BILL ANALYSIS

H.B. 1948
By: Elkins
Investments & Financial Services
Committee Report (Unamended)

BACKGROUND AND PURPOSE

Interested parties contend that authorizing the operators of perpetual care cemeteries to use the total return method to manage certain trusts that provide for the general care and maintenance of such cemeteries offers the operators the ability to extract enough income from the trusts to provide for the cemetery while at the same time generating higher portfolio growth. H.B. 1948 seeks to create a consistent, predictable distribution approach to assist in cemetery planning and to help prevent inflation from eroding the future value of such trusts by providing for such total return management method.

CRIMINAL JUSTICE IMPACT

It is the committee's opinion that this bill does not expressly create a criminal offense, increase the punishment for an existing criminal offense or category of offenses, or change the eligibility of a person for community supervision, parole, or mandatory supervision.

RULEMAKING AUTHORITY

It is the committee's opinion that rulemaking authority is expressly granted to the Finance Commission of Texas in SECTION 1 of this bill.

ANALYSIS

H.B. 1948 amends the Health and Safety Code to require the trustee of a perpetual care trust fund established for a perpetual care cemetery to use the net income method, defined by the bill as the calculation of permissible annual distributions by the trustee as equal to the annual net income of the fund, to determine permissible distributions from the fund to the corporation that established the fund. The bill authorizes a corporation on concurrence of the corporation's trustee to modify the terms of the trust instrument governing the fund to require the trustee to use the total return method, defined by the bill as the calculation of permissible annual distributions by the trustee as equal to the average fair market value of the assets in the fund multiplied by the total return percentage, in determining permissible distributions to the corporation. The bill requires the corporation, in order to convert a net income fund to a total return fund, to submit specified written documentation to the banking commissioner of Texas in support of the conversion at least 60 days before the effective date of the conversion, which must be the first day of the fund's next fiscal year.

H.B. 1948 authorizes a corporation that converts the corporation's fund to a total return fund to elect to reconvert the fund to a net income fund and modify the terms of the trust instrument governing the fund to require the trustee to calculate permissible distributions under the net income method. The bill requires the corporation, in order to reconvert a total return fund to a net income fund, to submit specified written documentation to the commissioner in support of the reconversion before the proposed effective date of the reconversion. The bill requires the trustee of a net income fund or a total return fund to make distributions to the corporation, annually or in more frequent installments agreed to by the trustee and the corporation, to be used by the corporation in the manner required by state law.

H.B. 1948 requires the trustee of a total return fund, or of a net income fund seeking to convert to a total return fund, to determine for the corporation, in the trustee's sole discretion and in accordance with the bill's provisions, the average fair market value of the fund at the beginning of each fiscal year. The bill requires the trustee to derive the fund's average fair market value at least annually and sets out provisions relating to the manner in which that value is determined. The bill requires the trustee of a total return fund, before the 31st day after the beginning of each fiscal year, to send written notice to the commissioner and to the corporation of the trustee's determination of the fund's current fair market value as of the beginning of the current fiscal year and the fund's average fair market value for determining permissible distributions for the fiscal year, with identification and explanation of any asset excluded from the determination. The bill requires a trustee who alters the methodology of determining fair market value in a manner that changes the fund's fair market value during a fiscal year to send written notice to the commissioner and to the corporation of the revised current and average fair market value of the fund and the reason for the revision before the first distribution is made based on the revised average fair market value. The bill's provisions relating to the determination of fair market value expressly do not alter or otherwise affect a fiduciary duty under other law to evaluate and monitor the fair market value of assets held in trust.

H.B. 1948 requires the trustee, in the exercise of the trustee's sole discretion and in a manner consistent with the prudent investor rule, to select the total return percentage to be used in determining permissible distributions from a total return trust at least annually, in an amount that represents a reasonable current return from the fund in light of the investment policy currently applicable to the fund, provided that the total return percentage does not exceed five percent. The bill requires the trustee of a total return fund, before the 31st day after the beginning of each fiscal year, to send written notice to the commissioner and to the corporation of the trustee's determination of the total return percentage to be applied in the fiscal year. The bill requires a trustee who alters the total return percentage during a fiscal year to send written notice to the commissioner and to the corporation of the revised total return percentage and the reason for the revision before the first distribution is made based on the new total return percentage.

H.B. 1948 authorizes the commissioner, by order and after notice and an opportunity for hearing, to convert a total return fund to a net income fund, limit or prohibit distributions from the fund, or both, if the fund's current fair market value at the beginning of a fiscal year is less than the fund's original principal, consisting of the sum of all required deposits into the fund; if the fund's average fair market value declines by 10 percent or more over a two-year period; or if the trustee or other fiduciary of the fund responsible for investment policy has demonstrated a lack of sufficient knowledge and expertise or has failed to ensure that an investment policy is in place to support the use of the total return method of calculating distributions in a manner consistent with achieving the fund's charitable purposes. The bill authorizes the commissioner to decline to impose such corrective measures if the commissioner finds that the cause of the adverse trend in the fund's fair market value is due to one or more unusual or temporary factors not within the control of the corporation or trustee of the corporation's fund and could not have been reasonably anticipated; the fund's current written investment policy, in light of anticipated distributions from the fund, is reasonably designed to protect the fund from further declines in fair market value; and the exception appears to be both necessary and appropriate for the fund's continued protection and perpetual existence.

H.B. 1948 establishes that a distribution from a total return fund is considered a distribution of all income of the fund that reasonably apportions the total return of the fund and prohibits a total return fund distribution from being considered a fundamental departure from applicable state law. The bill requires the trustee of a total return fund to treat a distribution as first being made from the following sources in order of priority unless the trust instrument provides otherwise: from net accounting income, from ordinary accounting income not allocable to net accounting income, from net realized short-term capital gains, from net realized long-term capital gains, and from the fund's principal. The bill authorizes the Finance Commission of Texas to adopt rules to implement and clarify the bill's provisions regarding distributions from perpetual care trust funds.

H.B. 1948 replaces references to fund income in statutory provisions relating to the use of such money with references to fund distributions and prohibits the use of a perpetual care trust fund's assets to pay court costs and attorney's fees awarded in a suit by plot owners to maintain a perpetual care cemetery. The bill replaces maintenance of separate records of principal and income with maintenance of separate records of fund assets as a condition on the establishment of a common trust fund by the trustors of two or more perpetual care trust funds.

H.B. 1948 establishes that the assets of a trust established to hold a gift of property in order to apply the principal, proceeds, or income of the property for any purpose consistent with the purpose of a corporation's perpetual care cemetery are not considered assets of the perpetual care trust fund and adds the condition that the purpose for which the property's principal, proceeds, or income is applied is consistent with the terms of the trust. The bill authorizes a trust that holds a gift specifically intended to serve the same general purpose as a perpetual care trust fund to be merged with the fund.

EFFECTIVE DATE

September 1, 2017.