SUBJECT: Allowing UT System regents to delegate investment authority

COMMITTEE: Higher Education — committee substitute recommended

VOTE: 7 ayes — Rangel, Ogden, Gallego, Harris, Kamel, Reyna, Rodriguez.

0 nays

2 absent — Goolsby, Moreno

WITNESSES: For — None

Against — None

On — Thomas O. Hicks, The University of Texas Board of Regents; Thomas Ricks, Jerry E. Turner and Dr. William Cunningham, The University of Texas System.

DIGEST: CSHB 1877 would amend the Education Code to allow the board of regents of The University of Texas System to contract with a nonprofit corporation to invest funds under board control, including the Permanent University fund, and to delegate other board powers or duties to a committee, officer, employee or other agent.

The board of regents alternately could delegate investment authority and contract for PUF investments to the same extent as allowed for institutional funds under Property Code Chapter 163 of the Property Code, Texas Uniform Management of Institutional Funds Act.

Investment contracts would have to be approved by the board or by rules of the board relating to contracting authority. The nonprofit corporation would be prohibited from any business other than investing funds designated by the board under the contract.

The board would approve the corporation's articles of incorporation and any amendments and bylaws, and corporation investment policies, including any changes, and would establish an audit and ethics committee and code.

The board would have authority to appoint and remove members of a nine-member board of directors. At least one member would be selected from a list of candidates with substantial background and expertise in investments submitted by the board of regents of the Texas A&M University System.

If an investment contract for the PUF were established, the board would be responsible for an annual financial audit of the PUF by the auditors of The University of Texas System and the Texas A&M University System. The corporation would be required to file quarterly reports with the board and would be subject to the Texas Non-Profit Corporation Act (VACS art.1396-1.01). The board would be required to retain an independent accounting firm to perform a financial audit of the PUF before the initial contract.

The corporation would be prohibited from entering into an agreement or transaction with any of the following: a director, officer or corporation employee acting an official capacity; business entity in which a director, officer or employee of the corporation has an interest; any former director, officer or corporation employee for two years. Any agreement or transaction that violated these rules would be considered void.

A person would be considered to have an interest in a business entity if any of the following applied: the person owns 5 percent or more of the voting stock or shares of the business entity; 5 percent or more of the fair market value of the business entity; or money received from business entity exceeded 5 percent of the person's gross income of the preceding year.

If any provision is determined to be invalid, other provisions of the bill are not necessarily effected and are regarded as severable.

The bill would take effect immediately if approved by two-thirds of the membership of each house.

SUPPORTERS SAY:

CSHB 1877 would help the University of Texas Board of Regents meet the investment challenges of the 1990s and beyond. The UT board manages both the $7.5 billion Permanent University Fund (PUF), the endowment that supports component institutions in both the UT and Texas A&M systems, and the UT system's investment assets. The UT system is relying more and more on private support and on endowment resources for funding, and these important funding sources depend heavily on the board's management. CSHB 1877 would help the board maximize investment return while providing necessary safeguards to ensure the investments are safe.

Investment challenges for the UT board will continue as traditional security markets probably will not give the high returns of past years, competition in a more complex investment environment will increase and full-time oversight of investment portfolios will be required. Today investment management is characterized by globalization, worldwide communications, sophisticated computer modeling, etc., causing integration of world financial markets and a proliferation of unique and complex securities. The UT system needs professionals who have highly sophisticated investment expertise and the necessary time to devote on investment decisions.

In 1993, when the Legislature amended the Property Code to allow public and private colleges and universities to delegate investment powers, the PUF is not explicitly included. CSHB 1877 would amend the Education Code to clarify that the UT boards's ability to delegate its investment authority and establish important safeguards. The Attorney General's Office concluded in April 1995 that Texas Constitution Art. 7, sec. 11b, confers sufficiently broad authority to allow the UT board to delegate investment authority to a nonprofit corporation to act on behalf of the board in investments.

The board needs authority to revise the organization of its investment management activities to create more cost-efficient and cost-effective procedures and benefit from investment professionals' expertise. Increasing the board's authority to carry out its fiduciary responsibility over the Permanent University Fund (PUF) and private endowment funds would result in more private-sector support for the UT system.

According to Cambridge Associates, a nationally recognized endowment consulting firm, the UT system has several weaknesses regarding its long-term investment programs: board members' limited investment experience and a lack of institutional memory due to board turnover; an overly long decision-making process, and lack of focus on investment policy and performance. The consulting firm suggested that the system try to attract and retain high-caliber investment professionals, establish a focused professional money management environment, streamline decision-making and eliminate bureaucratic obstacles.

Leading universities with multibillion-dollar endowments — Harvard, Stanford, Princeton and Duke — have established structures that emphasize independent operations and delegation of authority to maximize the probability of investment success. These universities allow delegation of investment decisions to an external department or a wholly owned and regent-controlled federally tax exempt affiliate subject to policy constraints and hybrid boards consisting of both regents/trustees and outside investment professionals. Investment management is recognized as a separate and distinct process that requires specialized and technical training, wide experience and focused attention.

CSHB 1877 would allow the UT board to establish oversight and organizational structures similar to universities like Harvard. These safeguards would avoid recent oversight failures like those involving Odessa College and Orange County, California, for example, and allow the board to optimize investment returns on all funds under its responsibility.

HB 1877 includes the PUF in the definition of institutional funds in the bill so that the board would not have to maintain two separate decision-making processes in managing the PUF and privately raised endowments.

Directors of the nonprofit corporation would be required to disclose any conflict of interest regarding a proposed investment or selection of a vendor; would not be able to participate in discussion of an investment or vendor selection involving conflict of interest; and would be prohibited from voting on any issue involving a conflict of interest.

OPPONENTS SAY: No apparent opposition

NOTES: The committee substitute made numerous technical and clarifying changes to the bill as filed.