HOUSE RESEARCH ORGANIZATION bill analysis | 5/24/2009 | SB 2567 Duncan (Pitts)

SUBJECT: State fiscal matters, including federal stimulus, UTMB, Pension Review

COMMITTEE: Appropriations — favorable, without amendment

VOTE: 20 ayes — Pitts, Raymond, Aycock, F. Brown, Button, Chavez, Creighton, Crownover, Darby, Dukes, Edwards, Giddings, Herrero, Hochberg, Isett, McClendon, D. Miller, Morrison, Otto, Villarreal

0 nays

7 absent — Cohen, Driver, Eiland, Flores, S. King, Riddle, Zerwas

SENATE VOTE: On final passage, May 13 — 31-0

WITNESSES: No public hearing

DIGEST: SB 2567 would amend several provisions in the Education Code and Government Code relating to state fiscal matters, including authorizing the University of Texas System board of regents to issue bonds for the University of Texas Medical Branch at Galveston, establishing a fund for federal stimulus money, and expanding the oversight authority of the Pension Review Board to include the investment strategies of public retirement systems, the Permanent University Fund, and the Permanent School Fund.

Establishing fund for federal stimulus money. The bill would create the American Recovery and Reinvestment Act (ARRA) Fund in the state treasury outside the General Revenue Fund. State agencies that received Recovery Act funds would deposit the funds into the ARRA fund as the comptroller determined necessary. Additional money could be deposited into the ARRA fund as provided. Money deposited into the ARRA fund could be used only for the purposes identified in the Recovery Act.

Agencies would transfer funds between the ARRA fund and other accounts as the comptroller determined necessary. The comptroller could issue guidelines to state agencies for implementing provisions governing the ARRA fund. Interest accrued would be retained in the fund.

Bonds for the University of Texas Medical Branch at Galveston. SB 2567 would authorize the board of regents of the University of Texas System to issue $150 million in tuition revenue bonds for The University of Texas Medical Branch at Galveston for any purpose reasonably necessary to assist in the recovery from damage or other impact caused by Hurricane Ike. This authority would include the irrevocable pledging of revenue for the payment for the bonds; the transfer of funds, subject to the Legislative Budget Board approval, from other institutions within the University of Texas System; and necessary actions in the acquisition of real property and the construction or reconstruction of improvements.

In determining whether to approve a transfer of state funds for the purpose of reimbursing the board of regents for all or part of the debt service on the bonds, the LBB would consider whether the commissioner's court of the county where the medical branch is located (Galveston) has entered into an agreement with the board under which the county agreed to reimburse the board for all or part of any otherwise unreimbursed costs incurred by the medical branch to provide health care services to county residents whose income level was not more than 100 percent of the federal poverty level, or whether Galveston County or a hospital district that includes the county imposes an ad valorem tax for health purposes. The county of residence of an individual would be determined in the manner as allowed by current law.

Changes to the Pension Review Board. The bill would rename the Pension Review Board the Pension and Investment Review Board (PIRB), revise the composition of its board of directors, and expand its oversight authority.

Expanded oversight of the Pension Review Board. SB 2567 would add the following duties to the PIRB regarding public retirement systems, public funds of the comptroller, and the nonprofit corporations managing the Permanent University Fund and Permanent School Fund:

- conduct a continuing review of their investment practices;
- conduct intensive studies of potential or existing problems that threaten or inhibit their financial condition or actuarial soundness; and
- review and document whether the PIRB believes that the entities are investing funds in compliance with the entity's investment strategy and applicable law governing their investments.

PIRB would have oversight of the investment strategies of public funds by the:

- comptroller;
- Employees Retirement System of Texas, including a retirement system administered by that system;
- Teacher Retirement System of Texas;
- Texas Municipal Retirement System;
- Texas County and District Retirement System; and
- Texas Emergency Services Retirement System.

Additionally, PIRB would have oversight of the investment strategies of:

- the Permanent University Fund by the University of Texas System board of regents or any entity acting on their behalf, including an authorized nonprofit corporation; and
- the Permanent School Fund by the State Board of Education or any entity acting on its behalf.

A contract with an investment manager or other person to provide services to an entity subject to these provisions relating to the management and investment of public funds for or on behalf of the entity would be subject to review by PIRB regarding the fees charged and paid by the entity and the services rendered to the entity in consideration for the fees.

Reporting requirements. An entity subject to these provisions would, within six months after the last day of the fiscal year under which the entity operated or, if a public retirement system, the 12-month accounting period under which the entity operated, file with PIRB and post on its website information that PIRB determined was necessary to perform its duties, unless the information was confidential under law.

An entity subject to these provisions would have to:

- develop and adopt a written investment strategy; and
- file a copy of the strategy or change in the strategy with PIRB within 90 days of adopting the strategy or change.

PIRB could require a public retirement system with total assets of at least $100 million to conduct an actuarial experience study every five years. These reports could be combined with any other required report.

The presiding officer or governing body of an entity subject to these provisions would be responsible for ensuring that a report or a response to a request for information made by PIRB for the purpose of performing its duties was filed timely with the board. A presiding officer consistently not submitting a required report in timely manner would have to provide grounds for removal by the appropriate appointing officer. PIRB would notify the appropriate appointing officer, if any, the governor, if the governor was not the appropriate appointing officer, and the Legislative Budget Board of its determination.

If an investment manager or a person covered by these provisions had a relationship to an entity that a reasonable person would find likely to materially diminish the person's independence of judgment in the performance of the person's responsibilities with respect to the management or investment of an entity's public funds, that person would have to immediately disclose the relationship in writing to the entity. Intentionally not doing so would be grounds for removal. Those with a potential conflict of interest would file a statement with the entity each year stating that they were aware that they were required to disclose material conflicts of interest.

Amending the PIRB board of directors. The bill would reduce the current number of Pension Review Board members from nine to seven and revise the board's composition. The bill would reduce the number of governor appointees to the PIRB from seven to five and revise the appointees by the speaker of the House and the lieutenant governor.

The governor would appoint five board members, with the advice and consent of the Senate, including three persons with experience in the fields of securities investment, pension administration, pension law, institutional investment, investment risk management, or institutional audits but who were not members or retirees of a public retirement system. The bill would remove the current provision that an appointee be experienced in the field of governmental finance and provide that one appointee be a contributing member of a public retirement system or receiving retirement benefits from a public retirement system, instead of having representation from both active and retired members as required under current law.

Instead of having the lieutenant governor and the speaker of the House appoint a member from their respective bodies, the bill would require each of them to appoint a board member who had experience in the field of securities investment, pension administration, pension law, institutional investment, investment risk management, or institutional audits.

Prohibitions and penalties for PIRB-related entities. Members of boards of covered entities or high-level employees could not accept items totaling more than $250 in a year, including food, entertainment, and gifts from another person seeking to do business with the entities. In addition, former members of covered entities' governing bodies could not be hired for investment or management work for the entities for two years after leaving the entities.

A person who committed fraud, theft, embezzlement, fraudulent conversion, unlawful appropriation, or misapplication of property in relation to service provided to a covered entity would be liable for a civil penalty of up to $250,000 for each offense. The PIRB or the attorney general could investigate suspected wrongdoing and conflicts of interest and, if they determined that a criminal offense could have occurred, would refer the case to the appropriate law enforcement agency for prosecution.

UTIMCO board of directors. SB 2567 would amend ch. 66 of the Education Code, relating to the board of directors of the nonprofit University of Texas Investment Management Company (UTIMCO), which has delegated authority to invest funds under the control and management of the University of Texas System Board of Regents, including the Permanent University Fund.

The bill would amend provisions regarding the composition of UTIMCO's board of directors. It would require that three UT board members — rather than at least three, plus the chancellor as under current law — be appointed to the UTIMCO board. This would be in addition to four other directors with substantial background and expertise in investments who were not:

- members of the board of regents or employees of the University of Texas System or the Texas A&M University System;
- employees of a component institution in the University of Texas System or the Texas A&M University System; or
- employees or contractors of UTIMCO.

In addition, the UT board would appoint two members to the UTIMCO board submitted by the board of regents of the Texas A&M University

System, instead of the current provision that the UT board select one or more of the UTIMCO board from a list of candidates with substantial background and expertise in investments that is submitted by the Texas A&M System.

UTIMCO would provide to the Legislative Budget Board (LBB) and the governor written notice of the terms of any payment to or agreement to pay a director, officer, or employee of UTIMCO a bonus, reward, or other incentive payment based on the performance of the director, officer, or employee, including the performance of an investment made or recommended by the director, officer, or employee. The notice would have to be provided to the LBB and the governor within seven days after the earlier of the date the UT board made the payment or entered into the agreement. If notice of an agreement were provided within seven days after the board entered into the agreement, the UT board would not be required to provide notice after payments were made under the agreement.

Other provisions. The bill would add that the state auditor could conduct audits of special water authorities, as specified in the audit plan of the state. By January 1, 2011, the state auditor would prepare a written report on its comprehensive financial audit, including an audit of the operations and performance of the Brazos River Authority and the Lower Colorado River Authority.

The bill also would amend sec. 661.062 of the Government Code to provide that a state employee who resigned, was dismissed, or separated from state employment by a state agency, other than an institution of higher education, was entitled to be paid for the accrued balance of vacation time if that person was not reemployed by the state in a position under which the employee accrued leave for one calendar month, rather than during a 30-day period as under current law.

This bill would take immediate effect if finally passed by a two-thirds record vote of the membership of each house. Otherwise, it would take effect August 31, 2009, the 91st after the last day of the legislative session.

SUPPORTERS SAY:

SB 2567 would make several critical amendments in the Education Code and the Government Code relating to state fiscal matters. The changes would include authorizing the University of Texas System board of regents to issue bonds for the University of Texas Medical Branch at Galveston and expanding the oversight authority of the Pension Review

Board to include the investment strategies of public retirement systems, the Permanent University Fund, and the Permanent School Fund.

Bonds for the University of Texas Medical Branch at Galveston. SB 2567 would be crucial in helping to meet the recovery needs of UTMB, which was devastated by Hurricane Ike last fall. Damages suffered by UTMB in Galveston were significant, estimated to be around $1 billion. University officials report that 59 percent of the annual budget was derived from patient care operations, a revenue stream that has been reduced significantly due to damage at the hospital and outpatient clinics.

The tuition revenue bonds (TRBs) would fund a hospital tower on Galveston Island to enable UTMB to restore its trauma and indigent care capacity. This second building is needed because the existing hospital suffered extensive flooding on the first two floors. FEMA requires that all repairs and construction be done according to current standards that would avoid future damage, so patient care will not be located on the first two floors. The existing hospital will have only about a 200- to 250-patient bed capacity, compared to the 500-bed capacity that existed before Hurricane Ike. The second building will allow the hospital to be restored to full capacity for both indigent care and trauma care.

The $150 million from TRBs authorized by the bill would be used to match $200 million from the Sealy Smith Foundation to build the building. Although a consulting firm had recommended moving all the patient beds from Galveston to the mainland, the community and the University of Texas System board of regents unanimously support a plan to renovate and mitigate the island-based facilities. The consultant’s report did not take into account that some of the FEMA money might not be available if UTMB medical operations were moved inland.

Rebuilding on Galveston would maintain the proximity and economies of scale with the rest of UTMB’s campus. The Sealy Smith Foundation, which contributes $20-$30 million a year to UTMB, has pledged $75 million for capital renovations and construction if the hospital is maintained on the Galveston campus.

Expanded oversight of the Pension Review Board. The bill would expand the oversight authority of the Pension Review Board and would rename it the Pension and Investment Review Board (PIRB). According to the Pension Review Board, Texas has 387 government-sponsored, public retirement systems with assets totaling about $190 billion, serving 2.3 million active and retired members. These include large pension funds such as those managed by the Employees Retirement System (ERS) and Teacher Retirement System (TRS), but they mostly include smaller municipal retirement systems that are controlled locally. The attorney general since June 2007 has called for more oversight of these pension funds, both state and local. According to the attorney general, 80 of the largest funds had $20 billion in unfunded liabilities.

No coherent state strategy and very little effective state oversight of Texas public pension and investment funds currently exists. As these funds belong to the people of Texas to provide necessary financial support to our public educational institutions and to secure the financial futures of individuals who dedicate their careers to public service, they demand a more disciplined approach to oversight.

SB 2567 would provide that rigorous oversight by requiring the PIRB to provide guidance on actuarial standards, monitor investment strategies of public pension funds and endowments, and review contracts providing fees charged by investment managers. In addition, the bill would increase transparency of the management of these investments by providing measures that would reduce conflicts of interest and reduce the influence of a person seeking to do business with an entity who managed public funds. Especially in light of the recent diminished value of public pension funds and endowments, the oversight measures included in SB 2567 would enhance the state's ability to manage and protect these critical financial assets.

OPPONENTS SAY:

Bonds for the University of Texas Medical Branch at Galveston. An independent outside consulting firm hired by the UT board of regents found that an inland location would be the best hope for securing the financial future of UTMB and recommended moving patient-care enterprises from Galveston to the mainland. The recommendation said an inland location made more sense because of the closer proximity to the more heavily populated outskirts of Houston, which has a greater proportion of patients with commercial and governmental insurance, and would help support operational costs of UTMB's health care system.

Expanded oversight of the Pension Review Board. While there is nothing wrong with wanting to increase the standards under which public pension funds and endowments operate, the methods that SB 2567 would employ to achieve greater accountability are unnecessary and, with respect to the Permanent University Fund, potentially unconstitutional.

Texas Constitution, Art. 7, sec. 11(b) provides the University of Texas Board of Regents exclusive authority to manage the Permanent University Fund (PUF). The Legislature has no authority to infringe of the board's sole and exclusive right to manage the PUF and, as such, the PUF should not be included in the bill. Under constitutional provisions for the state retirement system outlined in Texas Constitution, Art. 16, sec. 67, ERS and TRS cannot claim this exclusive right.

While heightened standards in the bill would be helpful, individual pension funds could easily make these changes on their own, without state oversight. The Pension Review Board was established to monitor state pensions, not investments. It has no expertise in this area and, even in hiring additional new staff at a cost of $1.6 million in the next biennium, it is questionable whether they would do a better job of overseeing the funds than those entities that have fiduciary responsibility to do so. In addition, it is questionable why the Texas County and District Retirement System and Texas Municipal Retirement System should be included under state oversight as they receive no state funding.

OTHER OPPONENTS SAY:

Bonds for the University of Texas Medical Branch at Galveston. Financing capital projects for public higher education institutions presents a challenge. TRBs are popular because they allow lawmakers to support more projects by paying only a small portion of the cost and leaving the remaining financial commitments for future legislatures and taxpayers. Because of limited state resources, there should be greater cost-sharing between the state and the institutions that issue the bonds.

Expanded oversight of the Pension Review Board. While the bill would add important oversight measures and tighten conflict-of-interest provisions for the state's largest pension funds, these same rules would not be extended to the nearly 400 local pension funds across the state. Municipalities large and small could benefit from the good government provisions that SB 2567 would offer.

NOTES:

The Legislative Budget Board estimates that the bill would cost the state roughly $24 million in fiscal 2010-2011 and approximately $14 million annually thereafter in debt service for the UTMB bonds and for the additional cost to the Pension and Investment Review Board to hire 11 new staff.