

Tobacco Settlement Permanent Trust Fund

Basic Financial Statements

December 31, 2015

Tobacco Settlement Permanent Trust Fund

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Independent Auditor's Report

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

Report on the Financial Statements

We have audited the accompanying financial statements of the Tobacco Settlement Permanent Trust Fund ("Fund"), a private purpose trust fund of the state of Texas, as of and for the year ended December 31, 2015, and the related notes to the financial statements, which collectively comprise the Fund'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 an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Fund'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 Fund's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

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Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Fund as of December 31, 2015, and the changes in its financial position for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As described in Note 2, the financial statements present only the Fund and do not purport to, and do not, present fairly the financial position of the State of Texas or the Texas Treasury Safekeeping Trust Company as of December 31, 2015, or the changes in their financial position for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

Other Matter

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis, 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.

Padgett, Statemann + Co., L.L.P.

Austin, Texas
March 9, 2016

Tobacco Settlement Permanent Trust Fund

Management's Discussion and Analysis

December 31, 2015

The Tobacco Settlement Permanent Trust Fund ("Fund") management's discussion and analysis is designed to assist the reader in focusing on significant financial issues and provide a performance overview of the Fund's operations for the year ended December 31, 2015. Please read this analysis in conjunction with the basic financial statements which follow this section. The Texas Treasury Safekeeping Trust Company ("Texas Trust") administers and manages the assets of the Fund.

Financial Highlights

- The total net position of the Fund decreased \$70.0 million, or 3% during the year 2015.
- The Fund provided \$55.0 million to political subdivisions for healthcare.

Overview of the Basic Financial Statements and Condensed Financial Information

The management's discussion and analysis is an introduction to the Fund's basic financial statements. The Fund has only one fund and, therefore, the government-wide and fund financial statements are the same since the Fund reports all of its activity as a fiduciary fund, which uses the same measurement focus for all statements.

The Statement of Fiduciary Net Position provides information about the nature and amounts of the Fund's cash, investments and receivables (assets), and their management fees (liabilities). The Statement of Changes in Fiduciary Net Position reports the additions to, deductions from, and net increases or decreases in net position.

This annual financial report consists of two parts:

- Management's discussion and analysis
- Basic financial statements

Statement of Fiduciary Net Position

Statement of Changes in Fiduciary Net Position

Notes to the Financial Statements

Tobacco Settlement Permanent Trust Fund

Management's Discussion and Analysis

December 31, 2015

The Statement of Fiduciary Net Position presents the financial position of the Fund at the end of the fiscal year and includes all assets and liabilities of the Fund. The difference between total assets and total liabilities equals the Fund's net position. At December 31, 2015 and 2014, Net Position was calculated as follows:

	<u>2015</u>	<u>2014</u>	<u>Amount of Increase (Decrease)</u>	<u>Percent Change</u>
Investments – at fair value	\$ 2,263,109,942	\$ 2,333,059,264	\$ (69,949,322)	(3.00%)
Other assets	<u>17,387</u>	<u>56,200</u>	<u>(38,813)</u>	<u>(69.06%)</u>
Total assets	2,263,127,329	2,333,115,464	(69,988,135)	(3.00%)
Total liabilities	<u>1,137,792</u>	<u>1,171,028</u>	<u>(33,236)</u>	<u>(2.84%)</u>
Net position held in trust	<u>\$ 2,261,989,537</u>	<u>\$ 2,331,944,436</u>	<u>\$ (69,954,899)</u>	<u>(3.00%)</u>

During the year, investments decreased \$69.9 million due to the payment of \$55.0 million to political subdivisions and lower investment returns as compared to 2014. Other assets decreased by \$38.8 thousand while total liabilities decreased by \$33.2 thousand. The decrease in other assets is attributable to a decrease in interest and other receivables.

The Statement of Changes in Fiduciary Net Position presents the activity within the Net Position balance for the year ended. Significant activity accounts include net investment income and distributions to local governments. The change in net position for the years ended December 31, 2015 and 2014 is as follows:

	<u>2015</u>	<u>2014</u>	<u>Amount of Increase (Decrease)</u>	<u>Percent Change</u>
Net investment income (loss)	\$ (9,202,484)	\$ 98,749,034	\$ (107,951,518)	(109.32%)
Distributions to local governments	55,000,000	50,000,000	5,000,000	10.00%
Expenses	<u>5,752,415</u>	<u>6,268,373</u>	<u>(515,958)</u>	<u>(8.23%)</u>
Net increase (decrease) in net position	(69,954,899)	42,480,661		
Net position held in trust at beginning of year	<u>2,331,944,436</u>	<u>2,289,463,775</u>		
Net position held in trust at end of year	<u>\$ 2,261,989,537</u>	<u>\$ 2,331,944,436</u>		

Tobacco Settlement Permanent Trust Fund

Management's Discussion and Analysis

December 31, 2015

Net Investment Income decreased by \$108 million compared to the previous year as a result of the lower investment returns earned by the Fund. During the year ended December 31, 2015, the total rate of return for the Fund was -0.43%, while the total rate of return for the previous year was 5.08%. The total Fund outperformed its benchmark for the year by 0.05%.

Asset Allocation

The current Texas Trust asset allocation structure as of December 31, 2015 is shown in the chart below:

Asset Class	Strategy	Current Market Value	Weight	Target	Policy Range
Fixed Income		\$878,720,603	38.8%	35.0%	20-50%
	Global Fixed Income	155,561,576	6.9%	10.0%	
	Cash	124,104,075	5.5%	0.0%	
	Alternative Fixed Income	380,836,161	16.8%	20.0%	
	Private Debt	218,218,791	9.6%	5.0%	
Equity		1,043,533,421	46.1%	45.0%	30-60%
	Global Public Equity	328,018,808	14.5%	15.0%	
	Hedged Equity	468,372,396	20.7%	20.0%	
	Private Equity	247,142,217	10.9%	10.0%	
Real Assets		317,642,721	14.0%	20.0%	10-30%
	Stable Value Real Assets	121,017,409	5.3%	5.0%	
	Enhanced Real Estate	126,477,303	5.6%	5.0%	
	Global Inflation Protected Securities	-	0.0%	3.0%	
	Natural Resources	70,148,009	3.1%	7.0%	
Strategic All Asset and Overlays		23,230,584	1.0%	0.0%	0-10%
Total Portfolio		\$2,263,127,329	100%	100.0%	100.0%

Tobacco Settlement Permanent Trust Fund

Management's Discussion and Analysis

December 31, 2015

The current structure represents the ongoing effort by the Texas Trust to achieve its investment objective to earn an annual total return that:

- Provides a predictable, stable stream of distributions.
- Ensures the inflation-adjusted value of distributions is maintained over the long-term.
- Ensures the inflation-adjusted value of the corpus after distributions and fund expenses is maintained over the long-term.
- Achieves the desired portfolio volatility and minimizes downside risk through diversification and risk management.

The 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.

The 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 return objective of the Fund.

The 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 will be exposed to real assets such as high quality real estate, timber, infrastructure assets, industrial and precious metals, energy, livestock, and grains.

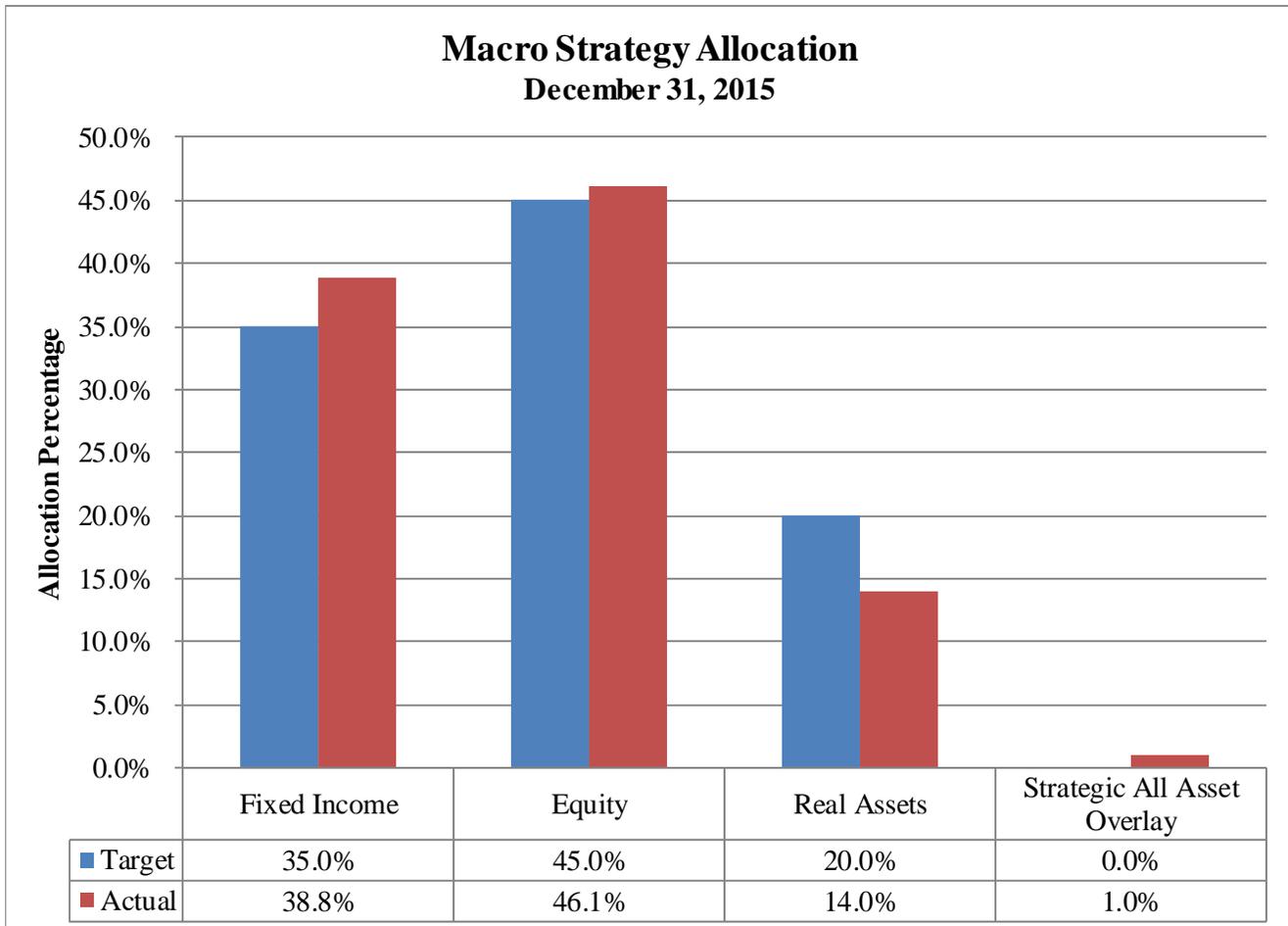
The All Asset strategies include exposures across equity, fixed income, and real estate classes. This portfolio may consist of long-only, hedged, and private strategies whose portfolios are diversified across a broad range of asset types.

Tobacco Settlement Permanent Trust Fund

Management's Discussion and Analysis

December 31, 2015

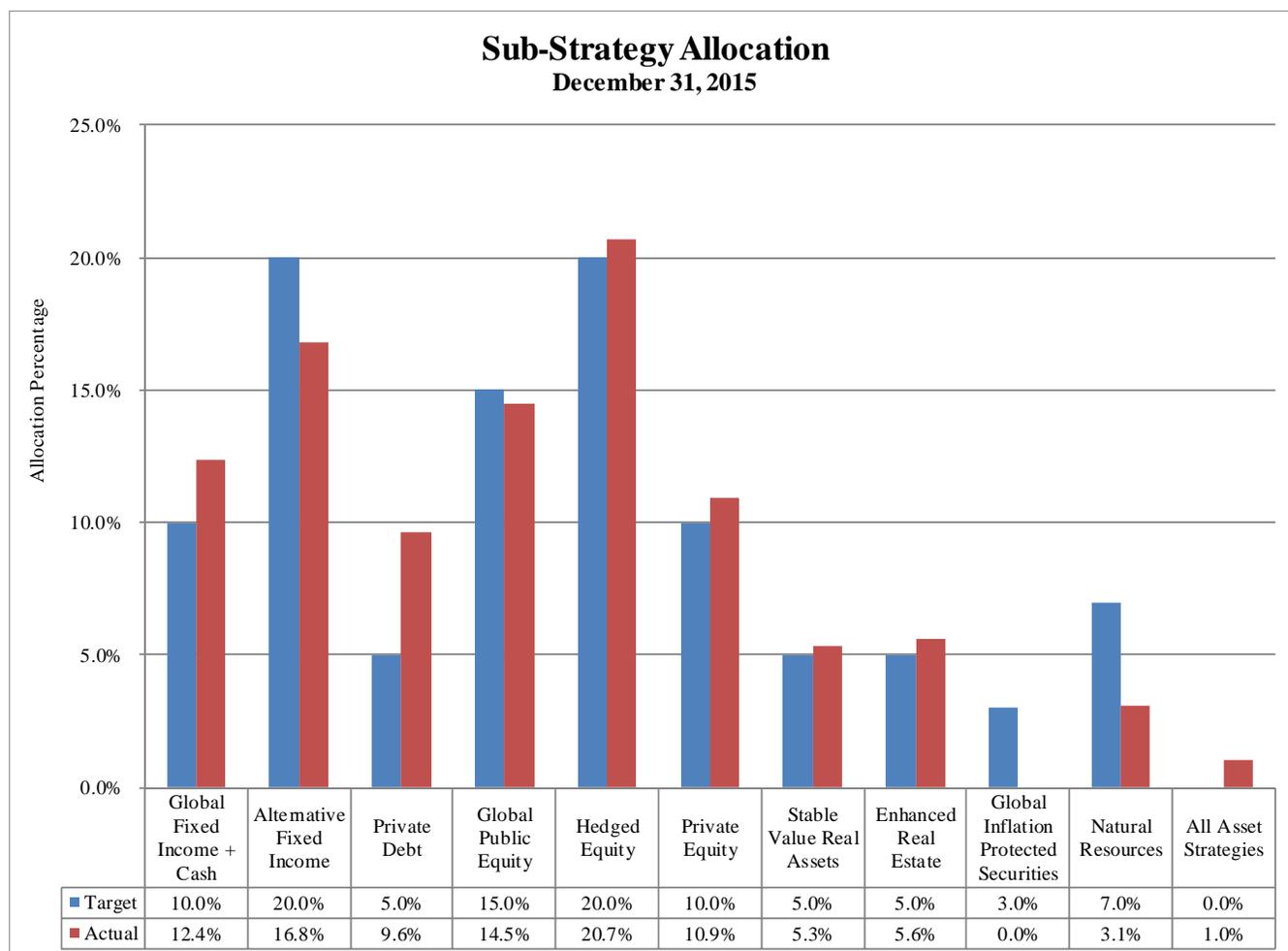
The following charts compare the Fund's macro strategy target asset allocation as of December 31, 2015 with its actual allocation as of December 31, 2015 and the Fund's sub-strategy asset allocation as of December 31, 2015 with its actual allocation as of December 31, 2015:



Tobacco Settlement Permanent Trust Fund

Management's Discussion and Analysis

December 31, 2015



The above chart compares the year-end actual allocation with its target allocation for each sub-strategy. The largest variations at year-end were a 3.9% underweight in natural resources and a 4.6% overweight in the private debt strategy. Both variances were well within the allowable target ranges for the strategy.

Unfunded Commitments

As of December 31, 2015, the Fund's outstanding unfunded commitments totaled \$480.6 million.

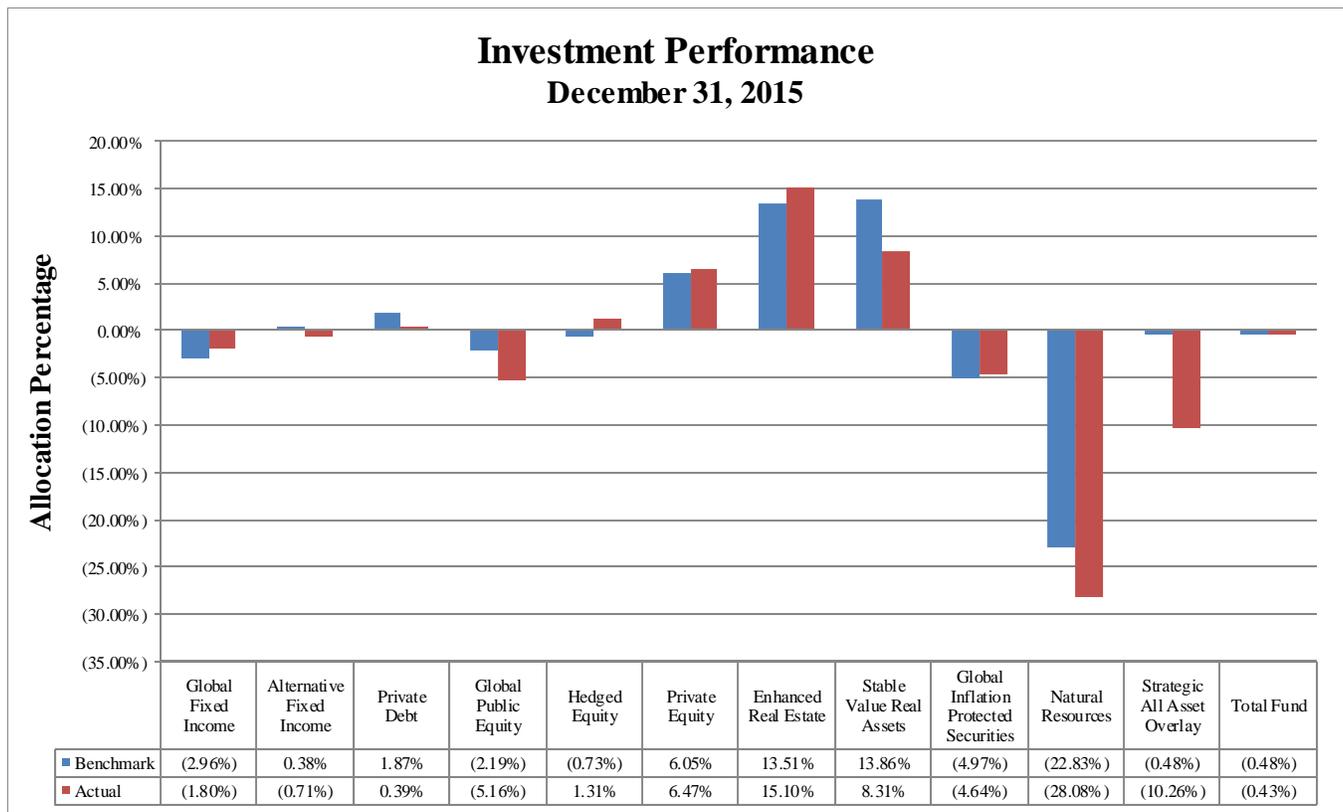
Tobacco Settlement Permanent Trust Fund

Management's Discussion and Analysis

December 31, 2015

Investment Performance

The chart below presents the Fund's performance as of December 31, 2015. During the year, the Fund's overall performance was -0.43%, while the policy benchmark return was -0.48%. During the year, the Global Fixed Income, Hedged Equity, Private Equity, Enhanced Real Estate, and Global Inflation Protected Securities composite outperformed its benchmark. All other strategies underperformed their respective benchmarks.



Below is the Fund's performance for the preceding 1 year, 2 year, and 3 year periods.

	<u>1 Year</u>	<u>2 Year</u>	<u>3 Year</u>
The Fund	(0.43%)	2.29%	4.73%

Tobacco Settlement Permanent Trust Fund

Management's Discussion and Analysis

December 31, 2015

Distribution and Contribution History

The maximum amount eligible and available for distribution in 2015 under the rules was \$46,761,489. See Note 4 for a more detailed explanation of the rules determining the maximum amount to distribute. The following chart reflects the Fund's distribution and contribution history:

<u>Contribution Month</u>	<u>Total</u>	<u>Distribution Month</u>	<u>Total Distribution From Tobacco Fund</u>	<u>Direct Distribution</u>	<u>Total Distributions</u>
		January 15, 1999	\$ -	\$ 300,000,000	\$ 300,000,000
January 3, 2000	\$ 444,581,000	April 1, 2000	-	100,000,000	100,000,000
December 29, 2000	433,888,365		-	-	-
January 2, 2001	67,523,342		-	-	-
June 12, 2001	43,407,228		-	-	-
December 31, 2001	491,573,700	April 12, 2001	14,306,508	50,000,000	64,306,508
May 1, 2002	19,317,882	April 12, 2002	17,760,000	-	17,760,000
December 30, 2002	26,914,041		-	-	-
December 31, 2002	148,494,658		-	-	-
April 30, 2003	7,264,688	April 17, 2003	22,041,497	-	22,041,497
	-	April 16, 2004	28,515,957	-	28,515,957
	-	April 18, 2005	50,282,384	-	50,282,384
	-	April 18, 2006	72,070,600	-	72,070,600
	-	April 20, 2007	82,691,441	-	82,691,441
	-	April 15, 2008	92,303,845	-	92,303,845
	-	April 15, 2009	92,303,845	-	92,303,845
	-	April 20, 2010	46,151,923	-	46,151,923
	-	April 18, 2011	51,000,000	-	51,000,000
	-	April 18, 2012	50,000,000	-	50,000,000
	-	April 16, 2013	50,000,000	-	50,000,000
	-	April 15, 2014	50,000,000	-	50,000,000
	-	April 15, 2015	55,000,000	-	55,000,000
Total	\$ 1,682,964,904		\$ 774,428,000	\$ 450,000,000	\$ 1,224,428,000

Tobacco Settlement Permanent Trust Fund

Management's Discussion and Analysis

December 31, 2015

The following chart reflects the Fund's Distribution Stabilization Account balances since inception.

Distribution Stabilization History

<u>Date</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance</u>
December 31, 2000	\$ 12,841,983	\$ -	\$ 12,841,983
December 31, 2001	10,186,788	-	23,028,771
December 31, 2002	10,332,806	-	33,361,577
December 31, 2003	9,679,918	-	43,041,495
December 31, 2004	30,952,305	-	73,993,800
December 31, 2005	8,007,844	-	82,001,644
December 31, 2006	9,187,938	-	91,189,582
December 31, 2007	10,255,983	-	101,445,565
December 31, 2008	-	(57,487,010)	43,958,555
December 31, 2009	-	-	43,958,555
December 31, 2010	10,145,226	-	54,103,781
December 31, 2011	-	(23,877,625)	30,226,156
December 31, 2012	-	(4,094,422)	26,131,734
December 31, 2013	15,905,911	-	42,037,645
December 31, 2014	23,305,033	-	65,342,678

Contacting Texas Trust's Financial Management

This financial report is designed to provide the Fund's beneficiaries, 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

Tobacco Settlement Permanent Trust Fund

Statement of Fiduciary Net Position

December 31, 2015

Assets

Interest and other receivables	\$ 17,387
Investments	<u>2,263,109,942</u>
Total assets	<u>2,263,127,329</u>

Liabilities

Accounts payable	<u>1,137,792</u>
Total liabilities	<u>1,137,792</u>

Net Position

Held in trust for other governments	<u><u>\$ 2,261,989,537</u></u>
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Notes to the financial statements form an integral part to this statement.

Tobacco Settlement Permanent Trust Fund
Statement of Changes in Fiduciary Net Position
Year Ended December 31, 2015

Additions

Investment income:	
Net decrease in fair value of investments	\$ (29,045,049)
Interest and investment income	<u>19,842,566</u>
Total income (loss) from investing activities	<u>(9,202,484)</u>
Total additions	<u>(9,202,484)</u>

Deductions

Professional fees and services	5,752,415
Disbursements to local governments	<u>55,000,000</u>
Total deductions	<u>60,752,415</u>
Change in net position held in trust for other governments	(69,954,899)
Net position held in trust for other governments at beginning of year	<u>2,331,944,436</u>
Net position held in trust for other governments at end of year	<u>\$ 2,261,989,537</u>

Notes to the financial statements form an integral part to this statement.

Tobacco Settlement Permanent Trust Fund

Notes to the Financial Statements

December 31, 2015

(1) Reporting Entity

The Tobacco Settlement Permanent Trust Fund (“Fund”) was established under the authority of House Bill 1161 (“Act”) enacted by the 76th Regular Session of the 1999 Texas Legislature. The purpose of the Fund is to collect monies from the tobacco companies, and distribute the funds to eligible local governmental units for reimbursement of previous healthcare costs associated with tobacco-related illness. The Fund was organized on July 24, 1998 and commenced operations on December 31, 1998.

The Act establishes the Fund with the Texas Comptroller of Public Accounts (“Comptroller”), who is required to administer and manage the assets of the Fund with the advice of, and in consultation with, the appointed Tobacco Settlement Permanent Trust Account Investment Advisory Committee (“Investment Advisory Committee”). The Comptroller is also required to make annual distributions to eligible governmental units and to prepare and distribute annual reports regarding the Fund’s assets and investments. The Investment Advisory Committee consists of 11 members appointed in accordance with the Act. The Comptroller, with the advice of, and in consultation with, the Investment Advisory Committee, has developed an Investment Policy which guides the investments of the Fund.

The Act requires the Texas Department of Health to collect information regarding the amount of each governmental unit’s unreimbursed healthcare expenditures, and to certify to the Comptroller the percentage payable from the Fund to each governmental unit.

(2) Summary of Significant Accounting Policies

(a) *Measurement Focus, Basis of Accounting, and Financial Statement Presentation*

The State of Texas reports the Fund as a private-purpose trust fund in its basic financial statements. Private-purpose trust funds are accounted for using the economic resources measurement focus and the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when the liability is incurred regardless of the time of the related cash flows.

(b) *Restrictions*

In accordance with the Act, the Fund is composed of money paid to the Fund in accordance with the Tobacco Settlement Agreement, assets purchased with that money, earnings of the Fund, and any other contributions made to the Fund. These amounts represent the corpus of the Fund and shall remain in the Fund and may not be distributed for any purpose that is not in accordance with the approved spending policy. The money and other assets contained in the Fund are not a part of the general funds of the State of Texas.

The Comptroller, with the advice and consultation of the Investment Advisory Committee, may use the earnings of the Fund for investment expense. Upon certification in accordance with the Health and Safety Code, Subchapter J, Chapter 12, the Comptroller shall make an annual distribution from the net earnings of the Fund, to each eligible political subdivision as provided in the agreement regarding disposition of settlement proceeds.

Tobacco Settlement Permanent Trust Fund

Notes to the Financial Statements

December 31, 2015

(2) Summary of Significant Accounting Policies (continued)

(c) *Investments*

Investments with a readily determinable fair value are reported at fair value based upon quoted market prices, or when quoted market prices are not readily determinable, estimated fair values based on market conditions and information provided by the investment administrators. For investments in limited partnerships where no readily determinable fair value exists, the fair value of the investment is based on the most recent capital account balance of each limited partnership as communicated by the investment administrator, adjusted for subsequent contributions, distributions, and withdrawals, or based upon their evaluation of estimated changes in values from the date of the most recent capital account balance. For investments in fund of hedge funds and direct investments in hedge funds, the fair value is based on net asset value information provided by the designated fund administrator. The Texas Treasury Safekeeping Trust Company (“Texas Trust”) reviews fair values and makes adjustments as necessary based on its evaluation.

According to the Act, the Comptroller is to administer and manage the assets of the Fund using the specified fiduciary standard of care and with the advice of, and in consultation with, the Investment Advisory Committee. The Fund is authorized to invest its funds according to the approved Investment Policy.

Tobacco Settlement Permanent Trust Fund

Notes to the Financial Statements

December 31, 2015

(2) Summary of Significant Accounting Policies (continued)

(c) Investments (continued)

The following table reflects the Fund's asset class target percentage and the allocation range per the Fund's Investment Policy:

Strategy – Sub-Strategy	Target Percentage	Benchmark(s) Strategy Range
<i>Fixed Income</i>	35%	<i>Allocation Range: 20%-50%</i>
Global Fixed Income	10%	9% Barclays Capital Multiverse Bond Index; 1% 3-Month T-Bill
Alternative Fixed Income	20%	HFRI FOF: Conservative Index
Private Debt	5%	Cambridge Associates – Private Debt Index
<i>Equity</i>	45%	<i>Allocation Range: 30%-60%</i>
Global Public Equity	15%	MSCI ACWI IMI Net Index
Hedged Equity	20%	HFRI FOF: Strategic Index
Private Equity	10%	Cambridge Associates – Private Equity Index
<i>Real Assets</i>	20%	<i>Allocation Range: 10%-30%</i>
Stable Value Real Estate	5%	NCREIF NFI – ODCE
Enhanced Real Estate	5%	Cambridge Associates Real Estate Fund Index
Global Inflation Protected Securities	3%	Barclays Capital Global Inflation Linked Bond Index
Natural Resources	7%	5% Bloomberg Commodity Index; 1% MSCI World Energy Equity Index 1% MSCI World Materials Equity Index
<i>All Asset Strategy</i>	0%	<i>Allocation Range: 0%-10%</i>
Risk Parity, Tactical Asset Allocation, Multi-Strategy	0%	Total Endowment Benchmark

Tobacco Settlement Permanent Trust Fund

Notes to the Financial Statements

December 31, 2015

(2) Summary of Significant Accounting Policies (continued)

(d) Custodian

The Fund contracts services to a custodian to assist with certain of its responsibilities. The custodian performs the duties involving the acquisition, sale, and holding of fixed income and equity investments in the Fund's name.

(e) Income Tax

The Fund is exempt from federal income tax on its operations in accordance with Internal Revenue Code Section 115.

(f) Use of Estimates

The preparation of 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 disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Accordingly, actual results could differ significantly from these estimates.

(3) Investments

The Fund reports investments at fair value on the Statement of Fiduciary Net Position, and all investment income, including changes in the fair value of investments, are reported in the Statement of Changes in Fiduciary Net Position.

The Texas Trust administers and manages the assets of the Fund using the specified fiduciary standard of care and with the advice of, and in consultation with, the Investment Advisory Committee. The Fund is authorized to invest its funds according to the approved Investment Policy. The Fund's investments as of December 31, 2015 are as follows:

	<u>Fair Value</u>
Investment Type	
Mutual Funds:	
Global fixed income	\$ 119,389,356
Global equities	20,707,833
Commodities	37,180,992
Hedge Funds:	
Fund of funds	114,619,279
Direct funds	1,134,270,074
Alternative Investments:	
Domestic	664,424,243
International	48,431,476
Investment in short-term investment fund	<u>124,086,688</u>
Total Endowment Fund Investments	<u>\$ 2,263,109,942</u>

Tobacco Settlement Permanent Trust Fund

Notes to the Financial Statements

December 31, 2015

(3) Investments (continued)

Credit Risk. The Fund's 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 Rating	Mutual Funds – Global Fixed Income	Investments in Short-Term Investment Fund
AAA	\$ -	\$ 124,086,688
Not Rated	119,389,356	-
Total	\$ 119,389,356	\$ 124,086,688

Concentration Risk: Excluding passive strategies, exposure to any investment firm will generally be limited to no more than 10% of Fund assets. Fund investments will generally not exceed more than 25% of any firm's assets under management. As of December 31, 2015, no more than 5% of the portfolio was invested in securities of one issuer.

Interest Rate Risk: The Fund's Investment Policy does not limit investment maturities. The following schedule reflects the average effective duration of the Endowment funds by investment type. The investments in the short-term investment fund use a weighted average maturity to reflect the interest rate risk.

Investment Type	Modified Duration
Mutual Funds: Global Fixed Income	2.14 years
Investment in short-term investment fund	23 days

Tobacco Settlement Permanent Trust Fund

Notes to the Financial Statements

December 31, 2015

(3) Investments (continued)

Foreign Currency Risk: The Fund's Investment Policy does not limit investments in any single foreign currency. The Fund's exposure to foreign currency risk derives from its position in foreign currency-denominated investments in limited partnerships.

<u>Currency</u>	<u>Alternative Investment</u>	<u>Total</u>
Euro	\$ 48,431,476	\$ 48,431,476

Treasury Pool

The Fund may participate in the Treasury Pool, which is an internal investment pool. The Comptroller maintains oversight responsibility for the Treasury Pool. This responsibility includes the ability to influence operations, designation of management, and accountability for fiscal matters. The Treasury Pool operates in accordance with the Comptroller's Investment Policy. The Fund receives allocated earnings based on its percentage share of the Treasury Pool, but its overall value remains the same as the initial deposit into the Treasury Pool plus accrued income. The Fund was not invested in the Treasury Pool at December 31, 2015.

(4) Annual Distribution From the Fund

The Comptroller is required by Government Code, Section 403.1041, to administer the Tobacco Settlement Permanent Trust Account (Trust Account) and manage the assets of the Trust Account with the advice of, and in consultation with, the Investment Advisory Committee. The Comptroller is also required to adopt rules necessary to implement the Comptroller's duties under Government Code, Section 403.1041, including rules distinguishing the net earnings of the Trust Account that may be distributed from earnings used for investment expenses and from the money and assets that are the corpus of the Trust Account.

A rule revision was adopted by the Comptroller with the advice and approval of the Investment Advisory Committee, and became effective for the actual distribution amount from the Fund for 2006 and for reserving an allocation for the distribution stabilization account ("DSA"), the calculations of which are based on these basic financial statements.

A rule revision was adopted by the Comptroller with the advice and approval of the Investment Advisory Committee, and became effective for the actual distribution amount from the Fund for 2011. If the net earnings of the trust account are less than the calculated actual distribution amount, the actual distribution amount shall not exceed the lesser of: 4.5% of the average market value or 4.5% of the year-end market value. The distribution shall be funded from the sources, until exhausted, in the order provided as follows:

- (1) adjusted current earnings;
- (2) positive net earnings; then
- (3) up to 50% of the balance of the distribution stabilization account.

Any or all positive net earnings, not otherwise distributed, may be distributed to the DSA.

Tobacco Settlement Permanent Trust Fund

Notes to the Financial Statements

December 31, 2015

(4) Annual Distribution From the Fund (continued)

In April 2015, the board elected to distribute \$55,000,000 based on the calculation performed on the audited financial statements as of December 31, 2014. The distribution was funded from fiscal year 2014 current earnings less investment expenses of \$45,887,437 and \$9,112,563 from positive net earnings. The remaining fiscal year 2014 positive net earnings of \$23,305,033 was transferred to the DSA. The December 31, 2014 balance in the DSA is \$65,342,678, which is part of the Fund.

The inflation adjusted corpus for the year ended December 31, 2015 was \$2,292,374,986. The average market value of the Trust Account using the most recent 20 calendar quarter-end market values was \$2,188,612,806. The market value at year-end was \$2,258,135,516. Based on these values, the maximum amount eligible for distribution in April 2016 under the rules is \$98,487,576. Because the net earnings are less than the calculated distribution amount and there are no positive net earnings, only \$46,761,489 is available for distribution. The distribution will be funded from the following sources, \$14,090,150 from current earnings less investment expenses, \$32,671,339 from the DSA.

If the maximum amount eligible is distributed, the total DSA reserve would be reduced to \$32,671,339. The reserve is intended to be used to facilitate the objectives of providing a predictable, stable stream of distributions over time and to ensure the inflation-adjusted value of the distributions is maintained over the long-term.

(5) Related Parties

Prior to September 1, 2001, the Comptroller provided financial and staff support to conduct and administer the day-to-day operations of the Texas Trust, including the Fund. Those expenses were neither recorded nor allocated to the Fund's basic financial statements and were paid through the General Fund of the Comptroller's Office.

Beginning September 1, 2005, the contract and agreement between the Comptroller and the Texas Trust allows the Texas Trust to charge a flat fee of 30 basis points to recover all costs associated with the management of the Fund. The Fund was charged \$5,752,415 for the months of January 2015 through December 2015.