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OPINION COMMITTEE

December 10, 2014

RQ-1233-CA

The Honorable Greg Abbott
Attorney General of the State of Texas
Attention: Opinion Committee
P.O. Box 12548
Austin, Texas 78711-2548

Re: Request for Interpretation of the Texas Public Funds Investment Act

Dear General Abbott:

The Public Funds Investment Act¹ (the "**PFIA**") was originally enacted in 1987 with an intent "to 'broaden' certain governmental entities' 'investment opportunities.'"² The PFIA provides that any one of certain enumerated "entities," including investment pools of public funds meeting enumerated eligibility requirements (each, an "**investment pool**"), may make the "authorized investments" listed in certain sections therein.³ An investing entity must make such authorized investments in accordance with the standard of care prescribed by the PFIA, which requires that investments are "made with judgment and care, under prevailing circumstances, that a person of prudence, discretion, and intelligence would exercise in the management of the person's own affairs, not for speculation, but for investment, considering the probable safety of capital and the probable income to be derived" (the "**Standard of Care**").⁴

The PFIA has thus provided a framework by which investment pools may be established to facilitate investment by local governmental entities. In practice, these investment pools often work with financial service providers to deploy assets in a manner which maximizes yield in accordance with the PFIA. In certain circumstances, prudent management and investment of investment pool assets may lead to the conclusion that the investment pool form one or more separate entities owned and controlled by such investment pool to make authorized investments conforming to the pool's investment policies and strategy. Such a "subsidiary" entity may take the form of a wholly-owned special purpose vehicle for a single investment or a wholly-owned

¹ Tex. Gov't Code §2256.001 et seq.

² Tex. Att'y Gen. Op. No. DM-489 (1998) at 1 (citing Fiscal Note, C.S.H.B. 1488, 70th Leg., R.S. (1987)).

³ See Texas Gov't Code §§2256.003, 2256.009-.0201.

⁴ Texas Gov't Code §2256.006.

entity owning multiple investments. Such structuring may facilitate the operations of the investment pool and, among other things, compliance with state and federal securities laws.

As the Texas Legislature has amended the PFIA, it has sought to “make timely changes in the [PFIA] to keep the [PFIA] current with changes in the investment industry” so that governmental entities are not hindered “in their efforts to best serve the public.”⁵ The Texas Legislature has adopted such amendments in order to “help state and local governmental entities in Texas better manage public funds by making the PFIA more reflective of the changes in the investment and securities industry.”⁶ Authority under the PFIA for local governmental entities to create one or more subsidiary entities as described above serves the best interests of the State of Texas (the “*State*”) and its subdivisions because it would allow an investment pool to invest in the full range of options otherwise suitable under the PFIA, thereby providing the State with the opportunity to prudently maximize the yield on taxpayer resources.

In the past, your office has issued opinions interpreting certain provisions of the PFIA pursuant to your authority under Section 402.042 of the Texas Government Code.⁷ We respectfully request that you issue an opinion as to: (i) whether an investment pool may invest all or a portion of its assets in a wholly-owned subsidiary trust or other entity (a “*Subsidiary*”) as long as such Subsidiary complies with all provisions of the PFIA applicable to “entities,” as such term is defined therein; (ii) whether the advisory board of such Subsidiary may be composed solely of the individuals serving on the advisory board of the parent investment pool (the “*Parent Pool*”) and whether Section 2256.0016(g)(2) of the PFIA requires that an investment pool’s advisory board be composed of both (a) participants in the investment pool, and (b) other persons who do not have a business relationship with the investment pool and are qualified to advise the investment pool; and (iii) whether an investment pool may be an entity formed under the laws of another state in the United States (*e.g.*, Delaware) as long as such entity otherwise satisfies all requirements under Texas law for such foreign entity to conduct business in the State.

Discussion of the PFIA

Investment Pools Generally

⁵ Bill Analysis, C.S.H.B. 2226, 82nd Leg., R.S. (2011).

⁶ *Id.*

⁷ See, *e.g.*, Tex. Att’y Gen. Op. No. 0834, Tex. Att’y Gen. Op. No. GA-0768, Tex. Att’y Gen. Op. No. GA-0469, Tex. Att’y Gen. Op. No. DM-489.

The PFIA provides the specifically enumerated “entities,” as such term is defined in the PFIA, with the authority to “purchase, sell, and invest its funds and funds under its control in investments authorized under [the PFIA] in compliance with investment policies approved by the governing body and according to the [Standard of Care].”⁸ The enumerated “entities” permitted to make such authorized investments include “an investment pool acting on behalf of two or more local governments, state agencies, or a combination of those entities.”⁹ The PFIA defines an “investment pool” as “an entity created under this code to invest public funds jointly on behalf of the entities that participate in the pool and whose investment objectives in order of priority are (1) preservation and safety of principal; (2) liquidity; and (3) yield.”¹⁰ However, the PFIA does not specifically require than an investment pool be formed as an entity under the jurisdiction of the State or pursuant to a contract governed by Texas law.

Authorized Investments for Investment Pools

The PFIA prescribes certain “authorized investments” that entities may make. Section 2256.016 of the PFIA provides that:

An entity may invest its funds and funds under its control through an eligible investment pool if the governing body of the entity by rule, order, ordinance, or resolution, as appropriate, authorizes investment in the particular pool. An investment pool shall invest the funds it receives from entities in authorized investments permitted by this subchapter.¹¹

The PFIA therefore includes *other investment pools* as authorized investments for investment pools governed by the statute and does not otherwise prohibit one investment pool from investing in another investment pool.

⁸ Tex. Gov’t Code §2256.003. *See also* § 2256.003 (providing that “[i]nvestment of the funds shall be governed by the following investment objectives, in order of priority: (1) preservation and safety of principal; (2) liquidity; and (3) yield”).

⁹ Tex. Gov’t Code §2256.003. *See also* §2256.002(5) (“‘Investing entity’ and ‘entity’ mean an entity subject to [the PFIA] and described in Section 2256.003 of [the PFIA].”).

¹⁰ Tex. Gov’t Code §2256.002(6).

¹¹ Tex. Gov’t Code §2256.016(a).

Investment Pool Advisory Boards

Investment pools must also conform to other requirements prescribed by the PFIA, including the following:

To be eligible to receive funds from and invest funds on behalf of an entity under this chapter, a public funds investment pool must have an advisory board composed: (1) equally of participants in the pool and other persons who do not have a business relationship with the pool and are qualified to advise the pool, for a public funds investment pool created under Chapter 791 [of the Texas Government Code] and managed by a state agency; or (2) of participants in the pool and other persons who do not have a business relationship with the pool and are qualified to advise the pool, for other investment pools.¹²

Under such provision, any investment pool that is *not* managed by a state agency must have an advisory board composed of participants and qualified independent persons, but such board is not required to be composed *equally* of such persons. However, Section 2256.016(g)(2) does not specify whether (i) such advisory board must include *both* participants and qualified independent persons or (ii) such advisory board is simply prohibited from including such persons who are not either participants or qualified independent persons described therein.

Request #1: Wholly-owned Subsidiary Investment Pools

As described above, in certain circumstances, an investment pool under the PFIA may find it advantageous to form a Subsidiary for purposes of investing some or all of such investment pool's assets. As long as a Subsidiary conforms to the eligibility requirements for investment pools set forth in the PFIA, it should qualify as an investment pool and therefore be an authorized investment for its Parent Pool under the PFIA. However, ambiguity exists under the PFIA with respect to whether the Subsidiary, as an eligible investment pool, is therefore an "entity" permitted to make "authorized investments." While the Subsidiary ultimately would act "on behalf of two or more local governments, state agencies, or a combination of those entities," because such entities are the participants in the Parent Pool, the Subsidiary would have only one direct owner—the Parent Pool. We respectfully request that you provide an opinion as to whether a wholly-owned Subsidiary of an investment pool that conforms to the eligibility requirements of the PFIA is an "entity" as defined in the PFIA and therefore may make authorized investments for the ultimate benefit of the participants in the Parent Pool.

Request #2: Composition of Advisory Boards of Investment Pools and their Subsidiaries

¹² Tex. Gov't Code §2256.016(g).

An investment pool and its participants may believe it advantageous for the advisory board of the investment pool to be composed exclusively of either (i) participants in the pool or (ii) other persons who do not have a business relationship with the pool and are qualified to advise the pool. Further, in the event that a Subsidiary otherwise meets the definition of "investment pool," such Subsidiary, its Parent Pool, and the participants therein may believe it advantageous for the advisory board of the Subsidiary to be identical to the advisory board of the Parent Pool. We respectfully request that you provide an opinion as to whether Section 2256.0016(g)(2) requires that an investment pool's advisory board be composed of *both* (i) participants in the pool and (ii) other persons who do not have a business relationship with the pool and are qualified to advise the pool. In addition, regardless of your opinion with respect to our request in the immediately preceding sentence, we respectfully request that you provide an opinion as to whether the advisory board of a wholly-owned Subsidiary of an investment pool that conforms to the eligibility requirements of the PFIA may be composed of the same individuals composing the advisory board of the Parent Pool.

Request #3: Investment Pools Governed by Foreign U.S. Jurisdictions

An investment pool may also determine that it is advantageous for it or its wholly-owned Subsidiary to organize in the jurisdiction of a state other than the State of Texas due to, among other reasons, the U.S. investment management industry's comfort and familiarity with entities (including trusts) formed in certain other states. Many fund sponsors and other financial service providers in the U.S. investment management industry choose, for example, to organize under the laws of the State of Delaware as corporations, limited liability companies, limited partnerships, or statutory trusts. In order to provide investment pool participants with the broadest range of investment products and service providers that conform to the PFIA's requirements for such products and services, an advisory board may, in accordance with its Standard of Care, determine that participants would materially benefit from a form of organization governed by laws of another state. We respectfully request that you provide an opinion as to whether an investment pool and/or its wholly-owned Subsidiary is not required to be an entity formed under Texas law so long as such entity is formed under the laws of another state in the United States and otherwise satisfies all requirements under Texas law for a foreign entity doing business in the State of Texas.

Office of the Attorney General
December 10, 2014, 2014

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Should you or your staff have any questions based upon the foregoing or require any additional information or documentation, please do not hesitate to contact me.

Respectfully Submitted,

A handwritten signature in black ink, appearing to read "René O. Oliveira", written over a horizontal line.

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