Report of the State Board of Education
Committee on School Finance/Permanent School Fund
January 12, 2010

The State Board of Education Committee on School Finance/Permanent School Fund met at 8:48 a.m. on Tuesday, January 12, 2010, 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; Rick Agosto, vice chair; Gail Lowe, Rene Nuñez

Absent: Cynthia Dunbar

Non-Committee Members Present: Pat Hardy, Mavis B. Knight

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.

ACTION ITEMS

1. **Proposed Amendment to 19 TAC Chapter 129, Student Attendance, Subchapter B, Student Attendance Accounting, §129.21, Requirements for Student Attendance Accounting for State Funding Purposes**
(Second Reading and Final Adoption)
(Board agenda page III-1)
[Official agenda item #17]

Belinda Dyer, director of forecasting and fiscal analysis, presented the item to update the current rule to reflect statutory changes resulting from the 81st Texas Legislature, 2009.

MOTION AND VOTE: *It was moved by Mr. Bradley, seconded by Mrs. Lowe, and carried unanimously to recommend that the State Board of Education approve by an affirmative vote of two-thirds of the members of the board, for second reading and final adoption proposed amendment to 19 TAC Chapter 129, Student Attendance, Subchapter B, Student Attendance Accounting, §129.21, Requirements for Student Attendance Accounting for State Funding Purposes with an effective date of 20 days after filing as adopted with the Texas Register.*

2. Adoption of Review of 19 TAC Chapter 105, Foundation School Program, Subchapter A, Definitions, and Subchapter B, Use of State Funds
(Adoption of Review)
(Board agenda page III-9)
[Official agenda item #18]

Lisa Dawn-Fisher, deputy associate commissioner for school finance, presented the item to adopt the review of the Foundation School Program rules found in 19 TAC Chapter 105, Subchapters A and B.

MOTION AND VOTE: *It was moved by Mr. Bradley, seconded by Mrs. Lowe, and carried unanimously to recommend that the State Board of Education adopt the review of 19 TAC Chapter 105, Foundation School Program, Subchapter A, Definitions, and Subchapter B, Use of State Funds, and the placement of this item on the consent agenda of the State Board of Education meeting of January 15, 2010.*

DISCUSSION ITEMS

3. Discussion of Proposed Amendment to 19 TAC Chapter 33, Statement of Investment Objectives, Policies, and Guidelines of the Texas Permanent School Fund, §33.65, Guarantee Program for School District Bonds
(Board agenda page III-27)

Dr. Dawn-Fisher and David Anderson, general counsel, presented the item for discussion. Dr. Dawn-Fisher reviewed a draft of the proposed amendments (Attachment A) and explained that changes will be required to comply with new statutory language and to reflect the most recent ruling from the Internal Revenue Service. The proposed rules will be presented to the committee for further discussion in February and for first reading and filing authorization in March.

4. Presentation by BlackRock Investment Management, LLC on Investment Management Services Provided to the Permanent School Fund
(Board agenda page III-37)

Holland Timmins, Executive Administrator and Chief Investment Officer, introduced Obie McKenzie, Managing Director and Debbie Jelilian, Director, of Blackrock Investment Management. Mr. McKenzie gave an overview of the firm highlighting the recent purchase of Barclays Global Investors by BlackRock. Ms. Jelilian provided the committee an in depth overview of the investment process and performance of the Permanent School Fund's international portfolio managed by BlackRock.

5. Review of Permanent School Fund Securities Transactions and the Investment Portfolio
(Board agenda page III-39)

Catherine Civiletto, 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, 2009 through November 30, 2009 unless otherwise noted. Ms. Civiletto reported on the following: the current fair market value of the Fund, PSF transactions occurring in the reporting

period, transfers from the General Land Office, current status of the Bond Guarantee Program and the available capacity in the program. Time was then allocated for answering questions from the committee.

CONSENT ITEMS

6. Ratification of the Purchases and Sales of the Investment Portfolio of the Permanent School Fund for the Months of October and November 2009
(Board agenda page III-17)
[Consent agenda item #(2)]

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 2009 in the amount of $542,463,790 and $376,338,171 respectively (Attachment B).*

7. Proposed Amendments to Section I of the Investment Procedures Manual
(Board agenda page III-19)
[Consent agenda item #(3)]

Mr. Timmins presented proposed technical amendments to the Investment Procedures Manual in order to maintain compliance with SEC Rule 15(2-12), which pertains to disclosure of financial information related to the Bond Guarantee Program to the appropriate SEC determined entity. Previously information was provided to a Nationally Recognized Municipal Securities Information Repository (NRMSID) and a State of Texas authorized entity (SID) as determined by the SEC. This information is now required to be provided to the Municipal Securities Rulemaking Board (MSRB). Statutory authority for this action is the Texas constitution, Article VII, §5(f).

MOTION AND VOTE: *By unanimous consent, the committee recommended to the State Board of Education adoption of the amendments to Section I of the Investment Procedures Manual (Attachment C).*

DISCUSSION ITEMS

8. Annual Reporting Requirement of the Internally Managed Permanent School Fund Investment Portfolio
(Board agenda page III-41)

Mr. Timmins provided the required certification 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.

9. Report of the Permanent School Fund Executive Administrator and Chief Investment Officer
(Board agenda page III-43)

Mr. Timmins discussed the current portfolio structure and the risks associated with both deflation and inflation. He indicated that the current portfolio has a limited amount of assets that provide strong inflation protection in the form of an allocation to TIPS (Treasury Inflation Protected Securities) within the fixed income portfolio. He stated that the allocations to real estate (6%) and real return (6%) will provide significant protection against an inflationary environment. Mr. Timmins added that the Fund should continue to focus on investments in those asset classes which will provide inflation protection.

The meeting recessed at 10:36 a.m. and reconvened at 10:52 a.m.

10. Presentations by Finalist Candidates for Private Equity Discretionary Separate Account Manager for the Permanent School Fund
(Board agenda page III-47)

Mr. Bradley invited Mr. Timmins to begin his presentation related to RFP# 701-09-021 Private Equity Discretionary Separate Account Manager(s). Mr. Timmins and Mr. Grubenman provided an executive summary that included the following: the purpose of the RFP; the current 6% target allocation for the asset class; the broad or well-diversified mandate; the discretionary authority the managers will exercise; the separate account, fund-of-one, structure; critical dates; selection criteria; and the private equity manager search process.

The meeting recessed at 12:07 p.m. and reconvened at 1:15 p.m.

Mr. Bradley introduced the item.

The following four firms gave presentations by their respective representatives:

Credit Suisse, Customized Fund Investment Group (CFIG)
Kelly M. Williams, Managing Director and Co-Head
Scott Hamner, Partner
Mina Pacheco Nazemi, Principal
Lee Brashear, Senior Associate

Hamilton Lane Advisors, LLC
Mario Giannini, CEO
Erik Hirsch, Chief Investment Officer
Stephen Brennan, Principal, Relationship Manager
Napoleon Stephenson, Vice President, Business Development

Partners Group (USA), Inc.
Alfred Gantner, Executive Chairman and Co-Founder
Sandra Pajarola, Partner, Private Equity
Scott Higbee, Partner, Investment Solutions

NB Alternatives Advisers, LLC
Anthony Tutrone, Managing Director, Global Head – NB Alternatives
John Buser, Managing Director, Global Head – Fund of Funds
Brien Smith, Managing Director, Head of Investment Team
Alan Dorsey, Managing Director, Global Head – Investment Strategy and Risk

The meeting recessed at 5:12 and reconvened at 5:20 p.m.

ACTION ITEM

11. Approval of the Selection of a Firm(s) to Provide Private Equity Discretionary Separate Account Manager for the Permanent School Fund and Authorization to Negotiate Terms and for Contract Execution by the Commissioner of Education
(Board agenda page III-25)
[Official agenda item #19]

The committee reviewed the RFP Respondents Overview for Private Equity Discretionary Separate Account Manager document, prepared by staff and in consultation with NEPC. The committee discussed, at length, the overview and each of the manager presentations. Staff and NEPC recommended the mandate be split evenly between two managers. Mr. Bradley extended an opportunity to members to make any alternate motions, if preferred.

MOTION AND VOTE: *It was moved by Mr. Nuñez and seconded by Mr. Agosto to recommend to the State Board of Education approval to contract with three firms to provide private equity discretionary separate account manager for the Permanent School Fund. Mr. Nuñez and Mr. Agosto voted yes. Mr. Bradley and Mrs. Lowe voted no. The motion failed.*

MOTION AND VOTE: *It was moved by Mr. Nuñez and carried unanimously to recommend to the State Board of Education approval of a contract with Credit Suisse Customized Fund Investment Group to serve as a private equity discretionary separate account manager for the Permanent School Fund and authorization for contract execution by the commissioner of education.*

MOTION: *It was moved by Mr. Agosto, second by Mr. Nuñez, to recommend to the State Board of Education approval of a second contract with NB Alternatives Advisers, LLC to serve as a private equity discretionary separate account manager for the Permanent School Fund.*

Mr. Agosto withdrew his motion in order that the committee could discuss the size of an assignment.

MOTION AND VOTE: *It was moved by Mr. Agosto, seconded by Mrs. Lowe, and carried unanimously to recommend to the State Board of Education approval of a second contract with NB Alternatives Advisers, LLC to serve as a private equity discretionary separate account manager for the Permanent School Fund and authorization for contract execution by the commissioner of education.*

MOTION AND VOTE: *It was moved by Mrs. Lowe, seconded by Mr. Agosto, and carried unanimously to recommend to the State Board of Education approval of $650 million to each of the firms selected to serve as a private equity discretionary separate account manager for the Permanent School Fund.*

The meeting of the Committee on School Finance/Permanent School Fund adjourned at 5:54 p.m.