

October 9, 1986

Honorable Robert W. Peterson  
State Auditor  
Office of the State Auditor  
State Capitol  
Bismarck, ND 58505

Dear Mr. Peterson:

Thank you for your letter of September 23, 1986, in which you seek my advice concerning four questions. First, may political subdivisions legally invest in money market mutual funds? Second, what requirements should the state's audit staff use to determine if investments are legal for political subdivisions? Third, are there legal requirements governing political subdivisions in retaining investment agents for purchasing their investments? Fourth, are security pledges required from a depository if a political subdivision invests in money market mutual funds?

The answer to your first question is controlled by N.D.C.C. § 21-06-07 which permits political subdivisions to invest their excess general and special funds "in bonds, treasury bills, and notes or other securities which are a direct obligation of the treasury of the United States or of an instrumentality thereof. . . ." The money market mutual funds contemplated as an investment by political subdivisions are not included within the legal list set forth in N.D.C.C. § 21-06-07. However, because the underlying assets of such a fund may constitute permissible investments for a political subdivision, a further discussion of the mutual fund or unit trust concept is warranted.

An investment in The Dreyfus Cash Management Fund (a money market mutual fund) involves purchasing shares of the Fund, the underlying assets of which constitute securities issued or guaranteed as to principle and interest by the U.S. government or its agencies or instrumentalities, and repurchase agreements in respect to these securities. See prospectus, page 2. The Fund, not the individual investors, is the owner of the government obligations.

In addition to purchasing and selling government obligations, the Fund also invests in repurchase agreements. Repurchase agreements involve the acquisition by the Fund of a government debt instrument for a relatively short period (usually not more than one week) subject to an obligation of the seller to repurchase, and the Fund to resell, the instrument at a fixed price. See prospectus, page 2. Repurchase agreements are essentially credit arrangements whereby the owner of the government obligation receives a short-term loan and uses the government obligation as collateral. The Fund's prospectus acknowledges that such a transaction is properly characterized as a loan. See prospectus, page 2.

Loans of public funds to private financial institutions are impermissible investments for political subdivisions. See N.D.C.C. § 11-14-20; 1982 N.D. Op. Att'y Gen. 228. Repurchase agreements, thus, are not permissible investments for public funds as set

forth in various sections of the North Dakota Century Code. Inasmuch as the asset portfolio of the Fund contains such repurchase agreements, the Fund itself is an impermissible investment for political subdivisions.

Additionally, the Fund is empowered to borrow money from banks in an amount up to 5% of the value of the Fund's total assets and to encumber its assets (up to 10%) to secure such borrowing. See prospectus, page 2. Such powers clearly violate the legislative intent as expressed in N.D.C.C. § 21-06-07 that investments of political subdivisions be highly secure and that any risk of loss of such funds be nonexistent for all practical purposes. The Fund's prospectus concedes the risk factor in stating that "there can be no assurance that the Fund's investment objective will be achieved or that the Fund will be able to maintain a net asset value of \$1.00 per share." See prospectus, page 3.

Therefore, it is my opinion that money market mutual funds are not permissible investments for political subdivisions under current legislation.

Your second question is concerned with whether there are legal guidelines to aid your audit staff in determining the legality of political subdivisions' investments. The investment authority for political subdivisions can essentially be broken down into two areas. First, as mentioned previously, N.D.C.C. § 21-06-07 permits political subdivisions to invest their excess general and special funds "in bonds, treasury bills, and notes or other securities which are direct obligation of the treasury of the United States or of an instrumentality thereof. . . ."

N.D.C.C. § 21-06-07 contemplates direct ownership of the enumerated investments as opposed to a unit trust or mutual fund approach.

The second area of investment authority for political subdivisions involves the depositing of funds with duly designated depositories and/or the Bank of North Dakota pursuant to N.D.C.C. Ch. 21-04. N.D.C.C. § 21-04-05 provides that the governing body of a political subdivision may designate a depository for its funds. The depository must be a "financial institution" situated and doing business within this state. "Financial institution" is defined to include state-chartered or federally-chartered banks and credit unions that are insured by the Federal Deposit Insurance Corporation and/or the National Credit Union Administration. N.D.C.C. § 21-04-01(3).

After designating a depository for its funds, the governing body is also required to ensure that the deposits are adequately secured by a surety bond or federal insurance and/or pledge of securities. N.D.C.C. §§ 21-04-07, 21-04-08, 21-04-09. If the requirements discussed above are satisfied, a political subdivision may invest its moneys in either demand deposits or time deposits of an appropriate institution.

Other than these two limited areas of permissible investments (N.D.C.C. § 21-06-07 and N.D.C.C. Ch. 21-04) there does not exist statutory authority for political subdivisions to pursue additional types of investments. Hopefully, the above discussion will provide

adequate guidance to your audit staff for the purpose of determining the legality of investments by political subdivisions.

Your third question relates to a political subdivision's authority to employ an agent in purchasing its investments. As stated above, N.D.C.C. Ch. 21-04 sets forth the legal requirements regarding the designation of public depositories by a political subdivision for the investment of its funds in demand or time deposits.

The North Dakota Century Code does not restrict the means by which a political subdivision may purchase permissible securities pursuant to N.D.C.C. § 21-06-07. Thus, it is my interpretation of N.D.C.C. § 21-06-07 that a political subdivision may purchase the enumerated investments by utilizing any investment agent that it deems prudent.

Your fourth inquiry concerns whether security pledges are required for the depositing of funds in money market mutual funds. Inasmuch as money market mutual funds are not permissible investments for political subdivisions under current North Dakota law, this situation should never arise.

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

Sincerely,

Steven E. Noack  
Assistant Attorney General