

Financial Statements  
and Independent Auditors' Report  
Permanent Health Fund  
*Years Ended August 31, 2011 and 2010*

# Permanent Health Fund

## Financial Statements

Years Ended August 31, 2011 and 2010

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## INDEPENDENT AUDITORS' REPORT

The Board of Regents of The University of Texas System  
The Board of Directors of The University of Texas Investment Management Company

We have audited the accompanying Statements of Fiduciary Net Assets of the Permanent Health Fund (the "Fund"), as of August 31, 2011 and August 31, 2010, and the related Statements of Changes in Fiduciary Net Assets for the years then ended. These financial statements are the responsibility of The University of Texas Investment Management Company ("UTIMCO" or "management"). 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. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing the audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements of the Fund are intended only to present the financial position of the Fund as of August 31, 2011 or August 31, 2010, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States and do not purport to, and do not, present the financial position of UTIMCO or The University of Texas System as of August 31, 2011 or August 31, 2010, or the changes in its financial position for the years then ended.

As discussed in Note 3, the financial statements include an investment in The University of Texas System General Endowment Fund (the "GEF"), valued at \$992,670,943 and \$905,156,085 as of August 31, 2011 and August 31, 2010, respectively. The GEF has 68.3% and 64.6% of its net assets as of August 31, 2011 and August 31, 2010, respectively, invested in assets whose fair values have been estimated by management in the absence of readily determinable fair values. Management's estimate of the value of the Fund is based on the net asset value per unit of GEF, which is also calculated by UTIMCO.

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Fund as of August 31, 2011 and August 31, 2010, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Management's discussion and analysis on pages 3 through 6 is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the financial statements of the Fund. The supplemental schedules are presented for purposes of additional analysis and are not a required part of the basic financial statements. This supplementary information is the responsibility of management. The supplemental schedules as of and for the years ended August 31, 2011, August 31, 2010, August 31, 2009, August 31, 2008, and August 31, 2007 have been subjected to the audit procedures applied by us in the audits of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

*Deloitte & Touche LLP*

October 31, 2011

### MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A) (Unaudited)

Our discussion and analysis of the Permanent Health Fund's (Fund) financial performance provides an overview of its activities for the year ended August 31, 2011. This discussion was prepared by The University of Texas Investment Management Company (UTIMCO) and should be read in conjunction with the Fund's financial statements and notes. The Fund is a pooled investment fund for the collective investment of state endowment funds for health-related institutions of higher education. The University of Texas System Board of Regents (UT Board) established the Fund in August 1999 with proceeds from state tobacco litigation. The Texas Constitution and various state statutes designate the UT Board as the fiduciary for the management of certain public endowment and operating funds. The UT Board has entered into an Investment Management Services Agreement delegating investment management responsibility for all investments to UTIMCO.

On March 1, 2001, the Fund purchased units in the General Endowment Fund (GEF) in exchange for the contribution of its investment assets. The GEF, established by the UT Board effective March 1, 2001, is a pooled fund for the collective investment of long-term funds under the control and management of the UT Board. The GEF has only two participants: the Fund and The University of Texas System Long Term Fund (LTF), which was also established by the UT Board. The GEF is organized as a pooled investment fund in which the Fund and the LTF purchase and redeem units quarterly. The GEF is under the fiduciary responsibility of the UT Board and is provided day-to-day operations by UTIMCO.

The purpose of the MD&A is to provide an objective and easily readable analysis of the Fund's financial statements based upon currently known facts, decisions or conditions.

### Financial Highlights

- The Fund's net fiduciary assets after distributions, increased by \$87.5 million from \$905.4 million to \$992.9 million or by approximately 9.7% for the year ended August 31, 2011, compared to an increase of \$63.1 million or approximately 7.5% for the year ended August 31, 2010. The change in net fiduciary assets from year to year is mainly attributable to the following:
  1. The Fund posted a net investment gain of 14.76%, calculated using the Modified Dietz Method as described by the CFA Institute, for the year ended August 31, 2011, compared to a net investment gain of 12.91% for the prior fiscal year. The net investment return of the Fund is dependent on the results of the investments held in the GEF. The GEF's investments in natural resources, developed country equities and credit-related fixed income were the biggest contributors to the 2011 return. For the year ended August 31, 2010, investments in credit-related fixed income, emerging market equities and real estate were the biggest contributors to the net investment gain.
  2. The Fund's distribution rate was increased by 2.4%, approximately the three year average rate of inflation, for the year ended August 31, 2011. This equated to an increase in the 2011 rate to \$.0554 per unit from the 2010 rate of \$.0541 per unit. The

## **PERMANENT HEALTH FUND**

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2010 rate was increased by 2.5% from the year ended August 31, 2009 rate. The fiscal year distributions represented 4.64% of the Fund's average net asset value for the year ended August 31, 2011, and 5.00% of the Fund's average net asset value for the year ended August 31, 2010.

3. There were no participant contributions to the Fund or withdrawals from the Fund during the years ended August 31, 2011 and 2010.

### **Use of Financial Statements and Notes**

The Fund's financial statements were prepared in accordance with standards issued by the Governmental Accounting Standards Board (GASB). Two financial statements are required by the GASB: the statement of fiduciary net assets and the statement of changes in fiduciary net assets.

The notes to the financial statements contain supplemental information that is essential for the fair presentation of the financial statements.

### **Statements of Fiduciary Net Assets**

The statements of fiduciary net assets present assets, liabilities, and net assets of the Fund as of the end of the fiscal year. These statements, along with all of the Fund's financial statements, are prepared using the accrual basis of accounting, whereby Fund investment income is recognized when earned and Fund expenses are recognized when incurred.

Since the Fund invests in only GEF units and a negligible amount of cash, the majority of the Fund's net assets represent investment in GEF units.

As of August 31, 2011, the Fund owned 5,054,800 GEF units representing an ownership percentage of 14.08%, compared to 5,294,171 GEF units representing an ownership percentage of 15.00% as of August 31, 2010. As of August 31, 2011 and 2010, the fair value of the GEF units was \$992.7 million and \$905.1 million, respectively.

The GEF invests in a broad mix of investments and is actively managed to its benchmark, the Endowment Policy Portfolio. The Endowment Policy Portfolio is the index or benchmark for the endowment funds that UTIMCO manages. The return of the Endowment Policy Portfolio is the sum of the weighted benchmark returns for each asset class. UTIMCO allocates GEF's assets to internally and externally managed portfolios in accordance with approved asset allocation policies, and attempts to supplement the original endowment corpus by increasing purchasing power over time.

## PERMANENT HEALTH FUND

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The following summarizes the statements of fiduciary net assets (in millions):

	<u>2011</u>	<u>2010</u>	<u>2009</u>
<b>Assets</b>			
GEF Units, at Fair Value	\$ 992.7	\$ 905.1	\$ 842.0
Cash and Cash Equivalents	0.2	0.3	0.3
<b>Net Assets Held in Trust</b>	<u>\$ 992.9</u>	<u>\$ 905.4</u>	<u>\$ 842.3</u>

### Statements of Changes in Fiduciary Net Assets

Changes in fiduciary net assets as presented on the statements of changes in fiduciary net assets are based on activity of the Fund. The purpose of these statements is to present additions to the Fund resulting from net investment income and participant contributions and to present deductions from the Fund resulting from administrative and investment expenses and participant distributions.

The net increase in investments of the Fund was \$125.0 million during the year compared to a increase in the appreciation of investments of \$100.1 million for the year ended August 31, 2010. The Fund's investment expenses totaled \$0.9 million, \$0.6 million, and \$0.9, respectively, for the years ended August 31, 2011, 2010, and 2009.

Distributions to participants totaled \$45.4 million, \$44.4 million and \$43.3 million, respectively, for the years ended August 31, 2011, 2010, and 2009. The increase in distributions is a result of the UT Board increasing the distribution rate from \$0.0541 per unit to \$0.0554 per unit for fiscal year 2011. The increase for fiscal year 2010 is a result of the UT Board's increase of the distribution rate from \$0.0528 per unit to \$0.0541 per unit.

The Fund's objectives are:

- Provide for current beneficiaries by increasing the annual distribution rate at least equal to the rate of inflation so that real purchasing power is maintained, and
- Provide for future beneficiaries by increasing the market value of endowment funds after the annual distribution at a rate at least equal to the rate of inflation so that future distributions maintain purchasing power as well.

Fund distributions are controlled by a spending policy approved by the UT Board. The key to preservation of endowment purchasing power over the long-term is control of spending through a target distribution rate. This target rate should not exceed the endowment's average annual investment return after fund expenses and inflation. The Fund distributions are increased annually at an three year average rate of inflation provided that the distribution rate remains within a range of 3.5% to 5.5% of the Fund's net asset value. As reported on the financial highlights schedule of the financial statements, the ratio of distributions to average net assets (12-quarter average) has remained between 3.5% to 5.5%.

## PERMANENT HEALTH FUND

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The following table summarizes the statements of changes in fiduciary net assets (in millions):

	<b>2011</b>	<b>2010</b>	<b>2009</b>
Investment Income (Loss)	\$ 133.8	\$ 108.1	\$ (139.2)
Less Investment Expenses	(0.9)	(0.6)	(0.9)
Net Investment Income (Loss)	<u>132.9</u>	<u>107.5</u>	<u>(140.1)</u>
Participant Distributions	<u>45.4</u>	<u>44.4</u>	<u>43.3</u>
Total Deductions	<u>45.4</u>	<u>44.4</u>	<u>43.3</u>
Change in Fiduciary Net Assets	87.5	63.1	(183.4)
Net Assets Held in Trust, Beginning of Year	<u>905.4</u>	<u>842.3</u>	<u>1,025.7</u>
Net Assets Held in Trust, End of Year	<u>\$ 992.9</u>	<u>\$ 905.4</u>	<u>\$ 842.3</u>

### Contacting UTIMCO

The above financial highlights are designed to provide a general overview of the Fund's investment results and insight into the following financial statements. Additional information may be found on our website and inquiries may be directed to UTIMCO via [www.utimco.org](http://www.utimco.org).

## PERMANENT HEALTH FUND

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### Statements of Fiduciary Net Assets

August 31, 2011 and 2010

(Dollars in thousands, except per unit amounts)

	<u>2011</u>	<u>2010</u>
<b>Assets</b>		
GEF Units, at Fair Value	\$ 992,671	\$ 905,156
Cash and Cash Equivalents	261	278
Other	-	8
<b>Net Assets Held in Trust (820,000,000 Units)</b>	<u>\$ 992,932</u>	<u>\$ 905,442</u>
<b>Net Asset Value Held in Trust Per Unit</b>	<u>\$ 1.211</u>	<u>\$ 1.104</u>

*The accompanying notes are an integral  
part of these financial statements*

## PERMANENT HEALTH FUND

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### Statements of Changes in Fiduciary Net Assets

Years Ended August 31, 2011 and 2010

(in thousands)

	<u>2011</u>	<u>2010</u>
<b>Additions</b>		
Investment Income:		
Net Increase in Investments	\$ 124,973	\$ 100,080
Allocation of GEF Net Investment Income	8,874	7,999
Other Income	-	1
Total Investment Income	<u>133,847</u>	<u>108,080</u>
Less Investment Expenses:		
UTIMCO Management Fee	875	499
Other Expenses	<u>31</u>	<u>30</u>
Total Investment Expenses	<u>906</u>	<u>529</u>
Net Investment Income	132,941	107,551
<b>Deductions</b>		
Administrative Fee for UT System Oversight	23	24
Participant Distributions	<u>45,428</u>	<u>44,362</u>
<b>Total Deductions</b>	<u>45,451</u>	<u>44,386</u>
<b>Change in Fiduciary Net Assets</b>	87,490	63,165
Net Assets Held in Trust, Beginning of Year	<u>905,442</u>	<u>842,277</u>
<b>Net Assets Held in Trust, End of Year</b>	<u>\$ 992,932</u>	<u>\$ 905,442</u>

*The accompanying notes are an integral  
part of these financial statements*

## PERMANENT HEALTH FUND

### *Notes to Financial Statements*

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#### **Note 1 – Organization and Basis of Presentation**

The Permanent Health Fund (Fund) is a pooled investment fund established for the collective investment of state endowment funds for health-related institutions of higher education, created August 30, 1999. The distributions from the Fund endowments support programs that benefit medical research, health education, public health, nursing, and treatment programs at health-related institutions of higher education. Fiduciary responsibility for the Fund rests with the Board of Regents of The University of Texas System (UT Board). The day-to-day operational responsibilities of the Fund are delegated to The University of Texas Investment Management Company (UTIMCO), pursuant to an Investment Management Services Agreement with the UT Board.

On March 1, 2001, the Fund purchased units in the General Endowment Fund (GEF) in exchange for the contribution of its investment assets. The GEF, established by the UT Board effective March 1, 2001, is a pooled fund for the collective investment of long-term funds under the control and management of the UT Board. The performance of the Fund is significantly impacted by the performance of the GEF. The GEF has only two participants: the Fund and The University of Texas System Long Term Fund (LTF), which was also established by the UT Board. The GEF is organized as a pooled investment fund in which the Fund and the LTF purchase and redeem units quarterly. The GEF is under the fiduciary responsibility of the UT Board and is provided day-to-day operations by UTIMCO.

The activities of the Fund are accounted for as a fiduciary fund. The financial statements of the Fund use an economic resources measurement focus and the accrual basis of accounting, whereby revenues are recorded when earned and expenses are recorded when a liability is incurred regardless of the timing of cash flows. The financial statements of the Fund are prepared in accordance with the requirements of the Governmental Accounting Standards Board (GASB).

The annual combined financial statements of The University of Texas System are prepared in accordance with the Texas Comptroller of Public Accounts' Annual Financial Reporting Requirements and include information related to the Fund. The accompanying financial statements may differ in presentation from the Texas Comptroller of Public Accounts' Annual Financial Reporting Requirements.

#### **Note 2 – Investment in GEF**

The Fund only invests in GEF units and a negligible amount of cash. The Fund also continues to receive securities as proceeds in class action suits from the securities the Fund previously owned. These securities are normally sold when received, but from time to time will be reflected as a Fund investment. At August 31, 2011, the Fund is the minority participant in the GEF, with ownership of 5,054,800 units, which represents 14.08% of the GEF. At August 31, 2010, the Fund held 5,294,171 units, which represented 15.00% of the GEF.

## PERMANENT HEALTH FUND

### *Notes to Financial Statements (cont.)*

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The GEF and the Fund have identical investment objectives. Additionally, the GEF's accounting policies follow the Fund's, as described in Note 3, except for the distributions to participants. On a monthly basis for accounting purposes, the GEF allocates its net investment income and realized gain or loss to the Fund based on its ownership of GEF units at month end. The allocated investment income and realized gain amounts increase the cost basis of the units in the GEF, and any allocated realized losses reduce the cost basis of the units in the GEF. Since the allocation is proportional to the percentage of ownership by the unitholders, no additional units are purchased. The Fund redeems GEF units quarterly to meet its distribution requirements to its unitholders.

### **Note 3 – Significant Accounting Policies**

(A) **Security Valuation** -- The Fund's investment in GEF units is valued at the net asset value per unit reported by the GEF. Investment assets which are held in the GEF that have readily determinable fair values are primarily valued on the basis of market valuations provided by independent pricing services. The GEF's investments in private investment funds, hedge funds, U.S. equity, non-U.S. equity, emerging market and fixed income investment funds and certain other equity securities are fair valued by management using the investments' capital balances and net asset value information provided by the investment manager as well as other considerations as described in the notes to the GEF financial statements. The Fund's investment in the GEF is valued at \$992,670,943 and \$905,156,085, as of August 31, 2011 and 2010, respectively.

(B) **Investment Income** -- Interest income is accrued as earned.

(C) **Security Transactions** -- A gain or loss is recognized on GEF unit sales on the basis of average cost.

(D) **Distributions to Participants** -- Cash distributions to participants are paid quarterly based on a per unit payout established by the UT Board. For the year ended August 31, 2011, the quarterly rate was \$.01385 per unit which equates to an annual rate of \$.0554 per unit and for the year ended August 31, 2010, the quarterly rate was \$.013525 per unit which equated to an annual rate of \$.0541 per unit. The ratio of distributions to average net assets (12-quarter average) was 4.96% as of August 31, 2011. The investment policy provides that the annual payout will be adjusted by the average consumer price index of the prior 36 months subject to a maximum distribution of 5.5% of the Fund's average market value and a minimum distribution of 3.5% of the Fund's average market value.

(E) **Fund Valuation** -- Valuation of the Fund's units occurs on a quarterly basis. Unit values are determined by dividing the value of the Fund's net assets by the number of units outstanding on the valuation date.

(F) **Purchases and Redemption of Units** -- Unit purchases occur on the first business day of each fiscal quarter. Unit redemptions occur on the last business day of each fiscal quarter. The value of participating units, upon admission to the Fund, is based upon the market value of net assets held as of the quarterly valuation date. Redemptions from the Fund will also be made at the market value price per unit at the quarterly valuation date at the time of the redemption. There are no transaction costs incurred by participants for the purchase or redemption of units. There were no purchase or redemption of Fund units during the years ended August 31, 2011 and 2010.

## PERMANENT HEALTH FUND

### *Notes to Financial Statements (cont.)*

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(G) **Participants' Net Assets** -- All participants in the Fund have a proportionate interest in the Fund's net assets.

(H) **Use of Estimates** -- The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

(I) **Cash and Cash Equivalents** -- Cash and Cash Equivalents consist of money market investments and other overnight funds.

#### **Note 4 – Investment Risk**

The investment risk disclosure that follows relates to the GEF's investments before securities lending transactions and the investment of cash collateral. Disclosures relating to the GEF's securities lending transactions are provided in Note 5. Values presented are the Fund's pro-rata share of GEF investments based on its unit ownership in the GEF.

##### **(A) Credit Risk**

Article VII, Section 11b of the Texas Constitution authorizes the UT Board, subject to procedures and restrictions it establishes, to invest the Permanent University Fund (the "PUF") in any kind of investment and in amounts it considers appropriate, provided that it adheres to the prudent investor standard. This standard provides that the UT Board, in making investments, may acquire, exchange, sell, supervise, manage, or retain, through procedures and subject to restrictions it establishes and in amounts it considers appropriate, any kind of investment that prudent investors, exercising reasonable care, skill and caution, would acquire or retain in light of the purposes, terms, distribution requirements, and other circumstances of the fund then prevailing, taking into consideration the investment of all of the assets of the fund rather than a single investment. Pursuant to Section 51.0031(c) of the Texas Education Code, the UT Board has elected the prudent investor standard to govern its management of the GEF.

Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization (NRSRO). The Fund's investment policy does not provide specific limitations or requirements regarding investment ratings. Per GASB Statement No. 40 (GASB 40), *Deposit and Investment Risk Disclosures, an amendment to GASB Statement No. 3*, unless there is information to the contrary, obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit quality. GASB 40 also provides that securities with split ratings, or a different rating assignment between NRSROs, are disclosed using the rating indicative of the greatest degree of risk. The following table presents the Fund's pro-rata share of each applicable GEF investment type grouped by rating as of August 31, 2011 and 2010:

# PERMANENT HEALTH FUND

## Notes to Financial Statements (cont.)

GEF Investment Type	August 31,		Rating
	2011	2010	
<b>Investments:</b>			
U.S. Government Guaranteed	\$ -	\$ 9,456,639	Exempt from Disclosure
U.S. Government Guaranteed	11,451,725	-	AA
Total U.S. Government Guaranteed	11,451,725	9,456,639	
U.S. Government Non-Guaranteed:			
U.S. Agency	-	299,966	AAA
U.S. Agency	265,956	-	AA
U.S. Agency Asset Backed	1,458,361	9,189,254	AAA
U.S. Agency Asset Backed	5,518,842	-	AA
Total U.S. Government Non-Guaranteed	7,243,159	9,489,220	
Total U.S. Government	18,694,884	18,945,859	
Corporate Obligations:			
Domestic	1,677,416	3,121,924	AAA
Domestic	688,305	1,655,122	AA
Domestic	5,365,363	8,991,166	A
Domestic	3,793,351	8,705,385	BAA/BBB
Domestic	576,358	2,256,450	BA/BB
Domestic	409,894	965,968	B
Domestic	592,478	1,968,476	CAA/CCC
Domestic	224,190	619,536	CA/CC
Domestic	23,919	80,283	C
Domestic	41,884	14,050	D
Domestic	115,135	65,515	Not Rated
Foreign	3,923,348	8,228,874	AAA
Foreign	1,060,140	2,450,574	AA
Foreign	2,076,075	1,581,423	A
Foreign	1,402,952	1,559,443	BAA/BBB
Foreign	235,267	154,346	BA/BB
Foreign	105,711	68,154	B
Foreign	-	259,390	Not Rated
Total Corporate Obligations	22,311,786	42,746,079	
Foreign Government and Provincial Obligations	14,887,622	10,464,141	AAA
Foreign Government and Provincial Obligations	2,479,464	4,118,524	AA
Foreign Government and Provincial Obligations	3,711,589	3,346,667	A
Foreign Government and Provincial Obligations	11,043,685	1,529,711	BAA/BBB
Foreign Government and Provincial Obligations	666,436	599,186	BA/BB
Foreign Government and Provincial Obligations	1,602,366	-	Not Rated
Total Foreign Government and Provincial Obligations	34,391,162	20,058,229	
Other Debt Securities	57,415	-	AAA
Other Debt Securities	177,123	80,535	AA
Other Debt Securities	588,228	408,627	A
Other Debt Securities	48,074	168,036	BAA/BBB
Other Debt Securities	99,472	-	BA/BB
Total Other Debt Securities	970,312	657,198	
Total Debt Securities	\$ 76,368,144	\$ 82,407,365	
Convertible Securities	\$ 288,422	\$ -	Not Rated
Other Investment Funds - Debt	\$ -	\$ 8,969,108	AA
Other Investment Funds - Debt	974,343	918,991	BA/BB
Total Other Investment Funds - Debt	\$ 974,343	\$ 9,888,099	
Cash and Cash Equivalents - Money Market Funds	\$ 39,774,797	\$ 84,968,774	AAA
Cash and Cash Equivalents - Money Market Funds	-	361	A
Cash and Cash Equivalents	1,453,538	365,988	Not Rated
Total Cash and Cash Equivalents	\$ 41,228,335	\$ 85,335,123	
<b>Net Deposit with Brokers for Derivative Contracts:</b>			
U.S. Government Guaranteed	\$ -	\$ 1,555,757	Exempt from Disclosure
U.S. Government Guaranteed	114,903	-	AA
Foreign Government and Provincial Obligations	2,181,923	-	BAA/BBB
Foreign Government and Provincial Obligations	150,774	-	Not Rated
Cash	1,598,370	4,272,869	Exempt from Disclosure
<b>Total Net Deposit with Brokers for Derivative Contracts</b>	<b>\$ 4,045,970</b>	<b>\$ 5,828,626</b>	

## PERMANENT HEALTH FUND

*Notes to Financial Statements (cont.)*

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### **(B) Concentrations of Credit Risk**

The GEF's investment policy statement contains the limitation that no more than 5% of the market value of fixed income securities may be invested in corporate or municipal bonds of a single issuer. The GEF does not hold any direct investments in any one issuer of corporate or municipal bonds that is 5% or more of the market value of the GEF's fixed income investments.

### **(C) Custodial Credit Risk**

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the GEF will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the GEF will not be able to recover the value of its investment or collateral securities that are in the possession of another party. Texas State Statutes and the GEF's investment policy statements do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments. As of August 31, 2011 and 2010, the GEF does not have any deposits or investments that are exposed to custodial credit risk.

### **(D) Interest Rate Risk**

Interest rate risk is the risk that changes in market interest rates will adversely affect the value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its value to changes in market interest rates. Interest rate risk inherent in the GEF is measured by monitoring the modified duration of the overall investment portfolio. Modified duration estimates the sensitivity of the GEF's investments to changes in interest rates. The GEF has no specific policy statement limitations with respect to its overall modified duration. The following table summarizes the GEF's modified duration and the Fund's pro-rata share of the GEF investment value by investment type as of August 31, 2011 and 2010:

**PERMANENT HEALTH FUND**  
*Notes to Financial Statements (cont.)*

GEF Investment Type	August 31,			
	2011		2010	
	Value	Modified Duration	Value	Modified Duration
<b>Investments:</b>				
U.S. Government Guaranteed:				
U.S. Treasury Bonds and Notes	\$ 11,233,667	10.47	\$ 7,801,942	10.39
U.S. Treasury Strips	-	-	421,891	0.94
U.S. Treasury Bills	115,868	0.50	1,109,505	0.13
U.S. Agency Asset Backed	102,190	3.47	123,301	6.41
Total U.S. Government Guaranteed	<u>11,451,725</u>	10.31	<u>9,456,639</u>	8.71
U.S. Government Non-Guaranteed:				
U.S. Agency	265,956	9.11	299,966	9.22
U.S. Agency Asset Backed	6,977,203	2.83	9,189,254	2.28
Total U.S. Government Non-Guaranteed	<u>7,243,159</u>	3.06	<u>9,489,220</u>	2.50
Total U.S. Government	<u>18,694,884</u>	7.50	<u>18,945,859</u>	5.60
Corporate Obligations:				
Domestic	13,508,293	6.33	28,443,875	5.28
Foreign	8,803,493	5.10	14,302,204	4.31
Total Corporate Obligations	<u>22,311,786</u>	5.84	<u>42,746,079</u>	4.96
Foreign Government and Provincial Obligations	<u>34,391,162</u>	6.76	<u>20,058,229</u>	6.44
Other Debt Securities	<u>970,312</u>	11.87	<u>657,198</u>	11.96
Total Debt Securities	<u>76,368,144</u>	6.74	<u>82,407,365</u>	5.52
Convertible Securities	<u>288,422</u>	2.37	-	-
Other Investment Funds - Debt	<u>974,343</u>	7.50	<u>9,888,099</u>	6.14
Cash and Cash Equivalents	<u>41,228,335</u>	0.08	<u>85,335,123</u>	0.08
Total	<u>\$ 118,859,244</u>	4.42	<u>\$ 177,630,587</u>	2.94
<b>Net Deposit with Brokers for Derivative Contracts:</b>				
U.S. Government Guaranteed:				
U.S. Treasury Bills	\$ 114,903	0.28	\$ 1,494,812	17.18
U.S. Treasury Bonds and Notes	-	-	60,945	0.27
Total U.S. Government Guaranteed	<u>114,903</u>	0.28	<u>1,555,757</u>	0.93
Foreign Government and Provincial Obligations	<u>2,332,697</u>	6.91	-	-
Cash	<u>1,598,370</u>	-	<u>4,272,869</u>	-
Total Net Deposit with Brokers for Derivative Contracts	<u>\$ 4,045,970</u>	3.99	<u>\$ 5,828,626</u>	0.25

The GEF has purchased options on ten year constant maturity swaps, with expirations ranging from five to seven years, as insurance against possible future increases in inflation. As of August 31, 2011 the Fund's pro-rata portion of these options had a notional value of \$391,705,600 and a fair value of \$1,754,984. As of August 31, 2010 the Fund's pro-rata portion of these options had a notional value of \$174,000,000 and a fair value of \$601,780. The risk of loss on these options is limited to the Fund's pro-rata portion of the premiums paid by the Fund upon the purchase of the options, which totaled \$2,144,107 as of August 31, 2011 and \$931,172 as of August 31, 2010. The GEF also

## PERMANENT HEALTH FUND

### *Notes to Financial Statements (cont.)*

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purchased both puts and swaptions on the Japanese Yen, with expirations ranging from one to two years, as insurance against the possibility of a downturn in the Japanese economy. As of August 31, 2011 the Fund's pro-rata portion of these puts and swaptions had a notional value of \$530,915,897 with a fair value of \$990,450 and a loss limited to \$2,857,607 which represents the premiums paid. It is estimated that these options would adjust the 2011 duration of total debt securities of 6.74 downward by approximately 1.04, and the total duration of 4.42 downward by approximately 1.17. It is estimated that these options would adjust the 2010 duration of total debt securities of 5.52 downward by approximately 0.26, and the total duration of 2.94 downward by approximately 0.22. One of the GEF's external managers also uses options and interest rate and credit default swaps to modify the duration of their portfolio in a cost efficient manner. It is estimated by management that these positions held by the external manager would not significantly adjust the modified duration as presented above.

#### ***(E) Investments with Fair Values That Are Highly Sensitive to Interest Rate Changes***

The GEF may invest in various mortgage backed securities, such as collateralized mortgage backed obligations. The GEF also may invest in investments that have floating rates with periodic coupon changes in market rates, zero coupon bonds and stripped Treasury and Agency securities created from coupon securities. No percentage of holdings limitations are specified in the investment policy statements regarding these types of securities. As of August 31, 2011 and 2010, the GEF's investments include the following investments that are highly sensitive to interest rate changes.

Collateralized mortgage obligations which are subject to early payment in a period of declining interest rates. The resultant reduction in expected total cash flows will affect the fair value of these securities. The Fund's pro-rata share of these securities amounted to \$6,553,891 and \$20,262,830 as of August 31, 2011 and 2010, respectively.

Mortgage backed securities which are subject to early payment in a period of declining interest rates. The resultant reduction in expected total cash flows will affect the fair value of these securities. The Fund's pro-rata share of these securities amounted to \$3,501,091 and \$3,235,833 as of August 31, 2011 and 2010, respectively.

Asset backed securities which are backed by home equity loans, auto loans, equipment loans and credit card receivables. Prepayments by the obligees of the underlying assets in periods of decreasing interest rates could reduce or eliminate the stream of income that would have been received. The Fund's pro-rata share of these securities amounted to \$792,679 and \$2,329,680 as of August 31, 2011 and 2010, respectively.

## PERMANENT HEALTH FUND

*Notes to Financial Statements (cont.)*

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### **(F) Foreign Currency Risk**

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of the GEF's non-U.S. dollar investments. As of August 31, 2011, there are no limitations on investments in non-U.S. denominated bonds or common stocks in relation to the GEF's total fixed income and developed country equity exposures in the GEF's investment policy statement.

During the year ended August 31, 2010, one of the GEF's external managers employs an investment strategy in which they hedge their long non-U.S. investment positions back to the U.S. dollar by utilizing currency transactions in amounts equal to the long investment position. In the following table the negative amounts shown for the Canadian Dollar, Czech Koruna, Hong Kong Dollar, Norwegian Kroner, Swiss Franc, and the UK Pound in the cash and cash equivalents section reflect this strategy. The negative amounts offset long positions presented in the foreign common stock section.

The following table summarizes the Fund's pro-rata exposure of the GEF's non-U.S. dollar investments at August 31, 2011 and 2010:

# PERMANENT HEALTH FUND

## Notes to Financial Statements (cont.)

GEF Investment Type	August 31,	
	2011	2010
<b>Foreign Common Stock:</b>		
Australian Dollar	\$ 3,269,096	\$ 2,308,604
Brazilian Real	4,668,978	3,927,379
Canadian Dollar	3,271,776	2,715,339
Chilean Peso	200,450	230,126
Czech Koruna	134,103	223,982
Danish Krone	252,673	88,477
Egyptian Pound	95,666	286,372
Euro	6,297,929	9,276,018
Hong Kong Dollar	10,252,625	12,248,311
Hungarian Forint	104,924	178,151
Indian Rupee	1,951,052	865,825
Indonesian Rupian	1,042,316	1,108,689
Israeli Shekel	5,339	7,579
Japanese Yen	3,707,553	3,680,221
Malaysian Ringgit	1,490,833	1,799,717
Mexican Peso	1,317,233	1,210,001
Moroccan Dirham	48,504	40,995
Norwegian Kroner	250,705	191,670
Pakistani Rupee	48,061	97,599
Peruvian Nuevo Sol	6,878	4,510
Philippine Peso	288,501	174,914
Polish Zloty	750,012	703,586
Russian Ruble	137,652	-
Singapore Dollar	1,177,737	1,081,542
South African Rand	2,387,134	2,677,969
South Korean Won	6,836,175	6,119,626
Swedish Krona	1,316,567	710,167
Swiss Franc	1,304,201	1,945,086
Taiwan Dollar	2,648,889	2,160,678
Thai Baht	1,435,569	1,508,541
Turkish Lira	1,023,846	1,118,298
UK Pound	9,712,065	7,246,071
United Arab Emirates Dirham	112,993	-
Total Foreign Common Stock	67,548,035	65,936,043
<b>Other - Equity Securities</b>		
Canadian Dollar	13	-
Malaysian Ringgit	122	-
Total Other - Equity Securities	135	-
<b>Foreign Preferred Stock:</b>		
Brazilian Real	3,138,726	2,762,788
Euro	-	73,317
South African Rand	5,389	-
South Korean Won	19,545	-
Total Foreign Preferred Stock	3,163,660	2,836,105
<b>Foreign Government and Provincial Obligations:</b>		
Australian Dollar	1,690,956	1,416,857
Brazilian Real	13,257,079	645,113
Canadian Dollar	1,396,334	1,927,724
Euro	6,550,362	3,692,756
Hong Kong Dollar	81,947	47,584
Hungarian Forint	476,531	326,641
Indonesian Rupian	666,436	599,186
Japanese Yen	1,413,649	2,518,539
Malaysian Ringgit	912,203	890,005
Mexican Peso	1,245,135	557,958
New Zealand Dollar	1,490,884	624,029

# PERMANENT HEALTH FUND

## Notes to Financial Statements (cont.)

GEF Investment Type	August 31,	
	2011	2010
<b>Foreign Government and Provincial Obligations (continued):</b>		
Norwegian Kroner	\$ 862,140	\$ 361,901
Polish Zloty	1,094,236	1,069,761
Singapore Dollar	717,530	169,337
South African Rand	832,005	505,643
South Korean Won	859,230	801,660
Swedish Krona	-	750,751
UK Pound	2,941,481	3,016,690
Total Foreign Government and Provincial Obligations	<u>36,488,138</u>	<u>19,922,135</u>
<b>Corporate Obligations:</b>		
Australian Dollar	1,389,728	2,207,959
Brazilian Real	-	194,399
Canadian Dollar	311,589	392,894
Danish Krone	-	53,881
Euro	4,209,369	6,606,217
Hong Kong Dollar	-	64,991
Japanese Yen	229,166	250,709
UK Pound	804,870	574,684
Total Corporate Obligations	<u>6,944,722</u>	<u>10,345,734</u>
<b>Convertible Securities:</b>		
Brazilian Real	288,422	-
Swiss Franc	-	3,522
Total Convertible Securities	<u>288,422</u>	<u>3,522</u>
<b>Purchased Options:</b>		
Australian Dollar	5,581,373	-
Euro	312,237	-
Japanese Yen	990,586	-
South Korean Won	4,419,238	-
Total Purchased Options	<u>11,303,434</u>	<u>-</u>
<b>Private Investment Funds:</b>		
Canadian Dollar	1,036,942	412,697
Euro	16,045,364	13,749,366
UK Pound	808,717	-
Total Private Investment Funds	<u>17,891,023</u>	<u>14,162,063</u>
<b>Investment Funds - Emerging Markets:</b>		
Brazilian Real	510,688	103,323
<b>Cash and Cash Equivalents:</b>		
Australian Dollar	177,739	50,941
Brazilian Real	134,008	73,515
Canadian Dollar	10,677	(26,346)
Chilean Peso	166	127
Czech Koruna	2	(23,127)
Danish Krone	69	437
Egyptian Pound	-	4,463
Euro	150,205	3,149,829
Hong Kong Dollar	34,455	(770,333)
Hungarian Forint	7	13
Indian Rupee	48,393	5
Indonesian Rupian	1,700	10,651
Israeli Shekel	202	201
Japanese Yen	840	67,317
Malaysian Ringgit	19,468	3,637
Mexican Peso	2,384	10,608
Moroccan Dirham	1,679	1,377
New Zealand Dollar	83	4
Norwegian Kroner	14,200	(78,363)
Peruvian Nuevo Sol	2,787	6
Philippine Peso	3,157	5,177
Polish Zloty	1,575	257

## PERMANENT HEALTH FUND

### Notes to Financial Statements (cont.)

GEF Investment Type	August 31,	
	2011	2010
<b>Cash and Cash Equivalents (continued):</b>		
Singapore Dollar	\$ 340	\$ 55
South African Rand	1,983	7,217
South Korean Won	17,939	7,346
Swedish Krona	151	11,327
Swiss Franc	-	(1,199,934)
Taiwan Dollar	80,690	66,230
Thai Baht	1,454	3,308
Turkish Lira	19	1
UK Pound	662,011	(52,244)
Total Cash and Cash Equivalents	1,368,383	1,323,702
<b>Written Options:</b>		
Australian Dollar	(3,414,553)	-
Euro	(2,618)	(2,978)
South Korean Won	(2,868,459)	-
UK Pound	-	(32)
Total Written Options	(6,285,630)	(3,010)
<b>Swaps:</b>		
Australian Dollar	(159)	5,416
Brazilian Real	3,649	3,590
Canadian Dollar	-	2,071
Euro	(1,913)	3,638
Japanese Yen	2,652	38,931
Mexican Peso	68,936	-
UK Pound	(31,849)	8,612
Total Swaps	41,316	62,258
<b>Futures:</b>		
Australian Dollar	4,162	-
Canadian Dollar	(4,173)	-
Euro	40,695	98,374
UK Pound	(11,495)	1,218
Total Futures	29,189	99,592
Total	\$ 139,291,515	\$ 114,791,467

#### (G) Counterparty (Credit) Risk

The derivative instruments utilized by the GEF, contain varying degrees of off-balance sheet risk whereby changes in the fair values of securities underlying the financial instruments may exceed the amounts recognized in the statement of changes in fiduciary net assets. The GEF manages these risks on an aggregate basis along with the risks associated with its other investments as part of its overall risk management process.

The Fund's pro-rata share of the GEF's gross counterparty exposure as of August 31, 2011 for options, swaps, and foreign currency exchange contracts is shown in the tables below.

## PERMANENT HEALTH FUND

Notes to Financial Statements (cont.)

Options				
Assets		Liabilities		Counterparty Rating
Notional	Notional	Fair Value as of August 31, 2011	Fair Value as of August 31, 2011	
\$ 663,030,720	\$ 166,905,684	\$ 9,500,766	\$ 5,498,267	
449,968,545	35,417,082	3,568,852	1,556,644	AA
<u>\$ 1,112,999,265</u>	<u>\$ 202,322,766</u>	<u>\$ 13,069,618</u>	<u>\$ 7,054,911</u>	

  

Swaps				
Assets		Liabilities		Counterparty Rating
Notional	Notional	Fair Value as of August 31, 2011	Fair Value as of August 31, 2011	
\$ 5,609,707	\$ 39,092,055	\$ 177,121	\$ 3,013,713	
135,989,295	337,967	95,784	7,117	AA
<u>\$ 141,599,002</u>	<u>\$ 39,430,022</u>	<u>\$ 272,905</u>	<u>\$ 3,020,830</u>	

  

Foreign Currency Exchange Contracts				
Assets		Liabilities		Counterparty Rating
Notional	Notional	Fair Value as of August 31, 2011	Fair Value as of August 31, 2011	
\$ 44,203,104	\$ 37,923,880	\$ 495,103	\$ 287,655	
18,550,734	16,697,406	164,741	970,622	AA
<u>\$ 62,753,838</u>	<u>\$ 54,621,286</u>	<u>\$ 659,844</u>	<u>\$ 1,258,277</u>	

The Fund's pro-rata share of the GEF's gross counterparty exposure as of August 31, 2010 for options, swaps, and foreign currency exchange contracts as shown in the following table.

**PERMANENT HEALTH FUND**

*Notes to Financial Statements (cont.)*

<b>Options</b>				
<u>Assets</u>	<u>Liabilities</u>	<u>Assets</u>	<u>Liabilities</u>	
<u>Notional</u>	<u>Notional</u>	<u>Fair Value as of August 31, 2010</u>	<u>Fair Value as of August 31, 2010</u>	<u>Counterparty Rating</u>
\$ 174,182,204	\$ 4,182,136	\$ 815,445	\$ 52,544	A
8,226	1,006,082	8,226	21,301	AA
<u>\$ 174,190,430</u>	<u>\$ 5,188,218</u>	<u>\$ 823,671</u>	<u>\$ 73,845</u>	
<b>Swaps</b>				
<u>Assets</u>	<u>Liabilities</u>	<u>Assets</u>	<u>Liabilities</u>	
<u>Notional</u>	<u>Notional</u>	<u>Fair Value as of August 31, 2010</u>	<u>Fair Value as of August 31, 2010</u>	<u>Counterparty Rating</u>
\$ 3,445,498	\$ 5,235,935	\$ 125,896	\$ 128,298	A
4,069,106	3,431,810	50,982	38,388	AA
<u>\$ 7,514,604</u>	<u>\$ 8,667,745</u>	<u>\$ 176,878</u>	<u>\$ 166,686</u>	
<b>Foreign Currency Exchange Contracts</b>				
<u>Assets</u>	<u>Liabilities</u>	<u>Assets</u>	<u>Liabilities</u>	
<u>Notional</u>	<u>Notional</u>	<u>Fair Value as of August 31, 2010</u>	<u>Fair Value as of August 31, 2010</u>	<u>Counterparty Rating</u>
\$ 10,189,995	\$ 6,618,036	\$ 225,799	\$ 126,537	A
5,074,934	5,441,619	112,128	132,106	AA
<u>\$ 15,264,929</u>	<u>\$ 12,059,655</u>	<u>\$ 337,927</u>	<u>\$ 258,643</u>	

As of August 31, 2011 and 2010, the GEF also had investments in futures contracts and options on future contracts. Futures contracts and options on future contracts expose the GEF to minimal counterparty credit risk since they are exchange traded and the exchange's clearinghouse, as counterparty to all exchange traded futures, guarantees them against default, and therefore they are not presented in the table above.

Counterparty risk for swaps, options and foreign currency exchange contracts is mitigated by having master netting arrangements between the GEF and its counterparties, and by the posting of collateral on a daily basis by the counterparty to the GEF to cover the GEF's exposure to a counterparty above the limits set in place in each master netting agreement. Collateral posted by counterparties for net assets is held by the GEF in one of its accounts at the GEF's custodian bank. As of August 31, 2011 and 2010, the Fund's pro-rata share was \$6,994,500 and \$975,741 respectively, of collateral held by the GEF related to derivative instruments other than futures. As of August 31, 2011 and 2010, the Fund's pro-rata share was \$6,826,244 and \$3,032,164, respectively, of collateral posted with brokers by the GEF related to derivative instruments other than futures.

## PERMANENT HEALTH FUND

Notes to Financial Statements (cont.)

### Note 5 – Securities Lending

In accordance with the prudent investor investment standards, the GEF loans securities to certain brokers who pay the GEF negotiated lenders' fees. These fees are included in the GEF's investment income, and the related expenses, net of rebates paid to borrowers, are included in investment expenses in the statement of changes in fiduciary net assets. The GEF receives qualified securities and/or cash as collateral against the loaned securities. The collateral, when received, will have a market value of 102% of loaned securities of U.S. issuers and a market value of 105% for loaned securities of non-U.S. issuers. If the market value of the collateral held in connection with loans of securities of U.S. issuers is less than 100% at the close of trading on any business day, the borrower is required to deliver additional collateral by the close of the next business day to equal 102% of the market value. For non-U.S. issuers, the collateral should remain at 105% of the market value of the loaned securities at the close of any business day. If it falls below 105%, the borrower must deliver additional collateral by the close of the following business day. The Fund's pro-rata share of the value of the GEF's securities loaned and the value of collateral held are as follows at August 31, 2011 and 2010:

<b>GEF Securities on Loan</b>	<b>2011 Value</b>	<b>2010 Value</b>	<b>Type of Collateral</b>	<b>2011 Value of Collateral</b>	<b>2010 Value of Collateral</b>
U.S. Government	\$ 458,705	\$ 990,513	Cash	\$ 468,123	\$ 1,010,507
Foreign					
Government	1,152,064	774,912	Cash	1,208,234	813,940
Corporate Bonds	1,180,401	1,323,781	Cash	1,209,903	1,354,865
Common Stock	9,638,303	13,473,584	Cash	9,998,413	13,980,575
<b>Total</b>	<b>\$ 12,429,473</b>	<b>\$ 16,562,790</b>	<b>Total</b>	<b>\$ 12,884,673</b>	<b>\$ 17,159,887</b>
U.S. Government	\$ 114,193	\$ -	Non-Cash	\$ 121,172	\$ -
Corporate Bonds	20,293	-	Non-Cash	21,533	-
Common Stock	-	222,756	Non-Cash	-	227,473
	<b>\$ 134,486</b>	<b>\$ 222,756</b>		<b>\$ 142,705</b>	<b>\$ 227,473</b>

Cash received as collateral for securities lending activities is invested and reinvested in a commingled pool managed exclusively for the benefit of the GEF, the PUF, the Intermediate Term Fund and other UT Board accounts that participate in securities lending activities. The pool is managed in accordance with investment guidelines established in the securities lending contract between the GEF and its securities lending agent. The maturities of the investments in the pool do not necessarily match the term of the loans, rather the pool is managed to maintain a maximum dollar-weighted average maturity of 60 days and an overnight liquidity of 20%. Lending income is earned if the returns on those investments exceed the rebate paid to borrowers of the securities. The income remaining after the borrower rebates is then shared with the lending agent on a contractually negotiated split. If the investment of the cash collateral does not provide a return exceeding the rebate or if the investment incurs a loss of principal, the payment of the shortfall to the borrower would come from the GEF and the securities lending agent in the same proportion as the split of income.

## PERMANENT HEALTH FUND

### Notes to Financial Statements (cont.)

The Fund's pro-rata share of the GEF's portion of the collateral pool investments, rating by NRSRO, and weighted average maturity as of August 31, 2011 and 2010 is shown in the following table.

Description	August 31,					
	2011			2010		
	Fair Value	Rating	Weighted Average Maturity In Days	Fair Value	Rating	Weighted Average Maturity In Days
Repurchase Agreements	\$ 4,571,470	No Rating Available	1	\$ 12,333,942	No Rating Available	1
Commercial Paper	4,496,905	P	28	2,829,314	P	35
Floating Rate Notes	1,106,206	AA		628,751	AA	
Floating Rate Notes	1,329,776	A		623,849	A	
Total Floating Rate Notes	<u>2,435,982</u>		33	<u>1,252,600</u>		26
Interest Bearing Notes	60,867	AA	76	-		-
Certificates of Deposit	1,317,903	P	33	849,878	P	63
Other Receivables/Payables	1,544	Not Rated	-	(105,847)	Not Rated	-
Total Collateral Pool Investment	<u>\$ 12,884,671</u>		20	<u>\$ 17,159,887</u>		12

Collateral pool investments are uninsured, and are held by the securities lending agent, in its name, on behalf of the GEF, except for the investments in repurchase agreements which are held in the securities lending agent's name by a third party custodian not affiliated with the GEF or the borrower of the associated loaned securities. Therefore, the collateral pool is not exposed to custodial credit risk because the pool investments are not held by counterparties to the lending transactions or a counterparties' trust department or agent.

Cash collateral is recorded as an asset with an equal and offsetting liability to return the collateral on the statements of fiduciary net assets. Pool investments are valued at amortized cost which is indicative of fair value. Investments received as collateral for securities lending activities are not recorded as assets because the investments remain under the control of the transferor, except in the event of default.

In the event of default, where the borrower is unable to return the securities loaned, the GEF has authorized the securities lending agent to seize the collateral held. The collateral is then used to replace the borrowed securities where possible. Due to some market conditions, it is possible that the original securities cannot be replaced. If the collateral is insufficient to replace the securities, the securities lending agent has indemnified the GEF from any loss due to borrower default.

As of August 31, 2011 and 2010, the GEF had no credit risk exposure to borrowers because the amounts the GEF owed to borrowers exceeded the amounts the borrowers owed the GEF.

There were no significant violations of legal or contractual provisions, no borrower or securities lending agent default losses, and no recoveries of prior period losses during the years ended August 31, 2011 and 2010.

## **PERMANENT HEALTH FUND**

*Notes to Financial Statements (cont.)*

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### **Note 6 – Fees and Expenses**

The Fund is assessed a management fee by UTIMCO to cover the costs of managing the Fund and providing day-to-day operations. The fee assessed for the year ended August 31, 2011, was \$874,369. The fee assessed for the year ended August 31, 2010, was \$498,506 net of a rebate of \$311,124 of excess reserves from UTIMCO to the Fund.

The Fund is assessed a fee to cover costs associated with UT System personnel in their effort to provide assistance to the UT Board and the Chancellor of the UT System in their oversight responsibilities of UTIMCO. For the years ended August 31, 2011 and 2010, the fees amounted to \$23,150 and \$24,350, respectively.

The Fund incurs other expenses related to its operations primarily consisting of audit fees, legal and custodial fees.

**PERMANENT HEALTH FUND**  
*Supplemental Schedule*

**Financial Highlights**  
*Years Ended August 31,*

	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
<b>Selected Per Unit Data</b>					
Net Asset Value, Beginning of Year	\$ 1.104	\$ 1.027	\$ 1.251	\$ 1.342	\$ 1.204
Income From Investment Operations					
Net Investment Income (A)	0.009	0.009	0.011	0.019	0.023
Net Realized and Unrealized Gains (Losses) on Investments	0.153	0.122	(0.182)	(0.059)	0.165
Total Income (Loss) from Investment Operations	0.162	0.131	(0.171)	(0.040)	0.188
Less Distributions					
From Net Investment Income	0.009	0.009	0.011	0.019	0.023
From Net Realized Gain and In Excess of Net Realized Investment Return	0.046	0.045	0.042	0.032	0.027
Total Distributions	0.055	0.054	0.053	0.051	0.050
Net Asset Value, End of Year	<u>\$ 1.211</u>	<u>\$ 1.104</u>	<u>\$ 1.027</u>	<u>\$ 1.251</u>	<u>\$ 1.342</u>
<b>Ratios and Supplemental Data</b>					
Net Assets, End of Year (in thousands)	\$ 992,932	\$ 905,442	\$ 842,277	\$ 1,025,693	\$ 1,100,056
Ratios to Average Net Assets					
Total Expenses	0.33%	0.31%	0.30%	0.27%	0.28%
Net Investment Income (A)	0.81%	0.84%	1.05%	1.40%	1.78%
Distributions (5-quarter average)	4.64%	5.00%	5.18%	3.82%	3.86%
Distributions (12-quarter average)	4.96%	4.66%	4.26%	3.90%	4.06%

(A) Net investment income is comprised of investment income (excluding the net increase in investments) and investment expenses as presented on the statements of changes in fiduciary net assets.