ATTACHMENT II
Text of 19 TAC

Chapter 33. Statement of Investment Objectives, Policies, and Guidelines of the Texas Permanent School Fund

Statutory Authority: The provisions of this Chapter 33 issued under the Texas Education Code, §§7.102(c)(31) and (33), 43.0031, 43.0033, and 43.004; Texas Government Code, §2263.004; and Texas Constitution, Article VII, §5(d) and (f), unless otherwise noted.

§33.1. Constitutional Authority and Constitutional Restrictions.

(a) The Texas Permanent School Fund (PSF) is comprised of the principal of all bonds and other funds, and the principal arising from the sale of the lands set apart for the PSF, including dividends and other income to the fund. The total amount distributed from the permanent school fund to the available school fund:

(1) must be an amount that is not more than 6.0% of the average of the market value of the permanent school fund, excluding real property belonging to the fund on the last day of each of the 16 state fiscal quarters preceding the regular session of the legislature that begins before that state fiscal biennium, in accordance with the rate adopted by:

(A) a vote of two-thirds of the total membership of the State Board of Education, taken before the regular session of the legislature convenes; or

(B) the legislature by general law or appropriation, if the State Board of Education does not adopt a rate as provided by subparagraph (A) of this paragraph; and

(2) over the 10-year period consisting of the current state fiscal year and the nine preceding state fiscal years, may not exceed the total return on all investment assets of the permanent school fund over the same 10-year period.

(b) In managing the assets of the PSF, the State Board of Education (SBOE) may acquire, exchange, sell, supervise, manage, or retain, through procedures and subject to restrictions it establishes and in amounts it considers appropriate, any kind of investment, including investments in the Texas Growth Fund created by the Texas Constitution, Article XVI, §70, that persons of ordinary prudence, discretion, and intelligence, exercising the judgment and care under the circumstances then prevailing, acquire or retain for their own account in the management of their affairs, not in regard to speculation but in regard to the permanent disposition of their funds, considering the probable income as well as the probable safety of their capital.

Source: The provisions of this §33.1 adopted to be effective September 1, 1996, 21 TexReg 3937; amended to be effective March 31, 2004, 29 TexReg 3174.

§33.2. Distributions to the Available School Fund.

Each year, the State Board of Education (SBOE) shall determine whether a distribution to the Available School Fund (ASF) shall be made for the current state fiscal year. The SBOE shall determine whether such distribution is permitted under the Texas Constitution, Article VII, §5(a)(2). The annual determination for the current fiscal year shall include a projection of the expected total return of the Permanent School Fund (PSF) at the end of the current fiscal year and the realized returns during the nine preceding state fiscal years. Any one-year distribution to the ASF shall not exceed 6.0% of the average market value of the PSF, excluding real property managed, sold, or acquired under the Texas Constitution, Article VII, §4, as determined under the Texas Constitution, Article VII, §5(a)(1).

Statutory Authority: The provisions of this §33.2 issued under the Texas Constitution, Article VII, §5(a)(2) and (f).

Source: The provisions of this §33.2 adopted to be effective April 21, 2010, 35 TexReg 3027.

§33.5. Code of Ethics.

(a) General principles. The Texas Permanent School Fund (PSF) is held in public trust for the benefit of the schoolchildren of Texas. All those charged with the management of the PSF will aspire to the highest

standards of ethical conduct. The purpose of the PSF code of ethics is to assist and help guide all such persons in the proper discharge of their duties and to assist them in avoiding even the appearance of impropriety.

(b) Fiduciary responsibility. The members of the State Board of Education (SBOE) serve as fiduciaries of the PSF and are responsible for prudently investing its assets. The SBOE members or anyone acting on their behalf shall comply with the provisions of this section, the Texas Constitution, Texas statutes, and all other applicable provisions governing the responsibilities of a fiduciary.

(c) Compliance with constitution and code of ethics. The SBOE members are public officials governed by the provisions of the Texas Government Ethics Act, as stated in the Texas Government Code, Chapter 572.

(d) Definitions. For purposes of this section, the following terms shall have the following meanings.

(1) SBOE Member--For the purposes of the PSF code of ethics, a member of the SBOE shall be deemed to include the SBOE Member's spouse and dependent child(ren). "Dependent child(ren)" is defined as an individual's child(ren), including adopted child(ren) or stepchild(ren) for whom the SBOE Member or SBOE Member's spouse provides more than 50% of support during the current or prior calendar year.

(2) Persons Providing PSF Investment and Management Services to the SBOE (PSF Service Providers) are the following individuals:

(A) any person responsible by contract for managing the PSF, investing the PSF, executing brokerage transactions, or acting as a custodian of the PSF;

(B) a member of the Committee of Investment Advisors;

(C) any person who provides consultant services for compensation regarding the management and investment of the PSF;

(D) any person who provides investment and management advice to an SBOE Member, with or without compensation, if an SBOE Member:

(i) gives the person access to PSF records or information that are identified as confidential; or

(ii) asks the person to interview, meet with, or otherwise confer with a PSF Service Provider or Texas Education Agency (TEA) staff;

(E) any member of the TEA PSF staff or legal staff who is responsible for managing or investing assets of the PSF, executing brokerage transactions, acting as a custodian of the PSF, or providing investment or management advice or legal advice regarding the investment or management of the PSF to an SBOE Member or PSF staff; or

(F) any person who submits a response to a Request for Proposal (RFP) or Request for Qualifications (RFQ), or similar types of solicitations, while such response is pending. An applicant is not required to file reports under this section except as required in the RFP or RFQ process.

(e) Assets affected by this section. The provisions of this section apply to all PSF assets, both publicly and nonpublicly traded investments.

(f) General ethical standards.

(1) SBOE Members and PSF Service Providers must comply with all applicable laws, specifically, the following statutes: Texas Government Code, Chapter 2263 (Ethics and Disclosure Requirements for Outside Financial Advisors and Service Providers), §572.051 (Standards of Conduct for Public Servants), §552.352 (Distribution of Confidential Information), §572.058 (Private Interest in Measure or Decision; Disclosure; Removal from Office for Violation), §572.054 (Representation by Former Officer or Employee of Regulatory Agency Restricted), §572.002 (General Definitions), §572.004 (Definition: Regulation), and Chapter 305 (Registration of Lobbyists);

Texas Penal Code, Chapter 36 (Bribery, Corrupt Influence, and Gifts to Public Servants) and Chapter 39 (Abuse of Office, Official Misconduct); and Texas Education Code, §43.0031 (Permanent School Fund Ethics Policy), §43.0032 (Conflicts of Interest), and §43.0033 (Reports of Expenditures). The omission of any applicable statute listed in this paragraph does not excuse violation of its provisions.

(2) SBOE Members and PSF Service Providers must be honest in the exercise of their duties and must not take actions that will discredit the PSF.

(3) SBOE Members and PSF Service Providers shall be loyal to the interests of the PSF to the extent that such loyalty is not in conflict with other duties, which legally have priority. SBOE Members and PSF Service Providers shall avoid personal, employment, or business relationships that create conflicts of interest. Should SBOE Members or PSF Service Providers become aware of any conflict of interest, they have an affirmative duty to disclose and to cure the conflict in a manner provided for under this section prior to the next SBOE or committee meeting and such SBOE Member shall take no action nor participate in the RFP or RFQ process, or similar types of solicitations, that concerns the conflict.

(4) SBOE Members and PSF Service Providers shall not use nonpublic information gained through their relationship with the PSF to seek or obtain personal gain beyond agreed compensation and/or any properly authorized expense reimbursement. This should not be interpreted to forbid the use of PSF as a reference or the communication to others of the fact that a relationship with PSF exists, provided that no misrepresentation is involved.

(5) An SBOE Member shall report in writing the name and address of any PSF Service Provider, as defined by subsection (d)(2)(D) of this section, who provides investment and management advice to that SBOE Member. The SBOE Member shall submit the report to the commissioner of education for distribution to the SBOE within 30 days of the PSF Service Provider first providing investment and management advice to that SBOE Member.

(6) SBOE Members and PSF Service Providers shall report in writing any action described by the Texas Education Code, §7.108, to the commissioner of education for distribution to the SBOE within seven days of discovering the violation.

(7) A PSF Service Provider shall not make any gift or donation to a school or other charitable interest on behalf of, at the request of, or in coordination with an SBOE Member. Any PSF Service Provider or SBOE Member shall disclose in writing to the commissioner of education any information regarding such a donation.

(8) A PSF Service Provider shall disclose in writing to the commissioner of education for dissemination to all SBOE Members any business or financial transaction greater than $50 in value with an SBOE Member, the commissioner of education, or any TEA employee within 30 days of the transaction. Excluded from this subsection are checking accounts, savings accounts, credit cards, brokerage accounts, mutual funds, or other financial accounts that are provided to the SBOE Member under the same terms and conditions as they are provided to members of the general public.

(9) An SBOE Member shall disclose in writing to the commissioner of education on a quarterly basis any business or financial transaction greater than $50 in value between the SBOE Member, or a business entity in which the SBOE Member has a significant ownership interest, and a PSF Service Provider. A report shall be filed even if there has not been a business or financial transaction greater than $50 in value between the SBOE Member, or a business entity in which the SBOE Member has a significant ownership interest, and a PSF Service Provider. Excluded from this subsection are checking accounts, savings accounts, credit cards, brokerage accounts, mutual funds, or other financial accounts that are provided to an SBOE Member under the same terms and conditions as they are provided to members of the general public. The reports shall be filed on or before January 15, April 15, July 15, and October 15 and shall cover the preceding three calendar months. The first report filed for each SBOE Member shall cover the preceding one-year period.

Subsection (u) of this section does not apply to the first report filed. The commissioner of education shall communicate the information included in the disclosure to all SBOE Members.

(g) Notification of disclosure. In order to preserve the integrity and public trust in the PSF, it is deemed necessary and appropriate to allow all SBOE Members a reasonable time to promptly review and respond to any disclosures or written inquiries made by applicants or made by PSF Service Providers as provided in SBOE operating procedures. In compliance with Texas Government Code, §2156.123, no SBOE Member or PSF Service Provider should publicly disclose any submission materials prior to completion of the RFP or RFQ process. For purposes of this subsection, an RFP or RFQ is completed upon final award of an RFP, or selection of qualified bidders for an RFQ, or closure without any selection. This subsection does not allow an SBOE Member to refrain from publicly disclosing a conflict of interest as required by subsections (f)(3) and (i)(4) of this section and Texas Government Code, §572.058.

(h) Disclosure.

(1) If an SBOE Member solicited a specific investment action by the PSF staff or a PSF Service Provider, the SBOE Member shall publicly disclose the fact to the SBOE in a public meeting. The disclosure shall be entered into the minutes of the meeting. For purposes of this section, a matter is a prospective directive to the PSF staff or a PSF Service Provider to undertake a specific investment or divestiture of securities for the PSF. This term does not include ratification of prior securities transactions performed by the PSF staff or a PSF Service Provider and does not include an action to allocate classes of assets within the PSF.

(2) In addition, an SBOE Member shall fully disclose any substantial interest in any publicly or nonpublicly traded PSF investment (business entity) on the SBOE Member's annual financial report filed with the Texas Ethics Commission pursuant to Texas Government Code, §572.021. An SBOE Member has a substantial interest if the SBOE Member:

(A) has a controlling interest in the business entity;

(B) owns more than 10% of the voting interest in the business entity;

(C) owns more than $25,000 of the fair market value of the business entity;

(D) has a direct or indirect participating interest by shares, stock, or otherwise, regardless of whether voting rights are included, in more than 10% of the profits, proceeds, or capital gains of the business entity;

(E) is a member of the board of directors or other governing board of the business entity;

(F) serves as an elected officer of the business entity; or

(G) is an employee of the business entity.

(i) Conflicts of interest.

(1) A conflict of interest exists whenever SBOE Members or PSF Service Providers have personal or private commercial or business relationships that could reasonably be expected to diminish their independence of judgment in the performance of their duties. For example, a person's independence of judgment is diminished when the person is in a position to take action or not take action with respect to PSF and such act or failure to act is, may be, or reasonably appears to be influenced by considerations of personal gain or benefit rather than motivated by the interests of the PSF. Conflicts include, but are not limited to, beneficial interests in securities, corporate directorships, trustee positions, or other special relationships that could reasonably be considered a conflict of interest with the duties to the PSF. Further, Texas Education Code, §43.0032, requires disclosure and no participation, unless a waiver is granted, when an SBOE Member or a PSF Service Provider has a business, commercial, or other relationship that could reasonably be expected to diminish a person's independence of judgment in the performance of the person's responsibilities relating to the management or investment of the PSF. Such business, commercial, or other relationship is defined to be a relationship that is prohibited under Texas Government Code, §572.051, or that would require public disclosure under Texas Government Code, §572.058,

or a relationship that does not rise to this level but that is determined by the SBOE to create an unacceptable risk to the integrity and reputation of the PSF investment program.

(2) Any SBOE Member or PSF Service Provider who has a possible conflict of interest as defined in paragraph (1) of this subsection shall disclose the possible conflict to the commissioner of education and the chair and vice chair of the SBOE on the disclosure form. The disclosure form is provided in this paragraph entitled "Potential Conflict of Interest Disclosure Form."

Figure: 19 TAC §33.5(i)(2)

(3) A person who files a statement under paragraph (2) of this subsection disclosing a possible conflict of interest may not give advice or make decisions about a matter affected by the possible conflict of interest unless the SBOE, after consultation with the general counsel of the TEA, expressly waives this prohibition. The SBOE may delegate the authority to waive this prohibition. If an SBOE Member or a PSF Service Provider wishes to seek a waiver or determination of a possible conflict of interest, the SBOE Member or PSF Service Provider shall request an opinion from the Texas Ethics Commission. An SBOE Member will be given the assistance of the TEA ethics advisor to help draft a request for an opinion, if such assistance is requested. When the SBOE Member or PSF Service Provider receives the opinion of the Texas Ethics Commission and if a waiver is still sought, the SBOE Member or PSF Service Provider shall forward the opinion to the SBOE chair and the commissioner. An opinion of the Texas Ethics Commission that determines a conflict exists is final and the SBOE may not waive the conflict of interest. An opinion of the Texas Ethics Commission that determines that no conflict exists will automatically result in an SBOE waiver. If a decision concerning a waiver cannot be achieved with sufficient expedition through the procedures specified in this subsection, the SBOE may vote to grant a waiver after consultation with the general counsel of the TEA.

(4) If an SBOE Member believes he or she has a conflict of interest based on the existence of certain relationships described in Texas Government Code, §572.058, the SBOE Member shall publicly disclose the conflict at an SBOE meeting or committee meeting and the SBOE Member shall not vote or otherwise participate in any decision involving the conflict. This requirement is in addition to the requirement of filing a disclosure under paragraph (2) of this subsection.

(5) Texas Government Code, §572.051, establishes standards of conduct for state officers and employees. SBOE Members and TEA employees shall abide by these standards.

(j) Prohibited transactions and interests.

(1) For purposes of this section, the term "direct placement" (with respect to investments that are not publicly traded) is defined as a direct sale of securities, generally to institutional investors, with or without the use of brokers or underwriters.

(2) For the purposes of this section, the term "placement agent" is defined as any third party, whether or not affiliated with a PSF Service Provider, that is a party to an agreement or arrangement (whether written or oral) with a PSF Service Provider for direct or indirect payment of a fee in connection with a PSF investment.

(3) No SBOE Member or PSF Service Provider shall:

(A) have a financial interest in a direct placement investment of the PSF;

(B) serve as an officer, director, or employee of an entity in which a direct placement investment is made by the PSF; or

(C) serve as a consultant to, or receive any fee, commission or payment from, an entity in which a direct placement investment is made by the PSF.

(4) No SBOE Member shall:

(A) act as a representative or agent of a third party in dealing with a PSF manager or consultant in connection with a PSF investment; or

(B) be employed for two years after the end of his or her term on the SBOE with an organization in which the PSF invested, unless the organization's stock or other evidence of ownership is traded on the public stock or bond exchanges.

(5) A PSF Service Provider shall:

(A) not act as a representative or agent of a third party in dealing with a PSF manager or consultant in connection with a PSF investment; and

(B) not use a placement agent in connection with a PSF investment unless:

(i) the relationship with the placement agent and any compensation is disclosed in writing to and approved by the SBOE;

(ii) the placement agent is registered with the Securities and Exchange Commission or the Financial Industry Regulatory Authority; and

(iii) such placement agent does not share any fees with a non-registered person or entity.

(6) A placement agent approved by the SBOE may only be used in accordance with the SBOE's approval. If a PSF Service Provider wishes to use the same placement agent for a different purpose or in a different manner, a separate approval is required.

(7) A placement agent shall file campaign contribution reports in the same manner as does a PSF Service Provider under subsection (o)(1) of this section.

(k) Solicitation of support. No SBOE Member shall solicit or receive a campaign contribution on behalf of any political candidate, political party, or political committee from a PSF Service Provider or any PSF manager, consultant, or staff member. The manager, PSF Service Provider, consultant, or staff member shall report any such incident in writing to the commissioner of education for distribution to the SBOE.

(l) Hiring external professionals. The SBOE may contract with private professional investment managers to help make PSF investments. The SBOE has the authority and responsibility to hire other external professionals, including custodians or consultants. The SBOE shall select each professional based solely on merit and subject to the provisions of §33.55 of this title (relating to Standards for Selecting Consultants, Investment Managers, Custodians, and Other Professionals To Provide Outside Expertise for the Fund).

(m) Responsibilities of PSF Service Providers. The PSF Service Providers shall be notified in writing of the code of ethics contained in this section. Any existing contracts for investment and any future investment shall strictly conform to this code of ethics. The PSF Service Provider shall report in writing any suggestion or offer by an SBOE Member to deviate from the provisions of this section to the commissioner of education for distribution to the SBOE within 30 days of the PSF Service Provider discovering the violation. The PSF Service Provider shall report in writing any violation of this code of ethics committed by another PSF Service Provider to the commissioner of education for distribution to the SBOE within 30 days of the PSF Service Provider discovering the violation. A PSF Service Provider or other person retained in a fiduciary capacity must comply with the provisions of this section.

(n) Gifts and entertainment.

(1) Bribery. SBOE Members are prohibited from soliciting, offering, or accepting gifts, payments, and other items of value in exchange for an official act, including a vote, recommendation, or any other exercise of official discretion pursuant to Texas Penal Code, §36.02.

(2) Acceptance of gifts.

(A) An SBOE Member may not accept gifts, favors, services, or benefits that may reasonably tend to influence the SBOE Member's official conduct or that the SBOE Member knows or should know are intended to influence the SBOE Member's official conduct. For purposes of this paragraph, a gift does not include an item with a value of less than $50, excluding cash or negotiable instruments.

(B) An SBOE Member may not accept a gift, favor, service, or benefit from a person that the SBOE Member knows is interested or is likely to become interested in a charter, contract, purchase, payment, claim, or other pecuniary transaction over which the SBOE has discretion.

(C) An SBOE Member may not accept a gift, favor, service, or benefit from a person that the SBOE Member knows to be subject to the regulation, inspection, or investigation of the SBOE or the TEA.

(D) An SBOE Member may not solicit, accept, or agree to accept a benefit from a person with whom civil or criminal litigation is pending or contemplated by the SBOE or the TEA.

(E) So long as the gift or benefit is not given by a person subject to the SBOE's or the TEA's regulation, inspection, or investigation, an SBOE Member may accept a gift, payment, or contribution from an individual who is not registered as a lobbyist with the Texas Ethics Commission if it fits into one of the following categories:

(i) items worth less than $50 (may not be cash, checks, or negotiable instruments);

(ii) independent relationship, such as kinship, or a personal, professional, or business relationship independent of the SBOE Member's official capacity;

(iii) fees for services rendered outside the SBOE Member's official capacity;

(iv) government property issued by a governmental entity that allows the use of the property; or

(v) food, lodging, entertainment, and transportation, if accepted as a guest and the donor is present.

(F) The following provisions govern the disposition of an individual who is a PSF Service Provider or who is both a lobbyist registered with the Texas Ethics Commission and who represents a person subject to the SBOE's or the TEA's regulation, inspection, or investigation.

(i) An SBOE Member may not accept:

(I) loans, cash, or negotiable instruments;

(II) travel or lodging for a pleasure trip;

(III) travel and lodging in connection with a fact-finding trip or to a seminar or conference at which the SBOE Member does not provide services;

(IV) entertainment worth more than $250 in a calendar year;

(V) gifts, other than awards and mementos, that combined are worth more than $250 in value for a calendar year. Gifts do not include food, entertainment, lodging, and transportation; or

(VI) individual awards and mementos worth more than $250 each.

(ii) An SBOE Member may accept food and beverages if the PSF Service Provider or lobbyist is present.

(G) An SBOE Member may not solicit, agree to accept, or accept an honorarium in consideration for services that the SBOE Member would not have been asked to provide but for the SBOE Member's official position. An SBOE Member may accept food, transportation, and lodging in connection with a speech performed as a result of the SBOE Member's position in accordance with the rulings with the Texas Ethics Commission, which may place limitations on the type of entity that may fund such travel. An SBOE Member must report the food, lodging, or transportation accepted under this subparagraph in the SBOE Member's annual personal financial statement.

(H) Under no circumstances shall an SBOE Member accept a prohibited gift if the source of the gift is not identified or if the SBOE Member knows or has reason to know that the gift is being offered through an intermediary.

(I) If an unsolicited prohibited gift is received by an SBOE Member, he or she should return the gift to its source. If that is not possible or feasible, the gift should be donated to charity. The SBOE Member shall report the return of the gift or the donation of the gift to the commissioner of education.

(J) A PSF Service Provider shall file a report annually on April 15 of each year on the expenditure report provided in this subparagraph entitled "Report of Expenditures of Persons Providing Services to the State Board of Education Relating to the Management and Investment of the Permanent School Fund." The report shall be for the time period beginning on January 1 and ending on December 31 of the previous year. The expenditure report must describe in detail any expenditure of more than $50 made by the person on behalf of:

Figure: 19 TAC §33.5(n)(2)(J)

(i) an SBOE Member;

(ii) the commissioner of education; or

(iii) an employee of the TEA or of a nonprofit corporation created under the Texas Education Code, §43.006.

(K) A PSF Service Provider shall file a report annually with the TEA's PSF office, in the format specified by the PSF staff, on or before April 15 of each year. The report will be deemed to be filed when it is actually received. The report shall be for the time period beginning on January 1 and ending on December 31 of the previous year. It shall list any individuals who served in any of the following capacities at any time during the reporting period:

(i) all members of the governing body of the PSF Service Provider;

(ii) the officers of the PSF Service Provider;

(iii) any broker who conducts transactions with PSF funds;

(iv) all members of the governing body of the firm of a broker who conducts transactions with PSF funds; and

(v) all officers of the firm of a broker who conducts transactions with PSF funds.

(L) This subsection does not apply to campaign contributions.

(M) Each SBOE Member and each PSF Service Provider shall, no later than April 15, file an annual report affirmatively disclosing any violation of this code of ethics known to that person during the time period beginning January 1 and ending December 31 of the previous year which has not previously been disclosed in writing to the commissioner of education for distribution to all board members, or affirmatively state that the person has no knowledge of any such violation. For purposes of this subparagraph only, "SBOE Member" means only the individual elected official.

(o) Campaign contributions.

(1) A PSF Service Provider shall, no later than April 15 and October 15, file a semi-annual report of each political contribution that the PSF Service Provider has made to an SBOE Member or a candidate seeking election to the SBOE in writing to the commissioner of education. The report shall be for the six-month time period preceding the reporting dates and include the name of each SBOE Member or candidate seeking election to the SBOE who received a contribution, the amount of each contribution, and date of each contribution. Subsection (u) of this section does not

apply to the first report filed. A report shall be filed even if the PSF Service Provider made no reportable contribution during the reporting period to an SBOE Member or a candidate seeking election to the SBOE. The commissioner of education shall communicate the information included in the disclosure to all SBOE Members.

(2) Any person or firm filing a response to an RFP or RFQ relating to the management and investments of the PSF shall disclose in the response whether at any time in the preceding four years from the due date of the response to the RFP or RFQ the person or firm has made a campaign contribution to a candidate for or member of the SBOE.

(p) Compliance with professional standards.

(1) SBOE Members and PSF Service Providers who are members of professional organizations which promulgate standards of conduct must comply with those standards.

(2) PSF Service Providers must comply with the Code of Ethics and Standards of Professional Conduct of the Chartered Financial Analyst Institute (CFA Institute).

(q) Transactions between PSF Service Providers and/or consultants.

(1) PSF Service Providers or persons who act as consultants to the SBOE regarding investment and management of the PSF shall not engage in any transaction involving the assets of the PSF with another PSF Service Provider or a person who acts as a consultant to the SBOE regarding investment and management of the PSF.

(2) PSF Service Providers and/or consultants to the SBOE who provide advice regarding investment and management of the PSF shall report to the SBOE on a quarterly basis all investment transactions or trades and any fees or compensation paid or received in connection with the transactions or trades with another PSF Service Provider or a person who acts as a consultant to the SBOE regarding investment and management of the PSF.

(r) Compliance and enforcement.

(1) The SBOE will enforce this section through its chair or vice chair or the commissioner of education.

(2) Any violation of this section will be reported to the chair and vice chair of the SBOE and the commissioner of education and a recommended action will be presented to the SBOE by the chair or the commissioner. A violation of this section may result in the termination of the contract or a lesser sanction. Repeated minor violations may also result in the termination of the contract.

(3) The PSF compliance officer under the direction of the TEA confidentiality officer shall act as custodian of all statements, waivers, and reports required under this section for purposes of public disclosure requirements.

(4) The ethics advisor of the TEA shall respond to inquiries from the SBOE Members and PSF Service Providers concerning the provisions of this section. The ethics advisor may confer with the general counsel and the executive administrator of the PSF.

(5) No payment shall be made to a PSF Service Provider who has failed to timely file a completed report as described by subsection (m) of this section, until a completed report is filed.

(s) Ethics training. The SBOE shall receive annual training regarding state ethics laws through the Texas Ethics Commission and the TEA's ethics advisor.

(t) TEA general ethical standards. The commissioner of education and PSF staff shall comply with the General Ethical Standards for the Staff of the Permanent School Fund and the Commissioner of Education.

(u) Reporting period. A new report required by an amendment to the code of ethics need only concern events after the effective date of the amendment. An amendment to a rule that presently requires a report does not affect the reporting period unless the amendment explicitly changes the reporting period.

(v) Statutory statement.

(1) A "statutory financial advisor or service provider" as defined in this subsection shall on or before April 15 file a statement as required by Texas Government Code, §2263.005, with the commissioner of education and the state auditor, for the previous calendar year. The statement will be deemed filed when it is actually received. A statutory financial advisor or service provider shall promptly file a new or amended statement with the commissioner of education and the state auditor whenever there is new information required to be reported under Texas Government Code, §2263.005(a).

(2) A "statutory financial advisor or service provider" is a member of the Committee of Investment Advisors or an individual or business entity, including a financial advisor, financial consultant, money or investment manager, or broker, who is not an employee of the TEA, but who provides financial services or advice to the TEA or the SBOE or an SBOE member in connection with the management and investment of the PSF and who may reasonably be expected to receive, directly or indirectly, more than $5,000 in compensation from the TEA or the SBOE during a fiscal year.

(3) An annual statement required to be filed under this subsection will be made using the form developed by the state auditor.

Statutory Authority: The provisions of this §33.5 issued under the Texas Education Code, §§7.102(c)(31) and (33) and 43.0031-43.0034; Texas Government Code, §2263.004; and Texas Constitution, Article VII, §5(f).

Source: The provisions of this §33.5 adopted to be effective September 1, 1996, 21 TexReg 3937; amended to be effective September 1, 1998, 24 TexReg 7777; amended to be effective April 2, 2000, 25 TexReg 2564; amended to be effective December 3, 2000, 25 TexReg 11648; amended to be effective December 15, 2002, 27 TexReg 11533; amended to be effective December 7, 2003, 28 TexReg 10930; amended to be effective October 10, 2004, 29 TexReg 9354; amended to be effective October 15, 2006, 31 TexReg 8347; amended to be effective August 24, 2008, 33 TexReg 6586; amended to be effective July 1, 2010, 35 TexReg 5529.

§33.10. Purposes of Texas Permanent School Fund Assets and the Statement of Investment Policy.

(a) The purpose of the Texas Permanent School Fund (PSF), as defined by the Texas Constitution, shall be to support and maintain an efficient system of public free schools. The State Board of Education (SBOE) views the PSF as a perpetual institution. Consistent with its perpetual nature, the PSF shall be an endowment fund with a long-term investment horizon. The SBOE shall strive to manage the PSF consistently with respect to the following: generating income for the benefit of the public free schools of Texas, the real growth of the corpus of the PSF, protecting capital, and balancing the needs of present and future generations of Texas school children. The PSF will strive to maintain intergenerational equity by attempting to pay out a constant distribution per student after adjusting for inflation.

(b) The purposes of the investment policy statement are to:

(1) specify the investment objectives, policies, and guidelines the SBOE considers appropriate and prudent, considering the needs of the PSF, and to comply with the Texas Constitution by directing PSF assets;

(2) establish SBOE performance criteria for an investment manager;

(3) communicate the investment objectives, guidelines, and performance criteria to the SBOE, PSF investment staff and managers, and all other parties;

(4) guide the ongoing oversight of PSF investment and test compliance with the Texas Constitution and other applicable statutes;

(5) document that the SBOE is fulfilling its responsibilities for managing PSF investments solely in the interests of the PSF; and

(6) document that the SBOE is fulfilling its responsibilities under Texas law.

Source: The provisions of this §33.10 adopted to be effective September 1, 1996, 21 TexReg 3937; amended to be effective September 1, 1998, 24 TexReg 7777; amended to be effective October 10, 2004, 29 TexReg 9357.

§33.15. Objectives.

(a) Investment objectives.

(1) Investment objectives have been formulated based on the following considerations:

(A) the anticipated financial needs of the Texas public free school system in light of expected future contributions to the Texas Permanent School Fund (PSF);

(B) the need to preserve capital;

(C) the risk tolerance set by the State Board of Education (SBOE) and the need for diversification;

(D) observations about historical rates of return on various asset classes;

(E) assumptions about current and projected capital market and general economic conditions and expected levels of inflation;

(F) the need to invest according to the prudent person rule; and

(G) the need to document investment objectives, guidelines, and performance standards.

(2) Investment objectives represent desired results and are long-term in nature, covering typical market cycles of three to five years. Any shortfall in meeting the objectives should be explainable in terms of general economic and capital market conditions and asset allocation.

(3) The investment objectives are consistent with generally accepted standards of fiduciary responsibility.

(4) Under the provisions of this chapter, investment managers shall have discretion and authority to implement security selection and timing.

(b) Goal and objectives for the PSF.

(1) Goal. The goal of the SBOE for the PSF shall be to invest for the benefit of current and future generations of Texans consistent with the safety of principal, in light of the strategic asset allocation plan adopted. To achieve this goal, PSF investment shall be carefully administered at all times.

(2) Objectives.

(A) The preservation and safety of principal shall be a primary consideration in PSF investment.

(B) Fixed income securities shall be purchased at the highest yield consistent with the preservation and safety of principal.

(C) To the extent possible, the PSF administrators shall hedge against inflation.

(D) Securities, except investments for cash management purposes as specified in §33.25 of this title (relating to Permissible and Restricted Investments and General Guidelines for Investment Managers), shall be selected for investment on the basis of long-term investment merits rather than short-term gains.

(c) Investment rate of return and risk objectives.

(1) Because the education needs of the future generations of Texas school children are long-term in nature, the return objective of the PSF shall also be long-term and focused on fairly balancing the benefits between the current generation and future generations while preserving the real per capita value of the PSF.

(2) Investment rates of return shall adhere to the Chartered Financial Analyst (CFA) Institute Global Investment Performance Standards (GIPS) guidelines in calculating and reporting investment performance return information.

(3) The overall risk level of PSF assets in terms of potential for price fluctuation shall not be extreme and risk variances shall be minimal. The primary means of achieving such a risk profile are:

(A) a broad diversification among asset classes that, as nearly as possible, react independently through varying economic and market circumstances;

(B) careful control of risk level within each asset class by avoiding over-concentration and not taking extreme positions against the market averages; and

(C) a degree of emphasis on stable growth.

(4) Over time, the volatility of returns (or risk) for the total fund, as measured by standard deviation of investment returns, should be comparable to investments in market indices in the proportion in which the PSF invests.

(5) The objective of the domestic equity fund shall be to earn, over time, an average annual total rate of return that meets or exceeds that of a representative benchmark index, combining dividends and capital appreciation, while maintaining an acceptable risk level compared to that of the representative benchmark index.

(6) The objective of the international equity fund shall be to earn, over time, an average annual total rate of return that meets or exceeds that of a representative international benchmark index in U.S. dollars, combining dividends and capital appreciation, while maintaining an acceptable risk level compared to that of the representative benchmark index.

(7) The objective of the domestic fixed income fund shall be to earn, over time, an average annual total rate of return that meets or exceeds that of a representative benchmark index, combining interest income and capital appreciation, while maintaining an acceptable risk level compared to that of the representative benchmark index.

(8) The objective of the real estate fund shall be to earn, over time, an average annual total rate of return that meets or exceeds that of a representative benchmark index in U.S. dollars, combining income and capital appreciation, while maintaining an acceptable risk level compared to that of the representative benchmark index.

(9) The objective of the private equity fund shall be to earn, over time, an average annual total rate of return that meets or exceeds that of a representative benchmark or a targeted internal rate of return in U.S. dollars, combining income and capital appreciation, while maintaining an acceptable risk level compared to that of the representative benchmark.

(10) The objective of the absolute return fund shall be to earn, over time, an average annual total rate of return that meets or exceeds that of a representative benchmark index in U.S. dollars, combining income and capital appreciation, while maintaining an acceptable risk level compared to that of the representative benchmark index.

(11) The objective of the real return fund shall be to earn, over time, an average annual total rate of return that meets or exceeds that of a representative benchmark index in U.S. dollars, combining income and capital appreciation, while maintaining an acceptable risk level compared to that of the representative benchmark index.

(12) The objective of the short-term cash fund shall be to provide liquidity for the timely payment of security transactions, while earning a competitive return. The expected return, over time, shall meet or exceed that of the representative benchmark index, while maintaining an acceptable risk level compared to that of the representative benchmark index.

(13) Notwithstanding the risk parameters specified in paragraphs (4)-(12) of this subsection, consideration shall be given to marginal risk variances exceeding the representative benchmark indices if returns are commensurate with the risk levels of the respective portfolios.

(d) Asset allocation policy.

(1) The SBOE shall adopt and implement a strategic asset allocation plan based on a well diversified, balanced investment approach that uses a broad range of asset classes indicated by the following characteristics of the PSF:

(A) the long-term nature of the PSF;

(B) the spending policy of the PSF;

(C) the relatively low liquidity requirements of the PSF;

(D) the investment preferences and risk tolerance of the SBOE;

(E) the rate of return objectives; and

(F) the diversification objectives of the PSF, specified in the Texas Constitution, Article VII, §5(d), the Texas Education Code, Chapter 43, and the provisions of this chapter.

(2) The strategic asset allocation plan shall contain guideline percentages, at market value of the total fund's assets, to be invested in various asset classes. The target mix may not be attainable at a specific point in time since actual asset allocation will be dictated by current and anticipated market conditions, as well as the overall directions of the SBOE.

(3) The SBOE Committee on School Finance/Permanent School Fund, with the advice of the PSF investment staff, shall review the provisions of this section at least annually and, as needed, rebalance the assets of the portfolio according to the asset allocation rebalancing procedure specified in the PSF Investment Procedures Manual. The SBOE Committee on School Finance/Permanent School Fund shall consider the industry diversification and the percentage allocation within the following asset classes:

(A) domestic equities;

(B) international equities;

(C) domestic fixed income;

(D) real estate;

(E) private equity;

(F) absolute return;

(G) real return; and

(H) cash.

(4) Investments shall not exceed the strategic ranges the SBOE establishes for each asset class.

(5) Periodically, the SBOE shall allocate segments of the total fund to each investment manager and specify guidelines, investment objectives, and standards of performance that apply to those assets.

Source: The provisions of this §33.15 adopted to be effective September 1, 1997, 22 TexReg 4359; amended to be effective March 31, 2004, 29 TexReg 3174; amended to be effective October 10, 2004, 29 TexReg 9357; amended to be effective October 15, 2006, 31 TexReg 8347.

§33.20. Responsible Parties and Their Duties.

(a) The Texas Constitution, Article VII, §§1-8, establishes the Available School Fund, the Texas Permanent School Fund (PSF), and the State Board of Education (SBOE), and specifies the standard of care SBOE members must exercise in managing PSF assets. In addition, the constitution directs the legislature to

establish suitable provisions for supporting and maintaining an efficient public free school system, defines the composition of the PSF and the Available School Fund, and requires the SBOE to set aside sufficient funds to provide free textbooks for the use of children attending the public free schools of this state.

(b) The SBOE shall be responsible for overseeing all aspects of the PSF and may employ any of the following parties, whose duties and responsibilities are as follows.

(1) An investment manager is a person, firm, corporation, bank, or insurance company the SBOE retains to manage a portion of the PSF assets under specified guidelines.

(2) A custodian is an organization, normally a bank, the SBOE retains to safekeep, and provide accurate and timely reports of, PSF assets.

(3) A consultant is a person or firm the SBOE retains to advise the PSF based on professional expertise.

(4) Investment counsel or consultant is a person or firm retained under criteria specified in the PSF Investment Procedures Manual to advise PSF investment staff and the SBOE Committee on School Finance/Permanent School Fund within the policy framework established by the SBOE. Counsel is responsible for asset allocation reviews, manager searches, spending policy recommendations and research related to the management of the fund's assets.

(5) A performance measurement consultant is a person or firm retained to provide the SBOE Committee on School Finance/Permanent School Fund an analysis of the PSF portfolio performance. The outside portfolio performance measurement service firm shall perform the analysis on a quarterly or as-needed basis. Quarterly reports shall be distributed to each member of the SBOE Committee on School Finance/Permanent School Fund, and a representative of the firm shall be available as necessary to brief the committee.

(6) The State Auditor's Office is an independent state agency that performs an annual financial audit of the TEA at the direction of the Texas Legislature. The financial audit, conducted according to generally accepted auditing standards, is designed to test compliance with generally accepted accounting principles. The state auditor performs tests of the transactions of the PSF Investment Office as part of this annual audit, including compliance with governing statutes and SBOE policies and directives. The TEA Internal Audit Division will participate in the audit process by participating in entrance and exit conferences, being provided copies of all reports and management letters furnished by the external auditor, and having access to the external auditor's audit programs and working papers.

(7) The SBOE may retain independent external auditors to review the PSF accounts annually or on an as-needed basis. The TEA Internal Audit Division will participate in the audit process by participating in entrance and exit conferences, being provided copies of all reports and management letters furnished by the external auditor, and having access to the external auditor's audit programs and working papers.

(c) The SBOE shall meet on a regular or as-needed basis to conduct the affairs of the PSF.

(d) In case of emergency or urgent public necessity, the SBOE Committee on School Finance/Permanent School Fund or the SBOE, as appropriate, may hold an emergency meeting under the Texas Government Code, §551.045.

(e) The SBOE shall have the following exclusive duties:

(1) determining the strategic asset allocation mix between asset classes based on the attending economic conditions and the PSF goals and objectives;

(2) ratifying the investment transactions pertaining to the purchase, sale, or reinvestment of fixed income, equity, or cash securities by all internal and external managers for the current reporting period;

(3) appointing members to the SBOE Investment Advisory Committee;

(4) approving the selection of, and all contracts with, external professional investment managers, financial advisors, financial consultants, or other external professionals employed to help the SBOE invest the PSF;

(5) approving the selection of, and the performance measurement contract with, a well-recognized and reputable firm employed to evaluate and analyze PSF investment results. The service shall compare investment results to the written investment objectives of the SBOE and also compare the investment of the PSF with the investment of other public and private funds against market indices and by managerial style;

(6) setting policies, objectives, and guidelines for investing PSF assets; and

(7) representing the PSF to the state.

(f) The SBOE may establish committees to administer the affairs of the PSF. The duties and responsibilities of any committee established shall be specified in the PSF Investment Procedures Manual.

(g) The PSF shall have an executive administrator, with a staff to be adjusted as necessary, who functions directly with the SBOE through the SBOE Committee on School Finance/Permanent School Fund concerning investment matters, and who functions as part of the internal operation under the commissioner of education. At all times, the PSF executive administrator and staff shall invest PSF assets as directed by the SBOE according to the Texas Constitution and all other applicable Texas statutes, as amended, and SBOE rules governing the operation of the PSF. The PSF staff shall:

(1) administer the PSF according to SBOE goals and objectives;

(2) execute all directives, policies, and procedures from the SBOE and the SBOE Committee on School Finance/Permanent School Fund;

(3) keep records and provide a continuous and accurate accounting of all PSF transactions, revenues, and expenses and provide reports on the status of the PSF portfolio;

(4) advise any officials, investment firms, or other interested parties about the powers, limitations, and prohibitions regarding PSF investments that have been placed on the SBOE or PSF investment staff by statutes, attorney general opinions and court decisions, or by SBOE policies and operating procedures;

(5) continuously research all internally managed securities held by the PSF and report to the SBOE Committee on School Finance/Permanent School Fund and the SBOE any information requested, including reports and statistics on the PSF, for the purpose of administering the PSF;

(6) establish and maintain a procedures manual that implements this section to be approved by the SBOE;

(7) make recommendations regarding investment and policy matters to the SBOE Committee on School Finance/Permanent School Fund and the SBOE; and

(8) establish and maintain accounting policies and internal control procedures concerning all receipts, disbursements and investments of the PSF, according to the procedures adopted by the SBOE.

Source: The provisions of this §33.20 adopted to be effective September 1, 1997, 22 TexReg 4359; amended to be effective September 1, 1998, 24 TexReg 7777; amended to be effective March 31, 2004, 29 TexReg 3174.

§33.25. Permissible and Restricted Investments and General Guidelines for Investment Managers.

(a) Permissible investments.

(1) Equities are considered to be common or preferred corporate stocks; corporate bonds, debentures, or preferreds that may be converted into corporate stock; and investment trusts. Stocks listed or traded on well recognized or principal U.S. or foreign exchanges or nationally recognized over-the-counter markets are permitted.

(2) Fixed income securities are considered to be U.S. or foreign treasury or government agency obligations, U.S. or foreign corporate bonds, asset- or mortgage-backed securities, taxable municipal obligations, Canadian bonds, Yankee bonds, supranational bonds (denominated in U.S. dollars), and 144A securities.

(3) Real estate is considered to be investments in real properties, as well as investments in real estate related securities and real estate related debt. Common property types associated with real estate investments are, but not limited to, apartments, office buildings, retail centers, infrastructure, timberlands, and industrial parks.

(4) Private equity is considered to be, but not limited to, venture capital, buy-out investing, mezzanine financing, and distressed debt.

(5) Absolute returns are investments in a diversified bundle of primarily marketable investment strategies that seek positive returns, regardless of market direction.

(6) Real returns are investments that target a return that exceed the rate of inflation, measured by the Consumer Price Index (CPI), by a premium.

(7) Cash equivalents are securities with maturities of less than or equal to one year that are considered to include interest bearing or discount instruments of the U.S. government or its agencies, money market funds, corporate discounted instruments, corporate-issued commercial paper, time deposits of U.S. or foreign banks, bankers acceptances, and fully collateralized repurchase agreements. Both U.S. and foreign offerings are permitted. All residual cash in the Texas Permanent School Fund (PSF) portfolio must be swept and invested on a daily basis.

(8) Any form of investment or nonpublicly traded investment may be considered by the State Board of Education (SBOE) based on risk and return characteristics, provided the investment is consistent with PSF goals and objectives.

(9) The SBOE may approve currency hedging strategies for the international portfolios and delineate the related procedures in the "Standards of Performance" section of the PSF Investment Procedures Manual.

(b) Prohibited transactions and restrictions. Unless the SBOE gives its written approval, the following prohibited transactions and restrictions apply for all PSF managers:

(1) short sales of any kind;

(2) purchasing letter or restricted stock;

(3) buying or selling on margin;

(4) engaging in purchasing or writing options or similar transactions;

(5) purchasing or selling futures on commodities contracts;

(6) borrowing money, or pledging or otherwise encumbering PSF assets;

(7) purchasing the equity or debt securities of the portfolio manager's organization or an affiliated organization;

(8) engaging in any purchasing transaction, after which the cumulative market value of common stock in a single corporation exceeds 2.5% of the PSF total market value or 5.0% of the manager's total portfolio market value;

(9) engaging in any purchasing transaction, after which the cumulative number of shares of common stock in a single corporation held by the PSF exceeds 5.0% of the outstanding voting stock of that issuer;

(10) engaging in any purchasing transaction, after which the cumulative market value of fixed income securities or cash equivalent securities in a single corporation (excluding the U.S. government, its

federal agencies, and government sponsored enterprises) exceeds 2.5% of the PSF total market value or 5.0% of the manager's total portfolio market value;

(11) purchasing tax exempt bonds;

(12) purchasing guaranteed investment contracts (GICs) from an insurance company or bank investment contracts (BICs) from a bank not rated at least AAA by Standard & Poor's or Moody's;

(13) purchasing any fixed income security not rated investment grade by at least two of the following ratings agencies: at least BBB- by Standard & Poor's, Baa3 by Moody's, and BBB by Fitch, subject to the provisions in the PSF Investment Procedures Manual related to the fixed income portfolio mandates regarding quality and duration;

(14) purchasing short-term money market instruments rated below A-1 by Standard & Poor's or P-1 by Moody's;

(15) engaging in any transaction that results in unrelated business taxable income (excluding current holdings);

(16) engaging in any transaction considered a "prohibited transaction" under the Internal Revenue Code or the Employee Retirement Income Security Act (ERISA);

(17) purchasing precious metals or other commodities;

(18) engaging in any transaction that would leverage a manager's position;

(19) lending securities owned by the PSF, but held in custody by another party, such as a bank custodian, to any other party for any purpose, unless lending securities according to a separate written agreement the SBOE approved; and

(20) purchasing fixed income securities without a stated par value amount due at maturity.

(c) General guidelines for investment managers.

(1) Each investment manager retained to manage a portion of PSF assets shall be aware of, and operate within, the provisions of this chapter and all applicable Texas statutes.

(2) As fiduciaries of the PSF, investment managers shall discharge their duties solely in the interests of the PSF according to the prudent expert rule, engaging in activities that include the following.

(A) Diversification. The investment policy shall be to diversify each manager's common stock portfolio by participating in industries and companies with above average prospects or sound fundamentals.

(B) Securities trading.

(i) Each manager shall send copies of each transaction record to the PSF investment staff and custodians.

(ii) Each manager shall be required to reconcile the accounts under management on a monthly basis with the PSF investment staff and custodians.

(iii) Each manager shall be responsible for complying fully with PSF policies for trading securities and selecting brokerage firms, as specified in §33.40 of this title (relating to Trading and Brokerage Policy). In particular, the emphasis of security trading shall be on best execution; that is, the highest proceeds to the PSF and the lowest costs, net of all transaction expenses. Placing orders shall be based on the financial viability of the brokerage firm and the assurance of prompt and efficient execution.

(iv) The SBOE shall require each external manager to indemnify the PSF for all failed trades not due to the negligence of the PSF or its custodian in instances where the selection of the broker dealer is not in compliance with §33.40 of this title (relating to Trading and Brokerage Policy).

(C) Acknowledgments in writing.

(i) Each external investment manager retained by the PSF must be a person, firm, or corporation registered as an investment adviser under the Investment Adviser Act of 1940, a bank as defined in the Act, or an insurance company qualified to do business in more than one state, and must acknowledge its fiduciary responsibility in writing. A firm registered with the Securities and Exchange Commission (SEC) must annually provide a copy of its Form ADV, Section II.

(ii) The SBOE may require each external manager to obtain coverage for errors and omissions in an amount set by the SBOE, but the coverage shall be at least the greater of $500,000 or 1.0% of the assets managed, not exceeding $10 million. The coverage should be specific as to the assets of the PSF. The manager shall annually provide evidence in writing of the existence of the coverage.

(iii) Each external manager may be required by the SBOE to obtain fidelity bonds, fiduciary liability insurance, or both.

(iv) Each manager shall acknowledge in writing receiving a copy of, and agreeing to comply with, the provisions of this chapter.

(D) Discretionary investment authority. Subject to the provisions of this chapter, any investment manager of marketable securities or other investments, retained by the PSF, shall have full discretionary investment authority over the assets for which the manager is responsible. Specialist advisors retained for alternative asset investments may have a varying degree of discretionary authority, which will be outlined in the respective management contract.

(d) Reporting procedures for investment managers. The investment manager shall:

(1) prepare a monthly and quarterly report for delivery to the SBOE, the SBOE Committee on School Finance/Permanent School Fund, and the PSF investment staff that shall include, in the appropriate format, items requested by the SBOE. The monthly reports shall briefly cover the firm's economic review; a review of recent and anticipated investment activity; a summary of major changes that have occurred in the investment markets and in the portfolio, particularly since the last report; and a summary of the key characteristics of the PSF portfolio. Quarterly reports shall comprehensively cover the same information as monthly reports but shall also include any changes in the firm's structure, professional team, or product offerings; a detail of the portfolio holdings; and transactions for the period. Periodically, the PSF investment staff shall provide the investment manager a detailed description of, and format for, these reports;

(2) when requested by the SBOE Committee on School Finance/Permanent School Fund, make a presentation describing the professionals retained for the PSF, the investment process used for the PSF portfolio under the manager's responsibility, and any related issues;

(3) when requested by the PSF investment staff, meet to discuss the management of the portfolio, new developments, and any related matters; and

(4) implement a specific investment process for the PSF. The manager shall describe the process and its underlying philosophy in an attachment to its investment management agreement with the PSF and manage according to this process until the PSF and manager agree in writing to any change.

Source: The provisions of this §33.25 adopted to be effective September 1, 1996, 21 TexReg 3937; amended to be effective September 1, 1998, 24 TexReg 7777; amended to be effective October 15, 2006, 31 TexReg 8347.

§33.30. Standards of Performance.

(a) The State Board of Education (SBOE) Committee on School Finance/Permanent School Fund shall set and maintain performance standards for the total fund, the equity fund, the fixed income fund, and the cash fund

of the Texas Permanent School Fund (PSF), and all investment managers based on criteria that include the following:

(1) time horizon;

(2) real rate of return;

(3) representative benchmark index;

(4) volatility of returns (or risk), as measured by standard deviation; and

(5) universe comparison.

(b) The SBOE Committee on School Finance/Permanent School Fund shall develop and implement the procedures necessary to establish and recommend to the SBOE the performance standards criteria.

(c) Performance standards shall be included in the PSF Investment Procedures Manual.

Source: The provisions of this §33.30 adopted to be effective September 1, 1996, 21 TexReg 3937; amended to be effective September 1, 1998, 24 TexReg 7777.

§33.35. Guidelines for the Custodian and the Securities Lending Agent.

Completing custodial and security lending functions in an accurate and timely manner is necessary for effective investment management and accurate records.

(1) A custodian shall have the following responsibilities regarding the segments of the funds for which the custodian is responsible.

(A) Provide complete custody and depository services for the designated accounts.

(B) Provide for investment of any cash on a daily basis to avoid uninvested amounts.

(C) Implement the investment actions in a timely and effective manner as directed by the investment managers.

(D) Collect all realizable income and principal and properly report the information on the periodic statements to the Texas Permanent School Fund (PSF) investment staff, the investment managers, or other appropriate parties.

(E) Provide monthly and annual accounting statements, as well as on-line, real-time accounting, that includes all transactions. Accounting shall be based on accurate security values for cost and market value and provided within a time frame acceptable to the State Board of Education (SBOE).

(F) Report to the PSF investment staff situations in which security pricing is either not possible or subject to considerable uncertainty.

(G) Distribute all proxy voting materials in a timely manner.

(H) Provide research and assistance to the SBOE and the PSF investment staff on all issues related to accounting and administration.

(I) Confirm that the depth of resources and personnel associated with the designated funds are comparable to those of the nation's leading custodial banks.

(2) A securities lending agent for the PSF shall have the following responsibilities.

(A) Provide complete transaction reporting for the designated funds.

(B) Provide a monthly accounting, as well as on-line, real-time accounting for securities lending transactions, based on accurate security values.

(C) Report to the PSF investment staff any irregular situation that is outside the standard of practice for securities lending or inconsistent with the provisions of the securities lending agreement.

(D) Implement a securities lending program for the PSF in a manner that does not impair any rights of the PSF by virtue of PSF ownership in securities.

(E) As requested, provide research and assistance to the SBOE and the PSF investment staff on all issues related to accounting and administration.

(F) Provide indemnification to the PSF satisfactory to the SBOE in the event of default on securities lending transactions.

(G) Fully disclose all revenues and other fees associated with the securities lending program.

(H) Comply with restrictions on types of securities lending transactions or eligible investments of cash collateral or any other restrictions imposed by the SBOE or the PSF investment staff. Unless the SBOE gives its written approval, the following guidelines apply to the PSF Securities Lending Program. Cash collateral reinvestment guidelines must meet the following standards.

(i) Permissible investments.

(I) U.S. Government and U.S. Agencies, under the following criteria:

(-a-) any security issued by or fully guaranteed as to payment of principal and interest by the U.S. Government or a U.S. Government Agency or sponsored Agency, and eligible for transfer via Federal Reserve Bank book entry, Depository Trust Company book entry, and/or Participants Trust Company book entry;

(-b-) maximum 397-day maturity on fixed rate;

(-c-) maximum three-year maturity on floating rate, with maximum reset period of 90 days and use a standard repricing index such as London InterBank Offered Rate (LIBOR), Federal Funds, Treasury Bills, or commercial paper; and

(-d-) no maximum dollar limit.

(II) Bank obligations, under the following criteria:

(-a-) time deposits with maximum 60-day maturity on fixed rate or three-year maturity for floating rate, with maximum reset period of 60 days and use a standard repricing index such as LIBOR, Federal Funds, Treasury Bills, or commercial paper;

(-b-) negotiable Certificates of Deposit with maximum 397-day maturity on fixed rate or three-year maturity for floating rate, with maximum reset period of 90 days and use a standard repricing index such as LIBOR, Federal Funds, Treasury Bills, or commercial paper;

(-c-) bank notes with maximum 397-day maturity on fixed rate or three-year maturity on floating rate, with maximum reset period of 90 days and use a standard repricing index such as LIBOR, Federal Funds, Treasury Bills, or commercial paper;

(-d-) bankers acceptances with maximum 45-day maturity;

(-e-) banks with at least $25 billion in assets with a short-term rating of "Tier 1" as defined in clause (ii)(IV) of this subparagraph for fixed rate and AA2 and AA by Moody's Investor Service and Standard & Poor's Corporation for floating rate. In

addition, placements can be made in branches within the following countries:

(-1-) Canada;

(-2-) France;

(-3-) United Kingdom; and

(-4-) United States; and

(-f-) dollar limit maximum per institution of 5.0% of investment portfolio at time of purchase.

(III) Commercial paper, under the following criteria:

(-a-) dollar limit maximum per issuer of 5.0% of investment portfolio at time of purchase including any other obligations of that issuer as established in subclause (II)(-d-) of this clause. If backed 100% by bank Letter of Credit, then dollar limit is applied against the issuing bank;

(-b-) must be rated "Tier 1" as defined in clause (ii)(IV) of this subparagraph; and

(-c-) maximum 397-day maturity.

(IV) Asset backed commercial paper, under the following criteria:

(-a-) dollar limit maximum per issuer of 5.0% of investment portfolio;

(-b-) must be rated "Tier 1" as defined in clause (ii)(IV) of this subparagraph; and

(-c-) maximum 397-day maturity.

(V) Asset backed securities, under the following criteria:

(-a-) maximum 397-day weighted average life on fixed rate;

(-b-) maximum three-year weighted average life on floating rate, with maximum reset period of 90 days and use a standard repricing index such as LIBOR, Federal Funds, Treasury Bills, or commercial paper; and

(-c-) rated Aaa and AAA by Moody's Investor Service and Standard & Poor's Corporation at time of purchase. One AAA rating may suffice if only rated by one Nationally Recognized Securities Rating Organization (NRSRO).

(VI) Corporate debt (other than commercial paper), under the following criteria:

(-a-) must be senior debt;

(-b-) maximum 397-day maturity on fixed rate;

(-c-) maximum three-year maturity on floating rate, with maximum rest period of 90 days and use a standard repricing index such as LIBOR, Federal Funds, Treasury Bills, or commercial paper;

(-d-) issuers or guarantor's short-term obligations must be rated "Tier 1" as defined in clause (ii)(IV) of this subparagraph for

fixed rate and AA2 and AA by Moody's Investor Service and Standard & Poor's Corporation for floating rate; and

(-e-) dollar limit maximum per issuer of 5.0% of investment portfolio at time of purchase, including any other obligations of that issuer.

(VII) Reverse repurchase agreements, under the following criteria:

(-a-) counterparty must be "Tier 1" rated as defined in clause (ii)(IV) of this subparagraph for fixed rate and AA2 and AA by Moody's Investor Service and Standard & Poor's Corporation for floating rate or be a "Primary Dealer" in Government Securities as per the New York Federal Reserve Bank;

(-b-) underlying collateral may be any security permitted for direct investment;

(-c-) lending agent or a third party custodian must hold collateral under tri-party agreement;

(-d-) collateral must be marked to market daily and maintained at the following margin levels;

(-1-) U.S. Government, U.S. Government Agency, sponsored Agency, International Organization at 100%;

(-2-) Certificate of Deposits, Bankers Acceptance, bank notes, commercial paper at 102% under one year to maturity and rated at least "Tier 1" as defined in clause (ii)(IV) of this subparagraph; and

(-3-) corporate debt (other than commercial paper) at 105% rated at least AA2/AA or better by Moody's Investor Service and Standard & Poor's Corporation at time of purchase;

(-e-) due to daily margin maintenance, dollar limits and maturity limits of underlying collateral are waived, except with respect to the maturity limit in subclause (II)(-d-) of this clause;

(-f-) maximum 180-day maturity; and

(-g-) dollar limit for total reverse repurchase agreements is the greater of $300 million or 15% of value of cash collateral portfolio with one counterparty at time of purchase.

(VIII) Foreign sovereign debt, under the following criteria:

(-a-) any security issued by or fully guaranteed as to payment of principal and interest by a foreign government whose sovereign debt is rated AA2/AA or better by Moody's Investor Service and Standard & Poor's Corporation at time of purchase. Securities must be delivered to Lending Agent or a third party under a Tri-Party agreement;

(-b-) dollar limit maximum per issuer or guarantor of 2.5% of investment portfolio; and

(-c-) maximum maturity of 397 days.

(IX) Short Term Investment Fund (STIF) and/or Registered Mutual Funds, under the following criteria:

(-a-) funds must comprise investments similar to those that would otherwise be approved for securities lending investment under the provisions of this subparagraph, not invest in derivatives, and not re-hypothecate assets;

(-b-) lender must approve each fund in writing and only upon receipt of offering documents and qualified letter; and

(-c-) fund must have an objective of a constant share price of one dollar.

(ii) Investment parameters.

(I) Maximum weighted average maturity of investment portfolio must be 180 days.

(II) Maximum weighted average interest rate exposure of investment portfolio must be 60 days.

(III) All investments must be U.S. dollar-denominated.

(IV) "Tier 1" credit quality is defined as the highest short-term rating category by the following NRSROs:

(-a-) Standard & Poor's;

(-b-) Moody's Investors Service;

(-c-) Fitch Investors Service; and

(-d-) Duff & Phelps, LLC.

(V) At time of purchase all investments must be rated in the highest short-term numerical category by at least two NRSROs, one of which must be either Standard & Poor's or Moody's Investors Service.

(VI) Issuer's ratings cannot be on negative credit watch at the time of purchase.

(VII) Interest and principal only (IO, PO) stripped mortgages are not permitted.

(VIII) Mortgage backed securities are not permitted.

(IX) Complex derivative or structured securities, including, but not limited to the following are not permitted:

(-a-) inverse floating rate notes;

(-b-) defined range floating rate notes;

(-c-) trigger notes; and

(-d-) set-up notes.

(I) Provide a copy of the investment policy governing the custodian's securities lending program, as amended, to the PSF investment staff.

(J) Confirm that the depth of resources and personnel associated with the designated funds are comparable to those of the nation's leading securities lending agents.

Source: The provisions of this §33.35 adopted to be effective September 1, 1996, 21 TexReg 3937; amended to be effective March 31, 2004, 29 TexReg 3174; amended to be effective August 14, 2005, 30 TexReg 4478; amended to be effective October 15, 2006, 31 TexReg 8347.

§33.40. Trading and Brokerage Policy.

(a) Security transaction policy.

(1) The following principles shall guide all Texas Permanent School Fund (PSF) transactions.

(A) Each manager shall be responsible for complying fully with PSF policies for trading securities and selecting brokerage firms, as specified in this section. In particular, the emphasis of security trading shall be on best execution; that is, the highest proceeds to the PSF and the lowest costs, net of all transaction expenses. Placing orders shall be based on the financial viability of the brokerage firm and the assurance of prompt and efficient execution.

(B) Ongoing efforts must be made to reduce trading costs, in terms of both commissions and market impact, provided the investment returns of the PSF are not jeopardized.

(2) The State Board of Education (SBOE) may enter into brokerage commission recapture agreements or soft dollar agreements.

(3) The SBOE may evaluate transaction activity annually through a trading cost analysis.

(b) Directed trades. The SBOE may adopt directed trade procedures for the PSF portfolio according to procedures developed by the SBOE Committee on School Finance/Permanent School Fund.

(c) Guidelines for selecting a brokerage firm and standards of ethical conduct for brokerage firms.

(1) Introduction and basic principles.

(A) The SBOE intends that any transaction of publicly traded security occur through a brokerage firm or automated trading system, regardless of location, to obtain the lowest transaction cost consistent with best execution.

(B) Each investment manager shall be responsible for selecting brokerage firms or automated trading systems through which PSF trading shall be completed. The selections must meet PSF guidelines and be for the exclusive benefit of the PSF.

(2) Guidelines for selection and standards of ethical conduct. The broker or dealer firm must:

(A) have appropriate trading and market expertise;

(B) have comprehensive, proprietary, in-house research capabilities;

(C) be in compliance with applicable federal and Texas laws related to conducting business as a broker or dealer, including the Anti-Fraud provisions of the Securities Exchange Act of 1934;

(D) be a member in good standing of the major financial exchanges;

(E) have on-site, in-house trading capability and direct access to major markets;

(F) have in-house access to trading support equipment;

(G) trade for competitive rates that provide the lowest transaction cost consistent with best execution;

(H) be financially able to accommodate a capital commitment trade over an industry standard settlement period;

(I) have the ability and record to clear and settle trades without unnecessary delays or fails; and

(J) have been in business as a broker or dealer for a reasonable period of time to ensure financial and operational stability.

(3) Exemptions.

(A) Broker/dealer firms that are certified as Texas based historically underutilized businesses (HUBs) are exempted from the requirements specified in paragraph (2)(B), (D), and (H) of this subsection; and

(B) broker/dealer firms that are operating as electronic communication networks are exempted from the requirements specified in paragraph (2)(B) of this subsection.

(4) Reporting requirements. The executive administrator of the PSF will report to the SBOE Committee on School Finance/Permanent School Fund, on an ongoing basis, a list of broker dealers with whom the PSF has conducted business during the fiscal year that have been granted exemptions under paragraph (2)(B), (D), and (H) of this subsection and will identify the specific exemptions granted.

(5) Review and evaluation. At least annually, the SBOE Committee on School Finance/Permanent School Fund shall review the brokerage firms used by PSF investment managers and all transactions for compliance with the provisions of this section.

(6) Broker expenditure report. A broker shall file a report annually on January 15 of each year on the expenditure report provided in §33.5(l)(2)(J) of this title (relating to Code of Ethics) entitled "Report of Expenditures of Persons Providing Services to the State Board of Education Relating to the Management and Investment of the Permanent School Fund." The report shall be for the time period beginning on December 1 of the previous year and ending on November 30 of the current year. The expenditure report must describe in detail any expenditure of more than $50 made by the person on behalf of:

(A) an SBOE Member;

(B) the commissioner of education; or

(C) an employee of the TEA or of a nonprofit corporation created under the Texas Education Code, §43.006.

Source: The provisions of this §33.40 adopted to be effective September 1, 1996, 21 TexReg 3937; amended to be effective September 1, 1998, 24 TexReg 7777; amended to be effective April 2, 2000, 25 TexReg 2568; amended to be effective October 11, 2000, 25 TexReg 10151; amended to be effective March 31, 2004, 29 TexReg 3174; amended to be effective October 10, 2004, 29 TexReg 9354.

§33.45. Proxy Voting Policy.

The State Board of Education (SBOE) recognizes its fiduciary obligations with respect to the voting of proxies of companies with securities that are owned by the Texas Permanent School Fund (PSF). Because the issues related to proxy voting are complex and directly impact investment values, the SBOE believes the PSF is best suited to vote the proxies of shares held in the PSF portfolio. Therefore, as part of the PSF investment policy, the SBOE instructs the PSF executive administrator and investment staff to vote all of the PSF proxies of companies according to the following guidelines. The executive administrator may delegate voting of proxies of securities not held in internally managed portfolios to external investment managers or proxy voting companies, provided voting is in accordance with the following guidelines.

(1) Routine matters. Routine proxy proposals shall be voted in support of company proposals unless there is a clear reason not to do so. Routine matters include:

(A) electing directors;

(B) determining the size of a board;

(C) changing a corporate name;

(D) appointing an auditor;

(E) splitting stock;

(F) amending articles of incorporation that are required to comply with federal or state regulation; and

(G) changing the date, time, or location of an annual meeting.

(2) Business matters. Business proposals that do not eliminate the rights of shareholders, especially minority shareholders, or the status of securities held, including ownership status, shall not be treated as routine; rather, they shall be carefully analyzed. These issues may be voted with management. However, business proposals that are nonroutine or would impair the economic interests of shareholders shall be voted against management. Examples of such proposals include:

(A) requests to alter bylaws to require a super majority to approve mergers;

(B) anti-takeover proposals that could restrict tender offers or deny majority owners from exercising judgment;

(C) proposals to dilute existing shares by issuing substantially more stock without adequate explanation by management; and

(D) proposals that would enrich management excessively or substantially increase compensation awards or employment contracts to senior management that become effective when ownership of the company changes (also known as "golden parachute" awards).

(3) Other matters. On all other matters, the PSF executive administrator, investment staff, and external investment managers shall vote proxies judged to be in the best interests of the PSF.

(4) Reporting to SBOE. At each regularly scheduled SBOE meeting, the PSF executive administrator shall advise the SBOE of all instances in which the PSF executive administrator or external investment managers voted against management. External investment managers shall provide written reports monthly to the executive administrator according to procedures and a format established by the executive administrator.

Source: The provisions of this §33.45 adopted to be effective September 1, 1996, 21 TexReg 3937; amended to be effective September 1, 1998, 22 TexReg 11671; amended to be effective March 31, 2004, 29 TexReg 3174.

§33.50. Socially and Politically Responsible Investment Policy.

Investments shall be considered based on the prudent person rule and the provisions of this chapter. Investments shall provide the highest return commensurate with the lowest risk and shall be diversified.

Source: The provisions of this §33.50 adopted to be effective September 1, 1996, 21 TexReg 3937.

§33.55. Standards for Selecting Consultants, Investment Managers, Custodians, and Other Professionals To Provide Outside Expertise for the Fund.

The State Board of Education (SBOE) may retain qualified professionals to assist in investment and related matters.

(1) Basis for selection. The SBOE shall retain professional assistance based solely on the demonstrated ability of the professional to provide the expertise or assistance needed. For each type of expertise, relevant and objective criteria shall be established to judge and select experts.

(2) Types of expertise for consideration. Examples of professionals or specialized expertise the SBOE may retain include: investment managers, accountants, consultants, legal counsel, custodians, security lending agents, and system specialists.

(3) Process for selecting professional assistance. The SBOE shall establish and maintain in the Texas Permanent School Fund (PSF) Procedures Manual an objective process for selecting expertise or

assistance. The SBOE Committee on School Finance/Permanent School Fund shall periodically review the process to ensure it reflects SBOE objectives.

Source: The provisions of this §33.55 adopted to be effective September 1, 1996, 21 TexReg 3937; amended to be effective September 1, 1998, 24 TexReg 7777.

§33.60. Performance and Review Procedures.

As requested by the State Board of Education (SBOE) or Texas Permanent School Fund (PSF) investment staff, evaluation and periodic investment reports shall supply critical information on a continuing basis, such as the amount of trading activity, investment performance, cash positions, diversification ratios, rates of return, and other perspectives of the portfolios. The reports shall address compliance with investment policy guidelines.

(1) Performance measurements. The SBOE Committee on School Finance/Permanent School Fund shall review the quarterly performance of each investment manager portfolio of the PSF in terms of the provisions of this chapter. The investment performance review shall include comparisons with representative benchmark indices, a broad universe of investment managers, and the consumer price index. A time-weighted return formula (which minimizes the effect of contributions and withdrawals) shall be used for investment return analysis. The review also may include quarterly performance analysis and comparisons of retained firms. The services of an outside, independent consulting firm that provides performance measurement and evaluation shall be retained.

(2) Meeting and reports. At least annually, the SBOE Committee on School Finance/Permanent School Fund shall meet with the PSF investment managers and custodian to review their responsibilities, the PSF portfolio, and investment results in terms of the provisions of this chapter.

(3) Review and modification of investment policy statement. The SBOE Committee on School Finance/Permanent School Fund shall review the provisions of this chapter at least once a year to determine if modifications are necessary or desirable. Upon approval by the SBOE, any modifications shall be promptly reported to all investment managers and other responsible parties.

(4) Compliance with this chapter and Texas statutes. Annually, the SBOE Committee on School Finance/Permanent School Fund shall confirm that the PSF and each of its managed portfolios have complied with the provisions of this chapter concerning exclusions imposed by the SBOE, proxy voting, and trading and brokerage selection.

(5) Significant events. The SBOE must be notified promptly if any of the following events occur within the custodian or external investment manager organizations:

(A) any event that is likely to adversely impact to a significant degree the management, professionalism, integrity, or financial position of the custodian or investment manager. A custodian must report the loss of an account of $500 million or more. An investment manager must report the loss of an account of $25 million or more;

(B) a loss of one or more key people;

(C) a significant change in investment philosophy;

(D) the addition of a new portfolio manager on the sponsor's account;

(E) a change in ownership or control, through any means, of the custodian or investment manager; or

(F) any violation of policy.

Source: The provisions of this §33.60 adopted to be effective September 1, 1996, 21 TexReg 3937; amended to be effective September 1, 1998, 24 TexReg 7777.

§33.65. Bond Guarantee Program.

(a) Statutory provision. The commissioner of education must administer the guarantee program for school district bonds according to the provisions of the Texas Education Code (TEC), Chapter 45, Subchapter C.

(b) Definitions. The following definitions apply to the guarantee program for school district bonds.

(1) Annual debt service--Payments of principal and interest on outstanding bonded debt scheduled to occur between September 1 and August 31 during the fiscal year in which the guarantee is sought as reported by the Municipal Advisory Council (MAC) of Texas or its successor, if the district has outstanding bonded indebtedness.

(A) The annual debt service will be determined by the current report of the bonded indebtedness of the district as reported by the MAC of Texas or its successor as of the date of the application deadline.

(B) The annual debt service does not include:

(i) the amount of debt service to be paid on the bonds for which the reservation is sought; or

(ii) the amount of debt service attributable to any debt that is no longer outstanding at the application deadline, provided that the Texas Education Agency (TEA) has sufficient evidence of the discharge or defeasance of such debt.

(C) The debt service amounts used in this calculation for variable rate bonds will be those that are published in the final official statement.

(2) Application deadline--The last business day of the month in which an application for a guarantee is filed. Applications must be received by the TEA division responsible for state funding by 5:00 p.m. on the last business day of the month to be considered in that month's application processing.

(3) Average daily attendance (ADA)--Total refined average daily attendance as defined by the TEC, §42.005.

(4) Bond Guarantee Program (BGP)--The guarantee program for school district bonds that is described by this section and established under the TEC, Chapter 45, Subchapter C.

(5) Bond order--The order adopted by the governing body of a school district that authorizes the issuance of bonds.

(6) Combination issue--An issuance of bonds for which an application is filed for a guarantee that includes both a new money portion and a refunding portion, as permitted by the Texas Government Code, Chapter 1207. The eligibility of combination issues for the guarantee is limited by the eligibility of the new money and refunding portions as defined in this subsection.

(7) Enrollment growth--Growth in student enrollment, as defined by §129.1025 of this title (relating to Adoption By Reference: Student Attendance Accounting Handbook), that has occurred over the previous five school years.

(8) Financial exigency--A determination by a school district board of trustees that the financial condition of the district requires a reduction in personnel, as authorized by the TEC, §21.211.

(9) New money issue--An issuance of bonds for the purposes of constructing, renovating, acquiring, and equipping school buildings; the purchase of property; or the purchase of school buses. Eligibility for the guarantee for new money issues is limited to the issuance of bonds authorized under the TEC, §45.003. A new money issue does not include the issuance of bonds to purchase a facility from a public facility corporation created by the school district or to purchase any property that is currently under a lease-purchase contract under the Local Government Code, Chapter 271, Subchapter A. A new money issue does not include an issuance of bonds to refinance any type of maintenance tax-supported debt. Maintenance tax-supported debt includes, but is not limited to:

(A) time warrants or loans entered under the TEC, Chapter 45, Subchapter E; or

(B) any other type of loan or warrant that is not supported by bond taxes as defined by the TEC, §45.003.

(10) Notes issued to provide interim financing--An issuance of notes, including commercial paper notes, designed to provide short-term financing for the purposes of constructing, renovating, acquiring, and equipping school buildings; the purchase of property; or the purchase of school buses. For notes to be eligible for the guarantee under this section, the notes must be:

(A) issued to pay costs for which bonds have been authorized at an election occurring before the issuance of the notes;

(B) approved by the Office of the Attorney General or issued in accordance with proceedings that have been approved by the Office of the Attorney General; and

(C) refunded by bonds issued to provide long-term financing no more than three years from the date of issuance of such notes, provided that the date of issuance of notes will be determined by reference to the date on which the notes were issued for capital expenditures and the intervening date or dates of issuance of any notes issued to refinance outstanding notes will be disregarded.

(11) Refunding issue--An issuance of bonds for the purpose of refunding bonds, including notes issued to provide interim financing, that are supported by bond taxes as defined by the TEC, §45.003. Eligibility for the guarantee for refunding issues is limited to refunding issues that refund bonds, including notes issued to provide interim financing, that were authorized by a bond election under the TEC, §45.003.

(12) Total debt service--Total outstanding principal and interest on bonded debt.

(A) The total debt service will be determined by the current report of the bonded indebtedness of the district as reported by the MAC of Texas or its successor as of the date of the application deadline, if the district has outstanding bonded indebtedness.

(B) The total debt service does not include:

(i) the amount of debt service to be paid on the bonds for which the reservation is sought; or

(ii) the amount of debt service attributable to any debt that is no longer outstanding at the application deadline, provided that the TEA has sufficient evidence of the discharge or defeasance of such debt.

(C) The debt service amounts used in this calculation for variable rate bonds will be those that are published in the final official statement.

(c) Data sources.

(1) The following data sources will be used for purposes of prioritization:

(A) projected ADA for the current school year as adopted by the legislature for appropriations purposes;

(B) final property values certified by the comptroller of public accounts, as described in the Texas Government Code, Chapter 403, Subchapter M, for the tax year preceding the year in which the bonds will be issued. If final property values are unavailable, the most recent projection of property values by the comptroller, as described in the Texas Government Code, Chapter 403, Subchapter M, will be used;

(C) debt service information reported by the MAC of Texas or its successor as of the date of the application deadline; and

(D) enrollment information reported to the Public Education Information Management System (PEIMS) for the five-year time period ending in the year before the application date.

(2) The commissioner may consider adjustments to data values determined to be erroneous or not reflective of current conditions before the deadline for receipt of applications for that application cycle.

(d) Application processing. To facilitate prioritization of applications for the guarantee or the credit enhancement authorized under §61.1038 of this title (relating to School District Bond Enhancement Program), all applications received during a calendar month will be held until the fifteenth business day of the subsequent month. On the fifteenth business day of each month, the commissioner of education will announce the results of the prioritization described in paragraph (5) of this subsection and process applications for initial approval for the guarantee or initial and final approval for the guarantee, as applicable, up to the available capacity as of the application deadline, subject to the requirements of this subsection. If Permanent School Fund (PSF) capacity has been exhausted, the commissioner will process the application for approval of the credit enhancement as specified in §61.1038 of this title.

(1) The school district may not submit an application for a guarantee or credit enhancement before the successful passage of an authorizing proposition.

(2) The actual guarantee of the bonds is subject to the approval process prescribed in subsection (e) of this section. An applicant school district is ineligible for consideration for the guarantee if its lowest credit rating from any credit rating agency is the same as or higher than that of the BGP.

(3) Refunding issues must comply with the following requirements to retain eligibility for the guarantee for the refunding bonds, except that subparagraph (D) of this paragraph does not apply to a refunding issue that provides long-term financing for notes issued to provide interim financing.

(A) The district must have an accreditation status of Accredited as defined by §97.1055 of this title (relating to Accreditation Status). If the district has an accreditation status of Accredited-Warned or Accredited-Probation, the commissioner will investigate the underlying reason for the accreditation rating to determine whether the accreditation rating is related to the district's financial soundness. If the accreditation rating is related to the district's financial soundness, the refunding bonds will not be eligible to retain the guarantee. Districts with an accreditation status of Not Accredited-Revoked will not be eligible to retain the guarantee on the refunding bonds.

(B) The bonds to be refunded must have been:

(i) previously guaranteed by the PSF or approved for credit enhancement under §61.1038 of this title;

(ii) issued on or after November 1, 2008, and before the effective date of §61.1038 of this title; or

(iii) issued as notes to provide interim financing as defined in subsection (b)(10) of this section.

(C) Only refunding issues as defined in subsection (b)(11) of this section are eligible for the guarantee.

(D) The district must demonstrate that issuing the refunding bond(s) will result in a present value savings to the district and that the refunding bond or bonds will not have a maturity date later than the final maturity date of the bonds being refunded. Present value savings is determined by computing the net present value of the difference between each scheduled payment on the original bonds and each scheduled payment on the refunding bonds. Present value savings must be computed at the true interest cost of the refunding bonds.

(E) If a district files an application for a combination issue, the application will be treated as a single issue for the purposes of eligibility for the guarantee. A guarantee for the combination issue will be awarded only if both the new money portion and the refunding portion meet all of the applicable eligibility requirements described in this subsection.

The district making the application must present data to the commissioner that demonstrate compliance for both the new money portion of the issue and the refunding portion of the issue.

(F) The refunding transaction must comply with the provisions of paragraphs (7) and (9) of this subsection.

(4) The commissioner will estimate the available capacity of the PSF on a monthly basis so that the commissioner is able to make the determination described in subsection (e)(2) of this section. If necessary, the commissioner will confirm that the PSF has sufficient capacity to guarantee the bonds before the issuance of the final approval for the guarantee in accordance with subsection (e)(4) of this section. The calculation of capacity will be based on a multiplier of three times the cost value of the PSF. The commissioner may reduce the multiplier to maintain the AAA credit rating of the BGP. Changes to the multiplier made by the commissioner are to be ratified or rejected by the State Board of Education (SBOE) at the next meeting for which the item can be posted.

(5) The SBOE will establish an amount of capacity to be held in reserve of no less than 5.0% of the fund's capacity. Guarantees will be awarded each month beginning with the districts with the lowest property wealth per ADA until the PSF reaches its net capacity to guarantee bonds, as determined by subtracting the amount to be held in reserve from the total available capacity. The reserved capacity can be used to award guarantees for districts that experience unforeseen catastrophes or emergencies that require the renovation or replacement of school facilities as described in the TEC, §44.031(h).

(A) The amount to be held in reserve may be increased by a majority vote of the SBOE based on changes in the asset allocation and risk in the portfolio and unrealized gains in the portfolio, or by the commissioner as necessary to prudently manage fund capacity. Changes to the amount held in reserve made by the commissioner are to be ratified or rejected by the SBOE at the next meeting for which the item can be posted.

(B) Guarantees will be awarded to applicants based on the fund's capacity to fully guarantee the bond issue for which the guarantee is sought. Applications for bond issues that cannot be fully guaranteed will not receive an award. The amount of bond issue for which the guarantee was requested may not be modified after the monthly application deadline for the purposes of securing the guarantee during the award process.

(6) An application received after the application deadline will be considered a valid application for the subsequent month, unless withdrawn by the submitting district before the end of the subsequent month.

(7) Each district that submits a valid application will be notified of the application status within 15 business days of the application deadline. If a district is awarded initial approval for the guarantee or initial and final approval for the guarantee, as applicable, as described in subsection (e) of this section, the following requirements must be met.

(A) If applicable, the district must comply with the provisions for final approval described in subsection (e)(4) of this section to maintain approval for the guarantee.

(B) The bonds must be approved by the Office of the Attorney General within 180 days of the date of the letter granting the approval of the guarantee. The initial approval for the guarantee or initial and final approval for the guarantee, as applicable, will expire at the end of the 180-day period. The commissioner may extend the 180-day period, based on extraordinary circumstances, on receiving a written request from the district before the expiration of the 180-day period.

(8) If a district does not receive a guarantee or for any reason does not receive approval of the bonds from the Office of the Attorney General within the specified time period, the district may reapply in a subsequent month. Applications that were denied a guarantee will not be retained for consideration in subsequent months.

(9) If the bonds are not approved by the Office of the Attorney General within 180 days of the date of the letter granting the approval of the guarantee, the commissioner will consider the application withdrawn, and the district must reapply for a guarantee.

(10) Districts may not represent the bonds as guaranteed for the purposes of pricing or marketing the bonds before the date of the letter granting approval of the guarantee.

(e) Application for the guarantee.

(1) Application process. Districts must apply to the commissioner of education for the guarantee or the credit enhancement of eligible bonds. The district must submit, in a form specified by the commissioner, the information required under the TEC, §45.055(b), and this section and any additional information the commissioner may require. The application and all additional information required by the commissioner must be received before the application will be processed.

(A) The application fee is $2,300.

(B) The fee is due at the time the application for the guarantee or the credit enhancement is submitted. An application will not be processed until the fee has been received in accordance with the process prescribed by the commissioner for remitting the fee on the application form.

(C) The fee will not be refunded to a district that:

(i) is not approved for the guarantee or the credit enhancement; or

(ii) does not sell its bonds before the expiration of its approval for the guarantee or the credit enhancement.

(D) The fee may be transferred to a subsequent application for the guarantee or the credit enhancement by the district if the district withdraws its application and submits the subsequent application before the expiration of its approval for the guarantee or the credit enhancement.

(2) Initial and final approval provisions.

(A) If, during the monthly estimation of PSF capacity described in subsection (d)(4) of this section, the commissioner determines that the available capacity of the PSF is 10% or less, the commissioner may require an applicant school district to obtain final approval for the guarantee as described in paragraph (4) of this subsection.

(B) If the commissioner has not made such a determination:

(i) the commissioner will consider the initial approval described in paragraph (3) of this subsection as both the initial and final approval; and

(ii) an applicant school district that has received notification of initial approval for the guarantee, as described in paragraph (3) of this subsection, may consider that notification as notification of initial and final approval for the guarantee and may complete the sale of the applicable bonds.

(3) Initial approval.

(A) Under the TEC, §45.056, the commissioner will investigate the applicant school district's accreditation status and financial status. A district must be accredited and financially sound to be eligible for initial approval by the commissioner. The commissioner's review will include the following:

(i) the purpose of the bond issue;

(ii) the district's accreditation status as defined by §97.1055 of this title in accordance with the following:

(I) if the district's accreditation status is Accredited, the district will be eligible for consideration for the guarantee;

(II) if the district's accreditation status is Accredited-Warned or Accredited-Probation, the commissioner will investigate the underlying reason for the accreditation rating to determine whether the accreditation rating is related to the district's financial soundness. If the accreditation rating is related to the district's financial soundness, the district will not be eligible for consideration for the guarantee; or

(III) if the district's accreditation status is Not Accredited-Revoked, the district will not be eligible for consideration for the guarantee;

(iii) the district's compliance with statutes and rules of the TEA; and

(iv) the district's financial status and stability, regardless of the district's accreditation rating, including approval of the bonds by the Office of the Attorney General under the provisions of the TEC, §45.0031 and §45.005.

(B) The commissioner will grant or deny initial approval for the guarantee based on the review described in subparagraph (A) of this paragraph and will provide an applicant district whose application has received initial approval for the guarantee written notice of initial approval.

(4) Final approval. The provisions of this paragraph apply only as described in paragraph (2) of this subsection. A district must receive final approval before completing the sale of the bonds for which the district has received notification of initial approval.

(A) A district that has received initial approval must provide a written notice to the TEA two working days before issuing a preliminary official statement (POS) for the bonds that are eligible for the guarantee or two business days before soliciting investment offers, if the bonds will be privately placed without the use of a POS.

(i) The district must receive written confirmation from the TEA that the capacity continues to be available before proceeding with the public or private offer to sell bonds.

(ii) The TEA will provide this notification within one business day of receiving the notice of the POS or notice of other solicitation offers to sell the bonds.

(B) A district that received confirmation from the TEA in accordance with subparagraph (A) of this paragraph must provide written notice to the TEA of the placement of an agenda item on a meeting of the school board of trustees to approve the bond sale no later than two business days before the meeting. If the bond sale is completed pursuant to a delegation by the board to a pricing officer or committee, notice must be given to the TEA no later than two business days before the execution of a bond purchase agreement by such pricing officer or committee.

(i) The district must receive written confirmation from the TEA that the capacity continues to be available for the bond sale before the approval of the sale by the school board of trustees or by the pricing officer or committee.

(ii) The TEA will provide this notification within one business day before the date that the district expects to complete the sale by official action of the board or of a pricing officer or committee.

(C) The TEA will process requests for final approval from districts that have received initial approval on a first come, first served basis. Requests for final approval must be received before the expiration of the initial approval.

(D) A district may provide written notification as required by this paragraph by facsimile transmission or by electronic mail in a manner prescribed by the commissioner.

(f) Limitations on access to the guarantee.

(1) The following limitations apply to bonds for which the election authorizing the issuance of bonds was called after July 15, 2004.

(2) The commissioner will limit approval of the guarantee to a district that has, at the time of the application for the guarantee, less than the amount of annual debt service per ADA that represents the 90th percentile of annual debt service per ADA for all districts, as determined by the commissioner annually, or less than the amount of total debt service per ADA that represents the 90th percentile of total debt service per ADA for all districts, as determined by the commissioner annually. The limitation will not apply to school districts that have enrollment growth, as defined in subsection (b)(7) of this section, of at least 25%, based on PEIMS data on enrollment available at the time of application. The annual debt service amount is the amount defined by subsection (b)(1) of this section. The total debt service amount is the amount defined by subsection (b)(12) of this section.

(3) The eligibility of bonds to receive the guarantee is limited to those new money, refunding, and combination issues as defined in subsection (b)(9), (11), and (6), respectively, of this section.

(g) Financial exigency. A school district that declares a financial exigency must designate the fiscal year to which the exigency applies. A state of financial exigency expires at the end of that fiscal year unless renewed or may be terminated by action of the board of trustees at any time before the end of the fiscal year.

(1) Declaration for current fiscal year.

(A) Application for guarantee of new money issue. The commissioner will deny approval of an application for the guarantee of a new money issue if the applicant school district has declared a state of financial exigency for the district's current fiscal year. The denial of approval will be in effect for the duration of the applicable fiscal year unless the district can demonstrate financial stability.

(B) Approval granted before declaration. If in a given district's fiscal year the commissioner grants approval for the guarantee of a new money issue and the school district subsequently declares a state of financial exigency for that same fiscal year, the district must immediately notify the commissioner and may not offer the bonds for sale unless the commissioner determines that the district may proceed.

(C) Application for guarantee of refunding issue. The commissioner will consider an application for the guarantee of a refunding issue that meets all applicable requirements specified in this section even if the applicant school district has declared a state of financial exigency for the district's current fiscal year. In addition to fulfilling all applicable requirements specified in this section, the applicant school district must also describe, in its application, the reason financial exigency was declared and how the refunding issue will support the district's financial recovery plan.

(2) Declaration in a previous fiscal year. An applicant school district that declared a state of financial exigency in a previous district fiscal year but that has not declared such a state for the district's current fiscal year will not be considered to be in a state of financial exigency for the purposes of this section.

(h) Allocation of specific holdings. If necessary to successfully operate the BGP, the commissioner may allocate specific holdings of the PSF to specific bond issues guaranteed under this section. This allocation will not prejudice the right of the SBOE to dispose of the holdings according to law and requirements applicable to the fund; however, the SBOE will ensure that holdings of the PSF are available for a substitute allocation sufficient to meet the purposes of the initial allocation. This allocation will not affect any rights of the bond holders under law.

(i) Defeasance. The guarantee will be completely removed when bonds guaranteed by the BGP are defeased, and such a provision must be specifically stated in the bond resolution. If bonds guaranteed by the BGP are defeased, the district must notify the commissioner in writing within ten calendar days of the action.

(j) Bonds issued before August 15, 1993. For bonds issued before August 15, 1993, a school district seeking the guarantee of eligible bonds must certify that, on the date of issuance of any bond, no funds received by the district from the Available School Fund (ASF) are reasonably expected to be used directly or indirectly to pay the principal or interest on, or the tender or retirement price of, any bond of the political subdivision or to fund a reserve or placement fund for any such bond.

(k) Bonds guaranteed before December 1, 1993. For bonds guaranteed before December 1, 1993, if a school district cannot pay the maturing or matured principal or interest on a guaranteed bond, the commissioner will cause the amount needed to pay the principal or interest to be transferred to the district's paying agent solely from the PSF and not from the ASF. The commissioner also will direct the comptroller of public accounts to withhold the amount paid, plus interest, from the first state money payable to the district, excluding payments from the ASF.

(l) Bonds issued after August 15, 1993, and guaranteed on or after December 1, 1993. If a school district cannot pay the maturing or matured principal or interest on a guaranteed bond, the commissioner will cause the amount needed to pay the principal or interest to be transferred to the district's paying agent from the PSF. The commissioner also will direct the comptroller of public accounts to withhold the amount paid, plus interest, from the first state money payable to the district, regardless of source, including the ASF.

(m) Payments. For purposes of the provisions of the TEC, Chapter 45, Subchapter C, matured principal and interest payments are limited to amounts due on guaranteed bonds at scheduled maturity, at scheduled interest payment dates, and at dates when bonds are subject to mandatory redemption, including extraordinary mandatory redemption, in accordance with their terms. All such payment dates, including mandatory redemption dates, must be specified in the order or other document pursuant to which the bonds initially are issued. Without limiting the provisions of this subsection, payments attributable to an optional redemption or a right granted to a bondholder to demand payment upon a tender of such bonds in accordance with the terms of the bonds do not constitute matured principal and interest payments.

(n) Guarantee restrictions. The guarantee provided for eligible bonds in accordance with the provisions of the TEC, Chapter 45, Subchapter C, is restricted to matured bond principal and interest. The guarantee does not extend to any obligation of a district under any agreement with a third party relating to bonds that is defined or described in state law as a "bond enhancement agreement" or a "credit agreement," unless the right to payment of such third party is directly as a result of such third party being a bondholder.

(o) Notice of default. A school district that has determined that it is or will be unable to pay maturing or matured principal or interest on a guaranteed bond must immediately, but not later than the fifth business day before maturity date, notify the commissioner.

(p) Payment from PSF.

(1) Immediately after the commissioner receives the notice described in subsection (o) of this section, the commissioner will instruct the comptroller to transfer from the appropriate account in the PSF to the district's paying agent the amount necessary to pay the maturing or matured principal or interest.

(2) Immediately after receipt of the funds for payment of the principal or interest, the paying agent must pay the amount due and forward the canceled bond or coupon to the comptroller. The comptroller will hold the canceled bond or coupon on behalf of the PSF.

(3) Following full reimbursement to the PSF with interest, the comptroller will further cancel the bond or coupon and forward it to the school district for which payment was made. Interest will be charged at the rate determined under the Texas Government Code, §2251.025(b). Interest will accrue as specified in the Texas Government Code, §2251.025(a) and (c).

(q) Bonds not accelerated on default. If a school district fails to pay principal or interest on a guaranteed bond when it matures, other amounts not yet mature are not accelerated and do not become due by virtue of the school district's default.

(r) Reimbursement of PSF. If payment from the PSF is made on behalf of a school district, the school district must reimburse the amount of the payment, plus interest, in accordance with the requirements of the TEC, §45.061.

(s) Repeated failure to pay. If a total of two or more payments are made under the BGP or the credit enhancement program authorized under §61.1038 of this title on the bonds of a school district, the commissioner will take action in accordance with the provisions of the TEC, §45.062.

Statutory Authority: The provisions of this §33.65 issued under the Texas Education Code, §7.102(c)(33) and §45.063.

Source: The provisions of this §33.65 adopted to be effective September 1, 1996, 21 TexReg 3937; amended to be effective December 5, 2004, 29 TexReg 11340; amended to be effective December 25, 2005, 30 TexReg 8431; amended to be effective February 22, 2009, 34 TexReg 1050; amended to be effective July 4, 2010, 35 TexReg 5537.

Figure: 19 TAC §33.5(i)(2)

POTENTIAL CONFLICT OF INTEREST DISCLOSURE FORM
(State Board of Education and Persons Providing Services to the State Board of Education Relating to the Management and Investment of the Permanent School Fund)

TO: Commissioner of Education or
Chair, State Board of Education

FROM:

DATE:

Description of Facts Creating Potential Conflict of Interest:

Proposed Action to Avoid Conflict of Interest:

REVIEWED AND APPROVED: _____

Cc: Internal Auditor
General Counsel

Figure: 19 TAC §33.5(n)(2)(J)

REPORT OF EXPENDITURES OF PERSONS PROVIDING SERVICES TO THE STATE BOARD OF EDUCATION RELATING TO THE MANAGEMENT AND INVESTMENT OF THE PERMANENT SCHOOL FUND
January 1, _____ through December 31, _____

Individual making report _____

Signature _____

Employer _____

Position _____

Services Rendered to SBOE _____

Expenditure(s) over $50 occurred (Yes or No)? _____ (If yes, complete transaction details below.)

Transaction 1.

DATE _____

AMOUNT, if greater than $50.00 _____

NAME OF PERSON(S) (SBOE MEMBER, COMMISSIONER, EMPLOYEE)

_____

DETAILED DESCRIPTION OF EXPENDITURE _____

_____

_____

_____

Transaction 2.

DATE _____

AMOUNT, if greater than $50.00 _____

NAME OF PERSON(S) (SBOE MEMBER, COMMISSIONER, EMPLOYEE)

_____

DETAILED DESCRIPTION OF EXPENDITURE _____

_____

_____

_____

Transaction 3.

DATE _____

AMOUNT, if greater than $50.00 _____

NAME OF PERSON(S) (SBOE MEMBER, COMMISSIONER, EMPLOYEE)

_____

DETAILED DESCRIPTION OF EXPENDITURE _____

_____

_____

_____