

By: Gallego

H.B. No. 1135

A BILL TO BE ENTITLED

AN ACT

relating to the investment and management of the permanent school fund.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF TEXAS:

ARTICLE 1. PERMANENT SCHOOL FUND ADVISORY COMMITTEE

SECTION 1.01. Subchapter D, Chapter 7, Education Code, is amended by adding Section 7.113 to read as follows:

Sec. 7.113. CONTRACT WITH STATE AUDITOR FOR INVESTIGATIONS. (a) In this section, "investigation" has the meaning assigned by Section 321.0136, Government Code.

(b) The board shall enter into a written contract with the state auditor under Chapter 771, Government Code, for the state auditor to investigate any allegation made in writing to the board raising the issue of misfeasance or malfeasance relating to the management or investment of the permanent school fund, including an allegation relating to:

(1) the board's compliance with the investment standards prescribed under Section 5(d), Article VII, Texas Constitution;

(2) any violation of the ethics policy adopted by the board under Section 43.0031;

(3) any violation of Section 43.0032;

(4) any conflict of interest that affects the board's decisions relating to:

- 1 (A) consultant and money manager selection;
2 (B) asset allocation; and
3 (C) broker-dealer eligibility requirements; and
4 (5) the effect of an informal advisor on the board's
5 decisions relating to management or investment of the permanent
6 school fund.

7 SECTION 1.02. Chapter 43, Education Code, is amended by
8 adding Sections 43.0011 and 43.0012 to read as follows:

9 Sec. 43.0011. DEFINITION. In this chapter, "interested
10 person" means a person who applies for or receives anything of value
11 as a direct or indirect result of permanent school fund
12 investments.

13 Sec. 43.0012. PERMANENT SCHOOL FUND INVESTMENT ADVISORY
14 COMMITTEE. (a) The permanent school fund investment advisory
15 committee shall advise the State Board of Education regarding
16 management and investment of the permanent school fund.

17 (b) The committee is composed of:

18 (1) three members appointed by the governor, who are
19 not subject to confirmation by the senate;

20 (2) three members appointed by the lieutenant
21 governor; and

22 (3) three members appointed by the speaker of the
23 house of representatives.

24 (c) A member of the committee serves at the will of the
25 member's appointing authority.

26 (d) A person appointed to the committee must possess
27 substantial experience and expertise in investments, as determined

1 by the appointing authority.

2 (e) The committee shall select a presiding officer from
3 among its members and shall meet at the call of the presiding
4 officer.

5 (f) A member of the committee may not receive compensation
6 but is entitled to reimbursement for travel expenses incurred by
7 the member while conducting the business of the committee as
8 provided by the General Appropriations Act.

9 (g) The committee is not subject to Chapter 2110, Government
10 Code.

11 SECTION 1.03. Section 43.0031(b), Education Code, is
12 amended to read as follows:

13 (b) The ethics policy must include provisions applicable
14 to:

15 (1) members of the State Board of Education;

16 (2) members of the permanent school fund investment
17 advisory committee;

18 (3) the commissioner;

19 (4) [~~(3)~~] employees of the agency; [~~and~~]

20 (5) [~~(4)~~] any person who provides services to the
21 board relating to the management or investment of the permanent
22 school fund; and

23 (6) an interested person.

24 SECTION 1.04. Section 43.0032, Education Code, is amended
25 by amending Subsections (a) and (c) and adding Subsection (a-1) to
26 read as follows:

27 (a) This section applies to:

- 1 (1) ~~[A]~~ member of the State Board of Education;
- 2 (2) a member of the permanent school fund investment
- 3 advisory committee;
- 4 (3) ~~[T]~~ the commissioner;
- 5 (4) ~~[T]~~ an employee of the agency;
- 6 (5) ~~[T or]~~ a person who provides services to the board
- 7 that relate to the management or investment of the permanent school
- 8 fund; and
- 9 (6) an interested person.

10 (a-1) A person to whom this section applies who has a

11 business, commercial, or other relationship that a reasonable

12 person would find likely ~~[could reasonably be expected]~~ to diminish

13 the person's independence of judgment in the performance of the

14 person's responsibilities relating to the management or investment

15 of the fund shall disclose the relationship in writing to the board.

16 (c) A person who files a statement under Subsection

17 (a-1) ~~[(a)]~~ disclosing a possible conflict of interest may not

18 give advice or make decisions about a matter affected by the

19 possible conflict of interest unless the board, after consultation

20 with the general counsel of the agency, expressly waives this

21 prohibition. The board may delegate the authority to waive the

22 prohibition established by this subsection.

23 SECTION 1.05. Section 43.0033, Education Code, is amended

24 to read as follows:

25 Sec. 43.0033. REPORTS OF EXPENDITURES. A consultant,

26 advisor, broker, money manager, investment manager, dealer, or

27 other person providing services to the State Board of Education

1 relating to the management and investment of the permanent school
2 fund shall file with the board regularly, as determined by the
3 board, a report that describes in detail any expenditure of more
4 than \$50 made by the person on behalf of:

- 5 (1) a member of the board;
- 6 (2) a member of the permanent school fund investment
7 advisory committee;
- 8 (3) the commissioner; [~~or~~]
- 9 (4) [~~(3)~~] an employee of the agency or of a nonprofit
10 corporation created under Section 43.006; or
- 11 (5) an interested person.

12 SECTION 1.06. Chapter 43, Education Code, is amended by
13 adding Sections 43.0035, 43.0036, 43.0051, and 43.0052 to read as
14 follows:

15 Sec. 43.0035. FAILURE TO DISCLOSE POTENTIAL CONFLICT OF
16 INTEREST RELATING TO MANAGEMENT OR INVESTMENT OF PERMANENT SCHOOL
17 FUND. If an interested person enters into an arrangement involving
18 the management or investment of the permanent school fund under
19 which the interested person serves as a consultant, advisor,
20 broker, money manager, investment manager, dealer, or vendor of a
21 consultant, advisor, broker, money manager, investment manager, or
22 dealer and the interested person fails to disclose a relationship
23 described by Section 43.0032(a-1) with another interested person:

24 (1) the arrangement is voidable by the State Board of
25 Education or the comptroller; and

26 (2) the State Board of Education or the comptroller
27 may enter an order declaring the person ineligible to contract for

1 business relating to management or investment of the permanent
2 school fund.

3 Sec. 43.0036. INFORMATION REGARDING PERSONS INTERESTED IN
4 INVESTMENTS OF PERMANENT SCHOOL FUND. (a) The State Board of
5 Education shall maintain on an Internet website a listing of each
6 interested person. The list must include the person's full name and
7 business address and must be updated at least once each calendar
8 quarter.

9 (b) The State Board of Education may use an Internet website
10 established and maintained by the agency to comply with this
11 section.

12 Sec. 43.0051. REQUIRED CONTRACT PROVISION. The State
13 Board of Education shall include as a part of each contract under
14 which a consultant, advisor, broker, money manager, investment
15 manager, dealer, or other person agrees to provide services to the
16 board relating to the management or investment of the permanent
17 school fund a standard provision adopted by the board:

18 (1) requiring the person to comply with all applicable
19 statutes and rules relating to the services provided by the person
20 to the board; and

21 (2) acknowledging that the board may terminate the
22 contract or any other arrangement between the board and the person
23 if the person fails to comply with those statutes and rules.

24 Sec. 43.0052. COOPERATION RELATING TO INVESTIGATION OR
25 DISCIPLINARY ACTIONS OF CERTAIN PERSONS INTERESTED IN MANAGEMENT OR
26 INVESTMENT OF PERMANENT SCHOOL FUND. (a) As appropriate, the
27 comptroller shall provide information relating to disciplinary

1 actions taken by the State Board of Education or the comptroller
2 against a consultant, advisor, broker, money manager, investment
3 manager, or dealer doing business with or seeking to do business
4 with the permanent school fund to:

5 (1) the United States Securities and Exchange
6 Commission;

7 (2) the securities commissioner;

8 (3) self-regulatory organizations, including the
9 National Association of Securities Dealers, Inc. (NASD); and

10 (4) professional organizations of persons involved in
11 management or investment of institutional funds, including the
12 Association for Investment Management and Research.

13 (b) The comptroller shall closely cooperate with persons
14 described by Subsections (a)(1)-(4) in those persons'
15 investigations involving consultants, brokers, or dealers doing
16 business with or seeking to do business with the permanent school
17 fund.

18 SECTION 1.07. Section 43.006(f), Education Code, is amended
19 to read as follows:

20 (f) The corporation shall file [~~quarterly~~] reports with the
21 State Board of Education concerning matters required by the board.
22 The board may determine the frequency of reports under this
23 subsection.

24 SECTION 1.08. Chapter 43, Education Code, is amended by
25 adding Sections 43.0061, 43.0062, and 43.0063 to read as follows:

26 Sec. 43.0061. BARRING CERTAIN PERSONS FROM CONTRACTING TO
27 PROVIDE SERVICES RELATING TO MANAGEMENT OR INVESTMENT OF PERMANENT

1 SCHOOL FUND. (a) An interested person may be barred from
2 contracting with the State Board of Education or another interested
3 person to provide services relating to the management or investment
4 of the permanent school fund if it is determined at a contested case
5 hearing held under Section 43.0062 that the interested person who
6 is the subject of the hearing has violated:

7 (1) the ethics policy adopted by the board under
8 Section 43.0031; or

9 (2) the conflict of interest restrictions under
10 Section 43.0032.

11 (b) This section does not affect the validity of a contract
12 entered into before a determination is made that the interested
13 person should be barred from contracting with the State Board of
14 Education or another interested person unless the contract may be
15 voided under this chapter.

16 Sec. 43.0062. HEARINGS BY STATE OFFICE OF ADMINISTRATIVE
17 HEARINGS. (a) The commissioner, on behalf of the State Board of
18 Education, and the chief administrative law judge of the State
19 Office of Administrative Hearings shall adopt a memorandum of
20 understanding under which the State Office of Administrative
21 Hearings conducts the contested case hearings required for purposes
22 of Section 43.0061.

23 (b) The memorandum of understanding must require the chief
24 administrative law judge and the State Board of Education to
25 cooperate in connection with a contested case hearing required for
26 purposes of Section 43.0061.

27 (c) The memorandum of understanding must provide that the

1 administrative law judge who conducts a contested case hearing for
2 the State Office of Administrative Hearings on behalf of the State
3 Board of Education, after completing the hearing, shall:

4 (1) determine whether a ground exists under Section
5 43.0061(a) so that an interested person should be barred from
6 contracting with the State Board of Education or another interested
7 person to provide services relating to the management or investment
8 of the permanent school fund; and

9 (2) if a determination is made that the interested
10 person should be barred from contracting with the board or another
11 interested person, notwithstanding Section 2003.042, Government
12 Code, enter the final decision in the case concerning the period for
13 which the person is barred based on:

14 (A) whether the person has previously violated
15 the ethics policy or conflict of interest restrictions;

16 (B) the seriousness of the person's violation;
17 and

18 (C) the damage to the interests of the permanent
19 school fund.

20 (d) A person may obtain judicial review of a decision of an
21 administrative law judge under this section in the manner provided
22 by Subchapter G, Chapter 2001, Government Code.

23 Sec. 43.0063. MANAGEMENT AND PERFORMANCE AUDIT. (a) As
24 frequently as the legislative audit committee determines necessary
25 or advisable, the committee shall select an independent firm with
26 substantial experience in evaluating institutional investment
27 practices and performance to evaluate investment management

1 practices and performance relating to the permanent school fund.

2 (b) The legislative audit committee shall determine
3 specific areas to be evaluated.

4 (c) A firm selected under this section shall file a report
5 of the firm's evaluation under this section with the legislative
6 audit committee not later than the date specified by the committee.

7 (d) The agency shall pay the costs of each evaluation under
8 this section out of the available school fund.

9 SECTION 1.09. Section 43.007, Education Code, is amended to
10 read as follows:

11 Sec. 43.007. PURCHASE AND SALE OR EXCHANGE OF INVESTMENTS
12 [~~SECURITIES~~]. (a) The State Board of Education may authorize the
13 purchase of all investments [~~of the types of securities~~] in which it
14 is authorized by law to invest the permanent school fund [~~in either~~
15 ~~registered or negotiable form~~]. The board may authorize the
16 reissue of those investments [~~securities~~] held at any time for the
17 account of the permanent school fund [~~in either registered or~~
18 ~~negotiable form~~]. The State Board of Education may authorize the
19 sale of any investments [~~of the securities~~] held for the account of
20 the permanent school fund and reinvest the proceeds of sale for the
21 fund and may authorize the exchange of any investments [~~of the~~
22 ~~securities~~] held for the account of the permanent school fund.

23 (b) In making purchases, sales, exchanges, and reissues,
24 the State Board of Education shall exercise the standard of care
25 prescribed by Section 5(d), Article VII, Texas Constitution
26 [~~judgment and care under the circumstances then prevailing that~~
27 ~~persons of ordinary prudence, discretion, and intelligence~~

1 ~~exercise in the management of their own affairs not in regard to~~
2 ~~speculation but in regard to the permanent disposition of their~~
3 ~~funds, considering the probable income as well as the probable~~
4 ~~safety of their capital].~~

5 (c) When any investments [~~securities~~] are sold, reissued,
6 or exchanged as provided by Subsection (a), the custodian of the
7 investments [~~securities~~] shall deliver the investments
8 [~~securities~~] sold, reissued, or exchanged in accordance with the
9 directions of the State Board of Education.

10 SECTION 1.10. The heading to Section 43.010, Education
11 Code, is amended to read as follows:

12 Sec. 43.010. DEFAULT OF SCHOOL DISTRICT BONDS [~~SECURITIES~~]
13 HELD BY [~~THE~~] PERMANENT SCHOOL FUND.

14 SECTION 1.11. Sections 43.010(b) and (d), Education Code,
15 are amended to read as follows:

16 (b) Revenue collected by either method specified by
17 Subsection (a) shall be distributed proportionately to all owners
18 of the defaulted bonds [~~securities~~] in compliance with the
19 following:

20 (1) the proportionate share for each owner is based on
21 the interest and principal requirements of the original bond
22 [~~security~~] before authorized refunding; and

23 (2) prior acceptance of refunding bonds [~~securities~~]
24 does not reduce an owner's proportionate share.

25 (d) The comptroller may not issue any warrant from the
26 foundation school fund to or for the benefit of any district that
27 has been for as long as two years in default in the payment of

1 principal or interest on any bond [~~security~~] owned by the permanent
2 school fund until the State Board of Education certifies that the
3 district has satisfactorily complied with the appropriate
4 provisions of this section, in which event the comptroller shall
5 resume making payments to or for the benefit of the district,
6 including the making of pretermitted payments.

7 SECTION 1.12. Section 43.015(f), Education Code, is amended
8 to read as follows:

9 (f) The comptroller shall be the custodian of investments
10 [~~all securities enumerated in Section 43.003(6) and of other~~
11 ~~securities as~~] designated by the State Board of Education in which
12 the school funds of the state are invested. The comptroller shall
13 keep those investments [~~securities~~] in the comptroller's custody
14 until paid off, discharged, delivered as required by the State
15 Board of Education, or otherwise disposed of by the proper
16 authorities of the state, and on the proper installment of any
17 interest or dividend, shall see that the proper credit is given, and
18 the coupons on bonds, when paid, shall be separated from the bonds
19 and cancelled by the comptroller.

20 SECTION 1.13. Section 43.017, Education Code, is amended to
21 read as follows:

22 Sec. 43.017. USE OF COMMERCIAL BANKS AS AGENTS FOR
23 COLLECTION OF INCOME FROM PERMANENT SCHOOL FUND INVESTMENTS. (a)
24 The State Board of Education may contract with one or more
25 commercial banks to receive payments of dividends and interest on
26 investments [~~securities~~] in which the state permanent school funds
27 are invested and transmit that money with identification of its

1 source to the comptroller for the account of the available school
2 fund by the fastest available means.

3 (b) In choosing each commercial bank with which to contract
4 as authorized by Subsection (a), the State Board of Education shall
5 assure itself of:

6 (1) the financial stability of the bank;

7 (2) the location of the bank with respect to its
8 proximity to the banks on which checks are drawn in payment of
9 dividends and interest on investments [~~securities~~] of the permanent
10 school fund;

11 (3) the experience and reliability of the bank in
12 acting as agent for others in the similar collection and
13 expeditious remittance of money; and

14 (4) the reasonableness of the bank's charges for the
15 services, both in amount of the charges and in relation to the
16 increased investment earnings of the available school fund that
17 will result from speedier receipt by the comptroller of the money.

18 SECTION 1.14. Section 43.018(b), Education Code, is amended
19 to read as follows:

20 (b) The State Board of Education may contract with a
21 commercial bank pursuant to this section only if:

22 (1) the bank is located in a city having a major stock
23 exchange;

24 (2) the bank is experienced in the operation of a fully
25 secured securities loan program;

26 (3) the bank has adequate capital in the prudent
27 judgment of the State Board of Education to assure the safety of the

1 securities entrusted to it as a custodian;

2 (4) the bank will require of any securities broker or
3 dealer to which it lends securities owned by the state permanent
4 school fund that the broker or dealer deliver to it cash collateral
5 for the loan of securities, and that the cash collateral will at all
6 times be not less than 100 percent of the market value of the
7 securities lent;

8 (5) the bank executes an indemnification agreement,
9 satisfactory in form and content to the State Board of Education,
10 fully indemnifying the permanent and available school funds against
11 loss resulting from borrower default or the failure of the bank to
12 properly execute the responsibilities of the bank under the
13 applicable securities lending agreement [~~the bank's service as~~
14 ~~custodian of securities of the permanent school fund and its~~
15 ~~operation of a securities loan program using securities of the~~
16 ~~permanent school fund~~];

17 (6) the bank will speedily collect and remit on the day
18 of collection by the fastest available means to the comptroller any
19 dividends and interest collectible by it on securities held by it as
20 custodian, together with identification as to the source of the
21 dividends or interest; and

22 (7) the bank is the bank agreeing to pay to the
23 available school fund the largest sum or highest percentage of the
24 income derived by the bank from use of the securities of the
25 permanent school fund in the operation of a securities loan
26 program.

27 SECTION 1.15. Section 321.013, Government Code, is amended

1 by adding Subsection (j) to read as follows:

2 (j) The State Auditor shall enter into a written contract
3 with the State Board of Education for the State Auditor to
4 investigate an allegation relating to the management and investment
5 of the permanent school fund as prescribed by Section 7.113,
6 Education Code. After an investigation of an allegation is
7 completed, the State Auditor shall prepare a written report of the
8 results of that investigation. The State Auditor shall submit the
9 report to the committee before publication. The State Auditor
10 shall file a copy of the report with the governor, the lieutenant
11 governor, the speaker of the house of representatives, each member
12 of the State Board of Education, and each member of the standing
13 committees of the senate and of the house of representatives with
14 primary jurisdiction over the State Board of Education.

15 SECTION 1.16. Not later than December 1, 2003, the
16 governor, lieutenant governor, and speaker of the house of
17 representatives shall appoint members of the permanent school fund
18 investment advisory committee, as required by Section 43.0012,
19 Education Code, as added by this article.

20 SECTION 1.17. Sections 43.0035 and 43.0051, Education Code,
21 as added by this article, apply only to an arrangement or contract
22 entered into on or after September 1, 2003.

23 SECTION 1.18. Not later than December 1, 2003, the State
24 Board of Education shall post on an Internet website the
25 information required by Section 43.0036, Education Code, as added
26 by this article.

27 SECTION 1.19. Not later than December 1, 2003, the

1 commissioner of education, on behalf of the State Board of
2 Education, and the chief administrative law judge of the State
3 Office of Administrative Hearings shall adopt a memorandum of
4 understanding as prescribed by Section 43.0062, Education Code, as
5 added by this article.

6 SECTION 1.20. Not later than December 1, 2003, the
7 legislative audit committee shall select an independent firm to
8 evaluate investment management practices and performance relating
9 to the permanent school fund as required by Section 43.0063,
10 Education Code, as added by this article. The evaluation must
11 include a comprehensive analysis of the State Board of Education's
12 investment program relating to the permanent school fund.

13 ARTICLE 2. COMPOSITION OF AND AUTHORIZED INVESTMENTS FOR
14 PERMANENT SCHOOL FUND

15 SECTION 2.01. Section 43.003, Education Code, is repealed.

16 SECTION 2.02. Sections 43.001(a) and (b), Education Code,
17 are amended to read as follows:

18 (a) The permanent school fund, which is a perpetual
19 endowment for the public schools of this state, consists of:

20 (1) all land appropriated for the public schools by
21 the constitution and laws of this state;

22 (2) all of the unappropriated public domain remaining
23 in this state, including all land recovered by the state by suit or
24 otherwise except pine forest land as defined by Section 88.111;

25 (3) all proceeds from the authorized sale of permanent
26 school fund land;

27 (4) all proceeds from the lawful sale of any other

1 properties belonging to the permanent school fund;

2 (5) all investments [~~authorized by Section 43.003~~] of
3 properties belonging to the permanent school fund; and

4 (6) all income from the mineral development of
5 permanent school fund land, including income from mineral
6 development of riverbeds and other submerged land.

7 (b) The available school fund, which shall be apportioned
8 annually to each county according to its scholastic population,
9 consists of:

10 (1) the interest and dividends arising from any
11 investments [~~securities~~] or funds belonging to the permanent school
12 fund;

13 (2) all interest derivable from the proceeds of the
14 sale of land set apart for the permanent school fund;

15 (3) all money derived from the lease of land belonging
16 to the permanent school fund;

17 (4) one-fourth of all revenue derived from all state
18 occupation taxes, exclusive of delinquencies and cost of
19 collection;

20 (5) one-fourth of revenue derived from state gasoline
21 and special fuels excise taxes as provided by law; and

22 (6) all other appropriations to the available school
23 fund made by the legislature for public school purposes.

24 ARTICLE 3. EFFECTIVE DATE

25 SECTION 3.01. This Act takes effect September 1, 2003.