Opinion No. 69-115

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BY: OPINION OF JAMES A. MALONEY, Attorney General Gary O'Dowd, Deputy Attorney General

TO: Mr. Ed Hartman, Chairman, State Investment Council, P.O. Box 966, Santa Fe, New Mexico 87501

QUESTIONS

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May the State Investment Council lawfully invest funds under its jurisdiction in loans guaranteed by the United States Small Business Administration?

CONCLUSION

Yes, but see analysis for qualifications.

OPINION

*{*183}* ANALYSIS

The statutory provisions which enumerate the securities in which the State Investment Council may invest are set forth in Section 11-2-8.12, N.M.S.A., 1953 Compilation. A detailed list of securities is provided and, in pertinent part, Section 11-2-8.12(A) specifically permits investment in:

"A. Bonds, notes, or other obligations of the United States, or those guaranteed by, or for which the credit of, the United States is pledged for the payment of the principal and interest or dividends thereof; . . ."

It is the practice of the Small Business Administration to underwrite or guarantee loans through the procedure established in the Small Business Act of 1953, 15 U.S.C. 631, et seq. The statutory plan contemplates that local banks will apply to the Small Business Administration for its guarantee of a loan to a specific New Mexico business; upon determination by the Small Business Administration that a guarantee would be proper, the bank and the Small Business Administration enter into an agreement whereby the repayment of the loan is substantially guaranteed by the Small Business Administration and whereby the bank may sell or assign an interest in a part of the loan. Inasmuch as the Small Business Administration assumes in these matters the role of guarantor of payment by the borrowing business, the Small Business Administration places itself under the duty of making payment, should it be required to perform on the guarantee, in the same form as that to which the business is obliged. Thus, in the ordinary course of

dealings, a Small Business Administration guarantee would be performed in money, and not in debentures or other negotiable instruments.

It is the frequently-repeated position of the Attorney General of the United States that guarantees of the sort here discussed are obligations of the United States. 42 Op. Att'y Gen. 1 (April 14, 1961) declares:

"A series of opinions of the Attorney General between 1953 and 1959 has established that a guarantee by a government agency contracted pursuant to a congressional grant of authority for constitutional purposes is an obligation fully binding on the United States . . ."

With particular reference to Small Business Administration guarantees, a letter from Attorney General N. deB. Katzenbach to R. D. Davis, Executive Administrator of the Small Business Administration, April 1, 1966, re-affirms the position of the Attorney General of the United States that *{*184}* "these guarantees are fully binding on the United States and are backed by its full faith and credit."

It has been the position of this office that other forms of federally backed loans and guarantees are proper objects of investment by the Council. See Attorney General Opinions Nos. 66-12 (January 31, 1966); 65-87 (June 8, 1965); 61-49 (June 9, 1961); and 59-135 (September 2, 1959). These opinions have considered various federal programs as objects of state investment, and have determined that within certain limitations involving servicing charges and forms of payment, the guarantee of a federal agency constitutes a pledge of the credit of the United States.

In order for the guarantee to meet the standards necessary for protection of the State's interests, however, that guarantee must not be conditional or voidable on the happening of events over which the State has no control. With particular reference to paragraph 17, Small Business Administration Form 597 (2-69), clarification of this point is in order before the State Investment Council may legally participate in the loan programs. Paragraph 17 (a) releases the Small Business Administration from its obligation as guarantor in the event of improper administration of the program by the participating bank. It is this office's understanding that in such circumstances the Small Business Administration contemplates remaining the guarantor of the State's investment, and would proceed against the bank for recovery of the guarantee paid. Such an arrangement should be explicitly incorporated into the instruments of State participation, and should be acknowledged by the parties at the time any agreement is signed. Such a provision would insure the protection of the State's interest, and would therefore be essential to the validity of participation by the State Investment Council.

It should additionally be noted that the Small Business Administration guarantees only a maximum of ninety percent of each loan made by participating banks. It is therefore apparent that any investment by the State Investment Council must be in that fractional portion of the individual loan which is completely guaranteed by the Small Business Administration. As a corollary, it would be improper for the State Investment Council to

invest in any given loan to an extent greater than ninety percent of its face value. It is our understanding that the acquisition of completely-guaranteed fractional shares of individual loans is permitted by the Small Business Administration regulations, and that several other states' investment authorities are presently participating in precisely this manner. So long as the State Investment Council is careful to acquire only guaranteed portions of Small Business Administration loans, such acquisition lies within the statute.

The question of the payment of so-called "servicing fees" has arisen as a result of language included in earlier opinions of this office concerning investment in FHA mortgages.

In Attorney General Opinion No. 61-49, **supra,** it was said that payments by the State Investment Council to a stock management company in return for its assistance and advice were improper. This conclusion was based on the basic trust doctrine that precludes a fiduciary from delegating his duties of discretion and judgment. With this notion we have no reason to be dissatisfied. We do, however, note that investment-participation plans which involve a certain expense of administration were explicitly approved in Attorney General Opinion No. 65-87, **supra.** We regard the facts involved therein as substantially the same as those here under consideration, and feel that no improper payment are required by the Small Business Administration loan-participation plan.

In summary, it would appear *{*185}* that the loan-guarantees made by the Small Business Administration are properly regarded as obligations of the United States. Provided that the State Investment Council acts in compliance with the terms of the Small Business Act and the rules of the Small Business Administration, and further provided that the portions of the loans which the Council might acquire are underwritten by the Small Business Administration, it is our opinion that the State Investment Council may invest state moneys in loans guaranteed by the Small Business Administration.