F I N A L   R E P O R T

MONEY MARKET AND MORTGAGE INVESTMENT FUNDS SUBCOMMITTEE

January, 1982

The Money Market and Mortgage Investment Funds Subcommittee of the Senate and House Standing Committees on Commerce was created by the Legislative Council in response to Senate Concurrent Resolutions 29 and 34, and Senate Resolution 19, introduced during the 1981 Session.

Under the Resolutions, the Subcommittee was charged with studying the following issues:

1. The effect of the increased use of money market funds investment on the Iowa economy and on the financial and business communities of the state and recommending necessary legislative changes, if any.

2. The problems of funding mortgage investment and special consideration of mortgage investment of moneys in the Iowa Public Employees' Retirement Fund and recommending necessary legislative changes, if any.

A Subcommittee of ten members was appointed, consisting of members of the House and Senate Standing Committees on Commerce. The members of the Subcommittee were: Senator Edgar H. Holden, Chair; Senators Richard Comito, John Jensen, Berl Priebe, and Patrick Deluhery; and Representatives LaVerne Schroeder, Robert M. L. Johnson, Douglas Shull, Charles Bruner, and Ned Chiodo.

The Subcommittee was authorized two meetings; these were held in Des Moines on November 24 and December 2, 1981. The Subcommittee heard testimony on each issue on each meeting day.

Money Market Mutual Funds

At its November 24 meeting, the Subcommittee received testimony from the following persons and groups concerning money market mutual funds: Kathryn M. Moon, National Retired Teachers' Association and American Association of Retired Persons; Merle Wilson and E. C. Betz, Iowa Retired Teachers' Association; Craig A. Goettsch, Superintendent of Securities, Iowa Department of Insurance; Kent Klopfenstein and Richard Goodsen, Iowa Savings and Loan League; John Pringle, Supervisor of Savings and Loan Associations, Office of the Auditor of State; Wes Ehrecke and F. Richard Thornton, Iowa Bankers Association; Thomas H. Huston, Iowa Superintendent of Banking; Ralph Schnur, Iowa Farm Bureau Federation; James Carney, Investment Company Institute; and John Sullivan, Iowa Credit Union League. At its December 2 meeting, the Subcommittee received testimony from the following persons and associations on money market mutual funds: William H. Dudley, Investors Diversified Services; Paul Newhauser, University of Iowa School of Law; Robert Soldofsky, Professor of Finance, University of Iowa, all on behalf of the Investment Company Institute; and James Mackay, R. G. Dickinson and Company.

Several speakers, arguing against further regulation of money market funds, opined that regulation, such as Senate File 550 introduced in the 1981 Session of the General Assembly, would be most detrimental to small investors, such as retirees, and to investors needing a very liquid, high-yield investment for a short time, such as farmers and small businesspersons. These persons see investment in money market funds as their only opportunity to gain access to market interest rates and to maintain the value of assets during periods of high inflation. Other speakers suggested that investment in money market funds is not causing the current financial difficulties of banks, savings and loan associations and other depository institutions. Rather, they argued, these difficulties are a consequence of past investment strategies of the institutions and over-regulation of the institutions by state and federal authorities. Traditionally, these institutions have made long-term loans while receiving deposits in short-term checking and savings accounts and have had to comply with regulatory limits on the interest rates they could offer investors as well as keep noninterest bearing reserves against their depository accounts. Money market funds are not subject to similar requirements.

Both proponents and opponents of money market mutual fund investment expressed the belief that continued federal and state deregulation of depository institutions is needed if these institutions are to compete successfully with money market funds for investors' dollars. Mr. Klopfenstein and Mr. Goodsen, speaking on behalf of the Iowa Savings and Loan League, observed that federal deregulation of savings and loan associations is occurring rapidly and will give federal associations the ability to effectively compete with money market funds. They opined, however, that federal deregulation endangers the dual system of having both federal and state chartered associations unless similar deregulation occurs on the state level. To this end, the League submitted a proposed bill draft providing for a revision of chapter 534 regulating savings and loan associations.

Several speakers explained current regulation of money market mutual funds. Craig A. Goettsch explained that money market funds are securities under chapter 502 of the Code and, like most securities registered with the Securities Division of the Department of Insurance, they are not insured. He noted that the Investment Company Act of 1940 requires the funds to be registered with the federal Securities and Exchange Commission. To reduce the investor's risk, the Commission places certain investment restrictions on the funds. Additionally, the federal Securities Act of 1933 requires that the investor receive a prospectus describing the mutual fund, the investment risks, the present portfolio of investments and disclosing the investment objectives of the fund. It was also noted that the federal Investment Company Act may preempt state legislation restricting money market funds and that such regulation may violate the federal Constitution by placing an undue burden on interstate commerce.

After discussion at the December 2 meeting, the Subcommittee decided that any further regulation of money market mutual funds is properly the responsibility of Congress and agreed that the General Assembly should take no action on the issue at this time. In related discussion regarding deregulation of depository institutions, the Subcommittee directed the Legislative Service Bureau to send a letter to the Iowa Savings and Loan League asking the League to prepare a position paper explaining the advantages of continuing the dual-system of having both federal and state-chartered savings and loan associations.

Mortgage Investment Funds

At its November 24 meeting, the Subcommittee received testimony from the following persons and groups concerning mortgage funds: Merle Wilson and E. C. Betz, Iowa Retired Teachers' Association; Edmund Longnecker, Dale DeKoster, and Keith Gungenhauser, Iowa Public Employees' Retirement System; Charles Wasker, James Cooper, and Tom Gratias, Home Builders Association; William McNarney, Iowa Housing Authority; and Bud Ewell, the Iowa Association of Realtors. At its December 2 meeting, the Subcommittee received testimony from Treasurer of State Maurice Baringer and from Edmund Longnecker, Administrator, Iowa Public Employees' Retirement System (IPERS). At the November 24 meeting, representatives of the housing industry recommended that the legislature mandate that at least ten percent of available IPERS funds be invested in securities secured by first liens on Iowa residential property. They opined that mortgages secured by the fund should carry an interest rate of approximately eleven percent. An eleven percent rate would be less than the current market mortgage interest rate, but would assure a greater investment return to the IPERS fund than its current 9.4 percent average return. The industry representatives noted that Iowa home constructions and home purchases are both at extremely low levels, facts which impact seriously on Iowa's economy. The speakers cited current high market interest rates as the principal cause of the housing industry's problems.

William McNarney noted that the IPERS investment portfolio currently contains about $87,000,000 worth of FNMA or GNMA mortgage-backed securities secured by FHA and VA mortgage loans from throughout the United States. He noted that a similar investment in Iowa mortgages would have a favorable impact on the Iowa economy. Representatives of the IPERS Advisory Investment Board stressed that IPERS may now and does invest in securities backed by home mortgages. They opined that the Board has a fiduciary obligation to system members to secure the highest secure rate of return on the IPERS portfolio and; therefore, if IPERS funds are invested in Iowa mortgages the interest terms must be competitive with other available investments. It was noted that the average yield on IPERS investments does not reflect current investment returns. Long-term investments at low market interest rates are now maturing. These result in the 9.4 percent average yield. The current market rate is approximately fourteen percent. At the December 2 meeting, Treasurer of State Baringer testified concerning current investment of all moneys held in the state treasury. He stated that treasury moneys are not available for sufficient lengths of time to permit investment of treasury moneys in mortgage loans. At that meeting, Mr. Longnecker explained current IPERS investments and the growth of the IPERS funds.

After discussion at the December 2 meeting, the Subcommittee agreed that any investment of IPERS funds in Iowa mortgages should be at the market rate. They further agreed that legislation mandating such investment is not appropriate. The Subcommittee then directed the Legislative Service Bureau to draft a resolution to the IPERS Advisory Board requesting that the Board consider investing directly in Iowa mortgages. A copy of this resolution is attached as part of this final report.

CPC-3777

SENATE/HOUSE CONCURRENT RESOLUTION NO.______

By

WHEREAS, the Money Market and Mortgage Investment Funds Subcommittee of the Senate and House Standing Committees on Commerce held hearings on the issue of investment of Iowa Public Employees' Retirement System moneys in first lien mortgages on residential property in Iowa; and

WHEREAS, the Subcommittee found a shortage of funds for loans secured by first lien mortgages on residential property exists in Iowa; and

WHEREAS, the Subcommittee found the shortgage of funds has resulted in a decline in both home sales and new home construction; and

WHEREAS, the Subcommittee found these declines have seriously affected the Iowa real estate and home construction industries; and

WHEREAS, the Subcommittee found these declines consequently have had a detrimental impact on the total economy of Iowa; and

WHEREAS, the Subcommittee found that a demand for decent, affordable housing exists in Iowa; and

WHEREAS, the Subcommittee found the trustee of the Iowa Public Employees' Retirement System has authority under section 97B.7, subsection 2, paragraph b, Code 1981, to invest moneys in the Iowa Public Employees' Retirement fund in bonds, notes, obligations, or other evidence of indebtedness secured by mortgages on deeds of trust which are a first lien upon unencumbered real property when the total indebtedness secured by the lien does not exceed seventy-five percent of the value of the property; and

WHEREAS, the Subcommittee found the trustee does invest in securities secured by mortgage loans on residential real property throughout the United States; and

WHEREAS, the Subcommittee found that a similar investment in Iowa mortgages would be beneficial to the Iowa economy; NOW THEREFORE,

BE IT RESOLVED BY THE SENATE, THE HOUSE CONCURRING, That the trustee of the Iowa Public Employees' Retirement System consider increasing its investment in Iowa mortgages; and

BE IT FURTHER RESOLVED, That the investment in Iowa mortgages be under terms and conditions similar to those for other mortgage-backed securities in which the trustee invests.

LSB:HJW:dg