

BILL ANALYSIS

C.S.H.B. 1003
By: Capriglione
Investments & Financial Services
Committee Report (Substituted)

BACKGROUND AND PURPOSE

Interested parties contend that certain state law regarding investment procedures for public funds is inconsistent with applicable regulations promulgated by the federal Securities and Exchange Commission in response to the recent financial crisis and that the eligibility of certain public fund investment pools may be jeopardized as a result. C.S.H.B. 1003 seeks to harmonize state law and the applicable federal regulations.

CRIMINAL JUSTICE IMPACT

It is the committee's opinion that this bill does not expressly create a criminal offense, increase the punishment for an existing criminal offense or category of offenses, or change the eligibility of a person for community supervision, parole, or mandatory supervision.

RULEMAKING AUTHORITY

It is the committee's opinion that this bill does not expressly grant any additional rulemaking authority to a state officer, department, agency, or institution.

ANALYSIS

C.S.H.B. 1003 amends the Government Code to make interest-bearing banking deposits that are guaranteed or insured by the Federal Deposit Insurance Corporation or its successor or by the National Credit Union Share Insurance Fund or its successor authorized investments for governmental entities under the Public Funds Investment Act. The bill establishes that a statutory provision relating to the authority of an issuer in the proceedings to authorize obligations or a credit agreement, or in a credit agreement, to waive sovereign immunity from suit or liability for the purpose of adjudicating a claim to enforce the credit agreement or obligation or for damages for breach of the credit agreement or obligation is applicable to the execution of a repurchase agreement and a guaranteed investment contract by an investing entity.

C.S.H.B. 1003 removes from the conditions making a no-load money market mutual fund eligible for consideration as an authorized investment for a governmental entity under the act the conditions that such a fund have a dollar-weighted average stated maturity of 90 days or fewer and that the fund include in its investment objectives the maintenance of a stable net asset value of \$1 for each share for the fund. The bill includes among the conditions for such consideration that the fund comply with certain specified federal Securities and Exchange Commission rules promulgated under the federal Investment Company Act of 1940. The bill revises an alternative set of conditions under which a no-load money market mutual fund is eligible for such consideration and in making those revisions removes the conditions that the fund be continuously rated as to investment quality of not less than AAA or its equivalent and that the fund conform to that act's requirements relating to the eligibility of investment pools to receive and invest funds of investing entities, retains the conditions that fund eligibility be based on registration with the federal Securities and Exchange Commission and on an average weighted maturity of less than two years, and includes as a condition of eligibility that the fund either has a

duration of one year or more and is invested exclusively in obligations approved by the act or has a duration of less than one year and the investment portfolio is limited to investment grade securities, excluding asset-backed securities.

C.S.H.B. 1003 requires that an investment pool's policy regarding holding deposits in cash be included in the pool's disclosure instrument furnished by the pool to the investment officer or other authorized representative of a governmental entity for purposes of establishing the pool's eligibility to receive funds from and invest funds on behalf of an entity. The bill removes the requirement that a public funds investment pool's portfolio holdings be sold as necessary to maintain a specified ratio of the market value of the portfolio divided by the book value of the portfolio and instead requires the governing body of the pool to take action as the body determines necessary to eliminate or reduce to the extent reasonably practicable any dilution or unfair result to existing participants, including a sale of portfolio holdings, to attempt to maintain the specified ratio. The bill changes the rating requirement for an investment pool to be eligible to receive funds from and invest funds on behalf of a governmental entity from a requirement that the pool be continuously rated no lower than AAA or AAA-m or at an equivalent rating by at least one nationally recognized rating service to a requirement that the pool be continuously rated no lower than the highest liquidity rating given to U.S. Treasury obligations by at least one nationally recognized rating service.

C.S.H.B. 1003 requires the governing body of an eligible entity, defined as a state agency or political subdivision that is an issuer of obligations for certain public improvements, to establish the entity's policy regarding hedging transactions and authorizes an entity to enter into hedging transactions, including hedging contracts, and related security, credit, and insurance agreements in connection with commodities used by an eligible entity in the entity's general operations, with the acquisition or construction of a capital project, or with an eligible public improvement project. The bill defines "hedging" as acting to protect against economic loss due to price fluctuation of a commodity or related investment by entering into an offsetting position or using a financial agreement or producer price agreement in a correlated security, index, or other commodity. The bill requires a hedging transaction to comply with the regulations of the federal Commodity Futures Trading Commission and the federal Securities and Exchange Commission. The bill prohibits a hedging contract and any security, credit, or insurance agreement related to a hedging contract, including a letter of credit reimbursement agreement, from having a term that exceeds five years. The bill authorizes an eligible entity to pledge as security for and to the payment of such an agreement any revenue the entity is authorized by law to pledge to the payment of any other obligation. The bill establishes that a statutory provision relating to the authority of an issuer in the proceedings to authorize obligations or a credit agreement, or in a credit agreement, to waive sovereign immunity from suit or liability for the purpose of adjudicating a claim to enforce the credit agreement or obligation or for damages for breach of the credit agreement or obligation is applicable to the execution by an eligible entity of a hedging contract and any related security, credit, or insurance agreement. The bill authorizes an eligible entity to credit any amount the entity receives under a hedging contract against expenses associated with a commodity purchase. The bill authorizes an eligible entity's cost of or payment under a hedging contract or agreement to be considered an operation and maintenance expense of the entity, an acquisition expense of the entity, a project cost of an eligible public improvement project, or a construction expense of the entity. The bill's provisions relating to hedging transactions prevail to the extent of any conflict between those provisions and another law or an eligible entity's municipal charter, if applicable.

EFFECTIVE DATE

On passage, or, if the bill does not receive the necessary vote, September 1, 2017.

COMPARISON OF ORIGINAL AND SUBSTITUTE

While C.S.H.B. 1003 may differ from the original in minor or nonsubstantive ways, the

following comparison is organized and formatted in a manner that indicates the substantial differences between the introduced and committee substitute versions of the bill.

INTRODUCED

SECTION 1. Section 2256.009(a), Government Code, is amended.

SECTION 2. Section 2256.010, Government Code, is amended by adding Subsection (c) to read as follows:

(c) An investment in negotiable certificates of deposit issued by a bank that has a certificate of deposit rating of at least 1 or the equivalent by a nationally recognized credit rating agency, or that is associated with a holding company having a commercial paper rating of at least A-1, P-1, or the equivalent by a nationally recognized credit rating agency, is an authorized investment under this subchapter.

SECTION 3. Section 2256.011, Government Code, is amended.

SECTION 4. Section 2256.014(a), Government Code, is amended to read as follows:

(a) A no-load money market mutual fund is an authorized investment under this subchapter if the mutual fund:

(1) is registered with and regulated by the Securities and Exchange Commission;

(2) provides the investing entity with a prospectus and other information required by the Securities Exchange Act of 1934 (15 U.S.C. Section 78a et seq.) or the Investment Company Act of 1940 (15 U.S.C. Section 80a-1 et seq.); and

(3) complies with federal Securities and Exchange Commission Rule 2a-7 (17 C.F.R. Section 270.2a-7), promulgated under the Investment Company Act of 1940 (15 U.S.C. Section 80a-1 et seq.) ~~[has a dollar-weighted average stated maturity of 90 days or fewer; and~~

~~[(4) includes in its investment objectives the maintenance of a stable net asset value of \$1 for each share].~~

SECTION 5. Section 2256.014(b), Government Code, is amended to read as follows:

(b) In addition to a no-load money market

HOUSE COMMITTEE SUBSTITUTE

SECTION 1. Same as introduced version.

No equivalent provision.

SECTION 2. Same as introduced version.

SECTION 3. Sections 2256.014(a) and (b), Government Code, are amended to read as follows:

(a) Same as introduced version.

(b) In addition to a no-load money market

mutual fund permitted as an authorized investment in Subsection (a), a no-load mutual fund is an authorized investment under this subchapter if the mutual fund:

- (1) is registered with the Securities and Exchange Commission;
- (2) has an average weighted maturity of less than two years;

(3) is invested exclusively in obligations approved by this subchapter;

~~(4) is continuously rated as to investment quality by at least one nationally recognized investment rating firm of not less than the highest liquidity rating given to United States Treasury obligations [AAA or its equivalent]; and~~

~~(5) conforms to the requirements set forth in Sections 2256.016(b) and (c) relating to the eligibility of investment pools to receive and invest funds of investing entities.~~

SECTION 6. Section 2256.015, Government Code, is amended.

SECTION 7. Sections 2256.016(b), (f), and (h), Government Code, are amended.

SECTION 8. Section 2256.019, Government Code, is amended.

SECTION 9. Subchapter A, Chapter 2256, Government Code, is amended by adding Section 2256.0206 to read as follows:

Sec. 2256.0206. AUTHORIZED INVESTMENTS: HEDGING

TRANSACTIONS. (a) In this section:

(1) "Eligible entity" means a state agency or political subdivision that is an issuer as defined by Section 1371.001.

(2) "Hedging" means acting to protect against economic loss due to price fluctuation of an investment, debt obligation, or commodity by entering into an offsetting position in a related security or by using a financial agreement or producer price agreement.

(b) This section prevails to the extent of any

mutual fund permitted as an authorized investment in Subsection (a), a no-load mutual fund is an authorized investment under this subchapter if the mutual fund:

- (1) is registered with the Securities and Exchange Commission;
- (2) has an average weighted maturity of less than two years; and

(3) either:

(A) has a duration of one year or more and is invested exclusively in obligations approved by this subchapter; or

(B) has a duration of less than one year and the investment portfolio is limited to investment grade securities, excluding asset-backed securities

~~[(4) is continuously rated as to investment quality by at least one nationally recognized investment rating firm of not less than AAA or its equivalent; and~~

~~[(5) conforms to the requirements set forth in Sections 2256.016(b) and (c) relating to the eligibility of investment pools to receive and invest funds of investing entities].~~

SECTION 4. Same as introduced version.

SECTION 5. Same as introduced version.

SECTION 6. Same as introduced version.

SECTION 7. Subchapter A, Chapter 2256, Government Code, is amended by adding Section 2256.0206 to read as follows:

Sec. 2256.0206. AUTHORIZED INVESTMENTS: HEDGING

TRANSACTIONS. (a) In this section:

(1) "Eligible entity" means a state agency or political subdivision that is an issuer as defined by Section 1371.001.

(2) "Eligible project" has the meaning assigned by Section 1371.001.

(3) "Hedging" means acting to protect against economic loss due to price fluctuation of a commodity or related investment by entering into an offsetting position or using a financial agreement or producer price agreement in a correlated security, index, or other commodity.

(b) This section prevails to the extent of any

conflict between this section and an eligible entity's municipal charter, if applicable.

(c) The governing body of an eligible entity shall establish its policy regarding hedging transactions.

(d) An eligible entity may enter into hedging contracts and related security and insurance agreements related to

commodities used in the general operations of an eligible entity or used in connection with the acquisition or construction of a capital project by the eligible entity.

A hedging transaction must comply with the regulations of the federal Commodity Futures Trading Commission and the federal Securities and Exchange Commission.

(e) An eligible entity may credit any amount the entity receives under a hedging contract or agreement against expenses associated with a commodity purchase.

(f) An eligible entity's payment under a hedging contract or agreement may be considered:

(1) an operation and maintenance expense of the eligible entity;

(2) an acquisition expense of the eligible entity; or

(3) a construction expense of the eligible entity.

SECTION 10. The changes in law made by this Act apply only to authorized investments of public funds governed by Chapter 2256, Government Code, as amended by this Act, that are made on or after the effective date of this Act. An authorized investment of public funds made

conflict between this section and:

(1) another law; or

(2) an eligible entity's municipal charter, if applicable.

(c) The governing body of an eligible entity shall establish the entity's policy regarding hedging transactions.

(d) An eligible entity may enter into hedging transactions, including hedging contracts, and related security, credit, and insurance agreements in connection with commodities used by an eligible entity in the entity's general operations, with the acquisition or construction of a capital project, or with an eligible project.

A hedging transaction must comply with the regulations of the federal Commodity Futures Trading Commission and the federal Securities and Exchange Commission.

(e) A hedging contract and any security, credit, or insurance agreement related to a hedging contract, including a letter of credit reimbursement agreement, may not have a term that exceeds five years. An eligible entity may pledge as security for and to the payment of an agreement described by this subsection any revenue the entity is authorized by law to pledge to the payment of any other obligation.

(f) Section 1371.059(c) applies to the execution by an eligible entity of a hedging contract and any related security, credit, or insurance agreement.

(g) An eligible entity may credit any amount the entity receives under a hedging contract against expenses associated with a commodity purchase.

(h) An eligible entity's cost of or payment under a hedging contract or agreement may be considered:

(1) an operation and maintenance expense of the eligible entity;

(2) an acquisition expense of the eligible entity;

(3) a project cost of an eligible project; or

(4) a construction expense of the eligible entity.

SECTION 8. Same as introduced version.

before the effective date of this Act is governed by the law in effect immediately before that date, and that law is continued in effect for that purpose.

SECTION 11. This Act takes effect immediately if it receives a vote of two-thirds of all the members elected to each house, as provided by Section 39, Article III, Texas Constitution. If this Act does not receive the vote necessary for immediate effect, this Act takes effect September 1, 2017.

SECTION 9. Same as introduced version.