



STATE OF KANSAS

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ATTORNEY GENERAL OPINION NO. 89- 123

Meredith Williams
Legislative Post Auditor
Legislative Division of Post Audit
109 West 9th, Suite 301
Mills Building
Topeka, Kansas 66612-1285

Re: Roads and Bridges; Miscellaneous -- Express
Highways and Freeways -- Management and Investment
of Moneys in Freeway Fund; Prudent Person Standard

Synopsis: Securities issued by the Federal Home Loan Mortgage
Corporation or the Federal National Mortgage
Association, and certificates of deposit in the
Kansas funds for Kansas farmers and small
businesses program are not inherently improper
investments of money in the state freeway fund.
Cited herein: K.S.A. 17-5004; 58-3601; 58-3606;
K.S.A. 1988 Supp. 59-3019; K.S.A. 1988 Supp.
68-2311, as amended by L. 1989, ch. 48, § 89;
K.S.A. 1988 Supp. 74-4921; 75-4201, as amended by
L. 1989, ch. 48, § 104; L. 1986, ch. 331, § 1;
12 U.S.C.S. § 1719(e).

* * *

Dear Mr. Williams:

You have requested our opinion regarding certain investments
of public moneys. Specifically, you ask whether
mortgage-backed securities issued by the Federal Home Loan

Mortgage Corporation (Freddie Mac) or the Federal National Mortgage Association (Fannie Mae), and one-year certificates of deposits in the Kansas funds for Kansas farmers and small businesses program (Kansas funds program), are proper investments for money in the state freeway fund. We conclude that such investments do not inherently conflict with the statutes governing management of the fund.

The pooled money investment board is charged with the duty of investing moneys in the freeway fund, which are considered trust funds. K.S.A. 1988 Supp. 68-2311, as amended by L. 1989, ch. 48, § 89. The standard of care to which the board is held is that of the prudent person:

"In investing or reinvesting moneys in the funds, and in acquiring, retaining, managing and disposing of investments of the funds, there shall be exercised the judgment and care under the circumstances then prevailing, which persons of 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 their funds, considering the probable income as well as the probable safety of their capital." K.S.A. 1988 Supp. 68-2311(a), as amended.

This prudent person standard is not unique to the freeway fund statute. Similar or identical statutory language appears in K.S.A. 17-5004(a)(1) (general rule regarding fiduciaries' standards for investments) and K.S.A. 1988 Supp. 74-4921(4)(a) (investment of KPERS funds). The standard established by these statutes should not be confused with the more flexible business care standard established by the other statutory schemes. For example, the uniform management of institutional funds act establishes a standard of business care, for members of a governing board for certain institutions, as defined in K.S.A. 58-3601(1). See K.S.A. 58-3606. In Attorney General Opinion No. 85-153, we explained the distinction between the prudent person and business care rules, stating that the business care standard allows greater discretion in investment decisions. A more restrictive standard is applied to conservators. See K.S.A. 17-5004(b). A list of suitable investments for conservators appears in K.S.A. 1988 Supp. 59-3019. Also more restrictive are the types of securities a

financial institution may pledge to secure the deposit of public funds.

Freddie Mac securities are eligible as securities to be pledged for securing the account of public funds. See K.S.A. 1988 Supp. 75-4201(p), as amended by L. 1989, ch. 48, § 104; Attorney General Opinion No. 86-20, modified in part by L. 1986, ch. 331, § 1. Likewise, Fannie Mae securities are eligible to pledge as security for the deposit of public funds, even though these securities are not direct obligations of the United States government or one of its agencies. See 12 U.S.C.S. § 1719(e). [The Fannie Mae securities are therefore not proper investments for moneys in the freeway construction fund, as that fund is subject to additional limitations not applicable to the state freeway fund. K.S.A. 1988 Supp. 68-2311(a), as amended.]

The Kansas funds for Kansas farmers and small businesses program involves one-year certificates of deposit (CD's) from Kansas financial institutions. These CD's are at below-market rates and provide funds for low-interest loans to farmers and small businesses. Investing at below-market rates is not per se a breach of a trustee's duty. Obviously a trustee is under a duty to invest trust funds. Burch v. Dodge, 4 Kan.App.2d 503, 509 (1980). However, we do not find any case which directly places a burden on a trustee to choose one CD over another in light of differing interest rates. One court has held that loaning ERISA trust funds at 2 1/8 percent less than the prevailing interest rate was not a breach of trust so long as the rate of return was reasonable, even when applying the "prudent investor rule." Brock v. Walton, 794 F.2d 586 (11th Cir. 1986). Thus, while it would be preferable for the program to be established by statute, the mere fact that the CD's are at below-market interest does not render them imprudent, as a matter of law. [We assume that the purpose of the investment in this program is for the benefit of the freeway fund, and the trustees are not failing in their duty of loyalty by favoring the Kansas funds program at the expense of the freeway fund.]

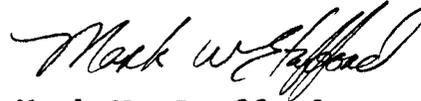
It may be possible to invest these moneys in securities or instruments which result in a slightly better return. As long as the investments are within the prudent person standard, however, we are not permitted to second-guess their advisability. One would have to show a breach of fiduciary duty to invalidate an otherwise prudent investment.

In conclusion, it is our opinion that securities issued by the Federal Home Loan Mortgage Corporation or the Federal National Mortgage Association, and certificates of deposit in the Kansas funds or Kansas farmers and small businesses program are not inherently improper investments of moneys in the state freeway fund.

Very truly yours,



ROBERT T. STEPHAN
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