SUBJECT: Revising operations of Texas Treasury Safekeeping Trust Company

COMMITTEE: Financial Institutions — committee substitute recommended

VOTE: 7 ayes — Averitt, Solomons, Denny, Grusendorf, Hopson, Menendez, Pitts

0 nays

2 absent — Marchant, Wise

SENATE VOTE: On final passage, April 11 — 29-0, on Local and Uncontested Calendar

WITNESSES: For — None

Against — None

On — *Registered but did not testify*: Lita Gonzalez, Mike Regan, Comptroller of Public Accounts

BACKGROUND: The Texas Treasury Safekeeping Trust Company is a special-purpose trust company established under the auspices of the comptroller. The company is designed to allow the comptroller to access directly Federal Reserve System services and to manage, disburse, transfer, secure, and invest funds and securities more economically and efficiently that otherwise would be deposited in and managed by local banks. The trust company manages about $7 billion in short-term cash deposits, including tobacco settlement money, from 22 state agencies authorized or required to deposit their funds into accounts outside the state treasury. Asset management and investment authority rests with the comptroller.

DIGEST: CSSB 1611 would amend Government Code, ch. 404 to provide guidance for and to regulate the activities of trust company staff, policy advisers and investment managers.

Investment advisory board. The comptroller, with the advice of the governor, lieutenant governor and House speaker, could appoint a seven-member investment advisory board to advise the comptroller on managing

the company's assets. The board would give guidance on investment philosophy, but would have no fiduciary responsibilities.

Board members would have to be Texas residents knowledgeable or experienced in finance, including fund management or business operations. Appointees' race, color, disability, gender, religion, age or national origin could not be factors in their selection. Those ineligible for consideration on the board would be:

- employees, managers, owners or controllers of at least 10-percent interests in businesses or other organizations receiving company funds; or
- persons receiving more than 5 percent of their gross income for the preceding calendar year from entities that received company funds.

The bill would establish a board training program and require members to complete at least one of its courses before assuming their duties. The training program would include information on the company's role and functions, assets and programs, and applicable statutes.

Board members would serve without compensation but could be reimbursed for actual and necessary expenses incurred while performing official duties and attending meetings, which would have to occur at least twice a year. The board would be subject to the Open Meetings Act.

The comptroller could remove board members for having been ineligible or unqualified when appointed; for not maintaining eligibility or qualifications during appointment; extended illness or disability; or absenteeism.

Administrative functions and management operations. The comptroller could delegate investment authority and contract with private professional investment managers to manage or assist with the management of company assets. The comptroller could delegate asset investment powers or duties to professional investment managers, employees or agents.

The comptroller could appoint a company chief executive officer (CEO) and delegate any of the comptroller's duties to the CEO and company employees. The company could hire employees, who would be considered

state employees, set salaries and specify duties, or contract with the Comptroller's Office for staff support.

The CEO, or a designee, would have to develop a career ladder program and compensation system necessary to retain qualified staff, annual performance evaluations, and a written equal employment opportunity policy. The CEO also would have to appoint an internal auditor subject to comptroller approval and direction.

The trust company could contract with a certified public accountant or the state auditor to conduct independent operational audits required to be submitted to the Legislative Budget Board by the comptroller. The state auditor's authority to audit the company would not be affected.

The trust company could purchase insurance for board members and staff only to protect against third-party liability and pay for all legal defense costs, including attorneys' fees.

The trust company would have to set a fee schedule to recover service costs and retain reserves adequate to support its operations. Participating agencies and entities authorized or required to deposit money or securities with the trust company would have to pay the fees.

To be eligible for federal reserve services, the trust company would have to hold capital stock and reserve balances outside the state treasury in a depository trust company in an amount required by regulatory bodies to achieve the company's statutory purposes. The bill also would specify that company net earnings credited to the treasury were from capital stock or capital stock investments.

The trust company would be exempt from state purchasing regulations and limits if it determined that certain purchases were related to its fiduciary duties. The company would have to develop operational plans including purchasing procedures and standards using best-value methods and use purchasing methods ensuring best value to the company and its participating agencies and entities.

The bill would take effect September 1, 2001.

SUPPORTERS SAY:

In recent years, the state's investment portfolio has become much more diversified. It is less reliant on fixed-income investments in favor of equities, especially since the state's multi-billion settlement of its lawsuit against major tobacco companies. The Safekeeping Trust Company, currently managed in-house and yielding returns exceeding benchmarks, nonetheless needs outside expertise and more flexibility to ensure the highest return on taxpayer dollars. An investment advisory board working in concert with financial consultants and fund managers, a professional CEO, and staff hired at competitive salaries would provide the guidance necessary to take the program to the next level financially.

Exempting the company from low-bidding requirements would allow it to negotiate investment management contracts more quickly and favorably. Enough checks and balances would be built into the structure to prevent conflicts of interest that could harm the state's investments or lead to favoritism or self-aggrandizement. The board would be advisory only; the comptroller would retain ultimate fiduciary responsibility and policy-making authority, even if a CEO were hired. The comptroller could replace fund managers — and board members for that matter — if they did not meet performance standards.

Precedent for this arrangement already exists in the University of Texas Investment Management Company (UTIMCO) and the comptroller's Texas Tomorrow Fund, whose board manages and invests its assets.

The bill would free up general revenue currently spent on trust company employee benefits, because under this bill, additional fee revenue not only would pay employee salaries but also benefits. Most of the company's nine current employees would be transferred from the state treasury division.

OPPONENTS SAY:

The precedents for this kind of public-private partnership argue against it. The problems caused by the influence of outside fund managers at odds with staff over the Permanent School Fund investment policy at the State Board of Education are legion and well-publicized. UTIMCO suffered sizable losses from speculative investments made because of conflicts of interest on the board. If conflicts of interest are not stringently avoided and too much authority is delegated to fund managers, adverse consequences can follow.

This type of approach to public fund management may seem attractive in today's market but can be risky and costly if not handled with utmost care and oversight. SB 1611 would not provide enough safeguards – the board and managers would answer only to the comptroller and therefore would not provide enough protections against relationships between board members and investors or fund managers.

The bill's language is entirely permissive, leaving too much discretion to one elected official. For example, the comptroller could delegate the entire company's investment authority to the private sector without ever appointing an advisory board or hiring any more staff, including a CEO. As many investors have become painfully aware during the past decade, fund managers' interests often are not the same as their own. The paramount concerns for public money always should be security, not profit.

It would be cheaper to hire good people and let them manage the program rather than incur the expense and possible conflicts of outside consultants.

The company is a state agency and should not be allowed to exempt itself from purchasing requirements that saved the state money through low-bid contracts.

OTHER OPPONENTS SAY:

The company specifically should be subject to the open records and all ethics provisions of state law as well as open meetings requirements.

The bill should be subject to sunset review to see how well it worked and whether returns increased before making this arrangement permanent.

NOTES:

The Senate-passed version would allow the company to contract with the comptroller for an independent operations audit. The Senate version would not preserve specifically the state auditor's authority to audit the company, nor would it authorize or delineate grounds for removal of advisory board members by the comptroller.