (Excess)	Covered Payroll	Contributions as a Percentage of Covered Payroll
2018	\$ 92,829	\$ 92,829	\$ -	\$ 8,667,871	1.07%

The information disclosed for each fiscal year is reported as of the fiscal year-end date.

Only one year of data is presented in accordance with GASB Statement No. 75. The information for all periods for the ten-year schedules that are required to be presented as required supplementary information is not available. During this transition period, the information will be presented for as many years as are available.

See notes to required supplementary information.

Texas Treasury Safekeeping Trust Company

Notes to Required Supplementary Information August 31, 2018

Note 1. Changes of Benefit Terms—Pension Plan

There were no changes to benefit terms.

Note 2. Changes of Assumptions—Pension Plan

Changes in assumptions since the previous are described as follows:

- Decrease the investment return assumption from 8.00% to 7.50%
- Decrease the inflation assumption from 3.50% to 2.50%
- No change to the salary scales above inflation for regular state employees
- Establish a general wage inflation assumption of 0.50% above inflation, or 3.00%
- Mortality assumptions updated from 1994 Group Annuity Mortality table to most recently published national tables, RP-2014 Mortality tables for employees and disability retirees
- Modified the application of Entry Age Normal (EAN) actuarial cost method from Ultimate EAN, the normal cost rate based on the benefits payable to a new member and the entry age characteristics of the current active membership, to individual EAN which bases the normal cost rate on benefits payable to each individual active member.

Note 3. Changes of Benefit Terms—OPEB Plan

There were no changes to benefit terms.

Note 4. Changes of Assumptions—OPEB Plan

Changes in assumptions since the previous are described as follows:

- Additional demographic assumptions (aggregate payroll increases and rate of general inflation) to reflect an experience study
- The percentage of current and future retirees and retirees spouses not yet eligible to participate in the Health Select Medicare Advantage plan who will elect to participate at the earliest date at which coverage can commence has been updated to reflect recent plan experience and expected trends
- Assumptions for administrative expenses, assumed per Capital Health Benefit Costs, Health Benefit Cost and Retiree Contribution trends to reflect recent health plan experience
- Effects in short-term expectations and revised assumed rate of general inflation. Decrease the investment return assumption from 8.00% to 7.50%

The following benefit revisions have been adopted since the prior valuations: a) an increase in the out-of-pocket cost applicable to services obtained at a free-standing emergency facility, b) an elimination of the copayment for virtual visits, c) a copay reduction for Airrosti and for out-of-state participants, d) elimination of the deductible for in-network services and application of a copayment rather than coinsurance to certain services like primary care and specialist visits. These minor benefit changes have been reflected in the fiscal year 2018 Assumed Per Capita Health Benefit Costs.

Supplementary Information

Texas Treasury Safekeeping Trust Company

**Combining Statement of Fiduciary Net Position—Agency Fund
August 31, 2018**

Assets	Endowment Funds	State Water Implementation Fund	Texas Economic Stabilization Investment Fund	Treasury Pool	Repurchase Agreement Pool	Other Agency Funds	Totals
Current assets:							
Cash in State Treasury	\$ -	\$ 212,386,652	\$ 906,989,005	\$ -	\$ -	\$ -	\$ 1,119,375,657
Cash in bank	732,976	25,000,000	-	51,783	156,642	59,763,323	85,704,724
Deposits	-	-	-	584,073,500	-	15,000,000	599,073,500
Investments	4,124,247,664	1,651,801,824	2,340,988,696	30,148,477,675	702,823,217	1,413,452,327	40,381,791,403
Swaps at fair value	163,364	-	-	-	-	-	163,364
Other assets	-	-	-	-	-	64,612,272	64,612,272
Receivables from:							
Interest and dividends	509,261	509,965	1,940,748	30,932,168	36,500	2,076,221	36,004,863
Total assets	\$ 4,125,653,265	\$ 1,889,698,441	\$ 3,249,918,449	\$ 30,763,535,126	\$ 703,016,359	\$ 1,554,904,143	\$ 42,286,725,783
Liabilities							
Liabilities:							
Accounts payable	\$ 2,098,384	\$ 564,229	\$ 397,116	\$ -	\$ 1,500,000	\$ -	\$ 4,559,729
Interest payable	-	-	-	534	-	-	534
Trades pending settlement	198,090	-	-	-	-	-	198,090
Obligations under reverse repurchase agreements	-	-	-	24,115,546	-	-	24,115,546
Futures contracts at fair value	2,436,008	-	-	-	-	-	2,436,008
Swaps at fair value	449,776	-	-	-	-	-	449,776
Funds held for others	4,120,471,007	1,889,134,212	3,249,521,333	30,739,419,046	701,516,359	1,554,904,143	42,254,966,100
Total liabilities	\$ 4,125,653,265	\$ 1,889,698,441	\$ 3,249,918,449	\$ 30,763,535,126	\$ 703,016,359	\$ 1,554,904,143	\$ 42,286,725,783

**Report On Internal Control Over Financial Reporting and
on Compliance and Other Matters Based on an Audit of
Financial Statements Performed In Accordance With
*Government Auditing Standards***

Independent Auditor's Report

To the Honorable Glenn Hegar
Comptroller of Public Accounts of the State of Texas

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of the business-type activities, and the aggregate remaining fund information of the Texas Treasury Safekeeping Trust Company (Texas Trust) as of and for the year ended August 31, 2018, and the related notes to the financial statements, which collectively comprise Texas Trust's basic financial statements, and have issued our report thereon dated December 12, 2018. Our report was modified to include a reference to the restatement of beginning net position of the business type activities due to the adoption of Governmental Accounting Standards Board Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other than Pensions*.

Internal Control over Financial Reporting

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

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

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

Compliance and Other Matters

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

Purpose of this Report

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

RSM US LLP

Austin, Texas
December 12, 2018

