

SUBJECT: Changing restrictions on the investment of certain public funds

COMMITTEE: Investments and Financial Services — committee substitute recommended

VOTE: 6 ayes — Parker, Stephenson, Burrows, Dean, Holland, Longoria
0 nays
1 absent — E. Johnson

WITNESSES: For — Jay Propes, Fidelity Investments; Greg Warner, First Southwest, Hilltop Securities; (*Registered, but did not testify:* Jack Roberts, Bank of America; Kari Torres, CPS Energy; Brandon Aghamalian, Denton Municipal Electric; Dale Laine, Federated Investors; Tom Oney, Lower Colorado River Authority)

Against — (*Registered, but did not testify:* Dolores Ortega Carter, County Treasurers of Texas)

On — Stephen Scurlock, Independent Bankers Association of Texas; Michael Clayton, State Auditor's Office; (*Registered, but did not testify:* Piper Montemayor, Comptroller of Public Accounts; Hillary Eckford, State Auditor's Office)

BACKGROUND: The Public Funds Investment Act (Government Code, ch. 2256) governs the investment of funds held by state agencies, local governments, nonprofits acting on behalf of local governments or state agencies, and investment pools acting on behalf of multiple entities already covered by the act.

DIGEST: CSHB 1003 would change certain requirements relating to the investments in which a public entity covered by the Public Funds Investment Act (PFIA) could invest.

The bill would allow an entity to invest in interest-bearing banking deposits that were guaranteed or insured by the Federal Deposit Insurance

Corporation or the National Credit Union Share Insurance Fund.

CSHB 1003 would change the requirements that apply to market funds in which public entities could invest. It would require any money market fund to comply with SEC rule 2a-7, instead of requiring the funds to both have a weighted average maturity of no more than 90 days and aim to have a stable net asset value of \$1 per share.

Alternatively, a position in a money market fund either would be required to have a duration of one year or more and be invested only in obligations approved by the PFIA or to have a duration of less than one year and be limited to investment grade securities, excluding asset-backed securities. These provisions would replace current law requiring the fund to be continuously rated AAA by at least one nationally recognized investment rating firm and to conform to certain requirements relating to investment pools.

CSHB 1003 would require eligible investment pools to provide to the public entity the pool's policy on holding deposits in cash. Instead of being required to receive a AAA rating from at least one nationally recognized service, the pool would be required to be rated no lower than the highest liquidity rating given to U.S. Treasury obligations.

While current law requires eligible investment pools to sell assets if the price-to-book ratio varies by more than half a percent, CSHB 1003 would require this action to be taken only if it did not result in any dilution or unfair result to existing participants.

The bill would allow certain public entities and all state agencies to engage in certain hedging transactions, as long as the transactions complied with federal regulations and did not have a term length longer than five years.

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 September 1, 2017, and would only apply to investments made on

or after that date.

SUPPORTERS
SAY:

CSHB 1003 would fix a variety of problems relating to restrictions on public investments, many caused by recent changes in federal regulation.

Net asset value (NAV). Currently, the Public Funds Investment Act (PFIA) prohibits investment in certain money market funds that do not attempt to keep a static \$1 NAV. However, SEC rule 2a-7, adopted in 2014, requires prime money market funds, which primarily invest in corporate debt securities, to have a floating NAV. This means that the PFIA now unintentionally prohibits investment in prime money market funds, which CSHB 1003 would resolve. These investments have been allowed in the past, and there is no reason to continue the unintentional prohibition now.

Ratings. The bill would address a possible situation in which U.S. Treasury bonds were downgraded. The PFIA requires eligible money market funds and investment pools to be rated AAA. However, it is possible for Treasury bonds to be downgraded, and without AAA-rated Treasury bonds, investment pools and money market funds would not be able to keep a AAA rating. By requiring funds and investment pools instead to have the highest liquidity rating given to Treasury obligations, the bill would ensure that PFIA did not unintentionally prohibit investments by public entities in common and low-risk money management tools.

Sales required by price-to-book threshold. CSHB 1003 also would allow investment pools flexibility to make the best decisions for their participants. Current law obligates the governing body to sell assets to maintain a price-to-book ratio of around 1.000, but this can result in losses to principal, even if the change in the price-to-book ratio is clearly temporary. The bill would give investment pools this flexibility only as necessary to reduce possible dilution or unfairness to existing participants.

Hedging transactions. The bill would give some entities much-needed authority to enter into hedging transactions. Current law allows municipal

utilities to enter into these types of contracts, and this bill would give some state agencies that same ability, reducing the impact of price volatility and improving their ability to anticipate costs. The bill would limit this authority to large entities such as state agencies and large municipalities, which would be expected to have the knowledge to properly evaluate these transactions.

OPPONENTS
SAY:

CSHB 1003 could allow entities to unknowingly increase the risk to their fiscal stability. The Legislature should be mindful of the ability of each entity to evaluate the financial instruments in which the PFIA allows investments.

Net asset value. NAV is an important metric used by investment officers of public entities to judge the quality of money market funds and limit the risk involved. The Legislature does not need to remove this limitation and allow investments in prime money market funds.

Sales required by price-to-book threshold. Under CSHB 1003, investment pools could allow deviations greater than one-half of one percent of the price-to-book ratio. While current law could cause losses to principal, the requirement exists so that those losses are limited. Allowing larger deviations could increase the risk to public entities.

Hedging. The bill could allow some entities to enter into agreements they did not understand. Many entities do not have the expertise to evaluate sophisticated financial agreements, and they unintentionally could violate bond covenants or other restrictions.