

**ATTACHMENT II**  
**Text of Proposed Amendments to 19 TAC**

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

**Subchapter A. State Board of Education Rules**

**§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 ~~chapter~~ section, the following terms shall have the following meanings.
  - (1) SBOE Member, ~~for~~ for the purposes of the PSF code of ethics, means a member of the SBOE shall be deemed to include the SBOE Member or a person related to the member within the second degree of affinity or consanguinity.
  - (2) Person means any individual, corporation, firm, limited liability company, limited partnership, trust, association, or other legal entity.
  - (3) Investment manager or manager means a Person who manages and invests PSF assets and may be either an internal investment manager or an external investment manager.
  - (4) ~~(2)~~ PSF Service Providers [Persons Providing PSF Investment and Management Services to the SBOE (PSF Service Providers)] are the following Persons [individuals] :
    - (A) any Person who is an external investment manager, as described in §33.20(b)(1) of this title (relating to Responsible Parties and Their Duties), or who is [person] responsible by contract for providing legal advice regarding [managing the PSF, investing] the PSF, executing PSF brokerage transactions, or acting as a custodian of the PSF;
    - (B) any Person except the Texas Education Agency (TEA) or a member of the PSF staff who acts as the sponsor, general partner, managing member, manager, or adviser to an investment fund or other investment vehicle (which, by way of example but without limitation, may include a partnership, a limited liability company, trust, association, or other entity) in which the PSF is invested. Such Persons hereafter in this chapter referred to as Fund Managers;
    - (C) ~~(B)~~ a member of the Committee of Investment Advisors;
    - (D) ~~(C)~~ any Person [person] who is Investment Counsel as described in §33.20(b)(4) of this title or provides consultant services for compensation regarding the management and investment of the PSF;
    - (E) ~~(D)~~ any Person [person] who provides investment and management advice to an SBOE Member, with or without compensation, if an SBOE Member:
      - (i) gives the Person [person] access to PSF records or information that are identified as confidential; or

- (ii) asks the Person ~~[person]~~ to interview, meet with, or otherwise confer with a PSF Service Provider or TEA ~~[Texas Education Agency (TEA)]~~ staff;
  - (F) ~~(E)~~ any Person who is a 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]~~
  - (G) any Person who is a member of TEA legal staff who is responsible for providing legal advice regarding the investment or management of the PSF; or
  - (H) ~~(F)~~ any Person ~~[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.
- (5) Expenditure, for purposes of this section, means any expenditure other than an expenditure made on behalf of an employee acting in the scope of their employment.
- (6) For purposes of this chapter, Fund Managers are not considered to be external investment managers, consultants, or Investment Counsel.
- (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 laws applicable to them, which may include one or more of [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 ; State Agency Ethics Policy [for Public Servants] ), §552.352 (Distribution or Misuse of Confidential Information), §572.002 (General Definitions), §572.004 (Definition: Regulation), §572.054 (Representation by Former Officer or Employee of Regulatory Agency Restricted; Criminal Offense), §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 and [-] 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 (which, by way of example but without limitation, may include obligations of Fund Managers to other investors in commingled funds) . SBOE Members and PSF Service Providers shall avoid personal, employment, or business relationships that create conflicts of interest as defined in subsection (i)(1) of this section. Should an SBOE Member or a PSF Service Provider become aware of any conflict of interest involving himself or herself or another SBOE Member or PSF Service Provider, he or she has an affirmative duty to disclose the conflict to the SBOE chair and vice chair and the commissioner within seven days of discovering the conflict and, in the case of a conflict involving himself or herself, 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)(4)(E) [~~(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 member of PSF staff or TEA legal staff who is a PSF Service Provider [~~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 or to a member of the PSF staff or TEA legal staff 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 business, [personal or private] commercial, or other [business] relationships, including, but not limited to, personal and private 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, familial relationships, 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) (No change.)

- (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 a waiver is not granted by the SBOE or its delegate to an SBOE Member or a PSF Service Provider for [wishes to seek a waiver or determination of] a possible conflict of interest, the SBOE Member or PSF Service Provider may [shall] request an opinion from the Texas Ethics Commission as to a determination of whether a conflict of interest exists. 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 vice 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. In accordance with Texas Government Code, §572.058, the SBOE may not waive the prohibition under this paragraph. 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 fixed income securities, generally to institutional investors, with or without the use of brokers or underwriters, primarily offered to Qualified Institutional Buyers (QIBs) and not registered by the Securities and Exchange Commission. The term does not include offerings or sales of interests in investment funds or investment vehicles.
  - (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 investment manager , Investment Counsel, 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 investment manager , Investment Counsel, or consultant in connection with a PSF investment; and
    - (B) except as approved by the SBOE, not use a placement agent in connection with a PSF investment unless:
      - (i) the relationship of the PSF Service Provider with the placement agent , and any compensation , and a description of the services provided by the placement

agent in connection with a PSF investment are ~~is~~ disclosed in writing to PSF staff ~~and approved by the SBOE~~ ;

- (ii) the placement agent is registered with the Securities and Exchange Commission (SEC) or the Financial Industry Regulatory Authority (FINRA) or, if not required to register with the SEC or FINRA, is registered with an applicable regulatory body ; ~~and~~
- (iii) such placement agent does not share any fees with a non-registered person or entity ; and ~~;~~
- (iv) in executed closing documents for the PSF investment, the PSF Service Provider contractually represents and warrants that the information provided about the placement agent is true, correct, and complete in all material respects.

~~[(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.]~~

(6) ~~(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 for the period during which the placement agent provides services in connection with a PSF investment .

- (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 or assist with PSF investments. The SBOE has the authority and responsibility to hire other external professionals, including custodians , Investment Counsel, or consultants. The SBOE shall select each professional based on merit and cost 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 , checks, loans, direct deposit, or negotiable instruments.
    - (B) An SBOE Member may not accept a gift, favor, service, or benefit from a Person [~~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 ~~[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 gift, favor, service, or benefit from a Person ~~[person]~~ with whom the SBOE Member knows that civil or criminal litigation is pending or contemplated by the SBOE or the TEA.
- (E) Except as prohibited in subparagraphs (A)-(D) of this paragraph and [So long as the gift or benefit is not given by a person] subject to the requirements for PSF Service providers and lobbyists in subparagraph (F) of this paragraph, ~~[SBOE's or the TEA's regulation, inspection, or investigation,]~~ an SBOE Member may accept a gift, favor, service, or benefit ~~[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, but ~~[&]~~ may not be cash, checks, loans, or negotiable instruments ~~[&]~~ ;
  - (ii) item is given in the context of a ~~[independent]~~ relationship, such as kinship, or a personal, professional, or business relationship that is 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) In addition to the requirements of subparagraph (E) of this paragraph, the ~~[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. A gift, favor, service, or benefit from a PSF Service Provider or lobbyist will not be considered a violation of the prohibition set forth in subparagraph (C) of this paragraph.
  - (i) An SBOE Member may not accept the following from a PSF Service Provider or lobbyist, even if otherwise permitted under subparagraph (E) of this paragraph :
    - (I) loans, cash, checks, direct deposits, or negotiable instruments;
    - (II) transportation ~~[travel]~~ or lodging for a pleasure trip;
    - (III) transportation or ~~[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 if accepted as a guest and the PSF Service Provider or lobbyist is present ; or
    - (VI) individual awards and mementos worth more than \$250 each if from a lobbyist or worth \$50 or more each if from a PSF Service Provider .
  - (ii) An SBOE Member may accept food and beverages as a guest 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 January 31 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 ~~[person]~~ on behalf of:
- Figure: 19 TAC §33.5(n)(2)(J) ~~[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 January 31 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 ~~[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 ~~[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 January 31 and July 31, 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) To the extent applicable to them, 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 involving ~~[between]~~ PSF Service Providers ~~[and/or consultants]~~ .
- (1) A PSF Service Provider other than a PSF executing broker [~~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 a Person who is an SBOE Member, Investment Counsel, [another PSF Service Provider or a person who acts as] a consultant to the SBOE or to an SBOE Member, or a member of the PSF staff or TEA legal staff who is responsible for managing or investing assets of the PSF or providing investment or management advice or legal advice regarding the investment or ~~[and]~~ management of the PSF.
  - (2) A PSF Service Provider other than a PSF executing broker [~~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 a Person who is an SBOE Member, Investment Counsel, [another PSF Service Provider or a person who acts as] a consultant to the SBOE or an SBOE Member, or a member of the PSF staff or TEA legal staff who is responsible for managing or investing assets of the PSF or providing investment or management advice or legal advice regarding the investment or ~~[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.

### **§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 total return ~~[yield]~~ consistent with the preservation and safety of principal.
    - (C) To the extent possible, the PSF management ~~[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 acceptable in the context of the overall goals and objectives for the investment of the PSF assets ~~[minimal]~~. The primary means of achieving such a risk profile are:
    - (A) a broad diversification among asset classes that ~~[as nearly as possible,]~~ react as independently as possible ~~[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 indices ~~[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 rate of return objective of the total PSF ~~[domestic equity]~~ fund shall be to earn, over time, an average annual total rate of return that meets or exceeds the rate of return of a composite benchmark index, consisting of [that of a] representative benchmark indices for the asset classes in which the PSF is invested that are aggregated in proportion to the actual asset allocation of the PSF for the relevant time period, while maintaining an acceptable risk level compared to that of the composite ~~[index, combining dividends and capital appreciation, while maintaining an acceptable risk level compared to that of the representative]~~ benchmark index.
  - (6) The rate of return objective of each asset class in which the PSF is invested, other than the short-term cash ~~[the international equity]~~ fund, shall be to earn, over time, an average annual average ~~[total]~~ rate of return that meets or exceeds that of a representative [international] benchmark index for such asset class in U.S. dollars, combining dividends, ~~[and]~~ capital appreciation, income, and

interest income, as applicable, 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 risk parity 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.]~~

(7) ~~[(13)]~~ 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.

(8) ~~[(14)]~~ Notwithstanding the risk parameters specified in paragraphs (4)-(6) ~~[(4)-(13)]~~ 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 guideline percentages will include both a target percentage and an acceptable strategic range for each asset class, recognizing that 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) emerging market equities;
  - (D) [~~(C)~~] domestic fixed income;
  - (E) emerging market debt local currency;
  - (F) [~~(D)~~] real estate;
  - (G) [~~(E)~~] private equity;
  - (H) [~~(F)~~] absolute return;
  - (I) [~~(G)~~] real return;
  - (J) [~~(H)~~] risk parity; and
  - (K) [~~(I)~~] cash ; and [ ]
  - (L) other asset classes as approved by the SBOE.
- (4) To the extent practicable, investments [~~Investments~~] shall not exceed the strategic ranges the SBOE establishes for each asset class , recognizing the inability to actively reduce allocations to certain asset classes .
- (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.

### **§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 instructional materials 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 contract with [~~employ~~] any of the following parties, whose duties and responsibilities are as follows.
  - (1) An external investment manager is a Person [~~person, firm, corporation, financial company, or insurance company~~] the SBOE retains by contract to manage and invest a portion of the PSF assets under specified guidelines.
  - (2) A custodian is an organization, normally a financial company, the SBOE retains to safe keep [~~safekeep~~] , and provide accurate and timely reports of, PSF assets.
  - (3) A consultant is a Person [~~person or firm~~] the SBOE retains to advise the SBOE on PSF matters based on professional expertise.
  - (4) Investment Counsel [~~counsel or consultant~~] is a Person [~~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. Investment Counsel may be assigned such tasks as ~~[is responsible for]~~ asset allocation reviews, manager searches, spending policy recommendations and research related to the management of PSF ~~[the fund's]~~ assets.

- (5) A performance measurement consultant is a Person ~~[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 Texas Education Agency (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 all investment transactions pertaining to the purchase, sale, or reinvestment of assets by all internal and external investment 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, Investment Counsel, financial or other consultants, or other external professionals retained ~~[employed]~~ to help the SBOE invest ~~[the]~~ PSF assets ;
  - (5) approving the selection of, and the performance measurement contract with, a well-recognized and reputable firm retained ~~[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 , including investing and managing assets and contracting in connection therewith, 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.

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

- (a) Permissible investments. Any investment that satisfies the prudence standard, is consistent with the Fund's investment policy and portfolio objectives, and is used in executing investment strategies approved by the State Board of Education (SBOE).
  - ~~[(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, real estate related debt, and real estate related funds. 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) Risk parity is an investment strategy that creates a portfolio in which various asset class groups contribute equally to the overall risk of the portfolio as measured by the standard deviation of returns.]~~

~~[(8) 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.]~~

~~[(9) 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.]~~

~~[(10) 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. Except as provided in subsection (a) of this section or as approved or delegated by the SBOE [Unless the SBOE gives its written approval] , the following prohibited transactions and restrictions apply to [for] all Texas Permanent School Fund (PSF) investment [PSF] managers with respect to the investment or handling of PSF assets, except as otherwise noted :

- (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 by ~~[money, or]~~ pledging or otherwise encumbering PSF assets;
- (7) purchasing the equity or debt securities of the PSF investment [portfolio] manager's own 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 investment manager's total portfolio market value with the PSF ;
- (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 publicly traded fixed income security not rated investment grade by Standard & Poor's (BBB-), Moody's (Baa3), or Fitch (BBB-), subject to the provisions of the PSF Investment Procedures Manual and the following restrictions:
  - (A) when ratings are provided by the three rating agencies, the middle rating shall be used;
  - (B) when ratings are provided by two ratings agencies, the lower rating is used; or



- (C) when a rating is provided by one rating agency, the sole rating is used;
  - (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. Each manager's portfolio should be appropriately diversified within its applicable asset class. [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 and investment managers retained for alternative asset investments may have a varying degree of discretionary authority, which will be outlined in [~~the respective management~~] contract documentation .
- (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.

### **§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 Texas Permanent School Fund (PSF) [fund] , for each asset class in which the assets [equity fund, the fixed income fund, and the cash fund] of the PSF are invested [Texas Permanent School Fund (PSF)] , and for 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.

**§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 94 ~~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 94 ~~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 94 ~~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-) issued by banks with at least \$25 billion in assets and, for floating rate bank obligations with a maturity greater than 397 days, a long-term rating of AA2 and AA by Moody's Investor Service and Standard & Poor's Corporation at time of purchase ; and, for fixed rate or floating rate bank obligations with a remaining maturity of 397 days or less, ~~with~~ a short-term rating of "Tier 1" as defined in clause (ii)(IV) of this subparagraph or, for such bank obligations without a short-term rating, an issuer rating of Tier 1 ~~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 94 [~~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 reset [~~reset~~] period of 94 [~~90~~] days and use a standard repricing index such as LIBOR, Federal Funds, Treasury Bills, or commercial paper;
  - (-d-) for floating rate corporate obligations with a maturity greater than 397 days, a long-term rating of AA2 and AA by Moody's Investor Service and Standard & Poor's Corporation at time of purchase ; and, for fixed rate or floating rate corporate obligations with a remaining maturity of 397 days or less, a [~~issuers or guarantor's~~] short-term rating of [~~obligations must be rated~~] "Tier 1" as defined in clause (ii)(IV) of this subparagraph or, for such corporate obligations without a short-term rating, an issuer rating of Tier 1 [~~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.

**§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. Upon request [~~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.





# Texas Permanent School Fund

19 TAC §33.5 (n)(2)(J)

## Annual Expenditures Report

### Report of Expenditures of Persons Providing Services to the State Board of Education Relating to the Management and Investment of the Permanent School Fund

Report for the Period  
 January 1 - December 31, 20\_\_\_\_ -  
 Due Date: January 31, 20\_\_\_\_ -

A PSF Service Provider shall file a report **annually on January 31** 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:

- (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.

Name of Individual Making Report:

Title:

Employer:

Services Rendered to TEA:

Did Expenditures over \$50 Occur (If Yes, complete transaction details below )

	Date	Amount	Name (SBOE Member, Commissioner, Employee)	Detailed Description of Expenditure
<input style="width: 50px; height: 15px;" type="button" value="Add Row"/> <input style="width: 50px; height: 15px;" type="button" value="Delete Row"/>		\$		

By typing my name in the box below, I certify that the content of this report is true and accurate.

Signature

Date