

**Report of the State Board of Education  
Committee on School Finance/Permanent School Fund  
August 13, 2009**

The State Board of Education Committee on School Finance/Permanent School Fund met at (9:10 a.m.) on Thursday, August 13, 2009, in Room #1-104 of the William B. Travis Building, 1701 N. Congress Avenue, Austin, Texas. The following members of the committee were present:

Presiding: David Bradley, chair; Gail Lowe, Rene Nuñez

Absent: Rick Agosto, vice chair; Cynthia Dunbar

**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=3958> or in the information section (yellow pages) of the agenda.

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

**DISCUSSION ITEMS**

**1. Consideration of Texas Attorney General Opinion GA-0707 Regarding Transfers from the Permanent School Fund to the Available School Fund and Consideration of Process to Make Required Determinations**

Mr. Bradley introduced this item. Mr. Bradley stated that the committee should begin to consider a process on how the board will make a determination of transfers, timing and frequency of distributions from the Permanent School Fund to the Available School Fund.

David Anderson, general counsel, directed the committee to pages 1-3 of the agenda which contained Article 7 of the Texas Constitution. Mr. Anderson added that Sections 5(a)(1) and 5(a)(2) are the two duties that the Constitution gives the State Board of Education which determines how much is paid out from the PSF to the ASF. Mr. Anderson stated that the board, for various budget cycles, had made a determination under Section 5(a)(1) to establish a spending rate. The board met in November 2008 to set a rate of 2.5% of the value of the Fund's investment assets. He added that based on the percentage distribution set by the board, the legislature sets a budget for the following two fiscal years knowing that they can count on the funds distributed by the PSF. Mr. Anderson stated that what is providing the current discussion is the decline in the stock market which for the first time raised the issue of what this means under Section 5(a)(2) which states that the distributions to the ASF cannot exceed over a ten year period the total return on all of the investment assets of the Fund.

Mr. Anderson added that an Attorney General's opinion was requested which came out in April 2009, stating that it was the board's call to make a decision as to whether a distribution would be made under Section 5(a)(2). Mr. Anderson stated that under the AG's opinion, the board has an obligation to look back nine fiscal years and make a best estimate of the current fiscal year to calculate the tenth year referenced in the Constitution, and determine if the distribution over the ten year period would exceed the Fund's total return over the same period. Mr. Anderson added that there is a reasonable assurance that this coming fiscal year it is unlikely that there will be a total return to distribute. He added that the Attorney General's opinion was not clear as to the possibility that the board's determination may or may not be changed later depending on market conditions. Mr. Anderson stated that staff recommendation would be for the board to make a decision in November of every other year that would coincide with the biennial distribution made by the board. Mr. Anderson stated that the board has to make an initial determination as to whether there is going to be a distribution for fiscal year 2010.

Mr. Bradley asked what would happen if in November, when the board takes a snapshot of the Fund's value, there is \$150 to be distributed, and whether the board was required to distribute that amount. Mr. Anderson stated that the \$150 would have to be distributed since the board made a commitment when it set the 2.5% spending rate. Mr. Bradley further asked if the market declined in December, does that \$150 distribution still have to happen during the year. Mr. Anderson stated that is the question that we do not have answer to. He further stated that however, the AG's opinion clearly states that it is an annual determination. In other words, the Board makes a determination and that is a determination made for the year.

Mrs. Lowe stated that Mr. Anderson's suggestion to visit the issue in September for discussion is a good idea.

The meeting recessed at 9:49 a.m. and reconvened at 10:00 a.m.

## **2. General Strategic Planning Session with NEPC, the New Investment Counsel for the Permanent School Fund**

Rhett Humphreys, Christopher Levell and Edward O'Donnell, as members of NEPC's asset allocation team, discussed NEPC's presentation "Kick-Off Meeting, Suggested Topics for Discussion and Brainstorming August 13, 2009" to provide their assumptions and resulting views on a broad range of topics. They had a lengthy discussion on private equity. Following the private equity discussions it was decided that:

- NEPC would review the process for Private Equity Discretionary Separate Account Manager for the Permanent School Fund,
- Visits to the managers selected for on-site due diligence meetings would occur after the September SBOE meetings and should consist of members of the Committee of School Finance/Permanent School Fund, NEPC, and staff,
- NEPC would present to the committee of the full board in September providing an introduction to their company and philosophy.

The meeting recessed at 11:36 a.m. and reconvened at 1:10 p.m.

The asset allocation team discussed the concept of risk budgeting in inflationary terms and correlations in asset allocation as well as liquidity and scenario analysis. They also discussed with the committee the concept of risk parity. In response to a question, they also noted that active versus passive management also moves in cycles, and that the stock market had just come out of a cycle when, in many cases, active managers did not add value. Mr. Levell noted that in portfolio construction, asset allocation was the most important factor, followed by manager selection, with active versus passive management being of lesser importance.

The meeting of the Committee on School Finance/Permanent School Fund adjourned at 2:50 p.m.