

Texas Treasury Safekeeping Trust Company

(A Component Unit of the State of Texas)

Basic Financial Statements
August 31, 2017

Contents

Independent Auditor's Report	1-2
Management's Discussion and Analysis	3-6
Basic Financial Statements	
Statement of Net Position—Proprietary Fund	7-8
Statement of Revenues, Expenses and Changes in Net Position—Proprietary Fund	9
Statement of Cash Flows—Proprietary Fund	10
Statement of Fiduciary Net Position—Fiduciary Funds	11
Statement of Changes in Fiduciary Net Position—Fiduciary Funds	12
Notes to Financial Statements	13-39

Required Supplementary Information (Unaudited)	
Schedule of Changes in Proportionate Share of the Net Pension Liability	40
Schedule of Contributions	41
Notes to Required Supplementary Information	42

Supplementary Information	
Combining Schedule—Statement of Fiduciary Net Position—Agency Fund	43

Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i>	44-45
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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 the aggregate remaining fund information of the Texas Treasury Safekeeping Trust Company (Texas Trust) as of and for the year ended August 31, 2017, 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 Texas Trust'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 Texas Trust'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, 2017, 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, 2017, and the changes in its 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.

Other Matter—Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis, the Schedule of Changes in Proportionate Share of the Net Pension Liability and the Schedule of Contributions, 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, 2017 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, 2017

Texas Treasury Safekeeping Trust Company

Management's Discussion and Analysis August 31, 2017

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, 2017, 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 (60) billion dollars at August 31, 2017.
- Texas Trust had fees for services in fiscal year 2017 of \$27,968,262 and non-operating revenues of \$215,312 (interest income). Operating expenses were \$30,343,539.

Overview of the Financial Statements

This report consists of five parts that explain some of the information in the financial statements in more detail—Independent Auditor's Report; Management's Discussion and Analysis (this section); Basic Financial Statements; Required Supplementary Information and Supplementary Information.

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 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.

The fund financial statements include statements for each of the following funds—Enterprise Fund, Investment Trust Fund and Agency Fund.

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 Texas Trust performs custodial and investment services for entities in the other two fund categories (investment trust fund and agency fund) for a fee designed on a cost recovery basis. In fiscal year (FY) 2017, the Texas Trust charged client funds \$27,968,262 in fees and incurred \$30,343,539 in related service expense generating those fees.

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.

Texas Treasury Safekeeping Trust Company

Management's Discussion and Analysis August 31, 2017

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.

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.

Condensed Financial Information for 2017 and 2016 (in 000's)

	Business-Type Activities	
	2017	2016
Assets:		
Current assets	\$ 36,423	\$ 35,450
Capital assets	2,068	1,941
Noncurrent assets	34,599	34,616
Total assets	73,090	72,007
Deferred outflows of resources:		
Deferred outflow for ERS pension liability	6,747	2,525
Total deferred outflows of resources	6,747	2,525
Liabilities:		
Current liabilities	5,627	4,259
Noncurrent liabilities	21,819	14,474
Total liabilities	27,446	18,733
Deferred inflows of resources:		
Deferred inflow for ERS pension liability	1,549	2,798
Total deferred inflows of resources	1,549	2,798
Net position:		
Invested in capital assets	2,068	1,941
Unrestricted	48,774	51,060
Total net position	\$ 50,842	\$ 53,001

Texas Treasury Safekeeping Trust Company

Management's Discussion and Analysis August 31, 2017

Condensed Financial Information for 2017 and 2016 (in 000's) (Continued)

	Business-Type Activities	
	2017	2016
Changes in net position:		
Charges for service:		
Endowments	\$ 11,174	\$ 8,622
SWIFT	3,657	2,338
TESTIF	2,070	1,454
Emerging Technology Fund	1,500	1,500
Treasury Pool	7,636	5,619
Investment Trust Fund	1,006	809
Other Agencies	925	886
	<u>27,968</u>	<u>21,228</u>
Interest income	<u>215</u>	<u>95</u>
Total revenues	28,183	21,323
Total expenses	<u>30,343</u>	<u>21,207</u>
Change in net position	<u>\$ (2,160)</u>	<u>\$ 116</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 and the Investment Trust Funds increased during FY 2017, while average balances for Treasury Pool, State Water Implementation Fund for Texas, Texas Economic Stabilization Investment Fund, and other state agencies funds decreased in FY 2017. Business-type activities generated revenue of \$27.9 million, an increase of \$6.7 million during FY 2017. Total expenses for business-type activities were \$30.3 million, an increase of \$9.1 million during FY 2017.

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 until the excess is eliminated.

Texas Treasury Safekeeping Trust Company

Management's Discussion and Analysis August 31, 2017

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

<u>Account</u>	<u>Fees in Basis Points</u>
Charges for service:	
Endowments	30
SWIFT	20
TESTIF	10
Treasury Pool	3
Investment Trust Fund (TexPool and TexPool Prime)	0.5
Other Agencies	Range from 2-6 basis points plus certain itemized charges for service

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, 2017 is \$21.4 million, an increase of \$7.4 million from August 31, 2016. See Notes to the Financial Statements for additional detail 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, 2017 totals \$20.1 billion and the net increase in fiduciary net position for FY 2017 is \$4.6 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, 2017 is \$40.2 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, 2017 amounts to \$2,067,924 (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. The Texas Trust maintains an account with the Federal Reserve, which establishes a reserve requirement for the Texas Trust. In order to meet the reserve requirement, the Texas Trust must maintain an average balance for the weekly measurement period that surpasses the required reserve amount.

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 Chief Financial Officer at (512) 463-3129.

Basic Financial Statements

Texas Treasury Safekeeping Trust Company

**Statement of Net Position—Proprietary Fund
August 31, 2017**

	Enterprise Fund
Assets:	
Current assets:	
Cash and cash equivalents:	
Cash in bank	\$ 52,432
Cash in State Treasury	1,172,678
Investments in repurchase agreements	28,763,904
Receivables from:	
Management fees	5,421,969
Interest	1,275
Other	12,398
Prepaid expenses	998,027
Total current assets	<u>36,422,683</u>
Noncurrent assets:	
Restricted cash and cash equivalents	
Cash in bank	34,297,016
Restricted investments	301,669
Capital assets:	
Depreciable:	
Software, net	356,565
Building and building improvements, net	1,169,597
Furniture and equipment, net	541,762
Total noncurrent assets	<u>36,666,609</u>
Total assets	<u>73,089,292</u>
Deferred outflows of resources:	
Deferred outflow for ERS pension liability	6,746,683
Total deferred outflows of resources	<u>6,746,683</u>

See notes to financial statements.

Texas Treasury Safekeeping Trust Company

Statement of Net Position—Proprietary Fund (Continued)
August 31, 2017

	Enterprise Fund
Liabilities:	
Current liabilities:	
Accounts payable	\$ 1,497,134
Payroll payable	3,481,185
Employee's compensable leave	648,277
Total current liabilities	<u>5,626,596</u>
Noncurrent liabilities:	
Employees' compensable leave	371,157
Net pension liability	21,447,953
Total noncurrent liabilities	<u>21,819,110</u>
Total liabilities	<u>27,445,706</u>
Deferred inflows of resources:	
Deferred inflow for ERS pension liability	1,548,695
Total deferred inflows of resources	<u>1,548,695</u>
Net position:	
Invested in capital assets	2,067,924
Unrestricted	48,773,650
Total net position	<u>\$ 50,841,574</u>

Texas Treasury Safekeeping Trust Company

**Statement of Revenues, Expenses and Changes in Net Position—Proprietary Fund
Year Ended August 31, 2017**

	Enterprise Fund
Operating revenue—management fees	<u>\$ 27,968,262</u>
Operating expenses:	
Salaries and wages	10,554,133
Payroll related costs	1,313,775
Pension expense	2,759,837
Professional fees and services	9,332,850
Travel	165,466
Materials and supplies	2,702,563
Communication and utilities	819,297
Repairs and maintenance	1,301,315
Rentals and leases	22,739
Printing and reproduction	16,300
Depreciation and amortization	382,765
Other operating expenses	972,499
Total operating expenses	<u>30,343,539</u>
Operating loss	<u>(2,375,277)</u>
Nonoperating revenue (expenses):	
Investment income	<u>215,312</u>
Net nonoperating revenues	<u>215,312</u>
Change in net position	(2,159,965)
Total net position at beginning of year	<u>53,001,539</u>
Total net position at end of year	<u><u>\$ 50,841,574</u></u>

See notes to financial statements.

Texas Treasury Safekeeping Trust Company

**Statement of Cash Flows—Proprietary Fund
Year Ended August 31, 2017**

	Enterprise Fund
Cash flows from operating activities:	
Proceeds from management fees	\$ 27,812,098
Payments to employees	(11,237,999)
Payments for operating expenses	(15,551,952)
Net cash provided by operating activities	<u>1,022,147</u>
Cash flows from capital and related financing activities:	
Payments for additions to capital assets	(510,153)
Net cash used in capital and related financing activities	<u>(510,153)</u>
Cash flows from investing activities:	
Proceeds from sale of investments	17,735
Proceeds from interest and investment income	320,593
Net cash provided by investing activities	<u>338,328</u>
Net increase in cash and cash equivalents	850,322
Cash and cash equivalents at beginning of year	<u>63,435,708</u>
Cash and cash equivalents at end of year	<u><u>\$ 64,286,030</u></u>
Reconciliation of operating loss to net cash provided by operating activities:	
Operating loss	\$ (2,375,277)
Adjustments to reconcile operating loss to net cash provided by operating activities:	
Depreciation expense	382,765
Changes in assets/liabilities:	
Receivables	(156,164)
Prepaid expenses	(71,529)
Benefits payable	1,982,619
Payables	1,259,733
Net cash provided by operating activities	<u><u>\$ 1,022,147</u></u>
Displayed as:	
Cash in bank	\$ 52,432
Cash in State Treasury	1,172,678
Investments in repurchase agreements	28,763,904
Restricted cash in bank	34,297,016
Total cash and cash equivalents	<u><u>\$ 64,286,030</u></u>

See notes to financial statements.

Texas Treasury Safekeeping Trust Company

**Statement of Fiduciary Net Position—Fiduciary Funds
August 31, 2017**

	Investment Trust Fund	Agency Fund
Assets:		
Cash in State Treasury	\$ -	\$ 1,232,819,918
Cash in bank	217	32,217,436
Deposits	-	591,358,500
Investments	20,144,192,464	38,271,328,084
Other assets	-	76,370,440
Accrued interest receivable	7,648,292	24,032,549
Trades pending settlement	-	1,041,349
	<hr/>	<hr/>
Total assets	\$ 20,151,840,973	\$ 40,229,168,276
Liabilities:		
Accounts payable	\$ 1,239,177	\$ 4,543,482
Accrued expenses	25,979	-
Interest payable	-	281
Trades pending settlement	3,493,456	24,813,702
Amounts payable to participants	18,151,528	-
Management fees reserved for operating expenses	332,927	-
Obligations under reverse repurchase agreements	-	35,827,142
Funds held for others	-	40,163,983,669
	<hr/>	<hr/>
Total liabilities	23,243,067	\$ 40,229,168,276
Net position:		
Held in trust for pool participants	<u>\$ 20,128,597,906</u>	

See notes to financial statements.

Texas Treasury Safekeeping Trust Company

**Statement of Changes in Fiduciary Net Position—Fiduciary Funds
Year Ended August 31, 2017**

	Investment Trust Fund
Additions:	
Investment income:	
Interest income	\$ 153,294,047
Expenses:	
Management fees and expenses	(9,503,713)
Net investment income	<u>143,790,334</u>
Deductions:	
Earnings paid to investors from net investment income	(143,836,410)
Expenses paid from management fees reserved for operating expenses	46,076
Net increase in participant investments	<u>4,638,014,224</u>
Net increase in net position	4,638,014,224
Net position at beginning of year	<u>15,490,583,682</u>
Net position at end of year	<u><u>\$ 20,128,597,906</u></u>

See notes to financial statements.

Notes to Financial Statements

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2017

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, 2017

Note 1. Summary of Significant Accounting Policies (Continued)

Measurement focus, basis of accounting and financial statement presentation: The Texas Trust financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the fiduciary fund financial statements, except for the agency funds which have no measurement focus but utilize the accrual basis of accounting for reporting its assets and liabilities. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

The Texas Trust financial statements include financial statements for each of the following fund classifications: a proprietary fund and fiduciary funds.

The Texas Trust reports the following major proprietary fund.

Enterprise Fund: Enterprise funds are used to report any activity for which a fee is charged to external users for services such as investment management and custodial services. 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 Enterprise Fund 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 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, \$296,986 in cash was held at DTC as of August 31, 2017, in order to maintain the account.

The Texas Trust maintains an account with the Federal Reserve, which establishes a reserve requirement for the Texas Trust. In order to meet the reserve requirement, the Texas Trust must maintain an average balance for the weekly measurement period that surpasses the required reserve amount. The Federal Reserve's reserve requirement is \$34 million as of August 31, 2017. The Texas Trust Federal Reserve account balance reported in restricted cash on August 31, 2017, was \$34,000,030.

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2017

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 including repurchase agreements, 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, 2017

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, 2017, 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, 2017, the Agency Fund had \$35,827,142 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.

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2017

Note 1. Summary of Significant Accounting Policies (Continued)

Receivables and payables: All trade receivables are shown net of an allowance for uncollectible amounts. The allowance as of August 31, 2017, was \$3,833. 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.

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, 2017, is held by the Comptroller with a par value of \$1,000,000. This amount is reflected in the Proprietary Fund's 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 reported amounts of assets and liabilities and fund net position at the date of the financial statements. 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.

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2017

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, 2017, 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>\$ 656,918,340</u></u>
Carrying amount	<u><u>\$ 657,925,601</u></u>
Proprietary cash at bank	\$ 52,432
Proprietary Funds non-current restricted cash at bank	34,297,016
Investment Trust Fund cash at bank	217
Agency Fund cash at bank	32,217,436
Agency Funds deposits	591,358,500
Total deposits carrying amount	<u><u>\$ 657,925,601</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, 2017

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.

Enterprise Fund: Investments for the Enterprise Fund, as of August 31, 2017, are as follows:

Investments	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:				
Equity securities	\$ 301,669	\$ -	\$ 301,669	\$ -
Total investments by fair value level	<u>\$ 301,669</u>	<u>\$ -</u>	<u>\$ 301,669</u>	<u>\$ -</u>
Investments measured at amortized cost:	Carrying Value			
Repurchase agreements	\$ 28,763,904			
Total investments at amortized cost	<u>\$ 28,763,904</u>			
Total investments	<u>\$ 29,065,573</u>			

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, 2017.

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, 2017. The weighted average maturity of the repurchase agreement pools are one day.

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2017

Note 2. Deposits and Investments (Continued)

TexPool and TexPool Prime Investment Trust Fund: Investments for TexPool and TexPool Prime, as of August 31, 2017, are as follows:

Investments	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:						
Commercial paper	\$ 2,831,320,000	\$ 2,825,456,875	\$ 2,825,813,403	\$ -	\$ 2,825,813,403	\$ -
Government sponsored enterprises	11,228,898,000	11,222,763,767	11,223,305,199	-	11,223,305,199	-
Repurchase agreements	4,204,277,919	4,204,277,919	4,204,277,919	-	4,204,277,919	-
United States government treasuries	1,095,000,000	1,094,572,439	1,094,469,785	-	1,094,469,785	-
Total debt securities	19,359,495,919	19,347,071,000	19,347,866,306	-	19,347,866,306	-
Total investments by fair value level	\$ 19,359,495,919	\$ 19,347,071,000	\$ 19,347,866,306	\$ -	\$ 19,347,866,306	\$ -
Investments measured at NAV:						
Money market mutual funds	\$ 797,075,107	\$ 797,121,464				
Total investments at NAV	\$ 797,075,107	\$ 797,121,464				
Total investments	\$ 20,156,571,026	\$ 20,144,192,464				

Shares of money market funds are valued daily based upon their reported net asset value and invest primarily in short-term U.S. Treasury and government securities. The redemption frequency is 1 day and there are no unfunded commitments as of August 31, 2017. 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.

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, 2017, 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, 2017.

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, 2017, TexPool had more than 5.0% of the pool's investments in the following GSEs: 39.2% with the Federal Home Loan Bank, 11.0% with the Federal Farm Credit Bank and 13.6% 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, 2017, commercial paper investments per issuer were less than 5.0% of the pool's investments.

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2017

Note 2. Deposits and Investments (Continued)

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:

Investments	Weighted Average Maturity (Days)	
	TexPool	TexPool Prime
Commercial paper	-	58
Government sponsored enterprises	38	-
Money market mutual funds	1	1
Repurchase agreements	2	1
United States government treasuries	83	53
Total portfolio weighted average maturity	30	47

Treasury Pool: Investments for the Treasury Pool, as of August 31, 2017, are as follows:

Investments	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:					
Asset backed securities	\$ 2,738,268,763	\$ 2,738,268,763	\$ -	\$ 2,738,268,763	\$ -
Commercial paper	8,175,903,527	8,175,903,526	-	8,175,903,526	-
Corporate obligations	1,636,697,450	1,636,697,450	-	1,636,697,450	-
Government mortgage-backed securities	1,977,932,274	1,977,932,274	-	1,977,932,274	-
Government sponsored enterprises	899,713,889	899,713,000	-	899,713,000	-
Small business administration	26,149,083	26,149,083	-	26,149,083	-
Stock in Texas Trust	1,000,000	1,000,000	-	-	1,000,000
Supranational	2,614,133,600	2,614,133,600	-	2,614,133,600	-
Treasury inflation-protected securities	212,562,604	212,562,604	-	212,562,604	-
United States government treasuries	4,343,256,078	4,343,022,500	-	4,343,022,500	-
United States government agencies— REFCO	366,394,146	366,394,146	-	366,394,146	-
United States government agencies— Lottery Treasury Strips	222,230,159	222,230,159	-	222,230,159	-
Total debt securities	23,214,241,573	23,214,007,105	-	23,213,007,105	1,000,000
Total investments by fair value level	\$ 23,214,241,573	\$ 23,214,007,105	\$ -	\$ 23,213,007,105	\$ 1,000,000
Investments measured at NAV:					
Money market mutual funds	\$ 2,277,000,000				
Total investments at NAV	\$ 2,277,000,000				
Investments measured at amortized cost:					
Repurchase agreements	\$ 1,800,000,000				
Total investments at amortized cost	\$ 1,800,000,000				
Total investments	\$ 27,291,241,573				

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 2016 and 2017. Money market funds are valued based upon their reported NAV.

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2017

Note 2. Deposits and Investments (Continued)

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). Money market funds must be rated AAAM by a NRSRO. The asset backed securities and corporate obligations that are not rated, are issued by Government Sponsored Enterprises that are rated AA+. The Treasury portfolio is rated AAAf 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.

Investments Subject to Credit Risk	AAA	AA	A	A-1	Not Rated
Asset-backed securities	\$ 2,133,535,680	\$ 4,503,294	\$ -	\$ -	\$ 600,229,789
Commercial paper	-	-	-	8,175,903,526	-
Corporate obligations	-	1,206,227,950	280,477,000	-	149,992,500
Government mortgage-backed securities	-	1,977,932,274	-	-	-
Government sponsored enterprises	-	899,713,000	-	-	-
Money market funds	1,676,000,000	-	-	-	601,000,000
Small business administration	-	26,149,083	-	-	-
Supranational	2,554,343,000	-	59,790,600	-	-

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 9.2% at August 31, 2017.

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements

August 31, 2017

Note 2. Deposits and Investments (Continued)

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:

Investments	Modified Duration (Years)
Asset-backed securities	1.221
Commercial paper	0.345
Corporate obligations	0.459
Government mortgaged-backed securities	3.255
Government sponsored enterprises	3.089
Repurchase agreements	0.003
Small business administration	15.451
Supranational	2.238
Treasury inflation-protected securities	5.356
United States government treasuries	0.507
United States government agencies—REFCO	3.899
United States government agencies—Lottery Treasury Strips	8.210
Treasury portfolio modified duration	1.038

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, 2017, was \$35,995,816 including accrued interest. The aggregate fair value of the securities underlying those agreements, including accrued interest, was \$35,827,422. There was credit exposure of \$168,394 at year-end.

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2017

Note 2. Deposits and Investments (Continued)

Endowment Funds: Investments for the Endowment Funds, as of August 31, 2017, are as follows:

Investments Measured at Net Asset Value (NAV)	Carrying Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Money market funds	\$ 185,179,164	N/A	Daily	1 day
Mutual funds—global equities	47,397,104	N/A	Daily	1 day
Mutual funds—global fixed income	280,052,474	N/A	Daily	1 day
Hedge funds—fund of funds	284,569,573	N/A	Daily, Monthly, Quarterly, Annually	1-95 days
Hedge funds—direct funds—fixed income	690,376,650	N/A	Daily, Monthly, Quarterly, Annually	2-92 days
Hedge funds—direct funds—equities	1,182,584,692	N/A	Daily, Monthly, Quarterly, Semi-Annually	1-120 days
Hedge funds—direct funds—all asset strategies	33,928,494	N/A	Annually	45 days
Hedge funds—direct funds—real assets	31,123,024	N/A	Monthly	30 days
Domestic alternative—private debt	405,074,031	\$ 229,699,937	N/A	N/A
Domestic alternative—private equity	324,769,752	334,303,389	N/A	N/A
Domestic alternative—real assets	518,871,161	209,609,336	N/A	N/A
International alternative—private debt	121,186	910,916	N/A	N/A
International alternative—private equity	49,064,824	18,529,972	N/A	N/A
International alternative—real assets	32,698,366	17,608,763	N/A	N/A
Total investments at NAV	\$ 4,065,810,495	\$ 810,662,314		

Money market funds and mutual funds are valued daily or monthly, as appropriate, at 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.

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.

Texas Treasury Safekeeping Trust Company

**Notes to Financial Statements
August 31, 2017**

Note 2. Deposits and Investments (Continued)

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. The investments in the money market fund are investments in State Street's Institutional Liquid Reserve fund which is rated AAAM by Standard & Poor's.

Standard & Poor's Credit Ratings	Mutual Funds— Global Fixed Income	Money Market Funds
AAA	\$ -	\$ 185,179,164
Not rated	280,052,474	-
Total	<u>\$ 280,052,474</u>	<u>\$ 185,179,164</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, 2017, no more than 5% of the portfolio was invested in securities of one issuer.

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 securities lending cash collateral pool and the short-term investment fund use a weighted average maturity to reflect the interest rate risk.

<u>Investments</u>	<u>Effective Duration (Years)</u>
Mutual funds—global fixed income	2.23
	<u>Weighted- Average Maturity</u>
Money market funds	23 days

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2017

Note 2. Deposits and Investments (Continued)

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	International Alternative Investments	Total
Euros	\$ 81,884,376	\$ 81,884,376

Derivatives: 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 include implementations of 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; to construct portfolios with risk and return characteristics that could not be created with cash market securities or to facilitate transition trading.

The fair value, changes in fair value, and notional value of the Endowment funds investments, classified by derivative type, are displayed in the following table as of August 31, 2017.

	Fair Value	Changes in Fair Value	Notional Value
Index Futures	\$ -	1,066,604	\$ 51,995,605

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2017

Note 2. Deposits and Investments (Continued)

State Water Implementation Fund for Texas: Investments for the SWIFT, as of August 31, 2017, are as follows:

Investments Measured at NAV	Carrying Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Money market funds	\$ 46,637,503	N/A	Daily	1 day
Mutual funds—global equities	36,173,025	N/A	Daily	1 day
Mutual funds—global fixed income	202,719,198	N/A	Daily	1 day
Mutual funds—commodities	9,009,290	N/A	Monthly	30 days
Hedge funds—fund of funds	100,098,904	N/A	Monthly, Quarterly	26-95 days
Hedge funds—direct funds—fixed income	347,670,373	N/A	Daily, Monthly, Quarterly	2-65 days
Hedge funds—direct funds—equities	430,219,788	N/A	Monthly, Quarterly, Semi-Annual, Anniversary	30-120 days
Hedge funds—direct funds—all asset strategies	88,561,711	N/A	Annually	45 days
Domestic alternative—private debt	242,470,194	\$ 104,177,319	N/A	N/A
Domestic alternative—private equity	1,921,471	100,723,530	N/A	N/A
Domestic alternative—real assets	274,349,799	61,767,069	N/A	N/A
Total investments	\$ 1,779,831,256			

Money market funds and mutual funds are valued daily or monthly, as appropriate, at 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 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 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.

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.

Texas Treasury Safekeeping Trust Company

**Notes to Financial Statements
August 31, 2017**

Note 2. Deposits and Investments (Continued)

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.

<u>Standard & Poor's Credit Ratings</u>	<u>Mutual Funds— Global Fixed Income</u>	<u>Money Market Funds</u>
AAA	\$ -	\$ 46,637,503
Not rated	202,719,198	-
Total	<u>\$ 202,719,198</u>	<u>\$ 46,637,503</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, 2017, 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.

<u>Investments</u>	<u>Effective Duration (Years)</u>
Mutual funds—global fixed income	2.32
	<u>Weighted- Average Maturity</u>
Money market funds	23 days

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2017

Note 2. Deposits and Investments (Continued)

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

Investments Measured at NAV	Carrying Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Money market funds	\$ 58,475,605	N/A	Daily	1 day
Mutual funds—global fixed income	1,839,424,967	N/A	Daily	1 day
Domestic alternative—private debt	301,071,092	\$ -	N/A	N/A
Total investments	<u>\$ 2,198,971,664</u>			

Money market funds and mutual funds are valued daily or monthly, as appropriate, at 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.

Alternative Fixed Income strategies 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.

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	\$ -	\$ 58,475,605
Not rated	1,839,424,967	-
Total	<u>\$ 1,839,424,967</u>	<u>\$ 58,475,605</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, 2017, 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, 2017

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>Investments</u>	<u>Effective Duration (Years)</u>
Mutual funds—global fixed income	2.49
	<u>Weighted- Average Maturity</u>
Money market funds	23 days

Repurchase Agreement Pool: The Texas Trust operates a Repurchase Agreement Pool in which state entities may invest non-appropriated funds. Investments for the Repurchase Agreement Pool, as of August 31, 2017, 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 one day.

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2017

Note 2. Deposits and Investments (Continued)

Other trust activities: 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, 2017, are as follows:

Investments	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:				
Commercial paper	\$ 167,284,119	\$ 167,284,119	\$ -	\$ -
Corporate obligations	9,396,973	-	9,396,973	-
Government sponsored enterprises	386,663,228	-	386,663,228	-
Government mortgage-backed securities	4,132,470	-	4,132,470	-
Investment in guaranteed investment contracts	24,427,389	24,427,389	-	-
Non-agency collateralized mortgage obligations	8,201	-	8,201	-
Political subdivision bonds	56,132,409	-	56,132,409	-
United States government treasuries	85,214,419	-	85,214,419	-
Total debt securities	<u>733,259,208</u>	<u>191,711,508</u>	<u>541,547,700</u>	<u>-</u>
Equity securities:				
Common and preferred stock	91,265,097	91,265,097	-	-
Investment in real estate trust fund	2,547,371	-	2,547,371	-
Warrants	111,460	-	111,460	-
Total equity securities	<u>93,923,928</u>	<u>91,265,097</u>	<u>2,658,831</u>	<u>-</u>
Total investments by fair value level	<u>\$ 827,183,136</u>	<u>\$ 282,976,605</u>	<u>\$ 544,206,531</u>	<u>\$ -</u>
	Carrying Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Investments measured at NAV:				
Money market funds	\$ 1,894,710	N/A	Daily, Weekly, Monthly	1-30 days
Total investments measured at NAV	<u>1,894,710</u>			
Investments measured at amortized cost:				
Repurchase agreements	394,109,321			
Total investments measured at amortized cost	<u>394,109,321</u>			
Total investments	<u>\$ 1,223,187,167</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.

Money market funds are valued daily or monthly, as appropriate, at NAV per share.

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2017

Note 3. Capital Assets

Capital asset activity for the year ended August 31, 2017, was as follows:

Business-Type Activities	Balance at September 1, 2016	Additions	Deletions	Balance at August 31, 2017
Depreciable assets:				
Buildings and building improvements	\$ 1,310,547	\$ 276,639	\$ -	\$ 1,587,186
Furniture and equipment	1,132,872	233,514	-	1,366,386
Total depreciable assets at historical cost	2,443,419	510,153	-	2,953,572
Less accumulated depreciation for:				
Buildings and building improvements	(337,228)	(80,361)	-	(417,589)
Furniture and equipment	(748,652)	(75,972)	-	(824,624)
Total accumulated depreciation	(1,085,880)	(156,333)	-	(1,242,213)
Total depreciable assets, net	1,357,539	353,820	-	1,711,359
Amortizable assets—intangible:				
Computer software	2,910,356	-	-	2,910,356
Total amortizable assets—intangible	2,910,356	-	-	2,910,356
Less accumulated amortization for:				
Computer software	(2,327,359)	(226,432)	-	(2,553,791)
Total accumulated amortization	(2,327,359)	(226,432)	-	(2,553,791)
Amortizable assets—intangible, net	582,997	(226,432)	-	356,565
Business-type activities—capital assets, net	\$ 1,940,536	\$ 127,388	\$ -	\$ 2,067,924

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2017

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 Employees Retirement System of Texas 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.

ERS Plan's membership as of the measurement date of August 31, 2016, is presented in the table below:

Employees retirement system's membership	ERS Plan
Retirees and beneficiaries currently receiving benefits	103,758
Terminated employees entitled to benefits but not yet receiving them	108,873
Current employees vested and nonvested	146,390
Total members	<u>359,021</u>

Texas Treasury Safekeeping Trust Company

**Notes to Financial Statements
August 31, 2017**

Note 4. Pension Plan (Continued)

The contribution rates for the state and the members for the ERS Plan for the measurement period of fiscal 2016 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 during the fiscal 2016 measurement period was \$745,543.

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, 2006, through August 31, 2011. The actuarial valuation as of August 31, 2016, incorporates the most significant across-the-board pay increases budgeted by the state legislature for the current biennium. The table below presents the actuarial methods and assumptions used to measure the total pension liability as of the August 31, 2016:

Actuarial Methods and Assumptions	
ERS Plan	
Actuarial valuation date	August 31, 2016
Actuarial cost method	Entry Age Normal
Amortization method	Level Percent of Payroll, Open
Actuarial assumptions:	
Discount rate	5.73%
Investment rate of return	8.00%
Inflation	3.50%
Salary increase	0% to 11.5%
Mortality	1994 Group Annuity Mortality Table with no setback for males and set forward two years for females. Generational mortality improvements in accordance with Scale AA are projected from the year 2000.
Cost-of-living adjustments	None—Employee 3.5%—Elected

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2017

Note 4. Pension Plan (Continued)

A single blended discount rate of 5.73% was applied to measure the total pension liability. The 5.73% discount rate incorporated an 8.00% long-term expected rate of return on pension plan investments and 2.84% 20-year municipal bond rate based on Federal Reserve Statistical Release H. 15. The long-term expected investment rate of return was applied to projected benefit payments through fiscal 2050 and the municipal bond rate was applied to all benefit payments thereafter.

The projections of cash flows used to determine this single 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 as of the measurement date, adjusted on consideration of subsequent events. There have been indicators of legislature's commitment to increase funding for the pension funds. The legislature passed House Bill No. 9 in the 84th legislative session during fiscal 2015 to increase the member contribution rates for fiscal 2016 and 2017. The state contribution rates also increased as the result of this legislative session. The legislature also maintained some changes made by Senate Bill 1459 in the 83rd legislative session. Considering these above events, the projected employer contributions are based on fiscal 2015 funding level.

The long-term expected rate of return on plan investments was developed using a building-block method with assumptions including asset class of investment portfolio, target allocation, real rate of return on investments and inflation factor. Under this method, best estimate ranges of expected future real rates of return (net of 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:

<u>Asset Class</u>	<u>Target Allocation</u>	<u>Long-Term Expected Arithmetic Real Rate of Return</u>
Global Equity	55%	4.02%
Global Credit	10%	0.19%
Intermediate Treasuries	15%	0.18%
Real Estate	10%	0.43%
Infrastructure	4%	0.25%
Hedge Funds	5%	0.35%
Cash	1%	0.00%
Total	<u>100%</u>	

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements
August 31, 2017

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:

	<u>1% Decrease</u>	<u>Current Discount Rate</u>	<u>1% Increase</u>
	4.73%	5.73%	6.73%
Texas Trust's proportionate share of the net pension liability	<u>\$ 27,623,171</u>	<u>\$ 21,447,953</u>	<u>\$ 16,292,790</u>

The pension plan's fiduciary net position is determined using economic resources measurement focus and the accrual basis of accounting. 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. 67, 72 and 31. 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 2016 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, 2017

Note 4. Pension Plan (Continued)

Texas Trust's total pension liability is based on an actuarial valuation performed as of August 31, 2016. For fiscal 2017 reporting, the measurement date of Texas Trust's net pension liability is August 31, 2016. The schedule of changes in Texas Trust's net pension liability for the fiscal year ending August 31, 2017, is presented below:

Total pension liability:	
Service cost	\$ 1,244,943
Interest on the total pension liability	2,738,534
Benefit changes	-
Difference between expected and actual experience of the total pension liability	144,988
Assumption changes*	5,755,754
Benefit payments and refunds	(2,331,092)
Net change in total pension liability	\$ 7,553,127
Total pension liability at beginning of year	\$ 37,827,282
Adjustment for change in trust company proportion	407,233
Total pension liability at end of year	\$ 45,787,642
Plan fiduciary net position:	
Contributions—employer	\$ 745,543
Contributions—member	732,423
Pension plan net investment income	1,382,403
Benefit payments and refunds	(2,331,092)
Pension plan administrative expense	(22,199)
Net change in plan fiduciary net position	\$ 507,078
Plan fiduciary net position at beginning of year	\$ 23,832,611
Plan fiduciary net position at end of year	\$ 24,339,689
Net pension liability at beginning of year	\$ 13,994,671
Net pension liability at end of year	\$ 21,447,953

* The change in the total pension liability due to the change in the single discount rate is included as an assumption change.

Texas Treasury Safekeeping Trust Company

Notes to Financial Statements August 31, 2017

Note 4. Pension Plan (Continued)

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 0.10855888% in fiscal year 2017 as compared with the 0.10548924% in the prior measurement period ending August 31, 2016.

For the fiscal year ending August 31, 2017, Texas Trust recognized pension expense of \$2,579,837. At August 31, 2017, Texas Trust reported deferred outflows of resources and deferred inflows of resources from the following sources:

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Difference between expected and actual experience	\$ 100,100	\$ 138,244
Changes of assumptions	4,073,917	1,410,451
Net difference between projected and actual investment return	1,136,284	-
Change in proportion and contribution difference	649,768	-
Contributions subsequent to the measurement date	786,614	-
Total	<u>\$ 6,746,683</u>	<u>\$ 1,548,695</u>

The \$786,614 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, 2018.

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

Years ending August 31:	
2018	\$ 1,298,751
2019	1,981,530
2020	997,737
2021	133,356
2022	-
Thereafter	-

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, 2017

Note 5. 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 \$71,749 for services provided. At August 31, 2017, the Texas Trust had accrued \$17,939 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, 2017, the Comptroller held \$1,172,678 to pay for the Texas Trust's September 1, 2017 payroll.

Note 6. Changes in Long-Term Liabilities

During the year ended August 31, 2017, the following changes occurred in long-term liabilities:

	Balance September 1, 2016	Additions	Reductions	Balance August 31, 2017	Amounts Due Within One Year
Compensable leave	\$ 941,416	\$ 907,936	\$ (829,918)	\$ 1,019,434	\$ 648,277
Net pension liability	13,994,671	7,453,282	-	21,447,953	-
Total	<u>\$ 14,936,087</u>	<u>\$ 8,361,218</u>	<u>\$ (829,918)</u>	<u>\$ 22,467,387</u>	<u>\$ 648,277</u>

**Required Supplementary Information
(Unaudited)**

Texas Treasury Safekeeping Trust Company

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

	2017	2016	2015
Total pension liability:			
Service cost	\$ 1,244,943	\$ 1,298,787	\$ 1,134,532
Interest on the total pension liability	2,738,534	2,504,156	2,314,146
Benefit changes**	-	(92,656)	-
Difference between expected and actual experience of the total pension liability	144,988	(300,382)	(251,875)
Assumption changes*	5,755,754	(3,617,403)	1,193,891
Benefit payments and refunds	(2,331,092)	(2,161,781)	(1,955,005)
Net change in total pension liability	\$ 7,553,127	\$ (2,369,279)	\$ 2,435,689
Total pension liability at beginning of year	\$ 37,827,282	\$ 39,340,344	\$ 36,904,655
Adjustment for change in trust company proportion	407,233	856,217	-
Total pension liability at end of year	\$ 45,787,642	\$ 37,827,282	\$ 39,340,344
Plan fiduciary net position:			
Contributions—employer	\$ 745,543	\$ 527,863	\$ 480,157
Contributions—member	732,423	487,529	428,736
Pension plan net investment income	1,382,403	60,066	3,238,376
Benefit payments and refunds	(2,331,092)	(2,161,781)	(1,955,005)
Pension plan administrative expense	(22,199)	(23,038)	(20,108)
Net change in plan fiduciary net position	\$ 507,078	\$ (1,109,361)	\$ 2,172,156
Plan fiduciary net position at beginning of year	\$ 23,832,611	\$ 24,941,972	\$ 22,769,816
Plan fiduciary net position at end of year	\$ 24,339,689	\$ 23,832,611	\$ 24,941,972
Net pension liability at beginning of year	\$ 13,994,671	\$ 14,398,372	\$ 14,134,839
Net pension liability at end of year	\$ 21,447,953	\$ 13,994,671	\$ 14,398,372
Texas Trust's covered-employee payroll	\$ 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-employee payroll	293.04%	215.71%	242.82%
Plan fiduciary net position as a percentage of total pension liability	55.32%	64.40%	63.40%

* The change in the total pension liability due to the change in the single discount rate is included as an assumption change.

** The impact of House Bill 9 passed by the 84th legislature is included as a benefit change.

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 three 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 accompanying independent auditor's report.

Texas Treasury Safekeeping Trust Company

**Schedule of Contributions
Last Three Fiscal Years**

	2017	2016	2015
Actuarially determined contributions	\$ 801,652	\$ 737,989	\$ 777,573
Contributions in relation to the actuarially determined contributions	786,614	745,626	527,863
Contribution deficiency (excess)	15,038	(7,637)	249,710
Covered-employee payroll	7,706,918	7,319,190	6,487,794
Contributions as a percentage of covered-employee payroll	10.21%	10.19%	8.14%

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

Only three 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 accompanying independent auditor's report.

Texas Treasury Safekeeping Trust Company

**Notes to Required Supplementary Information
August 31, 2016**

Note 1. Changes of Benefit Terms

There were no changes to benefit terms.

Note 2. Changes of Assumptions

Actuarially determined contributions are adjusted for actual payroll and administrative expenses. The change in total pension liability due to the change in the single discount rate is included as an assumption change.

Supplementary Information

Texas Treasury Safekeeping Trust Company

**Combining Schedule—Statement of Fiduciary Net Position—Agency Fund
August 31, 2017**

	Endowment Funds	State Water Implementation Fund	Texas Economic Stabilization Investment Fund	Treasury Pool	Repurchase Agreement Pool	Other Agency Funds	Totals
Assets:							
Current assets:							
Cash in State Treasury	\$ -	\$ 221,844,022	\$ 1,010,975,896	\$ -	\$ -	\$ -	\$ 1,232,819,918
Cash in bank	-	-	-	473,222	404,935	31,339,279	32,217,436
Deposits	-	-	-	576,358,500	-	15,000,000	591,358,500
Investments	4,065,810,495	1,779,831,256	2,198,971,664	27,291,241,573	1,712,285,929	1,223,187,167	38,271,328,084
Other assets	-	-	-	-	-	76,370,440	76,370,440
Receivables from:							
Interest and dividends	135,938	276,744	1,159,992	19,901,590	47,563	2,510,722	24,032,549
Trades pending settlement	1,041,349	-	-	-	-	-	1,041,349
Total assets	\$ 4,066,987,782	\$ 2,001,952,022	\$ 3,211,107,552	\$ 27,887,974,885	\$ 1,712,738,427	\$ 1,348,407,608	\$ 40,229,168,276
Liabilities:							
Accounts payable	\$ 2,066,123	\$ 604,473	\$ 372,887	\$ -	\$ 1,499,999	\$ -	\$ 4,543,482
Interest payable	-	-	-	281	-	-	281
Trades pending settlement	-	-	-	-	-	24,813,702	24,813,702
Obligations under reverse repurchase agreements	-	-	-	35,827,142	-	-	35,827,142
Funds held for others	4,064,921,659	2,001,347,549	3,210,734,665	27,852,147,462	1,711,238,428	1,323,593,906	40,163,983,669
Total liabilities	\$ 4,066,987,782	\$ 2,001,952,022	\$ 3,211,107,552	\$ 27,887,974,885	\$ 1,712,738,427	\$ 1,348,407,608	\$ 40,229,168,276

**Independent Auditor's 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***

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, each major fund, and the aggregate remaining fund information of the Texas Treasury Safekeeping Trust Company (Texas Trust) as of and for the year ended August 31, 2017, 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, 2017.

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 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 Texas Trust's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

RSM US LLP

Austin, Texas
December 12, 2017

