

BILL ANALYSIS

C.S.H.B. 2037
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Public Education
Committee Report (Substituted)

BACKGROUND AND PURPOSE

In January 2002, the State Board of Education voted unanimously to request a fiduciary review of the key governance and investment functions of the permanent school fund. The state auditor's office contracted with CORTEX Applied Research, Inc., to conduct the review, the purpose of which was to determine whether the fund's investment practices follow sound fiduciary principles and whether the fund's organizational structure and governance are designed in a manner that provides for the prudent, efficient, and ethical management of the fund. The report containing CORTEX's findings was released in March 2003.

A section of the report addresses the organizational structure of the fund and states that the current structure is inconsistent with those of a significant majority of institutions in the economy, including corporations, not-for-profit organizations, and government agencies. A recommendation outlined a proposal to create a governing board for a "state-sponsored, quasi-independent investment organization" to administer the fund.

C.S.H.B. 2037 is the enabling legislation for H.J.R. 77, which establishes the Permanent School Fund Management Council to oversee the investment and administration of the fund.

RULEMAKING AUTHORITY

It is the committee's opinion that rulemaking authority is expressly granted to the Permanent School Fund Management Council in SECTION 1 of this bill.

It is the committee's opinion that rulemaking authority previously granted to the State Board of Education is transferred to the Permanent School Fund Management Council in SECTIONS 3, 14, 15, 16, and 17 of this bill.

ANALYSIS

C.S.H.B. 2037 amends the Education Code to create the seven-member Permanent School Fund Management Council. The bill sets forth its composition and appointing authorities, provides for its membership to serve staggered four-year terms ending on February 1 in alternating odd-numbered years, provides for the filling of a vacancy for an unexpired term in the same manner as the original appointment, and establishes a requirement for the election of a presiding officer to one or more two-year terms by the council's membership and for the appointment of a chief investment officer of the permanent school fund to serve at the will of the council. The bill defines "council" and makes changes conforming to the creation and authority of the council.

C.S.H.B. 2037 authorizes the council to adopt rules and operating procedures as necessary to administer the permanent school fund and perform other duties imposed on the council by law.

C.S.H.B. 2037 requires the council to meet at least quarterly and authorizes the council to hold other meetings called by the presiding officer. The bill authorizes the council to create standing committees to advise the council. The bill requires the council to create an audit and ethics

committee, a policy committee, and a risk committee.

C.S.H.B. 2037 makes the council subject to the open meetings law, except that the council is not required to discuss an investment or potential investment with one or more council employees or with a third party in an open meeting to the same extent that the board of trustees of the Texas growth fund is provided an exception from the open meetings law.

C.S.H.B. 2037 requires the council to contract with a corporation formed by the comptroller of public accounts to provide administrative support to the council. The bill authorizes the council to contract with such a corporation to exercise any power or perform any duty of the council relating to the investment of the permanent school fund.

C.S.H.B. 2037 authorizes the Permanent School Fund Management Council to invest the permanent school fund in any investment permitted under an applicable provision of the Texas Constitution, which must be carefully examined by the council and be found to be safe and proper investments for the fund, and removes provisions specifically enumerating the types of permissible investments for the permanent school fund and vesting the investment authority with the State Board of Education (SBOE).

C.S.H.B. 2037 requires the council and the School Land Board to enter into a memorandum of understanding under which the council agrees not to invest in real estate without the consent of the board.

C.S.H.B. 2037 removes existing provisions relating to the permanent school fund ethics policy and requires the council to comply with, and makes the council subject to, the ethics policy adopted by the corporation with which the council contracts. The bill requires the council, if the corporation does not have an ethics policy, to adopt and comply with an ethics policy. The bill requires the comptroller to enforce the ethics policy, regardless of whether the policy is adopted by the corporation or the council.

C.S.H.B. 2037 makes certain existing conflict of interest disclosure provisions previously applicable to a member of the SBOE, the commissioner of education, an employee of the Texas Education Agency (TEA), and a person providing services to the SBOE regarding the fund's management or investment applicable instead to a member of the council, a council employee, and a person providing such services to the council. The bill removes the requirement for a consultation with TEA's general counsel before the council expressly waives a prohibition that precludes a person who files a statement disclosing a possible conflict of interest from giving advice or making decisions about a matter affected by the possible conflict of interest.

C.S.H.B. 2037 removes a provision requiring a consultant, advisor, broker, or any person providing services regarding the fund's management and investment to detail any expenditure of more than \$50 made on behalf of the commissioner in a mandatory expenditures report and instead requires a detailed description of such expenditures made on behalf of a corporation contracting with the council for administrative support and management.

C.S.H.B. 2037 requires the council to designate a council employee, rather than a TEA employee, to act as custodian of statements, waivers, and reports for purposes of public disclosure.

C.S.H.B. 2037 makes it a Class A misdemeanor for a person who is a former member of the council to make any communication to or appearance before the council or a member, chief investment officer, or employee of the council before the second anniversary of the date the individual ceased to be a member of the council if the communication or appearance is made with the intent to influence council action and on behalf of any person in connection with any matter on which the person seeks action by the council.

C.S.H.B. 2037 requires the state auditor to conduct an annual financial audit of the permanent school fund and authorizes the state auditor to contract with an independent and internationally recognized accounting firm with substantial experience in auditing investment accounts to conduct that financial audit. The bill requires the council to reimburse the state auditor for the cost of the audit. The bill requires the state auditor or the accounting firm selected to conduct the audit to report the results of the audit directly to the council. The bill requires the council, not later than the 30th day after the date the council receives a copy of the audit report, to file a copy of the audit report with the governor, the lieutenant governor, the speaker of the house of representatives, the commissioner, and the comptroller of public accounts.

C.S.H.B. 2037 requires the council, before December 1 of each year, to prepare a written report detailing the council's investment and fiduciary practices and policies. The bill requires the council, not later than January 1 of each year, to distribute the report to the governor, the lieutenant governor, the speaker of the house of representatives, the presiding officers of the senate and house standing committees with primary jurisdiction over primary and secondary education, the presiding officers of the senate and house standing committees with primary jurisdiction over state finance or appropriations, and the state auditor.

C.S.H.B. 2037 authorizes the council to direct the commissioner to perform certain remedial actions originally authorized to the SBOE with respect to a school district's default on payment of interest or principal on bonds issued by the district and held by the permanent school fund. The bill provides that certain actions with respect to the revision, readjustment, modification, refinancing, or refunding of defaulted school district bonds may be taken either by the council or the SBOE and that school district applications and payments relating to such actions may be directed to either the council or the board.

C.S.H.B. 2037 requires the comptroller to give reports, required or requested, to the council in the same manner as the comptroller gives such reports to the SBOE. The bill requires the comptroller to exchange or accept refunding bonds in lieu of other specified bonds or obligations on order either of the council or of the SBOE. The bill requires the comptroller to be custodian of all securities as designated by either the council or the SBOE.

C.S.H.B. 2037 amends the Natural Resources Code to make conforming changes.

C.S.H.B. 2037 requires the appropriate appointing authorities, not later than February 1, 2010, to appoint the initial members of the council as required by provisions of the bill and sets forth expiration dates for the initial members' terms. The bill prohibits the council from taking any action until all of the appointed members have taken office.

C.S.H.B. 2037 requires the council, the SBOE, the TEA, and the comptroller as soon as practicable after the date on which all of the members of the council have taken office, but not later than May 1, 2010, to develop and adopt a memorandum of understanding that identifies in detail the applicable powers and duties of the SBOE that are being transferred to the council as a result of the bill and establishes a plan for the identification and transfer of records, property, and unspent appropriations of the SBOE that are used for purposes of managing the permanent school fund to the council.

C.S.H.B. 2037 establishes that, not later than September 1, 2010:

- all full-time TEA employees who provide support to the SBOE relating to the investment of the permanent school fund become employees of the comptroller;
- all functions and activities performed by the SBOE with respect to the management of the permanent school fund that, as a result of the bill, are subject to management by the council are transferred to the council;
- a rule, form, policy, procedure, or decision adopted by the SBOE relating to the management of the permanent school fund that, as a result of the bill, is subject to

management by the council continues in effect as a rule, form, policy, procedure, or decision of the council until amended or replaced by the council;

- a reference in law or an administrative rule to the SBOE relating to the permanent school fund that, as a result of the bill, is subject to management by the council is a reference to the council;
- a complaint, investigation, or other proceeding before the SBOE relating to the permanent school fund that, as a result of the bill, is subject to management by the council is transferred without change in status to the council.

C.S.H.B. 2037 provides that the council assumes, as appropriate and without a change in status, the position of the SBOE under a contract or in an action or proceeding to which the SBOE is a party and that relates to the permanent school fund, and, as a result of the bill, is subject to management by the council.

C.S.H.B. 2037 repeals a provision authorizing the SBOE to invest the permanent school fund within the limits of the authority granted by provisions governing the permanent school fund and available school fund. The bill repeals a provision requiring SBOE to provide for an annual financial audit of the permanent school fund if a certain investment contract entered into with a nonprofit corporation includes the fund within the scope of funds under the control and management of SBOE to be invested by the corporation. The bill repeals a provision defining "board" to mean the State Board of Education for provisions governing guaranteed bonds regarding school district funds.

C.S.H.B. 2037 repeals the following sections in the Education Code:

- Section 7.102(c)(31)
- Section 43.006(e)
- Section 45.051(1)

EFFECTIVE DATE

December 1, 2009, if the constitutional amendment creating the Permanent School Fund Management Council is approved by the voters.

COMPARISON OF ORIGINAL AND SUBSTITUTE

C.S.H.B. 2037 differs from the original by creating the seven-member, rather than nine-member, Permanent School Fund Management Council. The substitute differs from the original by setting forth a different composition and different appointing authorities from the composition and authorities set forth in the original. The substitute differs from the original by providing for the appointment of a chief investment officer, rather than an executive administrator, of the permanent school fund to serve at the will of the council. The substitute removes a provision in the original requiring each member of the council to have substantial investment expertise or financial management experience. The substitute adds a provision not in the original defining "council" to mean the Permanent School Fund Management Council.

C.S.H.B. 2037 adds a provision not in the original requiring the council to meet at least quarterly and authorizing the council to hold other meetings called by the presiding officer. The substitute removes a provision in the original prohibiting a council rule or operating procedure from taking effect without approval by the commissioner of education. The substitute removes a provision in the original requiring the council to file quarterly reports with the commissioner and requiring the commissioner to determine the information to be included in the report.

C.S.H.B. 2037 adds a provision not in the original requiring the council to contract with a corporation formed by the comptroller of public accounts to provide administrative support to

the council and authorizing the council to contract with such a corporation to exercise any power or perform any duty of the council relating to the investment of the permanent school fund. The substitute removes a provision in the original requiring the Texas Education Agency (TEA) to provide administrative support for the council.

C.S.H.B. 2037 differs from the original by requiring the council and the School Land Board to enter into a memorandum of understanding under which the council agrees not to invest in real estate without the consent of the board, whereas the original prohibits the council from investing the permanent school fund in real estate, including commercial real estate, and from competing with the School Land Board in any real estate investment market.

C.S.H.B. 2037 differs from the original by removing existing provisions relating to the permanent school fund ethics policy and instead requiring the council to comply with, and making the council subject to, the ethics policy adopted by the corporation that the council contracts with, or, if the corporation does not have an ethics policy, requiring the council to adopt and comply with an ethics policy, whereas the original modifies the existing ethics policy only to the extent of making it applicable to the council rather than to the State Board of Education (SBOE), requiring submittal of a copy of the ethics policy to the commissioner of education, requiring consideration of comments from the commissioner before the adoption of a proposed policy, and prohibiting the council from adopting a proposed policy or policy change without the commissioner's approval. The substitute adds a provision not in the original requiring the comptroller to enforce the ethics policy, regardless of whether the policy is adopted by the corporation or the council.

C.S.H.B. 2037 differs from the original by requiring a council employee, rather than a TEA employee, to disclose in writing to the council a relationship pertaining to a possible conflict of interest. The substitute differs from the original by excluding the commissioner from such requirement. The substitute removes a provision in existing law requiring consultation with the TEA general counsel before an express waiver of a prohibition that precludes a person who files a statement disclosing a possible conflict of interest from giving advice or from making decisions about a matter affected by the possible conflict of interest, whereas the original retains existing law. The substitute removes a provision in existing law requiring the council or the council's designees to define in an adopted ethics policy the kinds of relationships that may create a possible conflict of interest, whereas the original retains and amends existing law.

C.S.H.B. 2037 differs from the original by removing an existing statutory provision requiring a consultant, advisor, broker, or any person providing services regarding the fund's management and investment to detail any expenditure of more than \$50 made on behalf of the commissioner in a mandatory expenditures report and instead requires a detailed description of such expenditures made on behalf of a corporation contracting with the council for administrative support and management, whereas the original amends this provision only to the extent of replacing references to the SBOE with references to the council.

C.S.H.B. 2037 differs from the original by requiring the council to designate an employee of the council, rather than of the agency as in the original, to act as custodian of statements, waivers, and reports for purposes of public disclosure.

C.S.H.B. 2037 adds a provision not in the original requiring the council to reimburse the state auditor for the cost of an annual financial audit of the permanent school fund.

C.S.H.B. 2037 differs from the original by adding the presiding officers of the standing committees of each house of the legislature with primary jurisdiction over state finance or appropriations and the state auditor as recipients of the written report detailing the council's investment and fiduciary practices and policies.

C.S.H.B. 2037 differs from the original by requiring the appointing authorities to make their appointments of the council's initial members not later than February 1, 2010, rather than January 1, 2010, as in the original, and conforms this provision to reflect the difference in appointing authorities between the substitute and the original.

C.S.H.B. 2037 differs from the original by requiring the agency and the comptroller, as well as the council and the SBOE, to develop and adopt a memorandum of understanding. The substitute requires such memorandum to be developed and adopted not later than May 1, 2010, rather than not later than March 1, 2010, as in the original.

C.S.H.B. 2037 adds a provision not in the original establishing that, not later than September 1, 2010, all full-time TEA employees who provide support to the SBOE relating to the investment of the permanent school fund become employees of the comptroller.

C.S.H.B. 2037 adds a provision not in the original repealing a provision requiring the State Board of Education to provide for an annual financial audit of the permanent school fund if a certain investment contract entered into with a nonprofit corporation includes the fund within the scope of funds under the control and management of the SBOE to be invested by the corporation. The substitute removes a provision in the original repealing provisions that require the governing body of a school district to pay the district's debt, if additional property taxes are necessary to pay a debt in a district under certain conditions, in a lump sum and that authorize the governing body to levy and collect additional maintenance taxes and to issue taxes to satisfy such debt.

C.S.H.B. 2037 differs from the original by providing an effective date December 1, 2009, rather than January 1, 2010, as in the original.