

**Report of the State Board of Education
Committee on School Finance/Permanent School Fund
January 30, 2020**

The State Board of Education Committee on School Finance/Permanent School Fund met at 9:03 a.m. on Thursday, January 30, 2020, in Room #1-104 of the William B. Travis Building, 1701 N. Congress Avenue, Austin, Texas. Attendance was noted as follows:

Present: Tom Maynard, chair; Donna Bahorich; Patricia Hardy; Ken Mercer

Absent: Lawrence A. Allen, Jr., vice chair

Public Testimony

The Committee on School Finance/Permanent School Fund received no presentations of public testimony.

ACTION ITEM

1. **Proposed Repeal of 19 TAC Chapter 105, Foundation School Program, Subchapter B, Use of State Funds (First Reading and Filing Authorization)**
(Board agenda page III-1)
[Official agenda item #16]

David Marx, director of financial compliance, explained that the proposed repeal reflects changes implemented by House Bill (HB) 3, 86th Texas Legislature, 2019.

MOTION AND VOTE: *It was moved by Mr. Mercer, seconded by Ms. Hardy, and carried unanimously to recommend that the State Board of Education approve for first reading and filing authorization the proposed repeal of 19 TAC Chapter 105, Foundation School Program, Subchapter B, Use of State Funds.*

DISCUSSION ITEM

2. **Discussion of Proposed Amendment to 19 TAC Chapter 109, Budgeting, Accounting, and Auditing, Subchapter B, Texas Education Agency Audit Functions, §109.23, School District Independent Audits and Agreed-Upon Procedures**
(Board agenda page III-5)

Mr. Marx explained that the item proposes for discussion an amendment to eliminate the requirement for out-of-state certified public accountancy firms to be licensed in Texas, reflecting changes made by HB 1520, 86th Texas Legislature, 2019.

3. **Review of Permanent School Fund Securities Transactions and the Investment Portfolio**
(Board agenda page III-8)

Catherine Civileto, deputy executive administrator, provided a summary on the status of the Permanent School Fund (PSF) portfolio. Reports presented to the committee were for the reporting period October and November 2019 unless otherwise noted. Ms. Civileto's report included the current fair market value of the Fund, the asset allocation mix as of November 30, 2019, PSF transactions occurring in the reporting period, revenues and expenditures for the fiscal period of September 1 to November 30, 2019, the activity in the securities lending program for the fiscal period beginning September 1, 2019 through August 31, 2020, the status of transfers from the General Land Office as of November 30, 2019, as per approved resolutions, current status of the Bond Guarantee Program and the available capacity in the program, broker commissions on both the internal and external equity portfolios for the period beginning January 1, 2019 through November 30, 2019, fixed income rating changes for the fiscal period September 1, 2019 through November 30, 2019, and short-term cash investments.

CONSENT ITEM

4. Ratification of the Purchases and Sales of the Investment Portfolio of the Permanent School Fund for the Months of October and November 2019

(Board agenda page III-9)

[Consent agenda item #(1)]

MOTION AND VOTE: *Based on the information provided by staff and the recommendation of the executive administrator and chief investment officer and the commissioner of education, the committee recommended by unanimous consent that the State Board of Education ratify the purchases and sales for the months of October and November 2019, in the amount of \$756,881,353 and \$783,201,264 respectively (Attachment A).*

DISCUSSION ITEMS

5. Annual Reporting Requirement of the Internally Managed Permanent School Fund Investment Portfolio

(Board agenda page III-10)

Holland Timmins, executive administrator and chief investment officer, provided the required attestation regarding compliance with 19 TAC Chapter 33 rules for the internally managed investment portfolios in the matters of permissible and restricted investments, trading and brokerage policy, and proxy voting policy.

6. Review of the Study of the Permanent School Fund Distributions as defined in House Bill 4388, 86th Legislature, 2019

(Board agenda page III-11)

Andrea Winkler, director of operational support, strategic initiatives division, provided an update on the study required by House Bill 4388. She reviewed the legislation requiring the Texas Education Agency to conduct a study on the distributions from the PSF and stated that the agency is seeking to issue a Request for Qualifications (RFQ) for an outside consultant to conduct the study.

7. Third Quarter 2019 Permanent School Fund Performance Report
(Board agenda page III-12)

Mike Maher, vice president of BNY Mellon Global and Risk Solutions, presented the third quarter of 2019 PSF performance report. Mr. Maher began with an overview of the U.S and foreign capital markets. He then reviewed the performance of the Fund for the third quarter of 2019. He stated that the PSF returned 0.62% net of fees for the third quarter underperforming the target benchmark by eight basis point. Mr. Maher attributed most of the underperformance to Emerging Market Debt and Risk Parity.

Mr. Maher reviewed the third quarter 2019 performance of the PSF by asset class, stating that the total domestic large cap equity composite outperformed its benchmark for the quarter by four basis points. Mr. Maher stated that Small/Midcap Equity portfolio outperformed its benchmark by nine basis points. He added that international equities returned 2.14% for the quarter, outperforming its benchmark by nine basis points for the period. The fixed income portfolio returned 2.28% for the quarter, outperforming its benchmark by one basis point. Mr. Maher stated that the Absolute Return composite returned -0.04% for the quarter, outperforming its benchmark, the HFRI Fund of Funds Composite Index, by 71 basis points. Mr. Maher added that the Real Estate composite returned 1.52% for the quarter, outperforming its benchmark by 10 basis points. Mr. Maher added that Total Risk Parity Strategies returned 1.43% in the third quarter of 2019, underperforming its benchmark by 53 basis points. He further stated that the Real Return Asset class returned -0.26% for the quarter, underperforming its benchmark by four basis points. He added that Emerging Market Debt returned -1.90% for the quarter, underperforming its benchmark by 111 basis points. Mr. Maher stated that private equity returned 3.37% for the quarter, underperforming its benchmark by two basis points. Finally, he stated that the total emerging market equity composite returned -4.29% for the third quarter 2019, beating its benchmark by four basis points.

ACTION ITEM

8. Proposed Amendments to 19 TAC Chapter 33, Statement of Investment Objectives, Policies, and Guidelines of the Texas Permanent School Fund, Subchapter A, State Board of Education Rules

(Second Reading and Final Adoption)

(Board agenda page III-13)

[Official agenda item #17]

Carlos Veintemillas, deputy chief investment officer and director of fixed income, stated the proposed amendments would reorganize references to the PSF distribution policy, include references to new authority and duties assigned to the SBOE by the 86th Texas Legislature, 2019, and address permissible investments.

MOTION AND VOTE: *By unanimous consent, the committee recommended that the State Board of Education approve for second reading and final adoption proposed amendments to 19 TAC Chapter 33, Statement of Investment Objectives, Policies, and Guidelines of the Texas Permanent School Fund, Subchapter A, State Board of Education Rules; and*

Make an affirmative finding that immediate adoption of proposed amendments to 19 TAC Chapter 33, Statement of Investment Objectives, Policies, and Guidelines of the Texas Permanent School Fund, Subchapter A, State Board of Education Rules, is necessary and shall have an effective date of 20 days after filing as adopted with the Texas Register.

DISCUSSION ITEMS

9. Discussion of Proposed Amendment to 19 TAC Chapter 33, Statement of Investment Objectives, Policies, and Guidelines of the Texas Permanent School Fund, Subchapter A, State Board of Education Rules, §33.25, Permissible and Restricted Investments and General Guidelines for Investment Managers

(Board agenda page III-31)

Mr. Veintemillas provided the committee information related to non-investment grade fixed-income bonds.

10. Review of the Private Equity Asset Class for the Permanent School Fund

(Board agenda page III-32)

The PSF private equity consultant, Neuberger Berman, was represented by Brien Smith, chief operating officer and managing director, and Kaci Boyer, senior vice president. PSF staff was represented by John Grubenman, director of private markets, and Erin Wedepohl, portfolio manager. Mr. Smith, Ms. Boyer, Mr. Grubenman and Ms. Wedepohl provided an update on the performance and progress of the PSF private equity program.

11. Report of the Permanent School Fund Administrator and Chief Investment Officer
(Board agenda page III-33)

Mr. Timmins informed the committee that Fitch Ratings has affirmed its 'AAA' rating of the Texas PSF's bond guarantee program. He updated the committee on the RFQ for legal counsel, PSF intern process, the PSF annual report and the quarterly report to the School Land Board.

The meeting of the Committee on School Finance/Permanent School

**TEXAS PERMANENT SCHOOL FUND
SUMMARY OF TRANSACTIONS FOR APPROVAL
(Including External Manager's Trades)
For October 1, 2019 through November 30, 2019**

Purchases/Capital Calls:

| | |
|-------------------------|------------------------------|
| Long Term Fixed Income | \$ 232,973,579 |
| Public Market Equities | 202,966,460 |
| Alternative Investments | <u>320,941,314</u> |
| TOTAL | <u>\$ 756,881,353</u> |

Sales/Distributions:

| | |
|-------------------------|------------------------------|
| Long Term Fixed Income | \$ 325,099,633 |
| Public Market Equities | 272,530,215 |
| Alternative Investments | <u>185,571,416</u> |
| TOTAL | <u>\$ 783,201,264</u> |

General Land Office Contributions:

| | |
|--|--|
| FY 2019 Cumulative November 2018 | FY 2020 Cumulative November 2019 |
| \$63,750,000 | \$2,500,000 |

Based on the above information provided by staff including a report that deposits to the Permanent School Fund from the General Land Office were \$63,750,000 through November 2018 for fiscal year 2019 versus \$2,500,000 through November 2019 for fiscal year 2020, and the recommendation of the Executive Administrator and Chief Investment Officer and the Commissioner of Education; it is moved by unanimous consent that the Committee on School Finance/Permanent School Fund ratify for the months of October 2019 and November 2019 Permanent School Fund portfolio purchases of \$756,881,353 and sales of \$783,201,264.