

**Report of the State Board of Education
Committee on School Finance/Permanent School Fund
January 31, 2013**

The State Board of Education Committee on School Finance/Permanent School Fund met at 11:30 a.m. on Thursday, January 31, 2013, in Room #1-104 of the William B. Travis Building, 1701 N. Congress Avenue, Austin, Texas. All members of the committee were present, as follows:

Presiding: Pat Hardy, chair; Lawrence A. Allen, Jr.; David Bradley; Ken Mercer; Thomas Ratliff

Public Testimony

This item provides an opportunity for the public to present testimony at the time the related item comes up for committee discussion or action. The procedures for registering and taking public testimony at State Board of Education committee meetings and general board meetings are provided at <http://www.tea.state.tx.us/index4.aspx?id=2147497741> or in the information section (yellow pages) of the agenda.

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

ACTION ITEM

1. Election of Chair
(No Agenda Exhibit)

Ms. Hardy, acting as temporary chair, brought the meeting to order.

MOTION AND VOTE: *It was moved by Mr. Bradley, seconded by Mr. Allen, and carried unanimously to elect Ms. Hardy as chair of the Committee on School Finance/Permanent School Fund.*

Ms. Hardy appointed Mr. Allen as vice chair.

DISCUSSION ITEM

2. Overview of the Permanent School Fund
(Board agenda page III-19)

Holland Timmins, executive administrator and chief investment officer, and Rhett Humphreys, partner with NEPC, gave a joint presentation to the committee including some members of the full board. The overviews were educational for both new and existing board members, providing a brief history of the Fund along with information on performance, asset allocation, fund growth, and an explanation of NEPC's role as the board's investment consultant.

It also was noted that the Bond Guarantee Program provided substantial savings to the school districts of Texas.

Following the departure of non-committee members, Mr. Ratliff and Mr. Humphreys discussed the November 2012 meeting consideration of the development of strategic relationships.

The meeting recessed at 1:08 p.m. and reconvened at 2:12 p.m.

ACTION ITEM

3. Per Capita Apportionment Rate for the 2012-2013 School Year

(Board agenda page III-1)
[Official agenda item #10]

Lisa Dawn-Fisher, associate commissioner for school finance and chief school finance officer, presented this item. The committee was asked to adopt a revised preliminary Available School Fund per capita apportionment rate of \$448.148 for the 2012-2013 school year based on a revised estimate of the amount available for expenditures from the fund (Attachment A). Dr. Dawn-Fisher explained that the estimate of the amount available for expenditure from the fund had changed as a result of 1) the School Land Board's having transferred an additional \$300 million into the Available School Fund and 2) recognition of a delay in the transfer of Motor Fuels Tax monies into the fund.

MOTION AND VOTE: *It was moved by Mr. Ratliff, seconded by Mr. Bradley, and carried unanimously to recommend that the State Board of Education adopt a revised preliminary per capita apportionment rate of \$448.148 for the 2012-2013 school year and to place this item on the consent agenda of the State Board of Education meeting of February 1, 2013. (Mr. Allen was absent for the vote.)*

CONSENT ITEM

4. Adoption of the Review of 19 TAC Chapter 30, Administration, Subchapter B, State Board of Education: Purchasing and Contracts

(Adoption of Review)
(Board agenda page III-5)
[Consent agenda item #(2)]

Norma Barrera, director of purchasing and contracts, presented this item, a review of 19 TAC Chapter 30, Administration, Subchapter B, State Board of Education: Purchasing and Contracts, as part of the four-year rule review process for state agency rules. Ms. Barrera stated that no public comments on the review were received, and she requested that the committee recommend that the State Board of Education adopt the review.

MOTION AND VOTE: *It was moved by Mr. Ratliff, seconded by Mr. Bradley, and carried unanimously to recommend that the State Board of Education adopt the review of 19 TAC Chapter 30, Administration, Subchapter B, State Board of Education: Purchasing and Contracts. (Mr. Allen was absent for the vote.)*

DISCUSSION ITEM

5. Review of Permanent School Fund Securities Transactions and the Investment Portfolio (Board agenda page III-21)

Catherine Civileto, deputy executive administrator, provided a summary of the status of the Permanent School Fund portfolio. Reports presented to the committee were for the reporting period October 1, 2012 through November 30, 2012 unless otherwise noted. Ms. Civileto's report included reporting on the current fair market value of the Fund, the asset allocation mix as of November 30, 2012, PSF transactions occurring in the reporting period, the status of transfers from the General Land Office as per the resolution they agreed to for the current fiscal year, current status of the Bond Guarantee Program and the available capacity in the program, proxy votes against management, details of purchases and sales on all portfolios, broker commissions on both the internal and external equity portfolios for the period beginning January 1, 2012 through November 30, 2012, and short-term cash investments.

CONSENT ITEM

6. Ratification of the Purchases and Sales of the Investment Portfolio of the Permanent School Fund for the Months of October and November 2012 (Board agenda page III-13) [Consent agenda item #(3)]

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 to ratify the purchases and sales for the months of October and November 2012 in the amount of \$494,419,601 and \$626,314,228 respectively (Attachment B).*

DISCUSSION ITEMS

7. Annual Reporting Requirement of the Internally Managed Permanent School Fund Investment Portfolio (Board agenda page III-23)

Mr. Timmins provided the required attestation regarding the compliance with 19 TAC Chapter 33 of the internally managed investment portfolio in the matters of permissible and restricted investments, trading and brokerage policy, and proxy voting policy.

8. Presentation by BlackRock Investment Management, LLC on Investment Management Services Provided to the Permanent School Fund (Board agenda page III-25)

Mr. Timmins introduced Obie Mckenzie, managing director and Timothy Murray, investment strategist, both of BlackRock. Mr. Mckenzie gave an update on BlackRock and its investment management capabilities. Mr. Murray then gave the committee an overview of the portfolio

management team structure and discussed BlackRock's investment philosophy and process. He concluded with a review of PSF international equity portfolio which included characteristics, holdings and performance.

9. Presentation by Private Equity Separate Account Managers on Investment Management Services Provided to the Permanent School Fund
(Board agenda page III-27)

The following two firms gave presentations by their respective representatives:

Credit Suisse Customized Fund Investment Group (CFIG)

Kelly Williams, Managing Director of CFIG and Group Head
Bernard Yancovich, Managing Director of CFIG
Tom Rest, Director of CFIG
Lee Brashear, Vice President of CFIG

NB Alternatives Advisors

John Buser, Managing Director of Neuberger Berman and Global Head of Private Equity Fund-of-Funds for NB Alternatives Advisors
Brien Smith, Managing Director of Neuberger Berman
Kaci Boyer, Associate

CONSENT ITEM

10. Decision on the Private Equity Structure of the Permanent School Fund
(Board agenda page III-15)
[Consent agenda item #(4)]

Ms. Hardy called on John Grubenman, director of private market investments, to address the item. Mr. Grubenman made a presentation on the existing private equity management structure and future alternatives.

Mr. Ratliff asked Mr. Humphreys and PSF staff which of the three proposed alternative structures they would recommend. Mr. Humphreys, Mr. Timmins, and Mr. Grubenman all responded that they would recommend the Hybrid Discretionary Separate Account & Collaborative Management alternative at this time while moving to the Consultant & Direct alternative in the future.

Mr. Bradley and Mr. Mercer asked clarifying questions of Mr. Humphreys and staff regarding the structures and proposed alternatives.

Chuck Campbell, partner with Jackson Walker and fiduciary counsel, stated that he and David Anderson, TEA general counsel, understand that the Hybrid Discretionary Separate Account & Collaborative Management alternative could be provided by either of the current private equity discretionary managers and would not require the issuance of a new request for proposal (RFP).

MOTION AND VOTE: *It was moved by Mr. Ratliff, seconded by Mr. Bradley, and carried unanimously, to recommend to the State Board of Education to move forward to implement the Hybrid Discretionary Separate Account & Collaborative Management Alternative as described by staff.*

DISCUSSION ITEM

11. Education on Emerging Market Debt

(Board agenda page III-29)

Mr. Humphreys provided a brief overview on the nature of emerging market debt. Mr. Humphreys stated that there were two types of debt including external debt usually denominated in U.S. dollars or Euros and local debt issued in the local currency of the issuer. Mr. Humphreys added that Emerging Market Debt was a large and growing part of the global debt markets. Mr. Humphreys also stated that the fiscal condition of some emerging markets was in good shape with low debt to GDP ratio and strong economic growth. This is in contrast to the strained financial condition of developed countries which are experiencing high debt levels combined with slow economic growth. Mr. Humphreys stated that emerging markets provided a great investment opportunity.

Keith Stronkowsky gave an overview of the return attribution and risk inherent in Emerging Market Debt Local Currency investing. He stated that local currency bonds have several distinct sources of return including currency, duration and credit risk premium. Mr. Bradley asked the demarcation line between investment grade bonds and high yield bonds. Carlos Veintemillas, deputy chief investment officer, stated that the line was set at BBB-. Anything below could be considered high yield.

CONSENT ITEM

12. Authorization to Issue a Request for Proposals for Emerging Market Debt Local Currency Discretionary Investment Managers

(Board agenda page III-17)

[Consent agenda item #(5)]

Mr. Veintemillas gave a brief presentation to the committee regarding the RFP. The main points covered were the minimum qualifications of the individual managers and their firms. A five percent allocation to this sector has been approved as part of the overall asset allocation plan.

MOTION AND VOTE: *By unanimous consent, the committee recommended to the State Board of Education approval to issue a Request for Proposals for Emerging Market Debt Local Current Discretionary Investment Managers.*

DISCUSSION ITEM

13. Report of the Permanent School Fund Executive Administrator and Chief Investment Officer

(Board agenda page III-31)

Mr. Timmins reported that staff has not seen any legislation introduced related to the PSF.

The meeting of the Committee on School Finance/Permanent School Fund adjourned at 5:03 p.m.