



KEN PAXTON
ATTORNEY GENERAL OF TEXAS

August 25, 2020

The Honorable John Whitmire
Chair, Committee on Criminal Justice
Texas State Senate
Post Office Box 12068
Austin, Texas 78711-2068

Opinion No. KP-0328

Re: Authority of the Teacher Retirement System with respect to investments in or ownership of real property (RQ-0334-KP)

Dear Senator Whitmire:

You tell us that recent news reports and presentations concerning the Teacher Retirement System of Texas (the “System”) board of trustees indicate the System “has increased its real estate holdings both in the United States and internationally.”¹ You ask whether “investments in or ownership of real estate either directly or indirectly” by the System violate the Texas Constitution or the Government Code. Request Letter at 2. If so, you ask what remedy would be appropriate or available. *Id.*

Article XVI, subsection 67(a)(1) of the Texas Constitution authorizes the Legislature to establish state and local retirement systems. *See* TEX. CONST. art. XVI, § 67(a)(1) (“The legislature may enact general laws establishing systems and programs of retirement and related disability and death benefits for public employees and officers.”). The provisions about which you ask—article XVI, subsection 67(a)(3) of the Constitution and section 825.301 of the Government Code—specify the System’s authority to invest its funds. *See id.* art. XVI, § 67(a)(3); TEX. GOV’T CODE § 825.301. The constitutional provision authorizes trustees of a statewide retirement system “to invest the funds of the system *in such securities* as the board may consider prudent investments.” TEX. CONST. art. XVI, § 67(a)(3) (emphasis added). Furthermore, as they make investments, the trustees must

exercise the judgment and care under the circumstances then prevailing that persons of ordinary prudence, discretion, and intelligence exercise in the management of their own affairs, not in regard to speculation, but in regard to the permanent disposition of

¹Letter from Honorable John Whitmire, Chair, Senate Comm. on Crim. Justice, to Honorable Ken Paxton, Tex. Att’y Gen. at 1 (Feb. 27, 2020), <https://www2.texasattorneygeneral.gov/opinions/opinions/51paxton/rq/2020/pdf/RQ0351.pdf> (Request Letter).

their funds, considering the probable income therefrom as well as the probable safety of their capital.

Id. Thus, the Constitution limits the System’s investments to “securities,” and the System must make the investments according to the “prudent person” standard. *Id.* Article XVI, subsection 67(a)(3) also authorizes the Legislature to “further restrict the investment discretion of a board,” which the Legislature does in part through subsection 825.301(a) of the Government Code. *Id.*; TEX. GOV’T CODE § 825.301(a) (governing the System’s investment of assets).

Before addressing subsection 825.301(a), we note that this office previously considered whether the System could invest its funds in real estate. *See generally* Tex. Att’y Gen. Op. No. MW-152 (1980) at 2–3. In the absence of state law at the time defining “securities” for purposes of the System’s investment authority, Opinion MW-152 relied on the definition of “securities” then current in the Texas Securities Act. *Id.* at 2. The opinion concluded that, while mortgage certificates secured by real estate were permissible, investments in the realty itself were not because real estate was not a security under that Act.² *Id.* In 1999, this office issued JC-0043, which overruled MW-152 to the extent of its reliance on the Texas Securities Act. *See* Tex. Att’y Gen. Op. No. JC-0043 (1999) at 13 (using instead an alternate statutory source to define “securities”). Opinion JC-0043 noted that, despite its overruling of MW-152, it maintained its position that “real estate itself is not a ‘security’ for purposes of article XVI, section 67(a)(3)” because the alternate definition of “securities” on which JC-0043 relied did not incorporate it. *Id.* at 21.³

We turn now to subsection 825.301(a) of the Government Code. In 1999, shortly after the issuance of JC-0043, the Legislature used its authority to delineate the System’s investment discretion for purposes of article XVI, subsection 67(a)(3) by amending subsection 825.301(a) to incorporate a definition of the term “security.” *See* Act of May 30, 1999, 76th Leg., R.S., ch. 1540, § 17, 1999 Tex. Gen. Laws 5282, 5287 (codified at TEX. GOV’T CODE § 825.301(a)); *see also* *Owens v. State*, 19 S.W.3d 480, 484 (Tex. App.—Amarillo 2000, no pet.) (“The Legislature may define terms which are not defined in the Constitution itself, provided its definitions constitute reasonable interpretations of the constitutional language and do not do violence to the plain meaning and intent of the constitutional framers.”). Subsection 825.301(a) now defines the term “securities” in part to include “any investment instrument within the meaning of the term as defined by” state and federal securities regulatory statutes: (1) the Texas Securities Act; (2) the federal Securities Act of 1933; or (3) the federal Securities Exchange Act of 1934. TEX. GOV’T CODE § 825.301(a). In addition, the term includes “any derivative instrument, and any other instrument commonly used by institutional investors to manage institutional investment

²In 1991, a proposed constitutional amendment that would have broadened the range of permissible investments by a statewide retirement system beyond securities to effectively permit investing directly in real estate was defeated by voters. *See* Tex. S.J. Res. 6, 72d Leg., R.S., 1991 Tex. Gen. Laws 3520 (proposing a constitutional amendment relating to investments by statewide retirement systems).

³In 2018, this office issued KP-0220 regarding the System’s authority to invest in certain life insurance products. *See* Tex. Att’y Gen. Op. No. KP-0220 (2018). Noting the Legislature’s 1999 legislative action, as discussed hereinafter, Opinion KP-0220 declared JC-0043 superseded to the extent inconsistent with state law. *Id.* at 2, n.5.

portfolios.” *Id.* Subsection 825.301(a) goes on to specify particular investments considered to be securities. *Id.*

In the first of the cross-referenced provisions above, the Texas Securities Act defines “security” or “securities” to

include any limited partner interest in a limited partnership, share, stock, treasury stock, stock certificate under a voting trust agreement, collateral trust certificate, equipment trust certificate, preorganization certificate or receipt, subscription or reorganization certificate, note, bond, debenture, mortgage certificate or other evidence of indebtedness, any form of commercial paper, certificate in or under a profit sharing or participation agreement, certificate or any instrument representing any interest in or under an oil, gas or mining lease, fee or title, or any certificate or instrument representing or secured by an interest in any or all of the capital, property, assets, profits or earnings of any company, investment contract, or any other instrument commonly known as a security, whether similar to those herein referred to or not.

TEX. REV. CIV. STAT. art. 581-4(A).⁴ Next, under the federal Securities Act of 1933, a “security”

means any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a “security,” or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

15 U.S.C. § 77b(a)(1). Finally, the federal Securities and Exchange Act of 1934 defines “security” to mean

any note, stock, treasury stock, security future, security-based swap, bond, debenture, certificate of interest or participation in any profit-

⁴Effective January 1, 2022, the Texas Securities Act will be codified as Title 12 of the Government Code in sections 4001.001–4008.105. See Act of May 21, 2019, 86th Leg., R.S., ch. 491, § 1.01, 2019 Tex. Sess. Law Serv. 1238, 1238–1307.

sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a “security”; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker’s acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

Id. § 78c(a)(10). And in specifying particular investments “considered to be securities,” for purposes of the System’s constitutional investment authority, subsection 825.301(a) identifies “[a]n interest in a limited partnership or investment contract” and “[a]ny instrument or contract intended to manage transaction or currency exchange risk in purchasing, selling, or holding securities.” TEX. GOV’T CODE § 825.301(a). Thus, the Legislature defined the term “securities” for purposes of the System’s constitutional investment authority broadly and comprehensively.

Since the time of Opinion MW-152’s analysis regarding whether the System possessed authority to invest in real estate, however, no changes to the Texas Constitution have broadened the investment authority of the System beyond “securities.” Thus, investments of System funds directly in realty continue to be unconstitutional. Tex. Att’y Gen. Op. Nos. KP-0220 (2018) at 2, n.5; JC-0043 (1999) at 21. But the Legislature’s broad delineation in subsection 825.301(a) of what constitutes a “security” for purposes of the System’s investment authority includes some elements that could potentially be associated with real estate. For example, each of the state and federal securities regulatory statutes incorporated by reference in subsection 825.301(a) include “investment contracts” in their definitions of “security.” See TEX. GOV’T CODE § 825.301(a); TEX. REV. CIV. STAT. art. 581-4(A); 15 U.S.C. § 77b(a)(1); 15 U.S.C. § 78c(a)(10); see also *Life Partners, Inc. v. Arnold*, 464 S.W.3d 660, 667 (Tex. 2015) (explaining the meaning of “investment contract” for purposes of the Texas Securities Act). In briefing sent to this office, the Texas State Securities Board (the “Board”) explains how certain securities known as “real estate securities” resemble investment contracts:

[“Real estate securities”] generally consist of interests, either debt or equity, in publicly traded real estate investment trusts . . . or real estate related operating companies. In these cases, the securities held by passive investors represent interests in the company that

owns and manages the real estate. As such, these securities resemble investment contracts.⁵

In addition, subsection 825.301(a) incorporates the Texas Securities Act definition of “security,” which includes “any limited partner interest in a limited partnership.” TEX. GOV’T CODE § 825.301(a); TEX. REV. CIV. STAT. art. 581-4(A). The System tells us that “private real estate funds are generally organized as limited partnerships” and describes its current investment holdings in such limited partner interests, along with its application of investment contract analysis under applicable caselaw “[w]hen appropriate.”⁶

You do not specify a particular real estate investment of the System as the focus of your inquiry. Investment vehicles are often complex and nuanced, and whether a particular investment product is a security for purposes of the System’s investment authority “will depend on the structure of the product and other fact-based inquiries that this office cannot undertake in the opinion process.” Tex. Att’y Gen. Op. No. KP-0220 (2018) at 4. Nor can this office address a remedy without a particular investment in mind. But to the extent any real estate investment of the System does not qualify as a “security” pursuant to subsection 825.301(a) of the Government Code, it is unconstitutional.

⁵Letter from Ms. Marlene K. Sparkman, Gen. Counsel, Tex. State Sec. Bd., to Ms. Virginia K. Hoelscher, Chair, Op. Comm. at 2 (Mar. 31, 2020) (on file with the Op. Comm.).

⁶Letter from Ms. Carolina de Onis, Gen. Counsel, Teacher Ret. Sys., to Honorable Ken Paxton, Tex. Att’y Gen., at 1–4 (Mar. 27, 2020) (on file with the Op. Comm.).

S U M M A R Y

Article XVI, subsection 67(a)(3) of the Texas Constitution and section 825.301 of the Government Code specify the authority of the Teacher Retirement System to invest its funds, which is limited to items qualifying as “securities” under subsection 825.301(a). To the extent any real estate investment of the System does not qualify as a “security” pursuant to subsection 825.301(a), it is unconstitutional.

Very truly yours,

A handwritten signature in black ink that reads "Ken Paxton". The signature is written in a cursive, flowing style.

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