

**Report of the State Board of Education
Committee on School Finance/Permanent School Fund
January 28, 2021**

The State Board of Education Committee on School Finance/Permanent School Fund met at 9:18 a.m. on Thursday, January 28, 2021, in the State Board of Education Room, Room #1-104 of the William B. Travis Building, 1701 N. Congress Avenue, Austin, Texas. Attendance was noted as follows:

Present: Tom Maynard, chair; Lawrence A. Allen, Jr., vice chair; Keven Ellis; Patricia Hardy; Marisa B. Perez-Diaz (virtual)

Public Testimony

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

ACTION ITEMS

1. Election of Chair

(Board agenda page III-1)

NOMINATION: Ms. Hardy nominated Mr. Maynard for chair of the Committee on School Finance/Permanent School Fund for a two-year term.

Mr. Maynard was elected chair of the Committee on School Finance/Permanent School Fund.

Mr. Maynard appointed Mr. Allen to serve as vice-chair.

2. Proposed Amendment to 19 TAC Chapter 109, Budgeting, Accounting, and Auditing, Subchapter C, Adoptions By Reference, §109.41, Financial Accountability System Resource Guide

(First Reading and Filing Authorization)

(Board agenda page III-2)

[Official agenda item #8]

David Marx, senior director, financial compliance, explained that the proposed amendment would adopt by reference the updated *Financial Accountability System Resource Guide* (FASRG). He explained the purpose of the guide, the changes to the document, and the introduction of a change document to list changes to the document.

MOTION AND VOTE: *It was moved by Mr. Allen, seconded by Ms. Hardy, and carried unanimously to recommend that the State Board of Education approve for first reading and filing authorization the proposed amendment to 19 TAC Chapter 109, Budgeting, Accounting, and Auditing, Subchapter C, Adoptions By Reference, §109.41, Financial Accountability System Resource Guide.*

DISCUSSION ITEM

- 3. Review of 19 TAC Chapter 109, Budgeting, Accounting, and Auditing, Subchapter A, Budgeting, Accounting, Financial Reporting, and Auditing for School Districts, Subchapter B, Texas Education Agency Audit Functions, Subchapter C, Adoptions By Reference, and Subchapter D, Uniform Bank Bid or Request for Proposal and Depository Contract**
(Board agenda page III-8)

Mr. Marx explained that this item is a four-year rule review of rules that provide requirements for school districts relating to budgeting, accounting, financial reporting, and auditing. Mr. Marx explained the changes being made and why the rules are needed.

ACTION ITEM

- 4. Adoption of Review of 19 TAC Chapter 30, Administration, Subchapter B, State Board of Education: Purchasing and Contracts**
(Adoption of Review)
(Board agenda page III-58)
[Official agenda item #9]

Jenna Mattingly, director, contracts and purchasing, stated that the rule being reviewed is related to the historically underutilized business (HUB) program and procedures for formal protests. She stated that staff is not recommending any changes to the rule at this time.

MOTION AND VOTE: *It was moved by Mr. Allen 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.*

The committee recommended that the item be placed on the consent agenda.

DISCUSSION ITEM

- 5. Review of Permanent School Fund Securities Transactions and the Investment Portfolio**
(Board agenda page III-62)

David Trice, managing director of investment finance and operations, provided a summary on the status of the Permanent School Fund (PSF) portfolio. Reports presented to the committee were for the reporting period October through November 2020, unless otherwise noted. Mr. Trice's report included reporting on the current fair market value of the Fund; the asset allocation mix as of November 30, 2020; PSF transactions occurring in the reporting period; revenues and expenditures for the fiscal period beginning September 1 through November 30, 2020; the activity in the securities lending program for the fiscal period beginning September 1 through November 30, 2020; the status of transfers from the General Land Office (GLO) as of November 30, 2020, 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, 2020, through November 30, 2020; fixed income rating changes for the fiscal period September 1, 2019, through November 30, 2020; and short-term cash investments.

ACTION ITEMS

6. Ratification of the Purchases and Sales of the Investment Portfolio of the Permanent School Fund for the Months of October and November 2020

(Board agenda page III-63)
[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 that the State Board of Education ratify the purchases and sales for the months of October and November 2020, in the amount of \$1,185,799,475 and \$1,135,739,201, respectively (Attachment A).*

7. Report on the Permanent School Fund Liquid Account

(Board agenda page III-64)
[Consent agenda item #(4)]

Mr. Trice provided a summary of the status of the PSF Liquid Account. Reports presented to the committee were for the reporting period October 1, 2020, through November 30, 2020. Mr. Trice's report included reporting on the current fair market value of the Liquid Account; the asset allocation mix as of November 30, 2020; transfer activity between the GLO and the Liquid Account; cumulative Income and Realized Gains transferred to the SBOE from the Liquid Account as of November 30, 2020; transactions occurring in the reporting period; and ratification of the cumulative Purchases and Sales of the Liquid Account since its inception, October 1, 2020, through November 30, 2020.

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 of the Permanent School Fund Liquid Account for the period October 1, 2020, through November 30, 2020, in the amounts of \$368,409,028 and \$335,445,845, respectively (Attachment B).*

DISCUSSION ITEMS

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

(Board agenda page III-65)

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

9. Third Quarter 2020 Permanent School Fund Performance Report

(Board agenda page III-66)

Mr. Mike Maher, vice president of BNY Mellon Global and Risk Solutions, presented the third quarter of 2020 PSF performance report. Mr. Maher began with an overview of the U.S. and foreign capital markets. Mr. Maher then reviewed the performance of the Fund for the third quarter of 2020. He stated that the PSF returned 4.86% net of fees for the third quarter, outperforming the target benchmark

by 27 basis points. Mr. Maher attributed most of the outperformance to Private Equity and Fixed Income.

Mr. Maher reviewed the third quarter 2020 performance of the PSF by asset class, stating that the total domestic large cap equity composite returned 8.98%, outperforming its benchmark for the quarter by five basis points. Mr. Maher added that Small/Midcap Equity portfolio returned 4.52% in the quarter, outperforming its benchmark by 21 basis points. He added that international equities returned 7.17% for the quarter, outperforming its benchmark by 34 basis points for the period.

The fixed income portfolio returned 0.88% for the quarter, outperforming its benchmark by 75 basis points. Mr. Maher stated that the Absolute Return composite returned 4.12% for the quarter, underperforming its benchmark, the HFRI Fund of Funds Composite Index, by 27 basis points. Mr. Maher added that the Real Estate composite returned -0.88% for the quarter, underperforming its benchmark by 18 basis points. Mr. Maher added that Total Risk Parity Strategies returned 5.39% in the third quarter of 2020, underperforming its benchmark by 25 basis points. He further stated that the Real Return Asset class returned 6.01% for the quarter, underperforming its benchmark by 7 basis points. He added that Emerging Market Debt returned 0.92% for the quarter, outperforming its benchmark by 30 basis points. Mr. Maher stated that private equity returned 8.17% for the quarter, outperforming its benchmark by 74 basis points. Finally, he stated that the total emerging market equity composite returned 10.45% for the second quarter 2020, beating its benchmark by 89 basis points.

ACTION ITEMS

10. Approval of an Extension of the Standard Contract with BNY Mellon and Authorization for Contract Execution by the Commissioner of Education

(Board agenda page III-67)

[Consent agenda item #(5)]

Mr. Timmins stated that the purpose of the item was for the committee and board to extend the standard contract with The Bank of New York Mellon and authorization for contract execution by the commissioner of education.

MOTION AND VOTE: *By unanimous consent the committee recommended that the State Board of Education approve renewal of the standard contract with The Bank of New York Mellon beginning September 1, 2021, and ending August 31, 2024, and authorize contract execution by the commissioner of education.*

11. 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-68)

[Consent agenda item #(6)]

Carlos Veintemillas, deputy chief investment officer and director of fixed income, stated that proposed amendments were related to the asset allocation of the PSF, securities lending in the Liquid Account, transactions and restrictions that apply to permissible investments, and updates to cross references and a section title.

Mr. Veintemillas made a presentation regarding the proposed amendment to allow the addition of non-investment grade rated bonds in the PSF fixed income portfolio. Rhett Humphreys, partner, NEPC, discussed the differences in investment grade rated and non-investment grade rated fixed income securities and how the proposed amendment could impact the risk and return of the PSF. Chuck Campbell, fiduciary counsel, stated that the committee was following a prudent investment process in considering the amendments. Mr. Timmins noted the agency had received one public comment on the proposal.

MOTION: *It was moved by Mr. Allen to recommend 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.

MOTION AND VOTE: *It was moved by Dr. Ellis, seconded by Mr. Allen, and carried to strike the proposed amendments related to the changes proposed in §33.25(b)(12) and §33.25(b)(13).*

VOTE: *A vote was taken on the original motion to recommend 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, as amended; 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.

The motion carried.

DISCUSSION ITEM

12. Review of the Private Equity Asset Class for the Permanent School Fund (Board agenda page III-76)

The PSF private equity consultant, Neuberger Berman, was represented by Brien Smith, chief operating officer and managing director, and Kaci Boyer, principal. PSF Staff was represented by John Grubenman, director of private markets, and Erin Wedepohl, managing director.

Mr. Smith, Ms. Boyer, Mr. Grubenman, and Ms. Wedepohl provided an update on the performance and progress of the PSF private equity program.

ACTION ITEM

13. Review of Real Return Asset Class for the Permanent School Fund

(Board agenda page III-77)

[Consent agenda item #(7)]

Mr. Veintemillas gave an update on the real return strategy and structure. Katie Reissman, managing director, Bill Glenn, portfolio manager, and Andrew Bunker, portfolio manager, also participated in the presentation. Keith Stronkowsky, senior consultant at NEPC, provided an overview of the real return structure. Both staff and NEPC recommended to terminate the external managers and have staff manage the remaining assets.

MOTION AND VOTE: *By unanimous consent, the committee recommended that the State Board of Education terminate Credit Suisse and PIMCO and allocate remaining funds to the PSF internally managed commodities portfolio to align the allocation with the asset allocation approved by the SBOE in July 2020.*

DISCUSSION ITEM

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

(Board agenda page III-78)

Mr. Timmins informed the committee that Fitch Ratings had reaffirmed the PSF's AAA rating. He also provided them an update on the Bond Guarantee Program. He reported that at this time there were not many bills filed during the 87th Texas Legislative Session affecting the PSF. Mr. Timmins provided the preliminary performance numbers for the fourth quarter reporting period.

The meeting of the Committee on School Finance/Permanent School Fund adjourned at 1:19 p.m.

**TEXAS PERMANENT SCHOOL FUND
SUMMARY OF TRANSACTIONS FOR APPROVAL
(Including External Manager's Trades)
For October 1, 2020 through November 30, 2020**

Purchases/Capital Calls:

Long Term Fixed Income	\$ 649,754,061
Public Market Equities	160,523,482
Alternative Investments	<u>375,521,932</u>
TOTAL	<u>\$ 1,185,799,475</u>

Sales/Distributions:

Long Term Fixed Income	\$ 363,026,347
Public Market Equities	567,256,560
Alternative Investments	<u>205,456,294</u>
TOTAL	<u>\$ 1,135,739,201</u>

General Land Office Contributions:

FY 2020 Cumulative November 2019	FY 2021 Cumulative November 2020
\$2,500,000	\$11,250,000

Based on the above information provided by staff including a report that deposits to the Permanent School Fund from the General Land Office were \$2,500,000 through November 2019 for fiscal year 2020 versus \$11,250,000 through November 2020 for fiscal year 2021, 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 2020 and November 2020 Permanent School Fund portfolio purchases of \$1,185,605,385 and sales of \$1,135,739,201.

**TEXAS PERMANENT SCHOOL FUND
SUMMARY OF TRANSACTIONS FOR APPROVAL
FOR PSF LIQUID ACCOUNTS
For October 1, 2020 through November 30, 2020**

Purchases:

Fixed Income	\$ 363,801,536
Public Market Equities	<u>4,607,492</u>
 TOTAL	 <u><u>\$ 368,409,028</u></u>

Sales:

Fixed Income	\$ 334,400,195
Public Market Equities	<u>1,045,650</u>
 TOTAL	 <u><u>\$ 335,445,845</u></u>

Based on the above information provided by staff 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 period October 1, 2020 through November 30, 2020 Permanent School Fund Liquid Account purchases of \$368,409,028 and sales of \$335,445,845.