

N.D.A.G. Letter to Ficek (Aug. 17, 1987)

August 17, 1987

Mr. Vince H. Ficek
Dickinson City Attorney
41 First Avenue West
P.O. Box 866
Dickinson, ND 58601-0866

Dear Mr. Ficek:

Thank you for your letter of July 21, 1987, in which you request my opinion on several questions regarding the municipal employees' pension plan and the policemen's pension plan.

Your first question inquires as to the restrictions, if any, limiting the board of trustees' investments in the municipal pension plan. N.D.C.C. § 40-46-08 establishes the investment parameters for the board of trustees overseeing the municipal pension plan as follows:

40-46-08. Investment of surplus in fund -Limitations. At the end of each fiscal year, the board of trustees may invest any surplus left in the city employees' pension fund, but no part of the moneys realized from any tax levy shall be used for any purpose other than the payment of pensions. Such surplus funds may be invested in interest-bearing bonds of the United States or the state of North Dakota, or bonds or warrants of any county, township, or municipal corporation of this state which constitute the general obligations or contingent general obligations of the issuing tax authority, or investments with any federally insured bank or savings and loan association. All securities in which moneys belonging to the fund are invested shall be deposited with the treasurer of the board for safekeeping. The board may also invest all or part of such surplus funds in other investments by selecting a funding agent or agents and establish an investment agreement contract regarding such surplus funds. The contract shall authorize the funding agent or agents to hold and invest such funds for the board and such funds shall be placed for investment only with a firm or firms whose primary endeavor is money management, and only after a trust agreement or contract has been executed.

N.D.C.C. § 40-45-06 establishes virtually identical investment parameters for the board of trustees overseeing the policemen's pension plan.

N.D.C.C. §§ 40-45-06 and 40-46-08 contemplate two investment alternatives. First, the boards of trustees may self-invest within a defined legal list. Second, the investment of the plans' assets may be accomplished by funding agents selected by the boards of trustees.

The boards of trustees' self-investment activities are limited to investments in certain debt instruments that constitute general obligations of the issuing governmental entity or investments with any federally insured bank or saving and loan association. Aside from those investments specifically enumerated in N.D.C.C. § 40-45-06 and 40-46-08, the boards of trustees are not otherwise authorized to directly invest the funds of the plans.

The second investment alternative available for the boards of trustees is to retain outside funding agents to invest the funds of the plans. The outside funding agent is not limited to a legal list as are the boards of trustees in regard to their self-investment activities. In the absence of a legal investment list, the outside funding agent would be subject to the prudent person fiduciary standard. The prudent person rule for investment purposes is frequently stated as follows:

[A] fiduciary shall discharge his duties with respect to a plan solely in the interests of the participants and beneficiaries and with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims.

29 U.S.C.A. § 1104 (West 1985). Thus, the boards of trustees may diversify the investment portfolios by retaining outside funding agents who would not be limited to the legal investment list that governs the boards in their self-investment activities.

Not only would the prudent person rule apply to the activities of the funding agent, but the boards of trustees would be held to such a standard in their selection of outside funding agents. The boards must exercise prudence in selecting funding agents to ensure that the funds' asset allocation goals are satisfied and that adequate diversification exists.

Your second question asks whether the requirements of N.D.C.C. §§ 40-45-06 and 40-46-08 regarding the selection of a funding agent or agents are satisfied by entering into an agreement with a trust department of a local bank. Your third question similarly asks for my interpretation as to who qualifies as a funding agent or a firm whose primary endeavor is money management.

It is important to note that the North Dakota Public Employees Retirement System is governed by a similar restriction as is the municipal employees' pension plan and the policemen's pension plan in regard to retaining a funding agent to invest the funds of the plan. See N.D.C.C. § 54-52-04(6). N.D.C.C. § 54-52-01(6) defines a funding agent as "an investment firm, trust bank, or other financial institution which the retirement board may select to hold and invest the employers' and members' contributions." This definition would be equally applicable in interpreting N.D.C.C. § 40-45-06 and 40-46-08.

N.D.C.C. §§ 40-45-06, 40-46-08, and 54-52-04(6) further require that the funding agent be a firm whose "primary endeavor is money management." Whether a firm's primary endeavor is money management involves a question of fact in which I cannot be of great assistance. However, it would be my observation that a trust department of a bank would ordinarily satisfy the statutory requirements.

Your fourth question asks for a definition of "surplus funds" as used in N.D.C.C. § 40-45-06 and 40-46-08. Although the term "surplus funds" is capable of varying definitions, depending on whether one accepts an accrual or cash-basis analysis, it would appear to me that the Legislature contemplated a cash-basis analysis in regard to determining the "surplus funds" which may be invested by the boards. Obviously, if an actuarial study of accrued liabilities and assets was conducted, the "surplus funds" would likely be very minimal. Such an interpretation would result in virtually no investment activities and seriously frustrate the economic interests of the funds.

On the other hand, a cash-basis analysis in determining "surplus funds" would allow the investment of funds that are not required for immediate distribution to retirees. Obviously, this determination will require actuarial and cash flow studies to ensure that the requisite liquidity is maintained. The amount of funds necessary for distribution purposes should be maintained in demand deposits at financial institutions or similarly liquid cash equivalents. The remainder of the plans' assets should be considered "surplus funds" to be invested by the boards of trustees.

If you have any further questions on this matter, please do not hesitate to contact me.

Sincerely,

Nicholas J. Spaeth

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