Office of the Attorney General
State of North Dakota

Opinion No. 82-77

Date Issued: November 19, 1982

Requested by: L. M. Stenehjem, Jr.
Commissioner of Banking and Financial Institutions

--QUESTION PRESENTED--

Whether public funds of political subdivisions may be invested in repurchase agreements with financial institutions located in North Dakota.

--ATTORNEY GENERAL'S OPINION--

It is my opinion that public funds of political subdivisions may not be invested in repurchase agreements with financial institutions located in North Dakota.

--ANALYSIS--

The Legislative Assembly has specified the precise types of investments which may be made with public funds of political subdivisions. Permissible investments for such public funds include interest-bearing deposits in duly designated public depositories. See Chapter 21-04 of the North Dakota Century Code. Additionally, sinking funds may be invested in the outstanding bonds for which the sinking funds are required and in interest bearing bonds of the United States, North Dakota, or municipalities as defined. See Section 21-03-43, N.D.C.C. Political subdivisions are also permitted 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. . . .' See Section 21-06-07, N.D.C.C. The public funds of political subdivisions may also be invested in 'notes or bonds secured by mortgage or deed of trust insured by the federal housing administrator, and debentures issued by the federal housing administrator, and in securities issued by national mortgage associations.' See Section 6-03-48, N.D.C.C.

All deposits of public funds in duly designated public depositories must be secured by a pledge of one hundred ten dollars in eligible securities for each one hundred dollars of public funds deposited (Section 21-04-09, N.D.C.C.), be insured by the Federal Deposit Insurance Corporation (Section 21-04-16, N.D.C.C.), or be secured by bond in favor of the public corporation depositor (Section 21-04-08, N.D.C.C.). Clearly, the Legislative Assembly intended that the authorized investments of political subdivision public funds must be highly secure and that any risk of loss of such funds must be nonexistent for all practical purposes.

A retail repurchase agreement is a means by which a financial institution 'purchases' funds from a customer subject to an obligation to repay the funds plus interest at a future time. Such a transaction has aspects of both a sale/repurchase and of borrowing. 2 Banking Law (M.B.) at § 26.12(1). The Department of Banking and Financial Institutions requires state banks to report funds acquired through repurchase agreements as borrowings.

Although many retail repurchase agreements suggest that the customer of the financial institution is purchasing an undivided interest in a larger U.S. government or agency security of the type which would be a permissible investment for public funds of a political subdivision in accordance with Sections 21-06-07, 6-03-48, or 21-03-43, N.D.C.C., the ability of a financial institution to fractionalize ownership of a U.S. government security is not clear. 2 Banking Law (M.B.) § 26.12(1), n. 3. Most repurchase agreements specify that the customer is not to be considered an owner of the underlying U.S. government or agency security. Repurchase agreements may also purport to create either a security interest or an equitable interest in favor of the customer in an underlying U.S. government security. However, repurchase agreements do not usually contain provisions to ensure the proper perfection of the security interest even if such an interest is created. Further, repurchase agreements state that funds transferred to the financial institutions are not deposits of the institutions and are not insured by federal deposit insurance. Thus, in the event of a default by the financial institution, the customer usually must rely on the equitable interest in the underlying U.S. government security or on the general credit worthiness of the financial institution for repayment. Id. at Section 26.12(1). Repurchase agreements do not provide for a pledge of assets, bond, or the federal deposit insurance which is required as security for the deposit of public funds in such a financial institution and no such security exists for the repayment of public funds which would be invested in repurchase agreements.

Repurchase agreements are not specified as permissible investments for public funds as set forth in various sections of the North Dakota Century Code and are not deposits which are subject to the public depository provisions of Chapter 21-04, N.D.C.C. Instead, repurchase agreements may more properly be determined to be loans of money to a financial institution. Section 47-14-01, N.D.C.C., states in part as follows:

'LOAN OF MONEY' DEFINED.--A loan of money is a contract by which one delivers a sum of money to another and the latter agrees to return at a future time a sum equivalent to that which he borrowed. . . .

Loans of public funds to private financial institutions are not permitted by law. See, e.g., Section 11-14-20, N.D.C.C., which prohibits loans of county funds and imposes a forfeiture for such loans and Article X, § 18 of the North Dakota Constitution which generally prohibits the making of loans or the extension of credit by political subdivisions. Since repurchase agreements are not investments which are deemed permissible by the

Legislative Assembly and are not deposits in accordance with Chapter 21-04, N.D.C.C., it is my opinion that public funds may not be invested in such agreements.

--EFFECT--

This opinion is issued pursuant to Section 54-12-01, N.D.C.C. It governs the actions of public officials until such time as the questions presented are decided by the courts.

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