TEXAS PUBLIC FUNDS INVESTMENT ACT – 85TH LEGISLATIVE SESSION UPDATE

Several bills affecting the Texas Public Funds Investment Act (PFIA) were proposed during the recently concluded 85th Texas Legislative Session. A few of these bills passed and will make significant changes to the PFIA. We have provided below a list of these bills and their status as well as a brief summary of each. The hyperlinks will take you to the Texas Legislature Online website where you can find additional details on each bill.

BILLS THAT PASSED

HB 1003 – Passed in House and Senate, signed by Governor June 14, 2017, takes effect immediately. Makes a number of housekeeping updates and other revisions to the PFIA. We have summarized some of the more important ones here, but have not included all of the changes:

- Modifies Section 2256.004(a)(3), raising the required level of endowments that would exempt institutions of higher education from $95 million on May 1, 1995 to $150 million on September 1, 2017.
- Modifies Section 2256.009(a), clarifying that interest bearing bank deposits insured by the FDIC or the National Credit Union Share Insurance Fund are authorized investments. The same language is also included in HB 2647.
- Modifies Section 2256.014(a), removing the 90-day weighted average maturity limit and the $1 NAV requirement for money market mutual funds. The PFIA will instead require money market funds to comply with SEC Rule 2a-7. The result will be that prime money market funds will once again be authorized investments. Investors should bear in mind that these prime funds now come with a floating NAV as well as potential liquidity fees and redemption gates.
- Modifies Section 2256.014(b), adding language that authorizes so-called ultra-short bond funds that have a duration of less than one year and whose investments are limited to investment grade securities, excluding asset-backed securities. The exclusion of asset-backed securities was an intentional measure designed to reduce the risk of price volatility in these funds. While bond funds were authorized previously, their portfolios were limited to securities authorized in other sections of the PFIA, a restriction that effectively eliminated most of them. In the wake of money market reform, several of the large fund companies have created ultra-short bond funds as an alternative to prime money market funds. Subject to several restrictions, many of these will now be authorized investments under PFIA.
- Includes a number of tweaks to Section 2256.016, related to the reporting, accounting, and disclosure requirements for local government investment pools. HB 1003 decouples the pools from money market funds in light of the SEC money market reforms by removing any references to money market funds in Section 2256.016. The revision recognizes both amortized cost and fair value accounting methods as valid for eligible investment pools and also requires pools to disclose their policy for holding deposits in cash. The bill also directs a pool's governing body to take appropriate action if the net asset value of the portfolio falls outside of the prescribed range of 0.995 to 1.005.
- Adds Section 2256.0206, which specifically authorizes certain entities (generally those with at least $250 million of outstanding debt) to enter into hedging agreements in order to "protect against economic loss due to price fluctuation of a commodity or related investment…" Eligible entities would be allowed to lock in costs for fuel, energy, construction expenses and the like. To illustrate the basic idea, consider a large school district and their bus fleet or electricity costs. The hedging language would allow that district to lock in their costs for fuel or electricity in future periods, hedging against price fluctuations and thereby providing budget certainty, avoiding situations like what occurred during 2008 and 2014 when oil prices spiked dramatically higher.

HB 1238 – Passed in House and Senate, signed by Governor June 15, 2017, takes effect September 1, 2017. HB 1238 revises the investment training requirements in Section 2256.008 and further confuses these requirements by creating another carve out, this one for housing authorities created under Chapter 392. Investment officers of these housing authorities will still need to obtain 10 hours of investment training within the first twelve months of assuming duties. In every subsequent two year period, they will need just five hours, unless they invest only in interest-bearing deposits or CD's in which case they will be exempted from the subsequent training provisions.

HB 1701 – Passed in House and Senate, signed by the Governor, takes effect September 1, 2017. This bill makes significant revisions to the policy certification requirements found in Section 2256.005 (k) and (l). Currently, any person offering to engage in an investment transaction must be provided a copy of the entity's investment policy and must sign a certification that acknowledges they have received it and have implemented procedures to preclude imprudent transactions. HB 1701 changes "person" to "business organization" and narrowly defines business organization as either an investment pool or an investment management firm under contract to manage the entity's portfolio with discretionary authority. Very few investment management contracts for public funds grant such discretion, meaning investment pools will generally be the only organizations still required to sign this certification. This bill has all but killed the *legal* requirement for the policy certification.

Public entities *may* wish to revise their investment policy as it seems likely that brokers, absolved of this legal requirement, may no longer be willing to sign those certifications. In our view, public entities should still provide their investment policy to their brokers, who in fact should be asking for it. Among other things, FINRA's "Know Your Customer" rules, largely established by the suitability requirements of FINRA Rule 2111, require that brokers, "have a reasonable basis to believe that a recommendation is suitable for a particular customer based on that customer's investment profile." Providing the broker with your investment policy should very clearly describe your investment profile, particularly with regard to the primary objective of safety of principal.

HB 2647 – Passed in House and Senate, signed by Governor June 15, 2017, takes effect immediately. HB 2647 modifies Section 2256.009(a), clarifying that interest bearing bank deposits insured by the FDIC or National Credit Union Share Insurance Fund are authorized investments. In addition, HB 2647 lays out specific language authorizing the shared deposit programs in a manner very similar to that already in the PFIA for shared certificates of deposit.

HB 2928 – Passed in House and Senate, signed by Governor June 15, 2017, takes effect September 1, 2017. HB 2928 makes two minor revisions. The first, to Section 2256.009(a) specifically includes obligations of the Federal Home Loan Banks as authorized investments. This solves a potential problem created by the Attorney General's opinion # KP-0128 which questioned whether the FHLB would be considered a U.S. agency or instrumentality for purposes of the PFIA. HB 2928 also modifies Section 2256.010(a) by adding a reference to Chapter 2257 (the Public Funds Collateral Act) in the section that describes the means for securing a certificate of deposit. This will clarify that certificates of deposit can be secured by an FHLB letter of credit.

BILLS THAT FAILED

HB 2648 – This bill did not make it out of committee, but much of the same language is included in HB 2928 which did pass (see above). HB 2648 would have specifically included obligations of the Federal Home Loan Banks as authorized investments.

HB 3082 – This bill did not make it out of committee and was not passed. HB 3082 would have revised the investment training requirements found in Section 2256.008. The initial 10 hours required within the first 12 months of taking office or assuming duties would remain. Subsequently, county treasurers would be required to attend 10 hours of training every two years while any other investment officer's training requirement would have been reduced to five hours every two years. With this bill failing, the requirement for most investment officers

remains at 10 hours within the first twelve months. Thereafter, the training requirement varies depending on the entity; with counties needing ten hours, school districts and other municipalities needing eight, and, thanks to HB 1238, five hours for housing authorities.

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