

**SUBJECT:** Allowing TRS to invest up to 10 percent of its portfolio in hedge funds

**COMMITTEE:** Pensions, Investments, and Financial Services — favorable, without amendment

**VOTE:** 9 ayes — Truitt, Anchia, C. Anderson, Creighton, Hernandez Luna, Legler, Nash, Orr, Veasey  
0 nays

**WITNESSES:** For — Tim Lee, Texas Retired Teachers Association; (*Registered, but did not testify:* John Fleming, Texas Mortgage Bankers)  
Against — None  
On — Ronnie Jung, Teacher Retirement System of Texas; Ted Melina Raab, Texas American Federation of Teachers

**BACKGROUND:** Government Code, sec. 825.3012 regulates the investment of Teacher Retirement System (TRS) assets in hedge funds. Under current statute, no more than 5 percent of the TRS portfolio may be invested in hedge funds.

**DIGEST:** HB 738 would raise the cap on the percentage of the TRS investment portfolio that could be invested in hedge funds from 5 percent to 10 percent.  
The bill would take immediate effect if it finally passed by a two-thirds record vote of the membership of each house. Otherwise, it would take effect September 1, 2011.

**SUPPORTERS SAY:** HB 738 would give TRS the flexibility and discretion to invest more of the TRS portfolio in hedge funds if such investment would benefit the portfolio. Although some hedge funds have had a bad reputation, they actually are a valuable way to reduce portfolio risk when used properly. In fact, the TRS investments in hedge funds have been outperforming those invested in equity funds and have lessened the impact of the national market crash on TRS assets. Increasing the hedge fund cap would help TRS meet its target return goals, reduce fund volatility, and protect against potential future market downturns.

TRS carefully balances its investment portfolio, with hedge funds constituting just a portion of a diverse set of instruments, to ensure steady, long-term growth of the assets. TRS investment managers are compensated based on performance of their investments, which incentivizes their responsible management of the assets. The State Auditor's Office recently concluded that the TRS hedge fund portfolio is managed with apparent due professional care. Given its trustworthy stewardship, granting TRS additional authority to invest in hedge funds, as HB 738 would do, is prudent and valuable to the TRS membership.

OPPONENTS  
SAY:

HB 738 would increase the exposure of TRS members' retirement savings to risk. Hedge funds are a relatively new and unknown tool for investment for public pension funds, so the cap should not be raised at this time.

OTHER  
OPPONENTS  
SAY:

Regardless of whether the cap is raised, HB 738 should contain a provision requiring TRS to annually report to the Legislature specifically on its hedge fund investments. Although TRS has demonstrated strong investment management prowess, legislative oversight would nonetheless be sensible and would provide reassurance to concerned TRS members that their elected representatives were monitoring the use of these sometimes controversial investment instruments.

NOTES:

The companion bill, SB 1666 by Duncan, was considered in a public hearing by the Senate State Affairs Committee on May 2 and left pending.