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July 13, 1993

The Honorable Larrie Bailey  
Treasurer of West Virginia  
Building 1, Suite 145-E  
Capitol Complex  
Charleston, West Virginia 25305

The Honorable Glen B. Gainer, III  
Auditor of West Virginia  
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Charleston, West Virginia 25305

Dear Treasurer Bailey and Auditor Gainer:

I am writing in response to your May 12, 1993 request for an Opinion of the Attorney General on the following question:

Is it lawful for the West Virginia Board of Investments to invest the trust funds in the "consolidated pension fund," which represents monies of the Public Employees Retirement System, in corporate stock of any private corporation or association?

The brief answer to this question is that it is not lawful for the West Virginia Board of Investments to invest trust funds from the consolidated pension fund in corporate stock of private corporations or associations. To do so violates Article X, § 6 of the Constitution of West Virginia, which prohibits the State from becoming a joint owner or stockholder in any company or association. Such investment also impairs the contractual obligation of the State in protecting public employees' pension property rights in violation of Article III, § 4 of the Constitution of West Virginia.

In rendering this Opinion, we must be mindful that the question presented comes to us wholly in the abstract and without any particularized factual circumstances. Readers must recognize the risk in predicting matters in the abstract. Certainly, it is a risky business to predict how courts may construe specific facts and how they may choose to apply the facts to the law. Inasmuch as we render opinions in the abstract without argument representing diverse points of view, we are constrained to approach matters conservatively.

### The Statutory Framework

Analysis of the legal issues raised by investment of pension trust funds in stock requires an initial review of the statutes governing the Public Employees Retirement System and the State Board of Investments.

The West Virginia Public Employees Retirement Act was originally adopted in 1961. West Virginia Code §§ 5-10-1 through 53 (1990 Repl. Vol. & 1992 Cum. Supp.). The Act provides for the investment of Public Employees Retirement System funds as follows:

All moneys of the retirement system not currently required for the payment of annuities or other benefits shall be invested by the board of public works in any securities or investments in which the sinking funds of the state may be legally invested, or in any securities or investments in which the deposits in savings banks and participation deposits in banks and trust companies may be legally invested, as provided by the general laws. . . .

W. Va. Code § 5-10-38 (1990 Repl. Vol. & 1992 Cum. Supp.).

The investment of the State's sinking fund is now handled by the Municipal Bond Commission which is the successor to the State Sinking Fund Commission. W. Va. Code § 13-3-1 (1991 Repl. Vol. & 1992 Cum. Supp.). The Municipal Bond Commission may invest in five classes of securities as follows:

- (1) Securities of the United States or any agency thereof which are guaranteed by or for which the full faith and credit of the United States is pledged for the payment of the principal and interest;
- (2) General obligations of this state or any of its agencies, boards or commissions;
- (3) General obligations of any county, municipality or school district in this state;
- (4) Pools of investment operated by the West Virginia board of investments provided that their investments are limited to the above named securities, and provided that securities purchased for these pools following the date of the enactment of this article shall not have maturities greater than five years in length; and
- (5) Repurchase agreements or similar banking arrangements with a member bank of banks of the federal reserve system or a bank, the deposits of which are insured by the federal deposit insurance corporation, or its successor: Provided, That such investments shall only be made to the extent insured by the federal deposit insurance corporation or to the extent

that the principal amount thereof shall be fully collateralized by direct obligations of or obligations guaranteed by the United States of America.

W. Va. Code § 13-3-7(a) (1991 Repl. Vol. & 1993 Cum. Supp.).

Additionally, in 1978, the Legislature established the consolidated pension fund "for the common investment of pension funds." W. Va. Code § 12-6-8(a) (1991 Repl. Vol. & 1992 Cum. Supp.). The consolidated pension fund was placed under the control of the West Virginia Board of Investments. Id. The Legislature has also established the permissible investments "[n]otwithstanding the restrictions which may otherwise be provided by law" which may be made by the West Virginia Board of Investments as follows:

(a) Any direct obligation of, or obligation guaranteed as to the payment of both principal and interest by, the United States of America;

(b) Any evidence of indebtedness issued by any United States government agency guaranteed as to the payment of both principal and interest, directly or indirectly, by the United States of America including, but not limited to, the following: Government National Mortgage Association, Federal Land Banks, Federal Home Loan Banks, Federal Intermediate Credit Banks, Banks for Cooperatives, Tennessee Valley Authority, United States Postal Service, Farmers Home Administration, Export-Import Bank, Federal Financing Bank, Federal Home Loan Mortgage Corporation, Student Loan Marketing Association and Federal Farm Credit Banks;

(c) Any evidence of indebtedness issued by the Federal National Mortgage Association to the extent such indebtedness is guaranteed by the Government National Mortgage Association;

(d) Any evidence of indebtedness that is secured by a first lien deed of trust or mortgage upon real property situate within this state, if the payment thereof is substantially insured or guaranteed by the United States of America or any agency thereof;

(e) Direct and general obligations of this state;

(f) Any undivided interest in a trust, the corpus of which is restricted to mortgages on real property and, unless all of such property is situate within the state and insured, such trust at the time of the acquisition of such undivided interest, is rated in one of the three highest rating grades by an agency which is nationally known in the field of rating pooled mortgage trusts;

(g) Any bond, note, debenture, commercial paper or other evidence of indebtedness of any private corporation or association organized and operating in the United States: Provided, That any such security is, at the time of its acquisition, rated in one of the three highest rating grades by an agency which is nationally known in the field of rating corporate securities: Provided, however, That if any commercial paper and/or any

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such security will mature within one year from the date of its issuance, it shall, at the time of its acquisition, be rated in one of the two highest rating grades by such an agency: Provided further, That any such security not rated in one of the two highest rating grades by any such agency and commercial paper or other evidence of indebtedness of any private corporation or association shall be purchased only upon the written recommendation from an investment adviser that has over three hundred million dollars in other funds under its management;

(h) Negotiable certificates of deposit issued by any bank, trust company, national banking association or savings institution organized and operating in the United States, which mature in less than one year and are fully collateralized;

(i) Interest earning deposits including certificates of deposit, with any duly designated state depository, which deposits are fully secured by a collaterally secured bond as provided in section four [§ 12-1-4], article one of this chapter; and

(j) Any corporate stock of any private corporation or association organized and operating in the United States and which is also listed on the Standard and Poor's List of 500.

W. Va. Code § 12-6-9 (1991 Repl. Vol. & 1992 Cum. Supp.) (emphasis added).

It is vital to note that West Virginia Code § 12-6-9 was amended to add subpart (j) allowing the Board of Investments to invest in stock of private corporations or associations during the third extraordinary session of the 1990 Legislature. Thus, prior to the 1990 amendment, investments in such stocks were not permitted.

The Legislature has placed specific limitations as to the percentages that may be invested in the various types of securities. One such restriction is that "at no time shall more than twenty percent of the portfolio of the consolidated pension fund be invested in corporate stock of any private corporation or association organized and operating in the United States and which is also listed on the Standard and Poor's List of 500." W. Va. Code § 12-6-10(5) (1991 Repl. Vol. & 1992 Cum. Supp.). Moreover, the Board of Investments is prohibited from investing more than three percent of the consolidated pension fund portfolio in a single private corporation or association. W. Va. Code § 12-6-10(3) (1991 Repl. Vol. & 1992 Cum. Supp.).

#### Fiduciary Duty

In the Dadisman case, the West Virginia Supreme Court declared various actions of the executive and the Legislature unconstitutional and illegal. The Court found unlawful the failure to budget and appropriate the level of Public Employees Retirement System funds called for by statute and necessary for the retirement fund to be actuarially sound. Further, the reappropriation to other purposes of funds previously earmarked for the retirement fund was also held to be unlawful. The Court also found that the Public Employees Retirement System embodied contractual and trust obligations by the State

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to the retired employee participants. These obligations were held to go beyond the explicit provisions of the statutes.

Because the funds at issue in this question are pension funds, greater obligations of care exist than those expressed in the statutes. Although Dadisman contains no language limiting specific types of investment, it is clear that the Court's opinion was intended to set a high fiduciary standard and to provide general guidance to the Board. As the court stated:

The respondents are mandated to remove pension funds from speculative to secure investments and to make future investments of the PERS funds consistently with the highest standards of fiduciary duty.

Dadisman, at 832. This high fiduciary obligation flows from the fact that pension funds are not state money, but are rather considered to be "property held in common for the benefit of each member and retirant, and dedicated to private ends." Dadisman, at syl pt. 2.

Clearly, the primary thrust of the Dadisman decision was the recognition of the fiduciary duty imposed on those entrusted with pension funds to manage and invest the funds with the absolute highest degree of care and responsibility. The funds are not taxpayers' money. Rather, the trust funds "have been earned by public employees for the benefit of the trust, thus, the funds are not public property." Dadisman, 384 S.E.2d at syl. pt. 22.

The discussion of fiduciary responsibility necessarily brings us full circle to the application of the Constitution of West Virginia. The State Constitution prohibits the impairment of contracts. W. Va. Const. Art. III, § 4. The State is not permitted to modify its contracts with other parties. It is well established that a public employee's rights under public pension statutes are contract rights. These are enforceable property rights that cannot be impaired or diminished by the State.

In Dadisman, the Court commented as follows:

State law, through the pension statute, establishes contractually based property rights in pension plan participants who have contributed from their wages and have earned the contributions of their employees. . . . These rights are recognized and protected under our State's Constitution. . . . Thus, the realization and protection of public employees' pension property rights is a constitutional obligation of the State.

Dadisman, 384 S.E.2d at 828.

#### The Constitution of West Virginia

Article X, § 6 of the Constitution of West Virginia provides in pertinent part "nor shall the State ever hereafter become a joint owner, or stockholder in any company or association in this State or elsewhere, formed for any purpose whatsoever."



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It appears plain that the legislative changes enacted in the third extraordinary session of the Legislature in August, 1990 which expanded the Board of Investments range of permissible investments into more speculative corporate stock violates the holding in Dadisman relative to the notion of fiduciary trust and impairment of contracts.<sup>1</sup> Surely, it violates all notions of basic common sense that a fiduciary could take speculative action on behalf of others that could or would not be taken by the fiduciary for him or herself.

Here, a creation of the State of West Virginia, the Board of Investments, cannot invest State funds in stock under the strict mandate of Article X, § 6 of the Constitution of West Virginia. Yet, statutes purport to allow such speculation on behalf of others. This does not comport with the highest degree of fiduciary care that must be exercised when dealing with the pension funds of State employees. Such a result is wholly counterintuitive.

We must note an absurdity in the present situation. While permitting speculative stock investment with respect to pension funds, the Legislature, in accordance with the Constitution, forbade the Board of Investments from investing the consolidated fund in stocks. W. Va. Code § 12-6-10(5) (1991 Repl. Vol. & 1992 Cum. Supp.). The consolidated fund is a special account for the investment of State and local government funds. How can it be that stricter prohibitions on investments apply to the State and local government funds than are imposed on the pension fund monies to which a higher degree of care is owed? The answer plainly is that such an absurdity cannot occur. Such disparity of treatment between pension funds and the consolidated funds whereby the consolidated funds are treated with a greater degree of fiduciary care and responsibility is not only unlawful but illogical as well.

Moreover, the statutory changes in 1990 allowing greater speculation with regard to pension funds violates the contractual obligation as enunciated in Dadisman. The change is a substantial one that works to diminish the contractual understanding held by public employees that speculative private corporate stock investments of their earned retirement funds were not permissible.

As the Court in Dadisman wrote, West Virginia Code § 5-10-38 is one of the terms of the contract between the State and the members of the Public Employees Retirement System. The State is severely restricted in its power to unilaterally modify the terms of the pension contract. The "Board of Investments has the highest fiduciary duty to see to it that the PERS funds are placed in secure, not speculative, investments." Dadisman, 384 S.E.2d at 831.

Most importantly, the Court stated:

Guidance for proper pension fund investments may be drawn from Code § 5-10-38, which from the 1961 passage of the pension act has authorized that pension moneys may be invested as are the sinking funds of the State

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<sup>1</sup>To the extent that the Opinion of the Attorney General of February 28, 1991 holds otherwise, it is respectfully observed that the Opinion did not appreciate the 1990 statutory changes that occurred subsequent to the Dadisman decision.

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or as are the deposits of saving banks. Because of the fluidity and erosion of the regulation of banking practice, the savings bank standard is no longer a meaningful one by which to measure compliance with fiduciary duties, and we are left with the standards for the State's sinking fund, which apparently remain consistent with the highest standards of fiduciary duty.

Dadisman, 384 S.E.2d at 832.

The State's sinking fund was discussed above. The Board of Investments should, as mandated to do in Dadisman, "remove pension funds from speculative to secure investments and to make future investments of the PERS funds consistently with the highest standards of fiduciary duty." Dadisman, 384 S.E.2d at 832. To do so should bring the Board of Investments into compliance with the Constitution of West Virginia.

#### Conclusion

In conclusion, we appreciate the opportunity to comment on this matter of tremendous importance to members of the Public Employees Retirement System who have in the past and are currently contributing a portion of their wages and earning their employers' contributions, so as to have a fiscally sound retirement.

Sincerely,



DARRELL V. MCGRAW, JR.  
ATTORNEY GENERAL

DVM/jy  
cc: Board of Investments  
Consolidated Public Retirement Board  
Municipal Bond Commission

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