HOUSE
RESEARCH
ORGANIZATION bill analysis 4/24/2019

HB 2706 (2nd reading)
Capriglione, Lambert
(CSHB 2706 by Stephenson)

SUBJECT: Expanding authorized investments for governmental entities

COMMITTEE: Pensions, Investments and Financial Services — committee substitute recommended

VOTE: 11 ayes — Murphy, Vo, Capriglione, Flynn, Gervin-Hawkins, Gutierrez, Lambert, Leach, Longoria, Stephenson, Wu

0 nays

WITNESSES: For — Bill Mastrodicasa, Lone Star Investment Pool (*Registered, but did not testify*: Adam Haynes, Conference of Urban Counties; Russell Schaffner, Tarrant County; Barry Haenisch, Texas Association of Community Schools; Dominic Giarratani, Texas Association of School Boards; Mark Terry, Texas Elementary Principals and Supervisors Association)

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

BACKGROUND: Government Code ch. 2256, also known as the Public Funds Investment Act, authorizes local governments, state agencies, and nonprofit corporations and investment pools acting on their behalf to participate in certain investment activities.

Sec. 2256.011 authorizes local governments, state agencies, and certain entities acting on their behalf to invest in a fully authorized collateralized repurchase agreement under certain conditions. Such an agreement must be secured by a combination of cash and obligations of the federal government.

Under sec. 2256.013, governmental entities may invest in commercial paper if the paper has a stated maturity of 270 days or fewer from the date of its issuance and meets certain credit rating requirements.

Sec. 2256.016(f) requires that a public funds investment pool that uses amortized cost or fair value accounting must mark its portfolio to market daily and, to the extent possible, stabilize at a $1.00 net asset value in order to be statutorily eligible to receive funds from and invest on behalf of a governmental entity. If the portfolio's value falls outside of a narrow range of value, the governing body of the public funds investment pool is required to take action to eliminate or reduce any dilution or unfair result to existing participants, to the extent reasonably practicable.

Sec. 2256.0204 authorizes independent school districts with an average daily attendance of at least 50,000 students to invest in certain corporate bonds with a minimum AA- rating.

DIGEST:

CSHB 2706 would expand the authority of entities governed by the Public Funds Investment Act (PFIA) to purchase, sell, and invest public funds, including allowing investment in certain repurchase agreements and commercial paper, and authorizing school districts to invest in corporate bonds. The bill also would bring investment officers of a local government that was investing bond proceeds under the authority of the PFIA.

Authorized investments. The bill would authorize all school districts, regardless of size, to invest in corporate bonds rated AA- or higher.

Under CSHB 2706, government entities would be authorized to invest public funds in repurchase agreements secured by commercial paper and corporate bonds. The bill also would expand the authorization to invest in commercial paper to include commercial paper with a stated maturity of 365 days or fewer from the date of issuance.

The bill would amend the calculation of yield for an authorized investment through an eligible investment pool to apply only to a pool for which a $1.00 net asset value was maintained. The eligibility standards to receive funds from and invest funds on behalf of an entity under PFIA would be changed so that a public funds investment pool that used amortized cost or fair value accounting would have to mark its portfolio to market daily, and if an investment pool used amortized cost:

- the investment pool would have to stabilize at $1.00 net asset value, to the extent reasonably possible;
- the governing body of the investment fund would have to take action as determined necessary to eliminate or reduce any dilution or unfair result to existing participants if the ratio of the market value of the portfolio divided by the book value was less than 0.995 or greater than 1.005; and
- the investment pool would have to report yield to its investors in accordance with federal regulation.

Under CSHB 2706, corporate bonds would be an eligible investment for a public funds investment pool.

Bond proceeds. The bill would allow an investment officer of a local government to invest bond proceeds or pledged revenue only to the extent permitted by the PFIA, in accordance with statutory provisions governing the debt issuance or the agreement, as applicable, and the local government's investment policy regarding the debt issuance or the agreement, as applicable. "Pledged revenue" would mean money pledged to the payment of or as security for bonds or other indebtedness issued by a local government; obligations under a lease, installment sale, or other agreement of a local government; or certificates or participation in such debts or obligations.

The bill would take effect September 1, 2019.

SUPPORTERS SAY:

CSHB 2706 would make appropriate updates to the Public Funds Investment Act (PFIA) to respond to changes in the investment landscape and allow local governments and other entities to make investments that would generate the higher returns without a meaningful increase in risk.

Expanding authorized repurchase agreements to include those secured by commercial paper and corporate bonds would be appropriate and consistent with existing investment regulation. Governmental entities are already allowed to invest in commercial paper and corporate bonds, and if

Texas governments can purchase certain securities directly, then those securities should be considered sufficiently credit worthy to serve as collateral for a repurchase agreement.

CSHB 2706 would extend the allowable maturity date for commercial paper investments to one year. This would present opportunities for local governments to see greater returns from investments in commercial paper with dates of maturity that were greater than the current limit of 270 days. The bill also would allow investment pools to invest in corporate bonds, which would be an appropriate extension of current authorizations. Investment pools are managed by trained and certified investment professionals, and under the bill, districts that invested in the pools would benefit from the higher yields of corporate bonds.

Adequate safeguards currently exist to protect less sophisticated investment advisers. Small school districts would be unlikely to invest in corporate bonds because certain monitoring and governance requirements would be cost prohibitive.

OPPONENTS SAY:

CSHB 2706 would undermine the purpose of the PFIA by emphasizing yield over the preservation and safety of principal. The bill could open new space for bad actors and less sophisticated investors to mismanage public funds. Many public investors have many other responsibilities and may lack the training needed to take on greater financial risks.

By allowing investment in repurchase agreements collateralized with commercial paper or corporate bonds, CSHB 2706 would allow an entity to purchase such repurchase agreements even if the public entity had not authorized such direct investments in their policy adopted by their governing boards. This would be an inappropriate and unnecessary expansion of the entity's invest authority.

The bill would allow all school districts to invest in corporate bonds rated AA- or higher. However, AA- rated bonds are not a low-risk investment, and smaller school districts do not have the staff resources to complete the credit analysis needed to buy such securities and monitor them through their life span. Less sophisticated investors of public funds, and the taxpayers they represent, warrant and deserve the protections currently afforded by the PFIA, including the prevention of school districts from investing in AA- corporate bonds.