

SINKING FUND STUDY COMMITTEE FINAL REPORT

The Sinking Fund Study Committee held its first meeting on November 30, 1984. At the meeting representatives of several governmental units and representatives of financial institutions addressed the Committee on the implementation of the pledging of collateral provisions and the repeal of the state sinking fund enacted in S.F. 2220 (84 Acts, Chapter 1230). Testimony presented at the meeting primarily dealt with the problems encountered in implementing the pledging system, the problems existing with the state sinking fund, and an exploration of options. The following is a brief summary of the points.

1. REASONS FOR THE ELIMINATION OR POSTPONEMENT OF PLEDGING AS EXPRESSED BY WITNESSES.

a. Pledging may place a monetary burden on local government units. The increased costs and paperwork incurred by financial institutions may be passed on to the governmental unit. This cost may be manifested to the governmental unit in service charges and a decreased rate of return on the deposited public funds.

b. There may be an additional administrative burden placed upon the public body treasurers as a result of pledging. The public body treasurers must do more paperwork in executing and implementing pledging. In addition, they must continuously monitor the value of pledged securities.

c. Concern has been expressed regarding the legal sufficiency of the pledging system to protect the governmental deposits. The problem involves the difficulty of obtaining a security interest on a U.S. government security that exists simply as an entry on a computer tape as opposed to the ease of obtaining a security interest on an existing paper certificate. Until a few years ago, most U.S. securities existed in paper certificate form. Increasingly, these are being replaced by entries on a computer tape. In the opinion of some witnesses, the problem has yet to be solved either by legislation or in the courts.

d. The pledging system used in other states have been called into question because of the legal issues raised in implementing the Iowa pledging mechanism. While the Federal Reserve System should have a mechanism which Iowa can utilize, the existing system has been rendered obsolete due to rapid technological changes in computer technology. However, the legal framework to deal with the computer technology has not been fully developed. It is expected that problems in the system will be resolved in the next few years.

2. REASONS FOR ELIMINATING THE STATE SINKING FUND AND INSTEAD USING PLEDGING OF ASSETS TO PROVIDE SECURITY FOR PUBLIC FUNDS.

a. The sinking fund makes the financial institutions liable for governmental losses arising from management practices of other financial institutions. The sinking fund approach favors the poorly managed institution at the expense of those which are well managed.

b. S.F. 2220 (84 Acts, chapter 1230) allowed savings and loan associations, savings banks, and credit unions to accept public funds. Previously, only banks could accept public funds. Thus, the sinking fund as currently structured would require financial institutions to be responsible for losses of public funds in differing types of financial institutions with difficult regulatory structures.

c. The potential costs of the sinking fund to financial institutions would be magnified if the failure of several financial institutions occurred within a short period of time. The sinking fund approach works best when there are few or no financial institution failures.

3. PROPOSED ALTERNATIVES FOR COMMITTEE ACTION.

a. Modification of the pledging system to provide greater security to the public funds and to reduce the paperwork.

b. Postpone pledging and return to the sinking fund temporarily. Explore the possibility of immediate contributions to the fund. Refunds if contributions are not used by the time the fund is terminated.

c. Abolish pledging and reinstate sinking fund with some possible modifications in how the sinking fund is currently operating.

4. COMMITTEE ACTION.

The Committee met on January 7, 1985 and heard reports from several individuals updating the status of pledging, efforts to resolve the legal and administrative problems, and proposals. After extended discussion on the issues, the Committee adopted this report as its final report.