

State Board of Administration of Florida
Florida Retirement System (FRS) Trust Fund

Fiscal Years Ended June 30, 2018 and 2017

FINANCIAL STATEMENTS, NOTES TO THE FINANCIAL STATEMENTS,
AND MANAGEMENT'S DISCUSSION AND ANALYSIS

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Crowe LLP
Independent Member Crowe Global

INDEPENDENT AUDITOR'S REPORT

The Board of Trustees
State Board of Administration of Florida

Report on the Financial Statements

We have audited the accompanying financial statements of the Florida Retirement System Trust Fund (the "Trust") administered by the State Board of Administration ("SBA") of Florida, as of and for the years ended June 30, 2018 and 2017, and the related notes to the financial statements, which collectively comprise the 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 an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the 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 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 opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Trust administered by the SBA as of June 30, 2018 and 2017, and the changes in financial position for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

As discussed in Note 1, the financial statements present only the Trust and do not purport to, and do not, present fairly the financial position of the State of Florida, the State Board of Administration of Florida or the Florida Retirement System as of June 30, 2018 and 2017, their changes in financial position, or, where applicable, their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

As described in Notes 2 and 3, the financial statements include investments valued at approximately \$37.8 billion and \$35.0 billion as of June 30, 2018 and 2017, respectively, for which fair value has been estimated by general partners and investment advisors, and reviewed and approved by the Trust's management, in the absence of readily ascertainable market values. Because of the inherent uncertainty of valuation, the estimate of values may differ from the values that would have been used had a ready market existed for the investment securities, and the differences could be material. Our opinion is not modified with respect to this matter.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the *management's discussion and analysis* on pages 3 through 10 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by 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 Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated November 9, 2018 on our consideration of the Trust's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is 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 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 the Trust's internal control over financial reporting and compliance.



Crowe LLP

Tampa, Florida
November 9, 2018

Management's Discussion and Analysis

Introduction

This section of the financial statements of the Florida Retirement System Trust Fund (the Trust) presents management's discussion and analysis of the Trust's financial position for the fiscal years ended June 30, 2018 and 2017. Please read it in conjunction with the basic financial statements and the accompanying notes, which follow this section.

As further described in Note 1 to the financial statements, the Florida Retirement System (FRS) Pension Plan (the Plan) is a cost-sharing, multiple-employer defined benefit pension plan for eligible members of the Florida Retirement System who have elected to participate in the Plan.

The Florida Legislature is responsible for establishing Plan structure, benefit levels and contribution rates, and providing statutory authority for administering the Plan. The Plan is administered by the Division of Retirement within the Department of Management Services (DMS). DMS's responsibilities include directing actuarial studies, collecting contributions to the Plan, transmitting contributions to the State Board of Administration of Florida (the SBA) for deposit in the Trust, and making benefit payments. The SBA is responsible for investing Trust assets consistent with statutory authority.

Financial Statements

The financial reporting entity represented in the basic financial statements and accompanying notes is the Trust, which consists of the assets held in trust by the SBA for the payment of retirement benefits and reasonable administrative expenses of the Plan. The financial statements of the Trust do not include the pension liabilities of the participating employers. The assets, liabilities, and net position of the Trust are reported in the comprehensive annual financial reports (CAFRs) published by the State of Florida and the Department of Management Services.

The Trust's basic financial statements include two-year comparative statements of net position and statements of changes in net position. The statements of net position provide a measurement of the financial status of the Trust as of the end of the fiscal year. The statements of changes in net position present the results of Trust activities during the fiscal years presented in this report.

The accompanying notes to financial statements also are important to the reader's understanding of the financial statements and provide additional information regarding the Trust, such as accounting policies, significant account balances and activities, material risks, obligations, contingencies and subsequent events, if any.

Management's Discussion and Analysis

Statements of Net Position

The statements of net position present the assets, liabilities and net position (total assets in excess of total liabilities) of the Trust as of the end of the fiscal year and are point-in-time financial statements.

| | As of June 30 | | |
|-----------------------------------|----------------------|-------------------|-------------------|
| | 2018 | 2017 | 2016 |
| Assets | <i>(In Millions)</i> | | |
| Cash and cash equivalents | \$ 114 | \$ 131 | \$ 137 |
| Investments | 165,794 | 157,725 | 145,571 |
| Receivables and prepaid expenses | 8,940 | 6,874 | 6,791 |
| Total assets | 174,848 | 164,730 | 152,499 |
| Liabilities | | | |
| Total liabilities | 13,530 | 10,569 | 10,588 |
| Net position held in trust | \$ 161,318 | \$ 154,161 | \$ 141,911 |

Statements of Changes in Net Position

The statements of changes in net position show the net investment income earned by the Trust, the contributions from employers and employees, and the deductions for members and beneficiaries that occurred during the fiscal year.

| | Fiscal Years Ended June 30 | | |
|---|----------------------------|-------------------|-------------------|
| | 2018 | 2017 | 2016 |
| | <i>(In Millions)</i> | | |
| Additions | | | |
| Investment income | \$ 14,512 | \$ 19,322 | \$ 1,332 |
| Investment expenses | (602) | (572) | (555) |
| Net security lending income | 43 | 49 | 40 |
| Total net investment income | 13,953 | 18,799 | 817 |
| Contributions: | | | |
| Employer/employee contributions received from DMS | 3,552 | 3,296 | 3,085 |
| Member-directed benefits received from the FRS Investment Plan Trust Fund | 71 | 71 | 55 |
| Total contributions | 3,623 | 3,367 | 3,140 |
| Total additions | 17,576 | 22,166 | 3,957 |
| Deductions | | | |
| Funds sent to DMS for benefit payments | 9,822 | 9,347 | 9,873 |
| Member-directed benefits sent to the FRS Investment Plan Trust Fund | 597 | 569 | 612 |
| Total deductions | 10,419 | 9,916 | 10,485 |
| Change in net position | 7,157 | 12,250 | (6,528) |
| Net position held in trust: | | | |
| Beginning of year | 154,161 | 141,911 | 148,439 |
| End of year | \$ 161,318 | \$ 154,161 | \$ 141,911 |

Management's Discussion and Analysis

Analysis

The Trust's net position increased by \$7.2 billion (4.6%) and increased by \$12.3 billion (8.6%) during fiscal years 2018 and 2017, respectively. For both fiscal years, market performance had a significant, positive impact on the Trust's bottom line.

Investment income was approximately \$14.5 billion and \$19.3 billion for fiscal years 2018 and 2017, respectively. In fiscal year 2018, global equity and alternative investment returns exceeded their benchmarks and contributed substantially to investment income. For fiscal year 2017, total investment income was up approximately \$18 billion over the previous year, as the Trust experienced positive, double-digit returns. Additional information has been provided in the "Investment Returns" section below.

Investment expenses totaled \$602 million, or .38% (38 basis points) of total average investments for fiscal year 2018, compared with investment expenses of \$572 million, or .39% (39 basis points) of total average investments for fiscal year 2017. The investment expense increased by \$30 million (5.2%) and \$17 million (3.1%) during fiscal years 2018 and 2017, respectively. The increases were due in large part to the growth in assets under management (AUM) and the addition of several new private asset investments.

Investment expenses are summarized below and are primarily comprised of fees and expenses deducted directly from earnings on the FRS Trust Fund. These expenses include such items as bank fees and investment management fees paid or accrued to third party investment managers who are responsible for managing the portion of the FRS Trust Fund not managed internally by the SBA. Additional items in this category include the SBA administrative service charge and other investment fees and expenses. The SBA administrative service charge (currently .0225% of assets under management) is statutorily charged to all SBA investment mandates for general investment services and is used to fund the SBA's operating costs. Other investment fees and expenses are also summarized below and generally represent expenditures not covered by the SBA administrative service charge.

| Investment expenses | Fiscal Years Ended June 30 | | |
|----------------------------------|----------------------------|-------------------|-------------------|
| | 2018 | 2017 | 2016 |
| | <i>(In Thousands)</i> | | |
| Bank fees | \$ 4,343 | \$ 4,223 | \$ 4,294 |
| Investment management fees | 550,267 | 521,736 | 509,323 |
| SBA admin service charge | 36,069 | 33,073 | 31,970 |
| Other fees and expenses: | | | |
| Consulting | 3,843 | 6,459 | 4,591 |
| Legal | 2,996 | 2,835 | 2,857 |
| Derivative | 2,496 | 2,324 | 1,434 |
| Miscellaneous | 1,762 | 1,210 | 969 |
| Total investment expenses | \$ 601,776 | \$ 571,860 | \$ 555,438 |

Management's Discussion and Analysis

Analysis (continued)

Net security lending income decreased by approximately \$6 million (12.2%) and increased by \$9 million (22.5%) in fiscal years 2018 and 2017, respectively. The fluctuations are due to changes in demand and pricing of loaned securities. The lending program continues to focus on maximizing earnings while managing reinvestment risk. (See Note 3 to the financial statements for additional information on the securities lending program.)

Contributions to the Trust consist primarily of amounts received from DMS for employer and employee retirement plan contributions during the fiscal year. Total contributions to the Trust increased by \$256 million (7.6%) and \$227 million (7.2%) during fiscal years 2018 and 2017, respectively. These amounts vary from year to year based upon a number of factors such as statutory contribution rates and the number of participating employers and employees.

Deductions from the Trust include amounts needed to fund benefit payments and member-directed transfers to the FRS Investment Plan Trust Fund throughout the year. Funds sent from the Trust to DMS for benefit payments increased by \$475 million (5.1%) and decreased by \$526 million (5.3%) during fiscal years 2018 and 2017, respectively. Member-directed benefits sent to the FRS Investment Plan Trust Fund reflect elections by the FRS members to transfer their membership from the Plan to the FRS Investment Plan. Member-directed benefits sent to the FRS Investment Plan Trust Fund increased by \$28 million (4.9%) and \$43 million (7.0%) during fiscal years 2018 and 2017, respectively.

Plan Choice

Chapter 2017-88, Laws of Florida was signed into law amending, among other sections, section 121.4501(4), Florida Statutes. The new law generally provides that effective January 1, 2018, all new hires will have until the last business day of the 8th month after hire to make a choice between the FRS Pension Plan and FRS Investment Plan. If a new hire does not make an active election by the deadline date, the new hire will default into the FRS Investment Plan, except those who are enrolled in the Special Risk Class (who will still default to the FRS Pension Plan). The first group of new hires will not default into the FRS Investment Plan until October 1, 2018. The SBA has prepared a preliminary analysis of the impact of the new law. Based on this analysis, the SBA does not currently believe the new law will have a material adverse effect on the FRS Trust Fund.

Management's Discussion and Analysis

Contribution Rates

Contributions consist of employer and employee contributions to the Plan received from DMS, and member-directed benefits received from the FRS Investment Plan Trust Fund.

| Membership Class | Employee Rate | Employer Rate ¹ | | |
|--|---------------|----------------------------|---------|---------|
| | FYs 2016-18 | FY 2018 | FY 2017 | FY 2016 |
| Regular | 3.00 % | 6.20 % | 5.80 % | 5.56 % |
| Special risk | 3.00 | 21.55 | 20.85 | 20.34 |
| Special risk: administrative support | 3.00 | 32.91 | 26.34 | 31.25 |
| Legislators | 3.00 | 49.14 | 40.38 | 44.10 |
| Governor, Lt. Governor, and cabinet officers | 3.00 | 49.14 | 40.38 | 44.10 |
| State Attorney, public defenders | 3.00 | 49.14 | 40.38 | 44.10 |
| Justices, judges | 3.00 | 37.92 | 34.98 | 34.01 |
| County and local elected officers | 3.00 | 43.78 | 40.75 | 40.57 |
| Senior management service | 3.00 | 20.99 | 20.05 | 19.73 |
| DROP | 0.00 | 11.60 | 11.33 | 11.22 |

¹ Employer rates presented in this table do not include employer contributions for Health Insurance Subsidy (1.66% for FYs 2018, 2017 and 2016) or plan administrative/educational expense (.06% for FYs 2018 and 2017, and .04% for FY 2016) as these amounts are not deposited into the Trust.

Management's Discussion and Analysis

Investment Returns¹

The Trust earned an overall investment return of 8.98% for fiscal year 2018, outperforming its benchmark over the trailing one-, three-, five-, ten- and fifteen-year periods. The 2018 total fund return exceeded the benchmark by 76 basis points. The 2017 total fund return exceeded the benchmark by 81 basis points.

For the fiscal years ended June 30, 2018 and 2017, the Trust's investment returns, by major asset class, were as follows:

| Asset Class | 2018 | | 2017 | |
|-----------------------------|----------------|----------------|---------|-----------|
| | Return | Benchmark | Return | Benchmark |
| Global equity | 11.61 % | 11.11 % | 19.70 % | 19.06 % |
| Fixed income | -0.19 | -0.32 | 0.27 | -0.16 |
| Real estate | 7.21 | 7.20 | 8.73 | 6.87 |
| Private equity ² | 17.25 | 14.18 | 18.21 | 21.98 |
| Strategic investments | 7.76 | 6.58 | 9.75 | 6.60 |
| Cash | 1.42 | 1.29 | 0.62 | 0.54 |
| Total fund | 8.98 | 8.22 | 13.77 | 12.96 |

¹ The above investment performance information for June 30, 2018 and 2017, is the investment return data supplied by the SBA's master custodian and performance measurement service provider, BNY Mellon Performance Reporting and Analytics Services. These rates of returns do not necessarily reflect the same information and accounting treatments as included in the Trust's Statements of Changes in Net Position, due to the latter's inclusion of subsequent updates to private market investment valuations, timing differences in the recognition of receivables and other items, and differences in GASB accounting rules and SBA performance measurement policies. For 2017, Total Fund performance, based on 2017 audited information as certified by BNY Mellon Performance Reporting and Analytics Services, was 13.53%. As of the issuance date of the audit report for 2018, final Total Fund performance based on 2018 audited information was not available.

² Per industry convention, Private Equity returns are presented on a dollar-weighted basis. All other returns (including Total Fund) are on a time-weighted basis. Time-weighted returns show the value of one dollar invested in a portfolio for the entire period while dollar-weighted returns show an average return of all dollars in the portfolio for the period.

More detailed information and analysis of the Trust's performance can be obtained from the SBA's Annual Investment Report, which can be found at www.sbafla.com.

Management's Discussion and Analysis

Economic Factors

The 2018 fiscal year generated another period of solid capital market returns, as optimism regarding the global economy helped investors overcome ongoing geopolitical tensions throughout the year. The year began on a strong note, as risky assets continued their climb supported by a healthy global economy, the approval of the most sweeping overhaul of the U.S. tax system in over three decades, and modest, yet still supportive, policy changes from global central banks. Bond yields moved gradually higher and oil prices rallied to a two-year high. Emerging market equities were the greatest beneficiaries during the first half of the year, benefitting from strong global growth, rising oil prices, and supportive central bank policies. Gains were not without headwinds, however. Ongoing tensions between the U.S. and North Korea, concerns over the potential economic impact of two major hurricanes hitting the U.S., pending roll back of central bank easing measures, and ongoing political uncertainty, particularly across the U.S., Germany, and Italy, all tempered returns.

The second half of the year began strong through January, but equity markets quickly came under pressure once in February and then again in March. Positive economic momentum and rising inflationary pressure ignited fears of a more hawkish Federal Reserve, causing U.S. bond yields to spike to a four-year high and equity markets to sell-off sharply in February. Though stocks recovered some losses, markets experienced another correction in March due to fears of a global trade-war ignited by the Trump administration's decision to impose tariffs on various imports. The re-emergence of volatility across capital markets triggered a more cautious sentiment and less risky assets fared better for a period. Though ongoing geopolitical tensions and escalating fears of a global trade war continued to distract investors, markets ended the year on a positive note, as U.S. earnings continued to be encouraging and commodity prices continued to rise.

Global equity markets generated solid returns over the one-year period ending June 30, 2018. U.S. equities led markets, supported by continued strong company earnings, renewed merger and acquisition activity and the approved U.S. tax reform in the beginning of the year. The broad U.S. equity market, as represented by the Dow Jones U.S. Total Stock Market Index, returned 14.8%. Developed international markets lagged the U.S., as political uncertainty across several countries and trade tensions with the U.S. negatively impacted economic data and equity market returns. The MSCI EAFE Index returned 6.8%. Emerging markets started the year off strong due to optimism over the health of the global economy. However, fears of a global trade war, rising U.S. interest rates, and a strengthening U.S. dollar triggered significant outflows toward the end of the year. Still outpacing international developed markets, the MSCI Emerging Markets Equity Index posted an 8.2% return. As U.S. yields rose throughout the year, the U.S. bond market, as represented by the Bloomberg Barclays Aggregate Bond Index, declined 0.4%. The mostly risk-on mentality drove spread sectors of the bond market to outpace safe haven treasuries, with the Bloomberg Barclays High Yield Index returning 2.6%.

Management's Discussion and Analysis

Contacting the Trust's Financial Management

This financial report is designed to provide citizens, taxpayers, Plan members, and other interested parties with an overview of the Trust's finances and the prudent exercise of the SBA's oversight. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Chief Operating/Financial Officer, State Board of Administration of Florida, P.O. Box 13300, Tallahassee, Florida 32317.

Statements of Net Position

| | As of June 30 | |
|---|-----------------------|-----------------------|
| | 2018 | 2017 |
| | <i>(In Thousands)</i> | |
| Assets | | |
| Cash and cash equivalents | \$ 114,328 | \$ 130,729 |
| Investments: | | |
| Fixed income | 36,371,280 | 33,757,801 |
| Equity | 88,951,288 | 87,671,435 |
| Alternative | 26,432,707 | 24,004,242 |
| Real estate | 11,406,346 | 10,984,655 |
| Other | 546 | 17,211 |
| Security lending collateral | 2,631,692 | 1,289,852 |
| Total investments | <u>165,793,859</u> | <u>157,725,196</u> |
| Receivables: | | |
| Accrued interest and dividends | 363,044 | 324,454 |
| Forward foreign currency contracts | 3,797,713 | 4,498,291 |
| Spot foreign currency contracts | 1,492,030 | 454,201 |
| Investments sold, but not settled | 2,877,500 | 1,221,252 |
| Margin receivable from counterparty | 60,880 | 41,239 |
| Due from DMS | 343,513 | 327,124 |
| Total receivables | <u>8,934,680</u> | <u>6,866,561</u> |
| Prepaid investment management fees | <u>5,056</u> | <u>7,623</u> |
| Total assets | <u>174,847,923</u> | <u>164,730,109</u> |
| Liabilities | | |
| Short sell obligations | 265,745 | 322,263 |
| Payables: | | |
| Accounts payable and accrued liabilities | 133,026 | 107,993 |
| Forward foreign currency contracts | 3,788,213 | 4,494,948 |
| Spot foreign currency contracts | 1,489,219 | 454,190 |
| Investments purchased, but not settled | 4,994,409 | 3,700,825 |
| Margin payable to counterparty | 19,836 | 988 |
| Obligations under security lending agreements | 2,659,233 | 1,328,234 |
| Due to DMS | 180,663 | 159,679 |
| Total payables | <u>13,264,599</u> | <u>10,246,857</u> |
| Total liabilities | <u>13,530,344</u> | <u>10,569,120</u> |
| Net position held in trust | <u>\$ 161,317,579</u> | <u>\$ 154,160,989</u> |

See accompanying notes to financial statements.

Statements of Changes in Net Position

| | Fiscal Years Ended June 30 | |
|--|----------------------------|-----------------------|
| | 2018 | 2017 |
| | <i>(In Thousands)</i> | |
| Additions | | |
| Investment income: | | |
| Interest income | \$ 767,549 | \$ 683,644 |
| Dividend income | 1,863,241 | 1,790,069 |
| Alternative investment income | 2,384,456 | 2,168,149 |
| Real estate income | 464,195 | 469,306 |
| Fines, forfeits, and securities litigation proceeds | 5,790 | 18,282 |
| Net increase/(decrease) in fair value of investments | 9,026,876 | 14,192,417 |
| Total investment income | <u>14,512,107</u> | <u>19,321,867</u> |
| Investment expenses: | | |
| Bank fees | (4,343) | (4,223) |
| Investment management fees | (550,267) | (521,736) |
| SBA investment service charges | (36,069) | (33,073) |
| Other fees and expenses | (11,097) | (12,828) |
| Total investment expenses | <u>(601,776)</u> | <u>(571,860)</u> |
| Net income from investments | <u>13,910,331</u> | <u>18,750,007</u> |
| Security lending income | 71,625 | 63,625 |
| Security lending expenses | (29,042) | (14,200) |
| Net income from security lending | <u>42,583</u> | <u>49,425</u> |
| Total net investment income | <u>13,952,914</u> | <u>18,799,432</u> |
| Contributions: | | |
| Employer/employee contributions received from DMS | 3,552,506 | 3,295,458 |
| Member-directed benefits received from the FRS Investment Plan Trust Fund | <u>70,597</u> | <u>71,110</u> |
| Total contributions | <u>3,623,103</u> | <u>3,366,568</u> |
| Total additions | <u>17,576,017</u> | <u>22,166,000</u> |
| Deductions | | |
| Funds sent to DMS for benefit payments | 9,822,417 | 9,347,568 |
| Member-directed benefits sent to the FRS Investment Plan Trust Fund | <u>597,010</u> | <u>568,912</u> |
| Total deductions | <u>10,419,427</u> | <u>9,916,480</u> |
| Change in net position | 7,156,590 | 12,249,520 |
| Net position held in trust | | |
| Beginning of year | <u>154,160,989</u> | <u>141,911,469</u> |
| End of year | <u>\$ 161,317,579</u> | <u>\$ 154,160,989</u> |

See accompanying notes to financial statements.

Notes to the Financial Statements

1. Financial Reporting Entity

The Florida Retirement System (FRS) Pension Plan (the Plan) is a cost-sharing, multiple-employer defined benefit pension plan qualified under IRC Section 401(a) and established by the Legislature of the State of Florida in accordance with Chapter 121, *Florida Statutes*, to provide for retirement benefits for eligible employees of the State and all participating county, municipal, district school board, community college and university employees. Under the FRS, employers and, as of July 1, 2011, employees make contributions to the Department of Management Service (DMS), Division of Retirement, the Plan administrator, which are initially deposited into the Florida Retirement System Contributions Clearing Fund, which holds all contributions for all plans of the FRS. The DMS, as the administrative agency of the Plan, provides full accounting and administration of benefit payments and contributions, commissions actuarial studies, and proposes rules and regulations for the administration of the Plan.

Chapter 121, *Florida Statutes*, established the Florida Retirement System Trust Fund (the Trust) and empowers and mandates the State Board of Administration (SBA) to receive, invest and hold the assets of the Plan in the Trust for the exclusive benefit of the Plan members and for the payment of reasonable costs of the Plan. The DMS sends employer and employee contributions to the Trust for investment by the SBA. The SBA is governed by a Board of Trustees, comprised of the Governor, as Chair, the Attorney General, and the Chief Financial Officer of the State of Florida.

The Trust is a separate legal entity within the State of Florida. These financial statements and notes include only the net position and change in net position of the Trust and do not purport to, and do not, present fairly the financial position of the State of Florida, the SBA, or the Plan as of June 30, 2018 and 2017, and the changes in their financial position for the years then ended, in conformity with accounting principles generally accepted in the United States (GAAP).

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying financial statements were prepared in conformity with GAAP as applicable to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and reporting principles. The Trust is accounted for as an investment trust fund pursuant to GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools* (GASB 31), GASB Statement No. 34, *Basic Financial Statements –and Management’s Discussion and Analysis – for State and Local Governments* (GASB 34), and GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position* (GASB 63). As such, the Trust presents statements of net position and statements of changes in net position.

Notes to the Financial Statements

2. Summary of Significant Accounting Policies (continued)

Measurement Focus and Basis of Accounting

The financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recognized when incurred, regardless of when the related cash flow takes place.

Investment Valuation

Section 215.47, *Florida Statutes*, gives the SBA the authority to invest in a range of instruments, including security lending agreements. The Trust's investments are reported in accordance with GASB reporting standards. Realized and unrealized gains and losses are reflected in the statements of changes in net position as "net increase/(decrease) in fair value of investments."

The fair values of the Trust's assets are obtained or estimated in accordance with the Global Pricing Guidelines established with the SBA's custodian bank, BNY Mellon, which uses a variety of independent pricing sources and designates certain vendors as the primary source based on asset type, class or issue. BNY Mellon monitors pricing information supplied by these primary sources and may use a supplemental pricing source or change the primary pricing source if any of the following occurs:

- The price of a security is not received from the primary pricing source.
- The primary pricing source no longer provides prices for a particular asset type, class or issue.
- The SBA or its portfolio investment manager challenges a price and BNY Mellon reviews the price with the vendor, who agrees that the price provided by that vendor may not be appropriate.
- The price from the primary source exceeds price tolerance checkpoints and results in a vendor comparison review where another source is deemed to be more appropriate by BNY Mellon.

When a portfolio includes securities or instruments for which the custodian bank does not receive fair value information from its vendor pricing source, the custodian bank uses a "non-vendor pricing source." Examples include, but are not limited to, limited partnerships or similar private investment vehicles that do not actively trade through established exchange mechanisms; other private placements where there is limited or no information in the market place; and unique fixed income and equity instruments. The SBA does not provide direction regarding the substitution of

Notes to the Financial Statements

2. Summary of Significant Accounting Policies (continued)

prices in instances where securities or instruments are in the portfolio of an investment manager appointed by the SBA. In cases where the SBA directed the purchase of securities or instruments, BNY Mellon may obtain the non-vendor prices by contacting the SBA only if it is not commercially reasonable to directly obtain the non-vendor price information from the broker of record, as identified by the SBA.

For private market investments, where no readily ascertainable market value exists (including limited partnerships, hedge funds, direct-owned real estate, and real estate pooled funds), fair values for the individual investments are based on the net asset value (NAV), which equates to the capital account balance, at the closest available reporting period, as communicated by the general partner and/or investment manager, adjusted for subsequent contributions and distributions. The valuation techniques vary based upon investment type and involve a certain degree of judgment. The most significant input into the NAV of an entity is the value of its investment holdings. The NAV is provided by the general partner and/or investment manager and reviewed by management.

Annually, the financial statements of all private market investments are audited by independent auditors. Private market investments, in which the SBA has a controlling interest or are reported at cost per GAAP, are also required to be valued, generally annually, by independent, licensed external appraisers selected by an appraisal management company retained by the SBA.

Money market funds and repurchase agreements are reported at amortized cost. Commingled funds are reported at the NAV of units held at the end of the period based upon the value of the underlying investments as reported by the external investment manager.

All derivative financial instruments are reported at fair value in the statements of net position. The instruments are adjusted to fair value at least monthly, with valuation changes recognized during the period as gains or losses in the statements of changes in net position and included in the “net increase/(decrease) in fair value of investments”. The nature and use of derivative instruments is discussed in Note 3 to the financial statements.

Because of the inherent uncertainty of the valuation using pricing methodologies other than the quoted market prices, the estimated fair values may differ from the values that would have been used had a ready market existed.

Cash and Cash Equivalents

The Trust reports all cash on hand and deposits in banks, including demand deposits, time deposits, and non-negotiable certificates of deposit as cash and cash equivalents.

Notes to the Financial Statements

2. Summary of Significant Accounting Policies (continued)

Plan Member-Directed Benefits to/from DMS and the FRS Investment Plan Trust Fund

The DMS sends employer and employee contributions to the Trust for investment purposes, and may also request return of funds from the Trust to meet benefit obligations of the FRS. The members of the FRS Investment Plan Trust Fund may direct their Plan account balance within the FRS Investment Plan Trust Fund be sent to the Trust to effectuate their second election. DMS will also fulfill member-directed second election requests for Trust account balances to be sent from the Trust to the FRS Investment Plan Trust Fund. To ensure timely payment, the Trust estimates such obligations at the first of each month and allocates them to the Trust's public market asset classes (excluding the Cash asset class). These allocations constitute liquidity assessments, which the asset classes are required to provide in a prudent, but reasonable time frame.

At fiscal year-end, the Trust accrues a receivable from DMS for employer and employee contributions due for the month of June, but the amount is received by the Trust the following fiscal year. The Trust accrues a payable at fiscal year-end for the expected amounts to be requested by DMS in order to fund the Deferred Retirement Option Program (DROP) payouts and benefit obligations as of June 30. DMS maintains records for all employer and employee contributions to the Plan.

Income Recognition

Investment transactions are accounted for on a trade (investment) date basis. Interest and dividend income is recorded on the accrual basis, with dividends accruing on the ex-dividend date.

Management Fees and Investment Service Expenses

The SBA hires external investment managers to invest a significant portion of the Trust's investment assets. The Trust typically pays investment management fees based on individually negotiated investment management agreements. The fees, usually paid quarterly, may be based on a sliding scale of the portfolio's net asset value at quarter-end, calculated by multiplying each level of net position by a specified basis point charge, or may be performance-related, typically associated with exceeding a market benchmark or hurdle rate. Fees are paid from the appropriate manager's portfolio and are recognized as an expense over the time period for which the fees are applicable. Certain investment management fees, usually in private equity portfolios, are paid at the beginning of the period. These fees are recorded as prepaid manager fee assets on the statements of net position and are expensed over their applicable time period.

Notes to the Financial Statements

2. Summary of Significant Accounting Policies (continued)

Pursuant to Section 215.515, *Florida Statutes*, the SBA charges the Trust a monthly investment service charge based on the month-end net asset value of the total Trust. The service charge is calculated and deducted from the Trust after each month's total net asset value of the Trust is determined. These charges are reported on the statements of changes in net position as part of the Trust's investment expenses. During fiscal years 2018 and 2017, the SBA investment service charge was .0225% (annualized).

Use of Estimates

The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and reported amounts of revenues (additions) and expenses (deductions) during the reporting period. Actual results could differ from those estimates.

Reclassifications

In the financial statements and notes, certain prior year amounts have been reclassified to conform to the current year presentation, which was changed to provide more consistent information by asset class. These reclassifications had no effect on the total net position or change in net position.

New Accounting Standards

In June 2015, the GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions (GASB 75)*. The objective of this Statement is to improve accounting and financial reporting by state and local governments for postemployment benefits other than pensions (other postemployment benefits or OPEB). It also improves information provided by state and local governmental employers about financial support for OPEB that is provided by other entities. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for all postemployment benefits (pensions and OPEB) with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency. The requirements of GASB 75 are effective for fiscal years beginning after June 15, 2017. The statements of net position and the statements of changes in net position are not affected by the adoption of GASB 75, as the Trust is not an OPEB plan.

In March 2016, the GASB issued Statement No. 81, *Irrevocable Split-Interest Agreements (GASB 81)*. The objective of this statement is to improve accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement. This Statement requires that a government that receives resources pursuant to an irrevocable split-interest agreement recognize assets, liabilities, and deferred inflows of resources at the inception of the agreement. Furthermore, this Statement requires that a government recognize assets representing its beneficial interests in

Notes to the Financial Statements

2. Summary of Significant Accounting Policies (continued)

irrevocable split-interest agreements that are administered by a third party, if the government controls the present service capacity of the beneficial interests. This Statement requires that a government recognize revenue when the resources become applicable to the reporting period. The requirements of GASB 81 are effective for financial statements for periods beginning after December 15, 2016, and should be applied retroactively. The statements of net position and the statements of changes in net position are not affected by the adoption of GASB 81, as the Trust is not a beneficiary of irrevocable split-interest agreements.

In March 2016, the GASB issued Statement No. 82, *Pension Issues—an amendment of GASB Statements No. 67, No. 68, and No. 73 (GASB 82)*. The objective of this Statement is to address certain issues that have been raised with respect to Statements No. 67, *Financial Reporting for Pension Plans*, No. 68, *Accounting and Financial Reporting for Pensions*, and No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*. Specifically, this Statement addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements. The requirements of GASB 82 are effective for reporting periods beginning after June 15, 2016, except for the requirements of this Statement for the selection of assumptions in a circumstance in which an employer's pension liability is measured as of a date other than the employer's most recent fiscal year-end. In that circumstance, the requirements for the selection of assumptions are effective for that employer in the first reporting period in which the measurement date of the pension liability is on or after June 15, 2017. The statements of net position and the statements of changes in net position are not affected by the adoption of GASB 82, as the Trust is not a Pension Plan.

In March 2017, the GASB issued Statement No. 85, *Omnibus 2017 (GASB 85)*. The objective of this Statement is to address practice issues that have been identified during implementation and application of certain GASB Statements. This Statement addresses a variety of topics including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits [OPEB]). The requirements of GASB 85 are effective for periods beginning after June 15, 2017. The adoption of GASB 85 had no material impact on the statements of net position and the statements of changes in net position.

In May 2017, the GASB issued Statement No. 86, *Certain Debt Extinguishment Issues (GASB 86)*. The primary objective of this Statement is to improve consistency in accounting and financial reporting for in-substance defeasance of debt by providing guidance for transactions in which cash and other monetary assets acquired with only existing resources—resources other than the proceeds of refunding debt—are placed in an irrevocable trust for the sole purpose of extinguishing debt. This Statement also improves accounting and financial reporting for prepaid insurance on

Notes to the Financial Statements

2. Summary of Significant Accounting Policies (continued)

debt that is extinguished and notes to financial statements for debt that is defeased in substance. The requirements of GASB 86 are effective for reporting periods beginning after June 15, 2017. The adoption of GASB 86 had no material impact on the statements of net position and the statements of changes in net position.

3. Deposits and Investments

Deposits

As of June 30, 2018, the recorded carrying amount of deposits totaled \$114.3 million and consisted of U.S. dollars and foreign currencies (U.S. value) in the amounts of \$14.5 million and \$99.8 million, respectively.

As of June 30, 2017, the recorded carrying amount of deposits totaled \$130.7 million and consisted of U.S. dollars and foreign currencies (U.S. value) in the amounts of \$4.7 million and \$126.0 million, respectively.

Investment Classifications

The SBA has the authority and responsibility for the investment of the Trust assets pursuant to Section 215.47, *Florida Statutes*, in a range of instruments including, but not limited to: federally guaranteed obligations, certain state bonds, corporate bonds, commercial paper, banker's acceptances, short-term obligations purchased individually or in pooled accounts, interests in certain open-end and closed-end management type investment companies or investment trusts, common and preferred stock, repurchase and reverse repurchase agreements, and real estate. The SBA may also buy and sell futures contracts, option contracts, and domestic or foreign notional principal contracts. The following are the major asset types invested in by the Trust.

- **Fixed Income**

Fixed income securities consist of short-term and long-term obligations. Short-term obligations consist primarily of U.S. Treasury and government-sponsored securities, money market funds, commercial paper, certificates of deposit, repurchase agreements, and other similar instruments. These investments are available to meet cash needs as they arise. Long-term obligations are comprised of both domestic and international securities and consist primarily of negotiable obligations of the U.S. Government and U.S. Government-sponsored agencies, corporate bonds, and securitized offerings such as mortgage-backed securities (MBS), collateralized mortgage obligations (CMO), asset-backed securities (ABS), and commercial mortgage-backed securities (CMBS).

Notes to the Financial Statements

3. Deposits and Investments (continued)

- **Equity**

Equity investments represent both domestic and international stocks traded on major stock exchanges. Also included as equities are preferred stock, commingled funds, real estate investment trusts (REITs), equity-linked notes and other securities. A REIT is a type of security that invests in real estate through property or mortgages and trades like a stock on the major exchanges. An equity-linked note is an instrument whose return is determined by the performance of a single equity security, a basket of equity securities, or an equity index.

- **Alternative**

The Trust invests in various funds and investment vehicles, which employ specific strategies and co-investments often outside the traditional asset classes. The most common investment categories for these funds include domestic and international private equity, activist equity, private debt/credit opportunities, closed-end real assets, insurance funds and hedge funds. The structure of these investments is generally a limited partnership or limited liability company and tends to be long term and illiquid in nature. Due to this type of structure, private debt/credit opportunities typically do not have established ratings or durations associated with these investments.

- **Real Estate**

Real estate investments include ownership primarily in office, multifamily, retail, industrial and agricultural properties, and secondarily in several alternative property types including self-storage and student housing. The program is focused on core risk strategies, but also includes value-add and opportunistic risk strategies. These assets are held directly, as part of a joint venture, and in open-ended and closed-ended commingled funds. Real assets and real estate partnership investments are classified as Alternative Investments for financial reporting purposes.

- **Other**

Included in this asset type are investments such as foreign currency contracts, futures, options purchased, and swaps.

Notes to the Financial Statements

3. Deposits and Investments (continued)

The following schedule discloses the Trust's investments, by type, at June 30, 2018 and 2017.

| Investment type | 2018 | 2017 |
|--|-----------------------|-----------------------|
| | <i>(In Thousands)</i> | |
| Fixed income | | |
| Certificates of deposit | \$ 200,077 | \$ 800,168 |
| Commercial paper | 4,182,322 | 4,050,193 |
| Money market funds | 35,981 | 16,867 |
| Repurchase agreements | 800,000 | 750,000 |
| U.S. guaranteed obligations | 12,308,170 | 11,123,264 |
| Federal agencies | 9,641,445 | 8,418,178 |
| Domestic bonds and notes | 7,005,685 | 6,646,865 |
| International bonds and notes | 2,197,600 | 1,952,266 |
| Equity | | |
| Domestic | 47,062,304 | 45,250,543 |
| International | 33,319,165 | 34,509,635 |
| International commingled funds | 8,569,819 | 7,911,257 |
| Alternative | | |
| Activist equity | 897,773 | 791,722 |
| Insurance | 118,209 | - |
| Hedge funds | 4,373,986 | 4,824,849 |
| Private debt/credit opportunities | 3,125,641 | 2,950,593 |
| Private equity | 13,735,057 | 11,657,171 |
| Real assets | 4,182,041 | 3,779,907 |
| Real estate | | |
| Direct investments | 8,948,949 | 8,486,964 |
| Commingled investment funds | 2,457,397 | 2,497,691 |
| Other | | |
| Futures (fixed income) | 2,691 | (3,149) |
| Futures (equity) | (49,731) | (8,245) |
| Options purchased | 40,306 | 30,620 |
| Swaps (fixed income) | 7,280 | (2,015) |
| Total investments excluding securities lending collateral | <u>163,162,167</u> | <u>156,435,344</u> |
| Securities lending collateral | | |
| Money market funds | 1,711,600 | 713,459 |
| Repurchase agreements | 863,630 | 508,840 |
| Domestic bonds and notes | 56,462 | 67,553 |
| Total securities lending collateral | <u>2,631,692</u> | <u>1,289,852</u> |
| Total investments | <u>\$ 165,793,859</u> | <u>\$ 157,725,196</u> |
| Liabilities - investments sold short | | |
| U.S. guaranteed obligations | (71,843) | (23,303) |
| Federal agencies | (177,174) | (290,622) |
| Options sold | (16,728) | (8,338) |
| Total liabilities - investments sold short¹ | <u>\$ (265,745)</u> | <u>\$ (322,263)</u> |

¹ Investments sold short are classified as liabilities on the statements of net position.

Notes to the Financial Statements

3. Deposits and Investments (continued)

Pledged Collateral

Certain investments included in the above schedule were pledged as collateral with the SBA's futures and swaps clearing counterparties. Investments pledged as collateral as of June 30, 2018 and June 30, 2017, are presented below:

| | 2018 | 2017 |
|-----------------------------|-----------------------|------------------|
| | <i>(In Thousands)</i> | |
| Investment type: | | |
| U.S. guaranteed obligations | \$ 101,326 | \$ 93,159 |
| Federal agencies | 1,606 | - |
| Total pledged collateral | <u>\$ 102,932</u> | <u>\$ 93,159</u> |

In addition, cash required to open futures and swap contracts (initial margins) may be pledged as collateral with the SBA's futures and swap counterparties. Such initial margin amounts are reflected as "Margin receivable from counterparty" on the statements of net position. Pursuant to these types of contracts, and also pending foreign currency contracts, the Trust agrees to receive or pay to the broker an amount of cash equal to the daily fluctuation in the value of the contract. Such receivables and payables are known as variation margin, which are reflected as "Margin receivable from counterparty" or "Margin payable to counterparty" on the statements of net position. All initial and variation margin amounts receivable from or payable to the broker as of June 30, 2018 and June 30, 2017, are presented below:

| | 2018 | 2017 |
|---|-----------------------|------------------|
| | <i>(In Thousands)</i> | |
| Margin receivable from counterparty: | | |
| Futures contracts | \$ 59,121 | \$ 29,350 |
| Swaps contracts | 1,759 | 4,074 |
| Foreign currency contracts | - | 7,815 |
| Total margin receivable from counterparty | <u>\$ 60,880</u> | <u>\$ 41,239</u> |
| Margin payable to counterparty: | | |
| Futures contracts | \$ 6,401 | \$ 262 |
| Swaps contracts | 8,265 | 726 |
| Foreign currency contracts | 5,170 | - |
| Total margin payable to counterparty | <u>\$ 19,836</u> | <u>\$ 988</u> |

Notes to the Financial Statements

3. Deposits and Investments (continued)

Fair Value Hierarchy

The Trust's investments are measured and reported at fair value and classified according to the following hierarchy:

Level 1 - Investments reflect unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2 - Investments reflect prices that are based on inputs that are either directly or indirectly observable for an asset or liability (including quoted prices for similar assets or liabilities), which may include inputs in markets that are not considered to be active.

Level 3 - Investments reflect prices based upon unobservable inputs for an asset or liability.

The categorization of investments within the hierarchy is based upon the pricing transparency of the instrument and should not be perceived as the particular investment's risk.

Fixed income and equity securities classified as Level 1 of the fair value hierarchy are valued using quoted prices at June 30 (or the most recent market close date if the markets are closed on June 30) in active markets from the custodian bank's external pricing vendors, which utilize primary exchanges.

Fixed income securities classified as Level 2 are valued using evaluated prices from the custodian bank's external pricing vendors. The pricing methodology involves the use of evaluation models such as matrix pricing, which is based on the securities' relationship to benchmark quoted prices. Other evaluation models use actual trade data, collateral attributes, broker bids, new issue pricings and other observable market information.

Equity securities classified as Level 2 are valued using evaluated prices from the custodial bank's external pricing vendors, or alternative pricing source, such as investment managers, if information is not available from the primary vendors.

Fixed income and equity securities classified as Level 3 are valued using prices from the custodian bank's external pricing vendors or an alternative pricing source, utilizing inputs such as stale prices, cash flow models, or broker bids.

Derivative instruments classified as Level 1 of the fair value hierarchy are valued using exchange-traded prices as provided by the custodian bank's external pricing vendors. Derivative instruments classified as Level 2 receive clearing house prices, which are based on models that reflect the contractual terms of the derivatives.

Notes to the Financial Statements

3. Deposits and Investments (continued)

Private equity funds and real estate direct investments classified as Level 3 were valued using the methodology as described in the footnotes for the *Additional GASB 72 Required Disclosures* tables, footnotes 13 and 15 (12 and 14 for 2017), respectively. Other private equity funds are measured at net asset value (NAV).

Certain investments, such as money market funds and repurchase agreements, are carried at amortized cost, and not priced at fair value. Commingled investments are measured at the net asset value (NAV) per share (or its equivalent) as provided by the investment manager.

The Trust has the following fair value measurements as of June 30, 2018 and June 30, 2017.

Notes to the Financial Statements

3. Deposits and Investments (continued)

| | | As of June 30, 2018 | | | |
|--|-----------------------|---|--|---------------------------------------|--|
| | | Fair Value Measurements Using | | | |
| | | Quoted Prices in Active Markets for Identical Assets | Significant Other Observable Inputs | Significant Unobservable Inputs | |
| Investments by fair value level | Total | (Level 1) | (Level 2) | (Level 3) | |
| (In Thousands) | | | | | |
| Fixed income | | | | | |
| Certificates of deposit | \$ 200,077 | \$ - | \$ 200,077 | \$ - | |
| Commercial paper | 4,182,322 | - | 4,182,322 | - | |
| U.S. guaranteed obligations | 12,308,170 | - | 12,308,170 | - | |
| Federal agencies | 9,641,445 | - | 9,641,445 | - | |
| Domestic bonds and notes | 7,005,685 | - | 6,954,900 | 50,785 | |
| International bonds and notes | 2,197,600 | - | 2,187,296 | 10,304 | |
| Total fixed income | 35,535,299 | - | 35,474,210 | 61,089 | |
| Equity | | | | | |
| Domestic | 47,062,304 | 47,062,088 | 7 | 209 | |
| International | 33,319,165 | 33,271,646 | - | 47,519 | |
| Total equity | 80,381,469 | 80,333,734 | 7 | 47,728 | |
| Alternative | | | | | |
| Private equity funds | 363,717 | - | - | 363,717 | |
| Real estate | | | | | |
| Direct investments | 8,948,949 | - | - | 8,948,949 | |
| Derivatives ² | | | | | |
| Futures (fixed income) | 2,691 | 2,691 | - | - | |
| Futures (equity) | (49,731) | (49,731) | - | - | |
| Options purchased | 40,306 | 40,306 | - | - | |
| Swaps (fixed income) | 7,280 | - | 7,280 | - | |
| Forward currency contracts, net ¹ | 9,500 | - | 9,500 | - | |
| Total derivatives | 10,046 | (6,734) | 16,780 | - | |
| Securities lending collateral | | | | | |
| Domestic corporate bonds and notes | 56,462 | - | 47,096 | 9,366 | |
| Total investments by fair value level | \$ 125,295,942 | \$ 80,327,000 | \$ 35,538,093 | \$ 9,430,849 | |
| Investments measured at the net asset value (NAV) | | | | | |
| Commingled international equity funds | 8,569,819 | | | | |
| Commingled real estate investment funds | 2,457,397 | | | | |
| Activist equity funds | 897,773 | | | | |
| Insurance funds | 118,209 | | | | |
| Hedge funds | 4,373,986 | | | | |
| Private debt/credit opportunities funds | 3,125,641 | | | | |
| Private equity funds | 13,371,340 | | | | |
| Private real asset funds | 4,182,041 | | | | |
| Total investments measured at the NAV | \$ 37,096,206 | | | | |
| Other investments carried at amortized cost | | | | | |
| Money market funds | 35,981 | | | | |
| Money market funds - security lending collateral | 1,711,600 | | | | |
| Repurchase agreements | 800,000 | | | | |
| Repurchase agreements- security lending collateral | 863,630 | | | | |
| Total investments carried at amortized cost | \$ 3,411,211 | | | | |
| Total investments ¹ | \$ 165,803,359 | | | | |
| Investments sold short | | | | | |
| U.S. guaranteed obligations | (71,843) | - | (71,843) | - | |
| Federal agencies | (177,174) | - | (177,174) | - | |
| Options sold | (16,728) | (16,728) | - | - | |
| Total investments sold short | \$ (265,745) | \$ (16,728) | \$ (249,017) | \$ - | |

¹ Forward currency contracts are valued at their net unrealized appreciation/(depreciation) and are reported on the statements of net position as receivables and/or liabilities.

² Spot contracts totaling approximately \$2.8 million are not considered derivative instruments and therefore, not included in this table.

Notes to the Financial Statements

3. Deposits and Investments (continued)

| | | As of June 30, 2017 | | | |
|--|-----------------------|---|--|---------------------------------------|--|
| | | Fair Value Measurements Using | | | |
| | | Quoted Prices in Active Markets for Identical Assets | Significant Other Observable Inputs | Significant Unobservable Inputs | |
| Investments by fair value level | Total | (Level 1) | (Level 2) | (Level 3) | |
| (In Thousands) | | | | | |
| Fixed income | | | | | |
| Certificates of deposit | \$ 800,168 | \$ - | \$ 800,168 | \$ - | |
| Commercial paper | 4,050,193 | - | 4,050,193 | - | |
| U.S. guaranteed obligations | 11,123,264 | 7,842,875 | 3,280,389 | - | |
| Federal agencies | 8,418,178 | - | 8,418,178 | - | |
| Domestic bonds and notes | 6,646,865 | - | 6,615,987 | 30,878 | |
| International bonds and notes | 1,952,266 | - | 1,948,507 | 3,759 | |
| Total fixed income | 32,990,934 | 7,842,875 | 25,113,422 | 34,637 | |
| Equity | | | | | |
| Domestic | 45,250,543 | 45,249,456 | - | 1,087 | |
| International | 34,509,635 | 34,378,379 | 96,181 | 35,075 | |
| Total equity | 79,760,178 | 79,627,835 | 96,181 | 36,162 | |
| Alternative | | | | | |
| Private equity funds | 314,550 | - | - | 314,550 | |
| Real estate | | | | | |
| Direct investments | 8,486,964 | - | - | 8,486,964 | |
| Derivatives² | | | | | |
| Futures (fixed income) | (3,149) | (3,149) | - | - | |
| Futures (equity) | (8,245) | (8,245) | - | - | |
| Options purchased | 30,620 | 30,620 | - | - | |
| Swaps (fixed income) | (2,015) | - | (2,015) | - | |
| Forward currency contracts, net ¹ | 3,343 | - | 3,343 | - | |
| Total derivatives | 20,554 | 19,226 | 1,328 | - | |
| Securities lending collateral | | | | | |
| Domestic corporate bonds and notes | 67,553 | - | 58,067 | 9,486 | |
| Total investments by fair value level | \$ 121,640,733 | \$ 87,489,936 | \$ 25,268,998 | \$ 8,881,799 | |
| Investments measured at the net asset value (NAV) | | | | | |
| Commingled international equity funds | 7,911,257 | | | | |
| Commingled real estate investment funds | 2,497,691 | | | | |
| Activist equity funds | 791,722 | | | | |
| Hedge funds | 4,824,849 | | | | |
| Private debt/credit opportunities funds | 2,950,593 | | | | |
| Private equity funds | 11,342,621 | | | | |
| Private real asset funds | 3,779,907 | | | | |
| Total investments measured at the NAV | \$ 34,098,640 | | | | |
| Other investments carried at amortized cost | | | | | |
| Money market funds | 16,867 | | | | |
| Money market funds - security lending collateral | 713,459 | | | | |
| Repurchase agreements | 750,000 | | | | |
| Repurchase agreements - security lending collateral | 508,840 | | | | |
| Total investments carried at amortized cost | \$ 1,989,166 | | | | |
| Total investments¹ | \$ 157,728,539 | | | | |
| Investments sold short | | | | | |
| U.S. guaranteed obligations | (23,303) | - | (23,303) | - | |
| Federal agencies | (290,622) | - | (290,622) | - | |
| Options sold | (8,338) | (8,338) | - | - | |
| Total investments sold short | \$ (322,263) | \$ (8,338) | \$ (313,925) | \$ - | |

¹ Forward currency contracts are valued at their net unrealized appreciation/(depreciation) and are reported on the statements of net position as receivables and/or liabilities.

² Spot contracts totaling approximately \$11 thousand are not considered derivative instruments and therefore, not included in this table.

Notes to the Financial Statements

3. Deposits and Investments (continued)

The valuation method for investments measured at the net asset value (NAV) per share (or its equivalent) as of June 30, 2018 and June 30, 2017 is presented in the footnotes to the tables below.

ADDITIONAL GASB 72 REQUIRED DISCLOSURES

| | 2018 Total | Unfunded Commitments | Redemption Frequency (If Currently Eligible) | Redemption Notice Period |
|--|----------------------|-------------------------|---|-----------------------------|
| (In Thousands) | | | | |
| Investments Measured at the NAV | | | | |
| Commingled international equity funds ¹ | \$ 8,569,819 | - | Daily, Monthly | 2 - 120 days |
| Commingled real estate investment funds ² | 2,457,397 | - | Quarterly | 15 - 90 days |
| Activist equity funds ³ | 897,773 | - | Monthly, Annually | 65 - 90 days |
| Insurance funds ⁴ | 118,209 | \$ 184,865 | Monthly, Biannually | 30 - 90 days |
| Hedge funds | | | | |
| Diversifying strategies (managed futures) ⁵ | 1,058,404 | - | Daily, Monthly | 10 - 35 days |
| Equity long/short ⁶ | 549,946 | - | Monthly, Quarterly | 30 - 125 days |
| Event driven ⁷ | 352,438 | - | Quarterly, Annually, Biennially | 45 - 90 days |
| Global macro ⁸ | 756,624 | - | Monthly, Quarterly | 15 - 60 days |
| Multi-strategy ⁹ | 795,875 | - | Quarterly, Annually, Biennially | 60 - 90 days |
| Opportunistic debt ¹⁰ | 525,827 | - | Quarterly, Annually | 60 - 90 days |
| Relative value ¹¹ | 334,872 | - | Quarterly | 45 - 90 days |
| Private debt/credit opportunity funds ¹² | 3,125,641 | \$ 2,470,351 | | |
| Private equity funds ¹³ | 13,371,340 | \$ 7,878,568 | | |
| Private real asset funds ¹⁴ | 4,182,041 | \$ 2,721,631 | | |
| Total Investments Measured at the NAV | \$ 37,096,206 | | | |
| Investments at Level 3 | | | | |
| Private equity funds ¹³ | \$ 363,717 | - | | |
| Real estate direct investments ¹⁵ | \$ 8,948,949 | \$ 168,929 | | |

¹ *Commingled International Equity Funds.* The six funds in this group are primarily invested in publically traded international equity securities. Three of these funds focus on emerging markets. Each are valued at the NAV of units held at the end of the period based upon the fair value of the underlying investments. Four funds within this strategy are redeemable daily and two funds are redeemable monthly.

² *Commingled Real Estate Investment Funds.* The eight funds in this group consist primarily of real estate investments owned directly or through partnership interests located in the United States. These investments include multi-family, industrial, retail, office, apartments and mortgage loans on income producing property. Each are valued at the NAV of units held at the end of the period based upon the fair value of the underlying investments. All funds within this strategy are eligible for redemption quarterly.

³ *Activist Equity Funds.* The three funds in this group invest in public companies with the intent to effect positive change through influencing management. The funds may be structured with a focus on specific domestic or foreign geographic regions. These investments are valued at the NAV per share. One fund (approximately 39% of this strategy) is currently eligible for redemption monthly. Another fund (approximately 35% of this strategy) is eligible for redemption in six months due to annual lock-up restrictions. The remaining fund (approximately 26% of this strategy) is subject to contractual lock-up restrictions and is not currently eligible for redemption.

⁴ *Insurance Funds.* The two funds in this group invest primarily in reinsurance contracts and insurance-linked securities. These investments are valued at NAV per share. One fund (approximately 43%) is eligible for redemption in six months, subject to exit restrictions. The other fund (approximately 57%) has varying restrictions due to underlying investment funds and redeemable within one to six months.

⁵ *Diversifying Strategies (Managed Futures) Hedge Funds.* The three funds that make up this group primarily trade equity and commodity futures, but can also participate in indexes, rates and currencies across global markets. These funds use a systematic approach and focus on trends in price and other market signals. These investments are valued at the NAV per share. All funds within this strategy are redeemable within a month or less, as they are not subject to lock-up restrictions.

Notes to the Financial Statements

3. Deposits and Investments (continued)

- ⁶ *Equity Long/Short Hedge Funds.* Consisting of five funds, this strategy invests both long and short, primarily in U.S. and global stocks that are mispriced by the markets. These managers vary in their use of short selling, leverage and definitions of growth or value. These funds are valued at the NAV per share. Two funds (approximately 29% of this strategy) are currently eligible for redemption monthly, while the remaining three funds (approximately 71% of this strategy) are redeemable in three months or less due to quarterly redemption restrictions.
- ⁷ *Event Driven Hedge Funds.* The four funds in this group seek to gain an advantage from pricing inefficiencies that may occur in the onset or aftermath of a corporate action or related event. These investments are valued at the NAV per share. Three funds in this strategy are no longer under contractual lock-up, but due to exit restrictions, the redemption period ranges from three to eighteen months. The remaining fund has been fully redeemed with a portion of the capital balance retained for contingency reserves.
- ⁸ *Global Macro Hedge Funds.* Consisting of five funds, which base their holdings (such as long and short positions in various equity, fixed income, currency, and futures markets) primarily on overall economic and political views of various countries. These funds are valued at the NAV per share. All funds in this strategy are no longer subject to contractual lock-up, and are redeemable in three months or less due to monthly and quarterly redemption restrictions.
- ⁹ *Multi-Strategy Hedge Funds.* The three funds in this group aim to diversify risks and reduce volatility by combining other strategies. These strategies are usually a mix of Equity Long/Short, Event-Driven, Opportunistic Debt and Relative Value. These funds are valued at the NAV per share. One fund (approximately 40% of this strategy) is eligible for redemption in six months or less due to annual redemption restrictions. Another fund (approximately 38% of this strategy) is eligible for redemption biennially with the next redemption in six months. The remaining fund (approximately 22% of this strategy) is eligible for redemption quarterly with the next redemption in three months.
- ¹⁰ *Opportunistic Debt Hedge Funds.* Consisting of four funds that pursue various strategies and asset classes, with an emphasis on mispriced debt or equity of companies in distress. These managers vary in their focus on early versus late stage situations, senior versus subordinated levels on the capital structure and non-traditional areas including high yield bonds and Emerging Markets debt, and may also pursue relative value and arbitrage strategies with various debt instruments. These funds are valued at the NAV per share. One fund (approximately 24% of this strategy) is eligible for redemption in six months and annually, thereafter. Two funds (approximately 45% of this strategy) are currently eligible for redemption in three months due to quarterly redemption restrictions. The remaining fund (approximately 31%) is currently in the redemption process and the final distribution is expected in four months.
- ¹¹ *Relative Value Hedge Funds.* Consisting of two funds, this strategy focuses on benefiting from valuation discrepancies that may be present in related financial instruments by simultaneously purchasing (long) or selling (short) these instruments. These investments are valued at the NAV per share. One fund (approximately 51% of this strategy) is eligible for redemption in three months, subject to exit restrictions. The other fund (approximately 49% of the value of this strategy) is eligible for redemption in three months and quarterly thereafter.
- ¹² *Private Debt/Credit Opportunity Funds.* There are 53 private debt/credit funds investing primarily in Distressed, Mezzanine and Loans with some exposure to Special Situations. The fair value of these funds has been determined using the NAV at June 30, 2018 or one quarter in arrears adjusted for current quarter cash flows. These funds are not eligible for redemption. Distributions are received as underlying investments within the funds are liquidated, which on average can occur over the span of five to ten years.
- ¹³ *Private Equity Funds.* There are 204 private equity funds investing primarily in Leveraged Buyouts funds, Venture Capital funds, Secondary funds and Growth funds with some exposure to Special Situations, Diversifying Strategies and GP Investments. The fair value of 202 funds has been determined using the NAV at June 30, 2018 or one quarter in arrears adjusted for current quarter cash flows. The fair value of the remaining two funds (approximately 3% of the value of these investments) was based on external appraisals at June 30, 2018 and classified as Level 3. These funds are not eligible for redemption. Distributions are received as underlying investments within the funds are liquidated, which on average can occur over the span of five to ten years.
- ¹⁴ *Private Real Asset Funds.* There are 66 real asset funds, 50 of which invest in real estate assets such as commercial office buildings, retail properties, multi-family residential properties, developments or hotels. In addition, the funds may be structured with a focus on specific geographic domestic or foreign regions. The remaining 16 funds invest in infrastructure, timberland, transportation and commodities. The fair value of these funds has been determined using the NAV at June 30, 2018 or one quarter in arrears adjusted for current quarter cash flows. These funds are not eligible for redemption. Distributions are received as underlying investments within the funds are liquidated, which on average can occur over the span of five to ten years.
- ¹⁵ *Direct Real Estate Investments.* There are 74 direct owned/joint venture real estate assets that are valued based on annual external and/or quarterly internal appraisals and are classified as Level 3.

Notes to the Financial Statements

3. Deposits and Investments (continued)

ADDITIONAL GASB 72 REQUIRED DISCLOSURES

| | 2017 Total | Unfunded Commitments | Redemption Frequency (If Currently Eligible) | Redemption Notice Period |
|--|----------------------|-------------------------|---|-----------------------------|
| (In Thousands) | | | | |
| Investments Measured at the NAV | | | | |
| Commingled international equity funds ¹ | \$ 7,911,257 | - | Daily, Monthly | 2 - 120 days |
| Commingled real estate investment funds ² | 2,497,691 | - | Quarterly | 15 - 90 days |
| Activist equity funds ³ | 791,722 | - | Monthly, Annually | 65 - 90 days |
| Hedge funds | | | | |
| Diversifying strategies (managed futures) ⁴ | 1,027,872 | - | Daily, Monthly | 10 - 35 days |
| Equity long/short ⁵ | 537,218 | - | Monthly, Quarterly | 30 - 125 days |
| Event driven ⁶ | 413,344 | - | Quarterly, Annually, Biennially | 45 - 90 days |
| Global macro ⁷ | 734,457 | - | Monthly, Quarterly | 15 - 60 days |
| Multi-strategy ⁸ | 1,064,451 | - | Quarterly, Annually, Biennially | 30 - 90 days |
| Opportunistic debt ⁹ | 603,194 | - | Quarterly, Annually | 65 - 90 days |
| Relative value ¹⁰ | 444,313 | - | Quarterly | 45 - 90 days |
| Private debt/credit opportunity funds ¹¹ | 2,950,593 | \$ 1,908,212 | | |
| Private equity funds ¹² | 11,342,621 | \$ 6,908,055 | | |
| Private real asset funds ¹³ | 3,779,907 | \$ 2,404,518 | | |
| Total Investments Measured at the NAV | \$ 34,098,640 | | | |
| Investments at Level 3 | | | | |
| Private equity funds ¹² | \$ 314,550 | - | | |
| Real estate direct investments ¹⁴ | \$ 8,486,964 | \$ 119,634 | | |

¹ *Commingled International Equity Funds.* The six funds in this group are primarily invested in publically traded international equity securities. Three of these funds focus on emerging markets. Each are valued at the NAV of units held at the end of the period based upon the fair value of the underlying investments. Four funds within this strategy are redeemable daily and two funds are redeemable monthly.

² *Commingled Real Estate Investment Funds.* The eight funds in this group consist primarily of real estate investments owned directly or through partnership interests located in the United States. These investments include multi-family, industrial, retail, office, apartments and mortgage loans on income producing property. Each are valued at the NAV of units held at the end of the period based upon the fair value of the underlying investments. All funds within this strategy are eligible for redemption quarterly.

³ *Activist Equity Funds.* The three funds in this group invest in public companies with the intent to effect positive change through influencing management. The funds may be structured with a focus on specific domestic or foreign geographic regions. These investments are valued at the NAV per share. One fund (approximately 38% of this strategy) is currently eligible for redemption monthly. Another fund (approximately 34% of this strategy) is eligible for redemption in six months due to annual lock-up restrictions. The remaining fund (approximately 28% of this strategy) is subject to contractual lock-up restrictions and is not currently eligible for redemption.

⁴ *Diversifying Strategies (Managed Futures) Hedge Funds.* The three funds that make up this group primarily trade equity and commodity futures, but can also participate in indexes, rates and currencies across global markets. These funds use a systematic approach and focus on trends in price and other market signals. These investments are valued at the NAV per share. All funds within this strategy are redeemable within a month or less, as they are not subject to lock-up restrictions.

⁵ *Equity Long/Short Hedge Funds.* Consisting of four funds, this strategy invests both long and short, primarily in U.S. and global stocks that are mispriced by the markets. These managers vary in their use of short selling, leverage and definitions of growth or value. These funds are valued at the NAV per share. One fund (approximately 18% of this strategy) is currently eligible for redemption monthly, while the remaining three funds (approximately 82% of this strategy) are redeemable in three months or less due to quarterly redemption restrictions.

⁶ *Event Driven Hedge Funds.* The four funds in this group seek to gain an advantage from pricing inefficiencies that may occur in the onset or aftermath of a corporate action or related event. These investments are valued at the NAV per share. All funds in this strategy are no longer under contractual lock-up, but due to exit restrictions, the redemption period ranges from three to eighteen months.

Notes to the Financial Statements

3. Deposits and Investments (continued)

- ⁷ *Global Macro Hedge Funds.* Consisting of five funds, which base their holdings (such as long and short positions in various equity, fixed income, currency, and futures markets) primarily on overall economic and political views of various countries. These funds are valued at the NAV per share. All funds in this strategy are no longer subject to contractual lock-up, and are redeemable in three months or less due to monthly and quarterly redemption restrictions.
- ⁸ *Multi-Strategy Hedge Funds.* The five funds in this group aim to diversify risks and reduce volatility by combining other strategies. These strategies are usually a mix of Equity Long/Short, Event-Driven, or Opportunistic Debt and Relative Value. These funds are valued at the NAV per share. Two funds (approximately 46% of this strategy) are eligible for redemption in six months or less due to annual redemption restrictions. Another fund (approximately 26% of this strategy) is eligible for redemption biennially with the next redemption date in six months. The remaining two funds (approximately 28% of this strategy) are eligible for redemption quarterly with the next redemption in three months.
- ⁹ *Opportunistic Debt Hedge Funds.* Consisting of three funds that pursue various strategies and asset classes, with an emphasis on mispriced debt or equity of companies in distress. These managers vary in their focus on early versus late stage situations, senior versus subordinated levels on the capital structure and non-traditional areas including high yield bonds and Emerging Markets debt, and may also pursue relative value and arbitrage strategies with various debt instruments. These funds are valued at the NAV per share. One fund (approximately 38% of this strategy) is subject to one-year recurring hard lock-ups for each contribution and can be redeemed between three and six months. Another fund (approximately 19% of this strategy) is eligible for redemption in six months and annually, thereafter. The remaining fund (approximately 43% of this strategy) is currently eligible for redemption in three months due to quarterly redemption restrictions.
- ¹⁰ *Relative Value Hedge Funds.* Consisting of three funds, this strategy focuses on benefiting from valuation discrepancies that may be present in related financial instruments by simultaneously purchasing (long) or selling (short) these instruments. These investments are valued at the NAV per share. Due to contractual lock-up restrictions, one fund (approximately 37% of this strategy) is eligible for redemption in two months, but subject to exit restrictions. Two funds (approximately 63% of the value of this strategy) are eligible for redemption in three months and quarterly thereafter.
- ¹¹ *Private Debt/Credit Opportunity Funds.* There are 50 private debt/credit funds investing primarily in Distressed, Mezzanine and Loans with some exposure to Special Situations. The fair value of these funds has been determined using the NAV at June 30, 2017 or one quarter in arrears adjusted for current quarter cash flows. These funds are not eligible for redemption. Distributions are received as underlying investments within the funds are liquidated, which on average can occur over the span of five to ten years.
- ¹² *Private Equity Funds.* There are 181 private equity funds investing primarily in Leveraged Buyouts funds, Venture Capital funds, Secondary funds and Growth funds with some exposure to Special Situations, Diversifying Strategies and GP Investments. The fair value of 179 funds has been determined using the NAV at June 30, 2017 or one quarter in arrears adjusted for current quarter cash flows. The fair value of the remaining two funds (approximately 3% of the value of these investments) was based on external appraisals at June 30, 2017 and classified as Level 3. These funds are not eligible for redemption. Distributions are received as underlying investments within the funds are liquidated, which on average can occur over the span of five to ten years.
- ¹³ *Private Real Asset Funds.* There are 58 real asset funds, 45 of which invest in real estate assets such as commercial office buildings, retail properties, multi-family residential properties, developments or hotels. In addition, the funds may be structured with a focus on specific geographic domestic or foreign regions. The remaining 13 funds invest in infrastructure, timberland, and commodities. The fair value of these funds has been determined using the NAV at June 30, 2017 or one quarter in arrears adjusted for current quarter cash flows. These funds are not eligible for redemption. Distributions are received as underlying investments within the funds are liquidated, which on average can occur over the span of five to ten years.
- ¹⁴ *Direct Real Estate Investments.* There are 68 direct owned/joint venture real estate assets that are valued based on annual external and/or quarterly internal appraisals and are classified as Level 3.

Notes to the Financial Statements

Deposit and Investment Risk

The Trust has deposits and a broad range of financial investments exposed to various risks, including overall market volatility. Due to the level of risk associated with certain financial investments, it is reasonably possible that changes in the values of financial investments will occur in the near term and that such changes could materially affect the amounts reported in the financial statements.

GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, requires that certain risks be discussed in the financial statements. These risks include credit risk, custodial credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. Each of these risks is discussed in more detail below.

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Credit quality ratings are used as an assessment of creditworthiness and are assigned by Nationally Recognized Statistical Rating Organizations (NRSROs). These ratings are disclosed in aggregate by investment type for the securities held as of the financial statement date.

The SBA, in compliance with Section 215.47, Florida Statutes, has adopted certain investment policies with regard to credit risk of fixed income securities, which generally are managed through individual portfolios with various asset classes. Some of the individual portfolios have slightly different restrictions on credit quality.

For the Short-Term Portfolio, securities must be high quality at the time of purchase. For short-term investment ratings, this is defined as the highest applicable rating from one of the NRSROs. For long-term investment ratings, this is defined as a minimum mid-single A rating from one of the NRSROs. Securities of a single issuer are generally limited to 5% of the amortized cost of the portfolio (excluding U.S. Treasuries and Agencies).

Generally, securities in other major portfolios, such as the Mortgage Index Portfolio, Intermediate Aggregate Less MBS Index Portfolio and the Core Portfolio, should be rated investment grade by at least one of the NRSROs at the time of purchase [allowing a very small allocation to below investment grade (down to BB-/Ba3) for the Core Portfolio]. Securities for a single issuer are generally limited to 5% of the fair value of the portfolio (excluding U.S. Treasuries and Agencies).

The Mortgage Index Portfolio limits securities generally to those issued by the Government National Mortgage Association (GNMA), Federal National Mortgage Association (FNMA), and Federal Home Loan Mortgage Corporation (FHLMC). No specific credit rating criteria are listed.

The Intermediate Aggregate Less MBS Index Portfolio and the Core Portfolio allow U.S. Treasuries, U.S. Government Agencies, and corporates. The Core Portfolio allow mortgage and asset backed securities, foreign sovereign debt, and municipals as well.

Notes to the Financial Statements

3. Deposits and Investments (continued)

For security lending portfolios, eligible cash collateral investments are the following:

- * Tri-party qualified repurchase obligations are collateralized by U.S. Treasury bills, notes, bonds, and/or strips, U.S. Government Agency securities, U.S. Government Agency mortgage-backed securities, and U.S. Equity securities. U.S. Treasury and Government Agencies must maintain a market value of at least 102% of the market value of the securities subject to being repurchased and U.S. equities must maintain a market value of at least 110% of the market value of the securities subject to being repurchased.
- * Money market mutual funds regulated by SEC rule 2a-7 and rated the highest applicable rating by at least one of the NRSROs.
- * U.S. Treasury bills, notes, and bonds.

Security lending investments that were purchased prior to the policy guidelines established in December 2008 are being held to maturity in existing lending portfolios.

Notes to the Financial Statements

3. Deposits and Investments (continued)

The following tables disclose credit quality ratings related to credit risk on investments held in the Trust at June 30, 2018 and 2017.

| Credit Quality Ratings As of June 30, 2018 | | | | | | | | | |
|---|----------------------|--------------------|----------------------------|---------------------|-----------------------|--------------------------|----------------------------------|--------------------------------|-------------------------------------|
| S&P ¹ | Moody's ¹ | Total ² | Certificates of Deposit | Commercial Paper | Money Market Funds | Repurchase Agreements | Federal Agencies ⁴ | Domestic Bonds and Notes | International Bonds and Notes |
| (In Thousands) | | | | | | | | | |
| A-1 - AAAm | | \$ 5,929,903 | \$ - | \$ 4,182,322 | \$ 1,747,581 | \$ - | \$ - | \$ - | \$ - |
| AAA | | 991,251 | - | - | - | - | - | 659,560 | 331,691 |
| AA | | 1,121,050 | - | - | - | 68,732 | 507,801 | 345,177 | 199,340 |
| A | | 2,089,634 | - | - | - | - | - | 1,459,874 | 629,760 |
| BBB | | 3,498,207 | - | - | - | - | - | 2,842,235 | 655,972 |
| BB | | 77,820 | - | - | - | - | - | 41,422 | 36,398 |
| B | | 19,947 | - | - | - | - | - | 6,924 | 13,023 |
| CCC | | 2,055 | - | - | - | - | - | 2,055 | - |
| CC | | 15,954 | - | - | - | - | - | 15,954 | - |
| D | | 1,864 | - | - | - | - | - | 1,864 | - |
| | Aaa | 635,968 | - | - | - | - | - | 586,026 | 49,942 |
| | Aa | 41,609 | - | - | - | - | - | 35,214 | 6,395 |
| | A | 209,059 | - | - | - | - | - | 165,538 | 43,521 |
| | Baa | 539,394 | - | - | - | - | - | 451,547 | 87,847 |
| | Ba | 191,593 | - | - | - | - | - | 144,477 | 47,116 |
| | Caa | 2,510 | - | - | - | - | - | 2,510 | - |
| NR | NR | 10,174,385 | 200,077 | - | - | 442,299 | 9,133,644 | 301,770 | 96,595 |
| | | \$ 25,542,203 | \$ 200,077 | \$ 4,182,322 | \$ 1,747,581 | \$ 511,031 | \$ 9,641,445 | \$ 7,062,147 | \$ 2,197,600 |

Ratings not applicable:

| | |
|--|-----------------------|
| Repurchase agreements ³ | \$ 1,152,599 |
| U.S. guaranteed obligations ³ | 12,308,170 |
| Domestic equities | 47,062,304 |
| International equities | 33,319,165 |
| Commingled international equity funds | 8,569,819 |
| Alternative investments | 26,432,707 |
| Real estate investments | 11,406,346 |
| Futures | (47,040) |
| Options | 40,306 |
| Swaps | 7,280 |
| Total investments | \$ 165,793,859 |

¹ S&P ratings were primarily used. If S&P did not provide a rating or did not provide the rating with the greatest degree of risk, then Moody's ratings were used. If neither rating agency issued a rating, the security was listed as "NR" (not rated). Long-term ratings are presented except for "A-1" or "A-2", which is a top tier short-term rating for S&P, and "AAAm", the top money market fund rating for S&P.

² All investments are included in this table, including security lending collateral investments.

³ U.S. guaranteed obligations and collateral for repurchase agreements, which are explicitly guaranteed by the U.S. Government, do not require disclosure of credit quality.

⁴ Federal Agency TBAs and mortgage-backed securities are classified as "NR" because they do not have explicit credit ratings on individual securities.

Notes to the Financial Statements

3. Deposits and Investments (continued)

| Credit Quality Ratings As of June 30, 2017 | | | | | | | | | |
|---|----------------------|-----------------------|----------------------------|---------------------|--------------------------|--------------------------|----------------------------------|--------------------------------|-------------------------------------|
| S&P ¹ | Moody's ¹ | Total ² | Certificates of Deposit | Commercial Paper | Money Market Funds | Repurchase Agreements | Federal Agencies ⁴ | Domestic Bonds and Notes | International Bonds and Notes |
| (In Thousands) | | | | | | | | | |
| A-1 / AAAm | | \$ 4,780,519 | \$ - | \$ 4,050,193 | \$ 730,326 | \$ - | \$ - | \$ - | \$ - |
| AAA | | 896,988 | - | - | - | - | 2,554 | 548,109 | 346,325 |
| AA | | 1,021,497 | - | - | - | 31,104 | 511,383 | 308,836 | 170,174 |
| A | | 1,882,080 | - | - | - | - | - | 1,313,079 | 569,001 |
| BBB | | 3,349,991 | - | - | - | - | - | 2,772,056 | 577,935 |
| BB | | 56,921 | - | - | - | - | - | 32,632 | 24,289 |
| B | | 21,689 | - | - | - | - | - | 8,307 | 13,382 |
| CCC | | 5,355 | - | - | - | - | - | 5,355 | - |
| D | | 2,625 | - | - | - | - | - | 2,625 | - |
| | Aaa | 501,501 | - | - | - | - | 10,853 | 448,645 | 42,003 |
| | Aa | 35,772 | - | - | - | - | - | 29,304 | 6,468 |
| | A | 545,681 | 200,018 | - | - | - | - | 308,570 | 37,093 |
| | Baa | 476,757 | - | - | - | - | - | 402,240 | 74,517 |
| | Ba | 172,883 | - | - | - | - | - | 152,771 | 20,112 |
| | B | 6,715 | - | - | - | - | - | 6,229 | 486 |
| | Caa | 2,590 | - | - | - | - | - | 2,590 | - |
| | Ca | 22,835 | - | - | - | - | - | 22,835 | - |
| NR | NR | 9,529,497 | 600,150 | - | - | 615,243 | 7,893,388 | 350,235 | 70,481 |
| | | \$ 23,311,896 | \$ 800,168 | \$ 4,050,193 | \$ 730,326 | \$ 646,347 | \$ 8,418,178 | \$ 6,714,418 | \$ 1,952,266 |
| Ratings not applicable: | | | | | | | | | |
| Repurchase agreements ³ | | \$ 612,493 | | | | | | | |
| U.S. guaranteed obligations ³ | | 11,123,264 | | | | | | | |
| Domestic equities | | 45,250,543 | | | | | | | |
| International equities | | 34,509,635 | | | | | | | |
| Commingled international equity funds | | 7,911,257 | | | | | | | |
| Alternative investments | | 24,004,242 | | | | | | | |
| Real estate investments | | 10,984,655 | | | | | | | |
| Futures | | (11,394) | | | | | | | |
| Options | | 30,620 | | | | | | | |
| Swaps | | (2,015) | | | | | | | |
| Total investments | | <u>\$ 157,725,196</u> | | | | | | | |

¹ S&P ratings were primarily used. If S&P did not provide a rating or did not provide the rating with the greatest degree of risk, then Moody's ratings were used. If neither rating agency issued a rating, the security was listed as "NR" (not rated). Long-term ratings are presented except for "A-1" or "A-2", which is a top tier short-term rating for S&P, and "AAAm", the top money market fund rating for S&P.

² All investments are included in this table, including security lending collateral investments.

³ U.S. guaranteed obligations and collateral for repurchase agreements, which are explicitly guaranteed by the U.S. Government, do not require disclosure of credit quality.

⁴ Federal Agency TBAs and mortgage-backed securities are classified as "NR" because they do not have explicit credit ratings on individual securities.

Notes to the Financial Statements

3. Deposits and Investments (continued)

All futures, options and swaps contracts held by the Trust at June 30, 2018 and 2017, were exchange-traded, therefore minimizing counterparty credit risk through the use of futures and swaps clearing merchants and clearing houses.

Counterparty credit ratings related to credit risk for spot and forward foreign currency contracts held at June 30, 2018 and 2017, are presented in the following tables.

As of June 30, 2018

| <u>Counterparty Credit Rating (Long/Short)¹</u> | | Net Unrealized | | |
|--|---------|----------------|----------------|-------------|
| S&P | Moody's | Receivables | Payables | Gain/(Loss) |
| (In Thousands) | | | | |
| AA/A-1 | | \$ 207,605 | \$ (203,162) | \$ 4,443 |
| A/A-1 | | 5,013,784 | (5,006,163) | 7,621 |
| BBB/A-2 | | 866 | (866) | - |
| | A/P-1 | 262 | (262) | - |
| | A/NR | 26 | (26) | - |
| | NR/P-1 | 41,337 | (41,102) | 235 |
| NR | NR | 25,863 | (25,851) | 12 |
| | | \$ 5,289,743 | \$ (5,277,432) | \$ 12,311 |

As of June 30, 2017

| <u>Counterparty Credit Rating (Long/Short)¹</u> | | Net Unrealized | | |
|--|---------|----------------|----------------|-------------|
| S&P | Moody's | Receivables | Payables | Gain/(Loss) |
| <i>(In Thousands)</i> | | | | |
| AA/A-1 | | \$ 544,522 | \$ (544,882) | \$ (360) |
| A/A-1 | | 4,274,390 | (4,270,241) | 4,149 |
| A/A-2 | | 31,284 | (32,566) | (1,282) |
| | A/P-1 | 328 | (328) | - |
| | NR/P-1 | 83,794 | (82,929) | 865 |
| NR | NR | 18,173 | (18,192) | (19) |
| | | \$ 4,952,491 | \$ (4,949,138) | \$ 3,353 |

¹ If no rating exists, "NR" is reported.

Notes to the Financial Statements

3. Deposits and Investments (continued)

Custodial Credit Risk

The custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the Trust will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party.

All U.S. dollar deposits at the Trust's custodian bank were covered by federal depository insurance (FDIC) as of June 30, 2018 and 2017. The remaining uninsured and uncollateralized deposits, totaling \$100 million and \$126 million as of June 30, 2018 and 2017, respectively, were held in foreign currencies in the SBA's custodian nominee name.

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the Trust will not be able to recover the value of investments or collateral securities that are in the possession of an outside party. The SBA's custodial credit risk policy states that custodial credit risk will be minimized through the use of trust accounts maintained at top tier third-party custodian banks. To the extent possible, negotiated trust and custody contracts shall require that all deposits, investments and collateral be held in accounts in the SBA's name, or in the case of certain foreign investments, in an omnibus client account, but separate and apart from the assets of the custodian banks.

This policy applies to investments evidenced by cash or securities, but does not apply to investments evidenced by contractual agreements such as alternatives, real estate, cleared derivative instruments (futures, options and swaps), external investment pools or open-ended mutual funds. These types of investments are not exposed to custodial credit risk because their existence is not evidenced by securities that exist in physical or book entry form.

As required by negotiated trust and custody contracts, many of the Trust's investments were held in the SBA's name (or, in the case of certain foreign investments, in an omnibus client account) by the custodial financial institutions. Presented below are investments that were uninsured and unregistered, with securities held by the counterparty, or by the counterparty's trust department but not in the SBA's name, as of June 30, 2018 and June 30, 2017.

| | 2018 | 2017 |
|--|-----------------------|-------------|
| | <i>(In Thousands)</i> | |
| Invested security lending collateral | | |
| Repurchase agreements | \$ 18,630 | \$ 58,840 |
| Domestic bonds and notes | 56,462 | 67,553 |
| Total investments exposed to custodial credit risk | \$ 75,092 | \$ 126,393 |

Notes to the Financial Statements

3. Deposits and Investments (continued)

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of an investment in a single issuer. The Trust did not hold any investments with a single issuer representing 5% or more of the Trust's fair value (amortized cost for short-term portfolios) at June 30, 2018 or 2017.

Investment policy guidelines allow the security lending programs to hold up to 30% of the cash collateral reinvestment portfolio in U.S. Treasury bills, notes, and bonds.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of fixed income instruments. The SBA, in compliance with Section 215.47, *Florida Statutes*, has adopted certain investment policies with regard to interest rate risk exposure for fixed income securities, which generally are managed through individual portfolios with various asset classes. The individual portfolios may have different policies regarding interest rate risk.

For the Short-Term Portfolio, the weighted-average maturity to final maturity date (WAL) is limited to 120 days in the internally managed FRS Short-term Investment Pool (STIPFRS) portfolio and weighted-average time to coupon reset (WAM) is limited to 60 days. For securities without a fixed interest rate, the next coupon reset date is used as the maturity for the reset WAM calculation. For the STIPFRS, no individual security shall have a final maturity date longer than 397 days except for U.S. Treasury and Agency securities, which shall not exceed five years.

The Mortgage Index Portfolio duration should be similar to the duration of the mortgage-related fixed income market and should remain within plus or minus 0.25 years of the Barclays Capital U.S. MBS Index duration. Swaps and/or Agency debentures may contribute no more than 25% of the portfolio's total duration.

The Intermediate Aggregate Less MBS Index Portfolio duration should remain within plus or minus 0.25 years of the Barclays Capital U.S. Intermediate Aggregate Bond Index duration less the MBS Index component. Interest rate swaps and interest rate futures, on a net basis, may contribute no more than 25% of the portfolio's total duration.

The Core Portfolio duration should remain within plus or minus 0.50 years of the Barclays Capital U.S. Intermediate Aggregate Bond Index duration. Interest rate swaps and interest rate futures may contribute no more than 25% of the portfolio's total duration.

Notes to the Financial Statements

3. Deposits and Investments (continued)

The Core Portfolio contains certain investments known as collateralized mortgage obligations (CMOs). CMOs are often more sensitive to interest rate changes than other fixed income instruments. Examples of CMO securities that qualify as “highly interest rate sensitive” include interest-only (IOs), principal-only (POs), and inverse floaters (INVs). IO and PO securities are transactions that involve the separation of the interest and principal components of a security. They are highly sensitive to prepayments by mortgagors, which increase the value of a PO and decrease the value of an IO. Inverse floaters (INV) have an inverse relationship to a benchmark rate, and the coupon payment is adjusted as the interest rate changes. If the benchmark interest rate decreases, the coupon rate increases and vice versa, which allows the bondholder to benefit from declining interest rates. Similar to an IO, an interest-only inverse floater’s value increases as interest rates rise.

For security lending portfolios, policy guidelines allow investment in the following:

- * Tri-party qualified repurchase obligations, with a term to repurchase not to exceed forty-five calendar days, that are fully collateralized by U.S. Treasury bills, notes, bonds and/or strips, U.S. Government Agency securities, U.S. Government Agency mortgage-backed securities and U.S. Equity securities.
- * Money market mutual funds regulated by SEC rule 2a-7.
- * U.S. Treasury bills, notes and bonds maturing within 92 days or less.

Security lending investments that were purchased prior to the investment policy guidelines established in December 2008 are still held in the lending programs, and are slowly paying down. For investments that had floating interest rates, interest rate reset dates were used to calculate WAM.

Notes to the Financial Statements

3. Deposits and Investments (continued)

The interest rate risk tables for the Trust as of June 30, 2018 and 2017, are presented below. Investment types, related to fixed income portfolios, are presented using effective weighted duration. Investment types related to short-term, and security lending collateral portfolios are presented using weighted-average maturity.

| Investment type | As of June 30, 2018 | | | |
|--|----------------------|------------|---------------------|-----------|
| | Total | Effective | Total | Weighted |
| | (Duration) | Weighted | (WAM) | Average |
| | (In Thousands) | (In Years) | (In Thousands) | (In Days) |
| Certificates of deposit | \$ - | NA | \$ 200,077 | 14 |
| Commercial paper | - | NA | 4,182,322 | 12 |
| Money market funds | - | NA | 1,747,581 | 2 |
| Repurchase agreements | - | NA | 1,663,630 | 4 |
| U.S. guaranteed obligations: | | | | |
| Treasury bills | 1,117,717 | 0.35 | - | NA |
| Treasury bonds and notes | 8,397,611 | 3.69 | - | NA |
| Index linked government bonds | 322,918 | 3.18 | - | NA |
| Bonds and notes | 15,717 | 3.98 | - | NA |
| Asset-backed | 337,180 | 5.18 | - | NA |
| GNMA mortgage-backed | 1,566,906 | 4.34 | - | NA |
| GNMA commitments to purchase (TBAs) | 311,382 | 4.34 | - | NA |
| Mortgage-backed CMOs and CMBs ¹ | 238,740 | 6.30 | - | NA |
| Federal agencies: | | | | |
| Discount notes | 1,307,593 | 0.03 | - | NA |
| Unsecured bonds and notes | 507,801 | 3.18 | - | NA |
| Agency strips | 141,742 | 2.59 | - | NA |
| Mortgage-backed | 4,202,301 | 5.13 | - | NA |
| FNMA, FHLMC commitments to purchase (TBAs) | 1,905,623 | 5.21 | - | NA |
| Mortgage-backed CMOs and CMBs ¹ | 1,576,385 | 4.59 | - | NA |
| Domestic: | | | | |
| Corporate bonds and notes | 5,145,926 | 4.44 | - | NA |
| Asset and mortgage-backed | 881,814 | 1.44 | 45,556 | 25 |
| Mortgage-backed CMOs and CMBs ¹ | 970,987 | 4.29 | 1,540 | 25 |
| Municipal/provincial | 13,663 | 4.93 | - | NA |
| Real estate mortgage loans | 2,661 | 1.47 | - | NA |
| International: | | | | |
| Government and agency obligations | 721,524 | 3.29 | - | NA |
| Corporate bonds and notes | 1,410,541 | 3.95 | - | NA |
| Asset and mortgage-backed | 28,218 | 0.65 | - | NA |
| Mortgage-backed CMOs and CMBs ¹ | 37,317 | 5.14 | - | NA |
| Futures-long ² | 9,141 | 4.44 | - | NA |
| Futures-short ² | (6,450) | 9.02 | - | NA |
| Credit default swaps ² | 6,343 | 0.07 | - | NA |
| Interest rate swaps ² | 937 | (2.82) | - | NA |
| Total fixed income investments | \$ 31,172,238 | | \$ 7,840,706 | |

¹ Includes investments in IOs, POs and INVs totaling \$53 million at June 30, 2018.

² The futures and swaps contracts' effective weighted durations were calculated using notional values rather than fair values. For foreign futures, local notional value was converted to a U.S. dollar value based on foreign exchange rates at June 30, 2018.

Notes to the Financial Statements

3. Deposits and Investments (continued)

| Investment type | As of June 30, 2017 | | | |
|--|----------------------|------------|---------------------|-----------|
| | Total | Effective | Total | Weighted |
| | (Duration) | Weighted | (WAM) | Average |
| | (In Thousands) | (In Years) | (In Thousands) | (In Days) |
| Certificates of deposit | \$ - | NA | \$ 800,168 | 76 |
| Commercial paper | - | NA | 4,050,193 | 18 |
| Money market funds | - | NA | 730,326 | 3 |
| Repurchase agreements | - | NA | 1,258,840 | 3 |
| U.S. guaranteed obligations: | | | | |
| Treasury bills | 1,094,652 | 0.23 | - | NA |
| Treasury bonds and notes | 7,842,876 | 3.90 | - | NA |
| Index linked government bonds | 241,913 | 6.54 | - | NA |
| Bonds and notes | 38,824 | 4.88 | - | NA |
| Asset-backed | 212,554 | 4.94 | - | NA |
| GNMA mortgage-backed | 1,150,183 | 3.26 | - | |
| GNMA commitments to purchase (TBAs) | 281,934 | 4.05 | - | NA |
| Mortgage-backed CMOs and CMBs ¹ | 260,328 | 3.28 | - | NA |
| Federal agencies: | | | | |
| Discount notes | 342,898 | 0.06 | - | NA |
| Unsecured bonds and notes | 514,881 | 2.72 | - | NA |
| Agency strips | 39,718 | 2.47 | - | NA |
| Mortgage-backed | 4,403,223 | 3.61 | - | NA |
| FNMA, FHLMC commitments to purchase (TBAs) | 1,661,753 | 4.11 | - | NA |
| Mortgage-backed CMOs and CMBs ¹ | 1,455,705 | 2.99 | - | NA |
| Domestic: | | | | |
| Corporate bonds and notes | 4,875,787 | 4.52 | - | NA |
| Asset and mortgage-backed | 761,229 | 1.28 | 49,899 | 25 |
| Mortgage-backed CMOs and CMBs ¹ | 1,002,447 | 2.28 | 8,168 | 25 |
| Municipal/provincial | 14,183 | 5.78 | - | NA |
| Real estate mortgage loans | 2,705 | 2.27 | - | NA |
| International: | | | | |
| Government and agency obligations | 732,247 | 3.35 | - | NA |
| Corporate bonds and notes | 1,175,311 | 4.11 | - | NA |
| Asset and mortgage-backed | 44,708 | 0.65 | - | NA |
| Futures-long ² | (4,163) | 3.64 | - | NA |
| Futures-short ² | 1,014 | 8.25 | - | NA |
| Credit default swaps ² | (2,508) | 0.01 | - | NA |
| Interest rate swaps ² | 493 | (1.11) | - | NA |
| Total fixed income investments | \$ 28,144,895 | | \$ 6,897,594 | |

¹ Includes investments in IOs, POs and INVs totaling \$65 million at June 30, 2017.

² The futures and swaps contracts' effective weighted durations were calculated using notional values rather than fair values. For foreign futures, local notional value was converted to a U.S. dollar value based on foreign exchange rates at June 30, 2017.

Notes to the Financial Statements

3. Deposits and Investments (continued)

Interest rate risk information for fixed income investments sold short is presented below as of June 30, 2018 and 2017.

| Investment type | 2018 | | 2017 | |
|--|---------------------|-------------------|---------------------|-------------------|
| | Total | Effective | Total | Effective |
| | | Weighted Duration | | Weighted Duration |
| | (In Thousands) | (In Years) | (In Thousands) | (In Years) |
| GNMA commitments to sell (TBAs) | \$ (71,843) | 4.53 | \$ (23,303) | 2.71 |
| FNMA, FHLMC commitments to sell (TBAs) | (177,174) | 4.70 | (290,622) | 4.44 |
| Total fixed income investments sold short ¹ | <u>\$ (249,017)</u> | | <u>\$ (313,925)</u> | |

¹ Investments sold short are reported as liabilities on the statements of net position.

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of a deposit or investment. Under Section 215.47, *Florida Statutes*, and subject to the limitations and conditions of the State Constitution or of the trust agreement relating to a trust fund, moneys available for investments by the Trust may be invested in fixed income obligations or stocks denominated in foreign currency. The SBA has developed for the Trust an Investment Policy Statement (IPS) that sets ranges on investments by asset class. All asset classes may hold non-U.S. securities, depending on portfolio guidelines. For fiscal years 2018 and 2017, Florida law limits the exposure to foreign securities held outside of foreign group trusts and certain other foreign entities to 50% of the total Trust. There is no requirement that this exposure to foreign currency risk be hedged through forward currency contracts, although some managers are authorized to use forward currency contracts.

Commingled international equity funds are collective investments where the Trust owns a portion of the total units in commingled funds with other investors. Exchange-traded funds (ETFs) are investment funds that hold assets such as stocks or bonds and are traded on the stock exchanges. The Trust owns a portion of the total shares in the ETFs. Participatory notes (P-Notes) allow the Trust to participate in certain foreign equity markets where direct participation is not possible due to local government regulations, tax policies, or for other reasons. The overall investments or notes themselves are denominated in U.S. dollars, but a portion of the underlying assets are exposed to foreign currency risk in various currencies.

Alternative investments are commingled investment funds (primarily limited partnerships) where the Trust owns a portion of the overall investment in the funds. For those funds denominated in U.S. dollars, some of the underlying investments may be exposed to foreign currency risk in various currencies.

Notes to the Financial Statements

3. Deposits and Investments (continued)

The Trust also holds positions in futures, options, swaps, and foreign currency contracts (see section in Note 3 to the financial statements on Derivatives for additional details) that are subject to foreign currency risk.

Following are the Trust's deposits and investments, by currency at fair value (in U.S. dollars), exposed to foreign currency risk as of June 30, 2018 and 2017.

| Currency | As of June 30, 2018 | | | | | | |
|--|---------------------|----------------------|-------------------------|---------------|----------------------------|--------------------------------|----------------------|
| | Investment Type | | | | | | Total |
| | Cash | Equity | Alternative Investments | Fixed Income | Futures, Options and Swaps | Foreign Currency Contracts-Net | |
| | (In Thousands) | | | | | | |
| Australian dollar | \$ 6,004 | \$ 975,574 | \$ - | \$ - | \$ (647) | \$ (121,659) | \$ 859,272 |
| Bangladesh taka | 18 | 17,719 | - | - | - | \$ | 17,737 |
| Brazilian real | 269 | 518,490 | - | - | - | (802) | 517,957 |
| British pound sterling | 14,914 | 3,881,481 | 63,391 | 871 | 1,070 | (32,602) | 3,929,125 |
| Canadian dollar | 7,423 | 1,451,843 | - | - | 14 | (17,620) | 1,441,660 |
| Chilean peso | 421 | 31,192 | - | - | - | - | 31,613 |
| Chinese yuan renminbi | 685 | 161,119 | - | - | - | (13,000) | 148,804 |
| Columbian peso | 14 | 9,260 | - | - | - | 5,654 | 14,928 |
| Costa rican colon | - | 3,051 | - | - | - | \$ | 3,051 |
| Czech koruna | 2 | 1,141 | - | - | - | 5,764 | 6,907 |
| Danish krone | 502 | 479,363 | - | - | - | (1,484) | 478,381 |
| Egyptian pound | 27 | 31,250 | - | - | - | \$ | 31,277 |
| Euro currency unit | 8,817 | 7,227,076 | 921,077 | - | 367 | (35,628) | 8,121,709 |
| Ghanaian cedi | - | 3,957 | - | - | - | \$ | 3,957 |
| Hong Kong dollar | 7,353 | 2,722,247 | - | - | - | (17,216) | 2,712,384 |
| Hungarian forint | 38 | 42,288 | - | - | - | 11,258 | 53,584 |
| Indian rupee | 3,844 | 859,735 | - | - | - | 62,698 | 926,277 |
| Indonesian rupiah | 99 | 148,011 | - | - | - | 50,631 | 198,741 |
| Israeli shekel | 2,161 | 102,803 | - | - | - | (14,341) | 90,623 |
| Japanese yen | 24,999 | 4,477,044 | - | - | (109) | 35,159 | 4,537,093 |
| Kenyan shilling | - | 26,513 | - | - | - | \$ | 26,513 |
| Kuwaiti dinar | - | 16,367 | - | - | - | \$ | 16,367 |
| Malaysian ringgit | 454 | 133,503 | - | - | - | 1,588 | 135,545 |
| Mauritius rupee | - | 2,667 | - | - | - | \$ | 2,667 |
| Mexican peso | 56 | 209,721 | - | - | - | 7,020 | 216,797 |
| Moroccan dirham | 8 | 5,318 | - | - | - | \$ | 5,326 |
| New Zealand dollar | 737 | 56,063 | - | - | - | (46,009) | 10,791 |
| Nigerian naira | 25 | 37,401 | - | - | - | \$ | 37,426 |
| Norwegian krone | 1,013 | 316,265 | - | - | - | (25,886) | 291,392 |
| Omani rial | - | 1,430 | - | - | - | \$ | 1,430 |
| Pakistani rupee | 92 | 15,080 | - | - | - | \$ | 15,172 |
| Peruvian sol | - | - | - | - | - | 6,700 | 6,700 |
| Philippines peso | 686 | 75,773 | - | - | - | (18,389) | 58,070 |
| Polish zloty | 401 | 85,600 | - | - | - | 31,248 | 117,249 |
| Qatari riyal | 36 | 25,257 | - | - | - | \$ | 25,293 |
| Romanian new leu | - | 19,225 | - | - | - | 6,138 | 25,363 |
| Russian ruble | - | 785 | - | - | - | 43,325 | 44,110 |
| Singapore dollar | 3,279 | 346,406 | - | - | - | (25,753) | 323,932 |
| South African rand | 2,337 | 423,989 | - | - | - | 21,332 | 447,658 |
| South Korean won | 2,888 | 1,191,859 | - | - | - | (39,626) | 1,155,121 |
| Sri lanka rupee | - | 16,352 | - | - | - | \$ | 16,352 |
| Swedish krona | 559 | 547,351 | - | - | - | 9,837 | 557,747 |
| Swiss franc | 918 | 1,347,407 | - | - | 3,170 | 99,354 | 1,450,849 |
| Taiwan new dollar | 7,111 | 819,799 | - | - | - | (2,756) | 824,154 |
| Thailand baht | 91 | 217,421 | - | - | - | 5,283 | 222,795 |
| Turkish lira | 490 | 134,326 | - | - | - | 14,255 | 149,071 |
| United Arab Emirates dirham | 56 | 48,697 | - | - | - | \$ | 48,753 |
| Vietnam dong | 1,018 | 39,134 | - | - | - | \$ | 40,152 |
| Other | 1 | - | - | - | - | \$ | 1 |
| Total foreign currency risk | 99,846 | 29,304,353 | 984,468 | 871 | 3,865 | 4,473 | \$ 30,397,876 |
| Other investments with potential exposure to foreign currency risk | | | | | | | |
| Alternative investments | - | - | 25,448,239 | - | - | \$ | 25,448,239 |
| P-notes and ETFs | - | 297,377 | - | - | - | \$ | 297,377 |
| Commingled international equity funds | - | 8,569,819 | - | - | - | \$ | 8,569,819 |
| Total investments subject to foreign currency risk | \$ 99,846 | \$ 38,171,549 | \$ 26,432,707 | \$ 871 | \$ 3,865 | \$ 4,473 | \$ 64,713,311 |

Notes to the Financial Statements

3. Deposits and Investments (continued)

| As of June 30, 2017 | | | | | | | |
|--|------------|---------------|-------------------------|--------------|----------------------------|--------------------------------|---------------|
| Investment Type | | | | | | | |
| Currency | Cash | Equity | Alternative Investments | Fixed Income | Futures, Options and Swaps | Foreign Currency Contracts-Net | Total |
| (In Thousands) | | | | | | | |
| Australian dollar | \$ 2,221 | \$ 1,001,326 | \$ - | \$ - | \$ - | \$ (153,563) | \$ 849,984 |
| Bangladesh taka | 81 | 16,617 | - | - | - | - | 16,698 |
| Brazilian real | 816 | 530,904 | - | - | - | (48,531) | 483,189 |
| British pound sterling | 20,495 | 3,948,224 | 33,527 | - | (342) | 51,778 | 4,053,682 |
| Canadian dollar | 4,148 | 1,424,480 | - | - | (48) | (87,385) | 1,341,195 |
| Chilean peso | 210 | 34,361 | - | - | - | (38,901) | (4,330) |
| Columbian peso | 2 | 9,967 | - | - | - | 11,052 | 21,021 |
| Czech koruna | 38 | 4,586 | - | - | - | 41,610 | 46,234 |
| Danish krone | 548 | 469,582 | - | - | - | (386) | 469,744 |
| Egyptian pound | 69 | 25,511 | - | - | - | - | 25,580 |
| Euro currency unit | 17,455 | 7,476,917 | 715,506 | - | 703 | (252,308) | 7,958,273 |
| Hong Kong dollar | 10,755 | 2,368,338 | - | - | - | (6,668) | 2,372,425 |
| Hungarian forint | 54 | 54,205 | - | - | - | (41,177) | 13,082 |
| Indian rupee | 12,152 | 983,825 | - | - | - | 86,136 | 1,082,113 |
| Indonesian rupiah | 343 | 196,188 | - | - | - | 55,328 | 251,859 |
| Israeli shekel | 2,123 | 90,438 | - | - | - | (38,217) | 54,344 |
| Japanese yen | 20,755 | 4,660,824 | - | - | (29) | (443,722) | 4,237,828 |
| Kenyan shilling | - | 24,481 | - | - | - | - | 24,481 |
| Kuwaiti dinar | 302 | 15,733 | - | - | - | - | 16,035 |
| Malaysian ringgit | 657 | 156,038 | - | - | - | 40,954 | 197,649 |
| Mexican peso | 2,746 | 237,709 | - | - | - | 99,242 | 339,697 |
| Moroccan dirham | 8 | 6,303 | - | - | - | - | 6,311 |
| New Zealand dollar | 1,656 | 70,860 | - | - | - | 74,627 | 147,143 |
| Nigerian naira | 116 | 32,252 | - | - | - | - | 32,368 |
| Norwegian krone | 2,065 | 228,965 | - | - | - | (66,052) | 164,978 |
| Omani rial | - | 6,507 | - | 63 | - | - | 6,570 |
| Pakistani rupee | 413 | 28,787 | - | - | - | - | 29,200 |
| Philippine peso | 465 | 104,087 | - | - | - | 5,633 | 110,185 |
| Polish zloty | 41 | 110,317 | - | - | - | 45,775 | 156,133 |
| Qatari riyal | 312 | 27,564 | - | - | - | - | 27,876 |
| Romanian new leu | - | 16,207 | - | - | - | 5,491 | 21,698 |
| Russian ruble | - | - | - | - | - | 36,081 | 36,081 |
| Singapore dollar | 1,818 | 410,302 | - | - | - | (63,941) | 348,179 |
| South African rand | 325 | 467,864 | - | - | - | 26,175 | 494,364 |
| South Korean won | 3,362 | 1,231,151 | - | - | - | (4,429) | 1,230,084 |
| Sri lanka rupee | - | 22,197 | - | - | - | - | 22,197 |
| Swedish krona | - | 671,413 | - | - | - | 72,915 | 744,328 |
| Swiss franc | 5,319 | 1,708,792 | - | - | 2,274 | (122,004) | 1,594,381 |
| Taiwan new dollar | 10,333 | 873,418 | - | - | - | (38,822) | 844,929 |
| Thailand baht | 129 | 231,936 | - | - | - | 6,211 | 238,276 |
| Turkish lira | 728 | 223,130 | - | - | - | 117,706 | 341,564 |
| United Arab Emirates dirham | 160 | 53,901 | - | - | - | - | 54,061 |
| Vietnam dong | 2,780 | 13,729 | - | - | - | - | 16,509 |
| Other | 1 | 11,292 | - | - | - | (4,408) | 6,885 |
| Total foreign currency risk | 126,001 | 30,281,228 | 749,033 | 63 | 2,558 | (633,800) | \$ 30,525,083 |
| Other investments with potential exposure to foreign currency risk | | | | | | | |
| Alternative investments | - | - | 23,255,209 | - | - | - | 23,255,209 |
| P-notes and ETFs | - | 297,162 | - | - | - | - | 297,162 |
| Commingled international equity funds | - | 7,911,257 | - | - | - | - | 7,911,257 |
| Total investments subject to foreign currency risk | \$ 126,001 | \$ 38,489,647 | \$ 24,004,242 | \$ 63 | \$ 2,558 | \$ (633,800) | \$ 61,988,711 |

Notes to the Financial Statements

3. Deposits and Investments (continued)

The tables below provide additional details on the futures contracts, option contracts and foreign currency contracts that are subject to foreign currency risk. The margin payments included in “Margin receivable from counterparty” and “Margin payable to counterparty” on the statements of net position, may also be exposed to foreign currency risk.

Futures

The Trust’s futures contract positions at June 30, 2018 and 2017, that were exposed to foreign currency risk are presented below.

| | | In Local Currency | | | In U.S. \$ |
|---|------------------------|-------------------|--------------------|--------------------|-----------------|
| | | Number of | Notional Traded | Notional Market | Unrealized |
| Currency | | Contracts | Exposure | Exposure | Gain/(Loss) |
| (In Thousands) | | | | | |
| As of June 30, 2018 | | | | | |
| Stock Index Futures: | | | | | |
| GBP FTSE 100 Index | British pound sterling | 53 | 4,034 | 4,029 | (5) |
| Canada S&P/TSE 60 Index | Canadian dollar | 21 | 4,028 | 4,046 | 18 |
| DJ Euro STOXX 50 | Euro currency unit | 279 | 9,622 | 9,460 | (162) |
| TOPIX Index Future | Japanese yen | 35 | 617,722 | 605,675 | (12,047) |
| Mini MSCI EAFE ¹ | U. S. dollar | 3,894 | 393,866 | 380,717 | (13,149) |
| Total futures subject to foreign currency risk | | 4,282 | 1,029,272 | 1,003,927 | (25,345) |
| As of June 30, 2017 | | | | | |
| Stock Index Futures: | | | | | |
| GBP FTSE 100 Index | British pound sterling | 143 | 10,620 | 10,357 | (263) |
| Canada S&P/TSE 60 Index | Canadian dollar | 40 | 7,176 | 7,114 | (62) |
| DJ Euro STOXX 50 | Euro currency unit | 417 | 14,763 | 14,307 | (456) |
| TOPIX Index Future | Japanese yen | 68 | 1,086,616 | 1,095,820 | 9,204 |
| Yen Denom NIKKEI | Japanese yen | 185 | 1,868,485 | 1,856,013 | (12,472) |
| Mini MSCI Emerging Market ¹ | U.S. dollar | 364 | 18,326 | 18,351 | 25 |
| Mini MSCI EAFE ¹ | U.S. dollar | 4,444 | 421,250 | 419,869 | (1,381) |
| Total futures subject to foreign currency risk | | 5,661 | 3,427,236 | 3,421,831 | (5,405) |

¹ Futures denominated in U.S. dollar are based on an index that converts the foreign issues to dollar equivalents at currency market exchange rates.

Notes to the Financial Statements

3. Deposits and Investments (continued)

Options

The Trust's options contract positions that were exposed to foreign currency risk are presented below.

| Currency | Notional Amount (Local Currency) | Total Market Value (Local Currency) | Total Market Value (in U.S. \$) |
|---|---|--|--|
| <i>(In Thousands)</i> | | | |
| As of June 30, 2018 | | | |
| Options purchased: | | | |
| Australian dollar | 42,000 | 438 | \$ 323 |
| British pound sterling | 75,600 | 815 | 1,077 |
| Euro currency unit | 151,200 | 667 | 779 |
| Swiss franc | 381,546 | 3,334 | 3,358 |
| U.S. dollar ¹ | 3,371,099 | 34,769 | 34,769 |
| Options sold: | | | |
| Australian dollar | (126,000) | (1,313) | (970) |
| Euro currency unit | (126,000) | (191) | (223) |
| Swiss franc | (107,289) | (186) | (188) |
| U.S. dollar ¹ | (1,725,356) | (15,347) | (15,347) |
| Total subject to foreign currency risk | 1,936,800 | 22,986 | \$ 23,578 |
| As of June 30, 2017 | | | |
| Options purchased: | | | |
| Euro currency unit | 440,550 | 2,316 | \$ 2,642 |
| Swiss franc | 460,227 | 2,864 | 2,991 |
| U.S. dollar ¹ | 1,433,581 | 24,987 | 24,987 |
| Options sold: | | | |
| Euro currency unit | (437,750) | (1,244) | (1,419) |
| Swiss franc | (306,147) | (686) | (717) |
| U.S. dollar ¹ | (478,882) | (6,202) | (6,202) |
| Total subject to foreign currency risk | 1,111,579 | 22,035 | \$ 22,282 |

¹ Currency options on a currency pair, that are denominated in U.S. dollar, are dependent on the exchange rate of the given foreign currency relative to the U.S. dollar.

Foreign Currency Contracts

Foreign currency contracts are agreements to exchange one currency for another currency at an agreed-upon price and settlement date. Currently, there are two types of foreign currency contracts being utilized by the Trust. Spot currency contracts are valued at spot (traded) currency rates and are used primarily for trade settlement and currency repatriation. Forward currency contracts are valued at interpolated forward rates and may be used to mitigate currency risk for changes in value associated with foreign holdings, payables and/or receivables. In addition, such contracts may be used to seek additional value independent of underlying equity assets. A currency overlay program is used to seek additional value and is run independently of the underlying equity assets. These contracts are recorded as receivables and payables on the statements of net position.

Notes to the Financial Statements

3. Deposits and Investments (continued)

Schedules of all foreign currency contracts outstanding at June 30, 2018 and 2017, are presented below, by currency.

| As of June 30, 2018 | | | | | | | | |
|----------------------------|--------------|----------------|--------------------------|-----------------|-------------------------|----------------|--------------------------|-----------------|
| Forward Currency Contracts | | | | | Spot Currency Contracts | | | |
| Currency | Receivables | Payables | Net | Unrealized | Receivables | Payables | Net | Unrealized |
| | | | Receivables/ Payables | Gain/ (Loss) | | | Receivables/ Payables | Gain/ (Loss) |
| (In Thousands) | | | | | (In Thousands) | | | |
| Australian dollar | \$ 63,110 | \$ (201,988) | (138,878) | \$ 1,209 | \$ 31,194 | \$ (13,975) | \$ 17,219 | \$ 52 |
| Brazilian real | 26,952 | (29,783) | (2,831) | 489 | 3,552 | (1,523) | 2,029 | 9 |
| British pound sterling | 91,600 | (106,161) | (14,561) | 254 | 38,940 | (56,981) | (18,041) | (67) |
| Canadian dollar | 30,197 | (63,454) | (33,257) | 48 | 17,391 | (1,754) | 15,637 | 103 |
| Chilean peso | - | (13,000) | (13,000) | 436 | - | - | - | - |
| Chinese yuan renminbi | 5,654 | - | 5,654 | (120) | - | - | - | - |
| Columbian peso | 5,764 | - | 5,764 | (141) | - | - | - | - |
| Czech koruna | - | - | - | - | 747 | (2,231) | (1,484) | 2 |
| Danish krone | 517,086 | (501,520) | 15,566 | 6,447 | 169,556 | (220,750) | (51,194) | (980) |
| Euro currency unit | 7,358 | (19,532) | (12,174) | 14 | 9,135 | (14,177) | (5,042) | (1) |
| Hong Kong dollar | 11,258 | - | 11,258 | (508) | - | - | - | - |
| Hungarian forint | 69,856 | (7,158) | 62,698 | (1,004) | - | - | - | - |
| Indian rupee | 50,631 | - | 50,631 | (1,615) | - | - | - | - |
| Indonesian rupiah | - | (14,341) | (14,341) | 257 | - | - | - | - |
| Israeli shekel | 390,172 | (462,767) | (72,595) | 6,260 | 213,131 | (105,377) | 107,754 | (284) |
| Japanese yen | - | - | - | - | 2,349 | (761) | 1,588 | - |
| Malaysian ringgit | 23,027 | (16,424) | 6,603 | 263 | 448 | (31) | 417 | - |
| Mexican peso | 20,594 | (63,804) | (43,210) | 1,611 | 42,699 | (45,498) | (2,799) | 303 |
| New Zealand dollar | 47,637 | (75,272) | (27,635) | (634) | 1,749 | - | 1,749 | 3 |
| Norwegian krone | 6,700 | - | 6,700 | (3) | - | - | - | - |
| Philippines peso | 5,642 | (24,208) | (18,566) | 33 | 177 | - | 177 | - |
| Polish zloty | 57,505 | (26,247) | 31,258 | (2,291) | - | (10) | (10) | - |
| Romanian new leu | 5,741 | - | 5,741 | (64) | 436 | (39) | 397 | 3 |
| Russian ruble | 43,325 | - | 43,325 | (394) | - | - | - | - |
| Singapore dollar | 63,725 | (99,804) | (36,079) | 1,139 | 12,050 | (1,724) | 10,326 | (3) |
| South African rand | 24,854 | (3,240) | 21,614 | (2,082) | 42 | (324) | (282) | - |
| South Korean won | 2,223 | (44,359) | (42,136) | 1,622 | 4,919 | (2,409) | 2,510 | (2) |
| Swedish krona | 62,420 | (57,209) | 5,211 | (2,516) | 5,360 | (734) | 4,626 | 25 |
| Swiss franc | 151,580 | (189,154) | (37,574) | 791 | 351,306 | (214,378) | 136,928 | 832 |
| Taiwan new dollar | 5,703 | (7,942) | (2,239) | 55 | - | (517) | (517) | - |
| Thailand baht | 5,596 | - | 5,596 | (231) | - | (313) | (313) | - |
| Turkish lira | 17,547 | (3,289) | 14,258 | 175 | - | (3) | (3) | - |
| U.S. dollar | 1,984,256 | (1,757,557) | 226,699 | - | 586,849 | (805,710) | (218,861) | 2,816 |
| Total | \$ 3,797,713 | \$ (3,788,213) | \$ 9,500 | \$ 9,500 | \$ 1,492,030 | \$ (1,489,219) | \$ 2,811 | \$ 2,811 |

Notes to the Financial Statements

3. Deposits and Investments (continued)

| As of June 30, 2017 | | | | | | | | |
|------------------------|----------------------------|-----------------------|---------------------------------|-------------------------------|-------------------------|---------------------|---------------------------------|-------------------------------|
| Currency | Forward Currency Contracts | | | | Spot Currency Contracts | | | |
| | Receivables | Payables | Net Receivables/ Payables | Unrealized Gain/ (Loss) | Receivables | Payables | Net Receivables/ Payables | Unrealized Gain/ (Loss) |
| | <i>(In Thousands)</i> | | | | <i>(In Thousands)</i> | | | |
| Australian dollar | \$ 19,193 | \$ (172,853) | \$ (153,660) | \$ (2,728) | \$ 5,650 | \$ (5,553) | \$ 97 | \$ 9 |
| Brazilian real | 6,667 | (56,815) | (50,148) | 72 | 2,249 | (632) | 1,617 | (18) |
| British pound sterling | 227,515 | (148,101) | 79,414 | 2,486 | 17,601 | (45,237) | (27,636) | 102 |
| Canadian dollar | 57,965 | (145,333) | (87,368) | (2,974) | 1,611 | (1,628) | (17) | (2) |
| Chilean peso | 6,382 | (45,283) | (38,901) | 58 | - | - | - | - |
| Chinese yuan renminbi | 6,283 | (10,691) | (4,408) | (72) | - | - | - | - |
| Columbian peso | 25,368 | (14,316) | 11,052 | (639) | - | - | - | - |
| Czech koruna | 52,406 | (10,796) | 41,610 | 2,711 | - | - | - | - |
| Danish krone | - | - | - | - | - | (386) | (386) | - |
| Euro currency unit | 431,445 | (714,729) | (283,284) | 2,364 | 69,836 | (38,860) | 30,976 | (24) |
| Hong Kong dollar | 12,926 | (20,012) | (7,086) | 22 | 1,796 | (1,378) | 418 | - |
| Hungarian forint | 35,913 | (77,090) | (41,177) | (1,503) | - | - | - | - |
| Indian rupee | 91,153 | (5,017) | 86,136 | 148 | - | - | - | - |
| Indonesian rupiah | 55,328 | - | 55,328 | (116) | - | - | - | - |
| Israeli shekel | 2,259 | (40,461) | (38,202) | (604) | - | (15) | (15) | - |
| Japanese yen | 110,390 | (604,782) | (494,392) | 7,748 | 68,721 | (18,051) | 50,670 | (51) |
| Malaysian ringgit | 39,935 | - | 39,935 | (155) | 1,187 | (168) | 1,019 | 1 |
| Mexican peso | 101,222 | (1,020) | 100,202 | 1,781 | 370 | (1,330) | (960) | (1) |
| New Zealand dollar | 137,365 | (56,363) | 81,002 | (914) | - | (6,375) | (6,375) | (34) |
| Norwegian krone | 51,078 | (117,130) | (66,052) | (1,185) | 12,352 | (12,352) | - | (3) |
| Philippines peso | 24,068 | (18,795) | 5,273 | (99) | 360 | - | 360 | - |
| Polish zloty | 122,670 | (76,902) | 45,768 | 631 | 7 | - | 7 | - |
| Romanian new leu | 5,491 | - | 5,491 | 77 | - | - | - | - |
| Russian ruble | 36,081 | - | 36,081 | (718) | - | - | - | - |
| Singapore dollar | - | (63,163) | (63,163) | (280) | - | (778) | (778) | (2) |
| South African rand | 26,840 | (2,439) | 24,401 | (96) | 2,732 | (958) | 1,774 | (16) |
| South Korean won | 40,806 | (44,002) | (3,196) | (25) | - | (1,233) | (1,233) | - |
| Swedish krona | 90,418 | (18,858) | 71,560 | 1,647 | 5,513 | (4,158) | 1,355 | 36 |
| Swiss franc | 40,943 | (209,401) | (168,458) | (4,642) | 92,875 | (46,421) | 46,454 | 14 |
| Taiwan new dollar | 5,326 | (43,456) | (38,130) | 395 | - | (692) | (692) | - |
| Thailand baht | 5,387 | - | 5,387 | 5 | 1,137 | (313) | 824 | - |
| Turkish lira | 138,444 | (20,829) | 117,615 | (52) | 91 | - | 91 | - |
| U.S. dollar | 2,491,024 | (1,756,311) | 734,713 | - | 170,113 | (267,672) | (97,559) | - |
| Total | \$ 4,498,291 | \$ (4,494,948) | \$ 3,343 | \$ 3,343 | \$ 454,201 | \$ (454,190) | \$ 11 | \$ 11 |

Notes to the Financial Statements

3. Deposits and Investments (continued)

Security Lending

During fiscal years 2018 and 2017, the Trust participated in security lending programs with two lending agents, including the Trust's custodian and one third-party agent. These security lending programs have indemnity clauses requiring the lending agent to assume the borrower's risk from default. There are no restrictions on the amount of securities that can be loaned at one time to one borrower.

In addition to the two agent lending programs, the Trust participated in security lending through investments in four commingled funds that do not offer borrower indemnification. The Trust receives a proportionate share of the security lending income generated from these activities.

Collateral requirements for securities on loan range from 100% to 105%, depending on the lending agent, the type of security lent, and the type of collateral received. As of June 30, 2018, the Trust had received and invested approximately \$2.7 billion in cash collateral and received \$10.3 billion in securities as collateral for the lending programs. The collateral held for the security lending transactions exceeded the fair value of the securities on loan (including accrued interest). As a result, none of the lending programs were under-collateralized at the end of the fiscal year. The Trust does not have the ability to pledge or sell the non-cash collateral securities unless the borrower defaults, so the non-cash portion is not reported on the statements of net position.

Maturities of investments made with cash collateral generally are not matched to maturities of the securities loaned, because security lending agreements generally are open-ended with no fixed expiration date. As such, investments made with cash collateral are limited to those with a final maturity up to 92 days. However, investments in one of the security lending programs included investments with final maturities of six months or more, representing approximately 28% of that lender's total collateral invested at June 30, 2018. This is due to the portfolio containing some legacy non-repo securities that will remain until they are sold or mature.

Notes to the Financial Statements

3. Deposits and Investments (continued)

| Securities on Loan¹ | As of June 30 | |
|---|-----------------------|----------------------|
| | 2018 | 2017 |
| | <i>(In Thousands)</i> | |
| Securities on loan for cash collateral, by security type | | |
| U.S. guaranteed obligations | \$ 60,950 | \$ 141,736 |
| Federal agencies | 33,496 | 14,508 |
| Domestic corporate bonds and notes | 39,945 | 69,582 |
| International bonds and notes | 81,584 | 77,240 |
| Domestic equities | 144,785 | 235,581 |
| International equities | 2,165,492 | 747,803 |
| Total securities on loan for cash collateral | 2,526,252 | 1,286,450 |
| Securities on loan for non-cash collateral, by security type | | |
| U.S. guaranteed obligations | 2,533,830 | 2,606,857 |
| Federal agencies | 5,346 | 10,599 |
| Domestic corporate bonds and notes | 6,404 | 74,626 |
| International bonds and notes | 22,667 | 25,872 |
| Domestic equities | 6,972,054 | 5,326,784 |
| International equities | 544,372 | 1,246,340 |
| Total securities on loan for non-cash collateral | 10,084,673 | 9,291,078 |
| Total securities on loan | \$ 12,610,925 | \$ 10,577,528 |

¹ Fair value includes accrued interest on fixed income securities.

Notes to the Financial Statements

3. Deposits and Investments (continued)

Derivatives

The Trust accounts for derivatives in accordance with GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments* (GASB 53). This statement defines a derivative instrument as a financial instrument or other contract that has all of the following characteristics:

- a. Settlement factors. It has (1) one or more reference rates and (2) one or more notional amounts or payment provisions or both. Those terms determine the amount of the settlement or settlements, and in some cases, whether or not a settlement is required.
- b. Leverage. It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.
- c. Net settlement. Its terms require or permit net settlement, it can readily be settled net by a means outside the contract, or it provides for delivery of an asset that puts the recipient in a position not substantially different from net settlement.

Derivative instruments in the Trust as of June 30, 2018 and 2017, consisted of futures, options, forward currency contracts, and swaps.

The SBA has established investment guidelines for each investment portfolio. Pursuant to these guidelines, derivative investment instruments are authorized to be used as tools for managing risk or executing investment strategies more efficiently than could otherwise be done in cash markets, and may only be used as part of a prudent investment process. Various derivative investment instruments are used as part of the investment strategy to hedge against interest rate risk, currency risk in foreign markets, default risk, and mortgage-backed security prepayment risk, and to effectively manage exposure to domestic and international equities, bonds, and real estate markets.

A futures contract is an agreement between a buyer and a seller to exchange a particular good for a particular price at a particular date in the future, all of which are specified in a contract common to all members in a market on an organized futures exchange. Upon entering into a futures contract, collateral (cash and/or securities) is deposited with the counterparty, in SBA's name, in accordance with the initial margin requirements of the counterparty. Futures contracts are marked to market daily by the board of trade or exchange on which they are traded. The resulting gain/loss is received/paid the following day until the contract expires. The frequency of cash flows depends upon specified collateral and margin limits mutually agreed upon by the SBA and third-party counterparty. Futures contracts involve, to varying degrees, risk of loss in excess of the variation margin disclosed in the statements of net position. Losses may arise from future changes in the value of the underlying instrument.

Notes to the Financial Statements

3. Deposits and Investments (continued)

An option gives the buyer a stipulated privilege of buying or selling a stated property, security, or commodity at a given price (strike price) within a specified time (for an American-style option, at any time prior to or on the expiration date). A securities option is a negotiable contract in which the seller (writer), for a certain sum of money called the option premium, gives the buyer the right to demand within a specified time the purchase (call) from or sale (put) to the option seller of a specified number of bonds, currency units, index units, or shares of stock, at a fixed price or rate, called the strike price.

A forward contract is a contractual obligation, typically over-the-counter, traded between two parties to exchange a particular good or instrument at a set price on a future date. The buyer of the forward agrees to pay the price and take delivery of the good or instrument and is said to be “long” the forward contract, while the seller of the forward, or “short,” agrees to deliver the good or instrument at the agreed price on the agreed date.

A swap is a contractual agreement to exchange a stream of periodic payments utilizing a central clearing house whereby, each party in the transaction enters into a contract with the central counterparty. These agreements may be over-the-counter or exchange-traded. Upon entering into a swap contract through a clearing house, collateral is deposited with the counterparty, in SBA’s name, in accordance with the initial margin requirements of the counterparty. Swaps are available in and between all active financial markets. Examples include:

Interest rate swap – An agreement between two parties, where one stream of future interest payments is exchanged for another based on a specified principal amount. Interest rate swaps often exchange a fixed payment for a floating payment that is linked to an interest rate.

Credit default swap – An agreement that allows one party to “buy” protection from another party for losses that might be incurred as a result of default by a specified reference credit (or credits). The “buyer” of protection pays a premium for the protection, and the “seller” of protection agrees to make a payment to compensate the buyer for losses incurred if a defined credit event occurs.

Notes to the Financial Statements

3. Deposits and Investments (continued)

The fair value, changes in fair value, and notional amounts of the derivative investments are classified by type and presented by fiscal year in the tables below.

| Fiscal Year Ended June 30, 2018 | | | | | |
|-----------------------------------|--|-----------------------------------|--|------------------------------|--|
| Investment Derivatives | Notional (in US \$) (In Thousands) | Increase/(Decrease) in Fair Value | | Fair Value | |
| | | Classification | Amount (in US \$) (In Thousands) | Classification | Amount (in US \$) (In Thousands) |
| Futures¹ | | | | | |
| Futures (fixed income) | \$ 1,570,100 | Investment Income | \$ (42,343) | Investment | \$ 2,691 |
| Futures (equity) | 1,911,248 | Investment Income | 147,816 | Investment | (49,731) |
| Total futures | \$ 3,481,348 | | \$ 105,473 | | \$ (47,040) |
| | | | | Receivables | |
| Forward currency contracts | \$ 9,500 | Investment Income | \$ (9,014) | (Payables), net ² | \$ 9,500 |
| Options | | | | | |
| Options purchased | \$ 4,062,730 | Investment Income | \$ (97,127) | Investment | \$ 40,306 |
| Options sold | (2,073,613) | Investment Income | 48,966 | Liability | (16,728) |
| Total options | \$ 1,989,117 | | \$ (48,161) | | \$ 23,578 |
| Swaps | | | | | |
| Interest rate swaps | \$ 30,260 | Investment Income | \$ 9,354 | Investment | \$ 937 |
| Credit default swaps | 496,000 | Investment Income | (1,953) | Investment | 6,343 |
| Total swaps | \$ 526,260 | | \$ 7,401 | | \$ 7,280 |

¹ The total notional values of long and short fixed income futures positions were \$2,174,800,000 and \$(604,700,000), respectively. The total notional value of long equity futures positions was \$1,911,248,384.

² The total receivable and payable notional and fair values (in U.S. dollars) for forward currency contracts were \$3,797,712,678 and \$(3,788,213,197) as of June 30, 2018, and are presented on the statements of net position as forward foreign currency contracts receivable and forward foreign currency contracts payable.

Notes to the Financial Statements

3. Deposits and Investments (continued)

| Fiscal Year Ended June 30, 2017 | | | | | |
|-----------------------------------|---|-----------------------------------|---|------------------------------|---|
| Investment Derivatives | Notional (in US \$) <i>(In Thousands)</i> | Increase/(Decrease) in Fair Value | | Fair Value | |
| | | Classification | Amount (in US \$) <i>(In Thousands)</i> | Classification | Amount (in US \$) <i>(In Thousands)</i> |
| Futures¹ | | | | | |
| Futures (fixed income) | \$ 1,495,700 | Investment Income | \$ (31,113) | Investment | \$ (3,149) |
| Futures (equity) | 2,013,876 | Investment Income | 308,984 | Investment | (8,245) |
| Total futures | <u>\$ 3,509,576</u> | | <u>\$ 277,871</u> | | <u>\$ (11,394)</u> |
| | | | | Receivables | |
| Forward currency contracts | <u>\$ 3,343</u> | Investment Income | <u>\$ 63,097</u> | (Payables), net ² | <u>\$ 3,343</u> |
| Options | | | | | |
| Options purchased | \$ 2,416,630 | Investment Income | \$ (129,010) | Investment | \$ 30,620 |
| Options sold | (1,297,844) | Investment Income | 88,832 | Liability | (8,338) |
| Total options | <u>\$ 1,118,786</u> | | <u>\$ (40,178)</u> | | <u>\$ 22,282</u> |
| Swaps | | | | | |
| Interest rate swaps | \$ 241,105 | Investment Income | \$ 5,673 | Investment | \$ 493 |
| Credit default swaps | 171,000 | Investment Income | (1,183) | Investment | (2,508) |
| Total swaps | <u>\$ 412,105</u> | | <u>\$ 4,490</u> | | <u>\$ (2,015)</u> |

¹ The total notional values of long and short fixed income futures positions were \$2,032,700,000 and \$(537,000,000), respectively. The total notional value of long equity futures positions was \$2,013,875,750.

² The total receivable and payable notional and fair values (in U.S. dollars) for forward currency contracts were \$4,498,290,371 and \$(4,494,947,721) as of June 30, 2017, and are presented on the statements of net position as forward foreign currency contracts receivable and forward foreign currency contracts payable.

Commitments

Each year the Trust enters into a number of agreements that commit the Trust, upon request, to make additional investment purchases (i.e., capital commitments) up to predetermined amounts over certain investment time periods. The unfunded capital commitments for private equity, real estate and strategic investments not reported on the Trust's statements of net position totaled \$13.4 billion and \$11.3 billion as of June 30, 2018 and 2017, respectively.

Notes to the Financial Statements

4. Contingencies and Litigation

In the ordinary course of operations, the SBA, on behalf of the Trust, may be party to various claims, legal actions, and class action lawsuits. The SBA General Counsel's Office handles these matters either directly or with assistance of outside legal counsel. In the opinion of the SBA's management and legal counsel, these matters are not anticipated to have a material financial impact on the Trust.

5. Related Parties

The DMS, the FRS Investment Plan Trust Fund and the SBA are considered related parties for the purpose of the Trust's financial statements. The Trust has a variety of transactions with the DMS, the FRS Investment Plan Trust Fund and the SBA. The DMS administers the Plan, including collecting employer and employee contributions, remitting those contributions to SBA for investment in the Trust, requesting withdrawals from the Trust for benefit payments, and then paying those benefit payments to members. The SBA administers the FRS Investment Plan Trust Fund, including working with DMS to collect employer and employee contributions and processing member-directed benefit amounts between the Trust and the FRS Investment Plan Trust Fund. The SBA provides investment services to the Trust and charges an investment service charge on the Trust's net asset value each month-end.

Significant transactions between the Trust, DMS, FRS Investment Plan Trust Fund and the SBA for fiscal years 2018 and 2017, were as follows:

| | 2018 | 2017 |
|---|-----------------------|---------------------|
| | <i>(In Thousands)</i> | |
| Receivables: | | |
| Due from DMS | \$ 343,513 | \$ 327,124 |
| Payables: | | |
| Due to DMS | 180,663 | 159,679 |
| Due to the SBA for investment service charges | 6,053 | 5,773 |
| Total payables | \$ 186,716 | \$ 165,452 |
| Additions: | | |
| Employer/employee contributions received from DMS | 3,552,506 | 3,295,458 |
| Member-directed benefits received from the FRS Investment Plan Trust Fund | 70,597 | 71,110 |
| Total additions | \$ 3,623,103 | \$ 3,366,568 |
| Deductions: | | |
| Funds sent to the DMS for benefit payments | 9,822,417 | 9,347,568 |
| Member-directed benefits sent to the FRS Investment Plan Trust Fund | 597,010 | 568,912 |
| Investment service charges to the SBA ¹ | 36,069 | 33,073 |
| Total deductions | \$ 10,455,496 | \$ 9,949,553 |

¹ Based on month-end net asset values.



Crowe LLP
Independent Member Crowe Global

**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**

The Board of Trustees
State Board of Administration of Florida

We have audited, 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, the financial statements of the Florida Retirement System Trust Fund (the "Trust") administered by the State Board of Administration ("SBA") of Florida, as of and for the year ended June 30, 2018, and the related notes to the financial statements, and have issued our report thereon dated November 9, 2018. As discussed in Note 1, the financial statements present only the Trust and do not purport to, and do not, present fairly the financial position of the State of Florida, the SBA of Florida or the Florida Retirement System, their changes in financial position, or, where applicable, their cash flows in conformity with accounting principles generally accepted in the United States of America. As described in Notes 2 and 3, the financial statements include investments valued at approximately \$37.8 billion as of June 30, 2018, for which fair value has been estimated by general partners and investment advisors, and reviewed and approved by the Trust's management, in the absence of readily ascertainable market values. Because of the inherent uncertainty of valuation, the estimate of values may differ from the values that would have been used had a ready market existed for the investment securities, and the differences could be material. Our opinion is not modified with respect to these matters.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the 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 opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Trust's internal control. Accordingly, we do not express an opinion on the effectiveness of the Trust's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the 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 the Trust's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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 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 Trust's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.


Crowe LLP

Tampa, Florida
November 9, 2018