



DATE: March 11, 2021

TO: House Appropriations Committee

FROM: Lise Kruse, Commissioner

SUBJECT: Testimony in Support of SB 2008

Chairman Vigesaa and members of the Appropriations Committee, thank you for the opportunity to provide testimony regarding the Department of Financial Institutions Appropriation request for the 2021-2023 biennium, SB 2008.

1. DEPARTMENT SUPERVISORY AUTHORITY

The Department of Financial Institutions supervises state-chartered banks, credit unions, trust companies, and other financial corporations which includes collection agencies, money brokers, deferred presentment service providers (payday lenders), money transmitters, mortgage loan originators and debt settlement service providers. The Department also has examination responsibilities for the Bank of North

Dakota. North Dakota Century Code chapters 6, 13, and 51 are associated with the Department.

The Department is a special fund, self-supporting agency, receiving no general fund dollars. The Department's budget consists of three cost centers: (1) banks and trust companies, (2) credit unions, and (3) consumer licensees. Banks, trust companies, and credit unions pay annual assessments that cover all direct examination costs and allocated overhead for the respective cost centers. The State Banking Board and State Credit Union Board are given the authority to set the assessment formula to cover the examination and allocated overhead costs for the respective industry. In addition, trust companies pay examination fees for their safety and soundness examinations; by statute the commissioner sets the examination fee at an amount sufficient to recover costs. Consumer licensees pay fees for processing and supervisory responsibilities related to the consumer cost center: investigation fees upon initial licensing, annual license fees, and examination fees when an examination is performed. Again, the examination fee is set by the commissioner at an amount sufficient to recover all costs.

2. DEPARTMENT PURPOSE

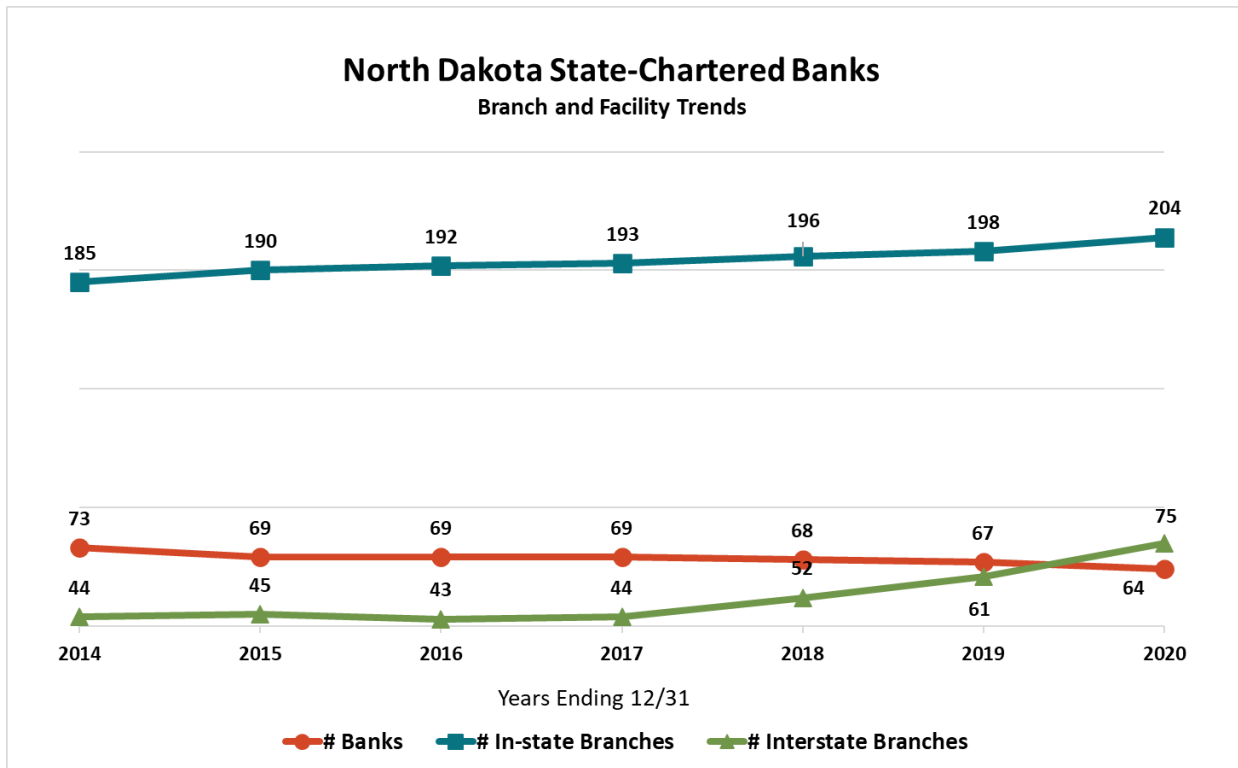
The Department directly serves our banks, credit unions and non-depository financial institutions. Indirectly, every citizen of North Dakota is impacted as they can be confident in the financial services to which they have access. The Department's purpose is to ensure

the safety and soundness of the institutions we regulate, which then results in financial services being available to the North Dakota citizen.

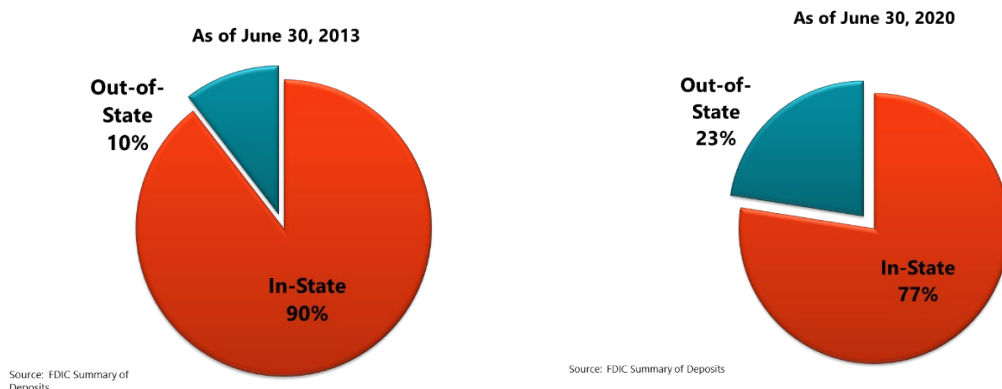
A community bank and credit union are central to economic development. Since our institutions are closely connected to their local markets, they are directly affected when the economy weakens, and throughout North Dakota, the agricultural economy has a large impact. Similarly, any economic pressures resulting from the pandemic may result in an increasing number of bank and credit union customers experiencing difficulties repaying their loans, and the institution ends up with troubled loans or loan losses. When an institution has a large volume of problem assets, and is then categorized as a troubled institution, our Department must exert more resources to ensure the institution is restored to a healthy condition. Key to our mission is to identify and find ways to remediate problem institutions. Our objective is to ensure institutions are financially strong and in compliance with applicable laws and regulations. Strong institutions can take targeted risks that can help their communities.

State-Chartered Banks

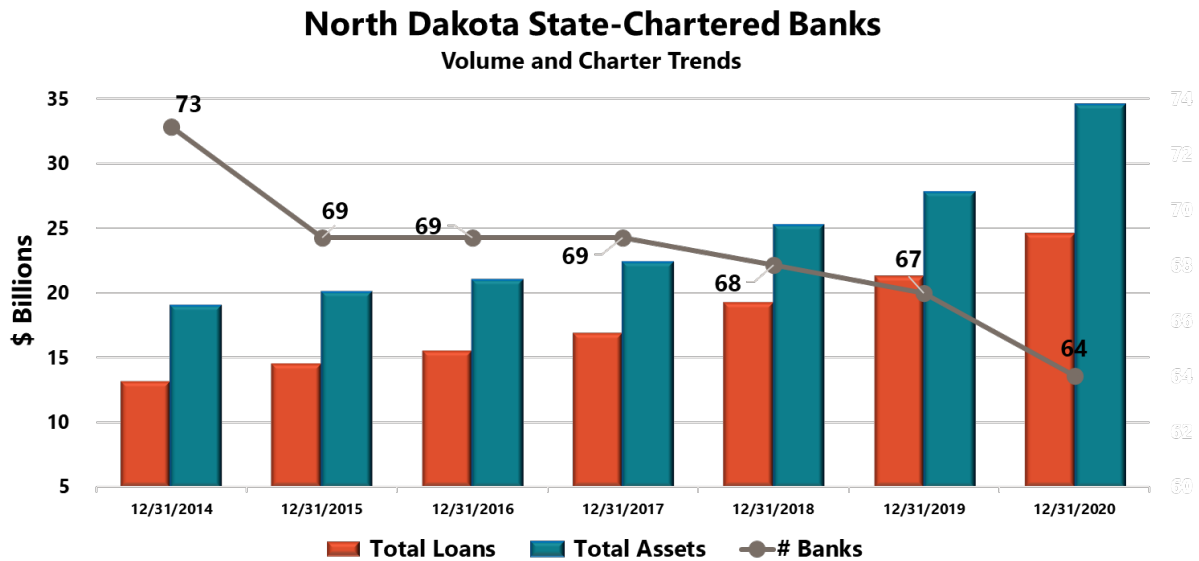
Currently, there are 63 state-chartered banks, plus the Bank of North Dakota, down from the 64 shown in the graph below due to a merger since year-end. The number of banks continue to decline by a few each year due to merger and consolidation activity. While the total number of banks has declined and is expected to further decline, total branches and total assets continue to grow.



Our banks are expanding outside of North Dakota borders. This pie chart shows the banks' deposit percentage that comes from outside of North Dakota.



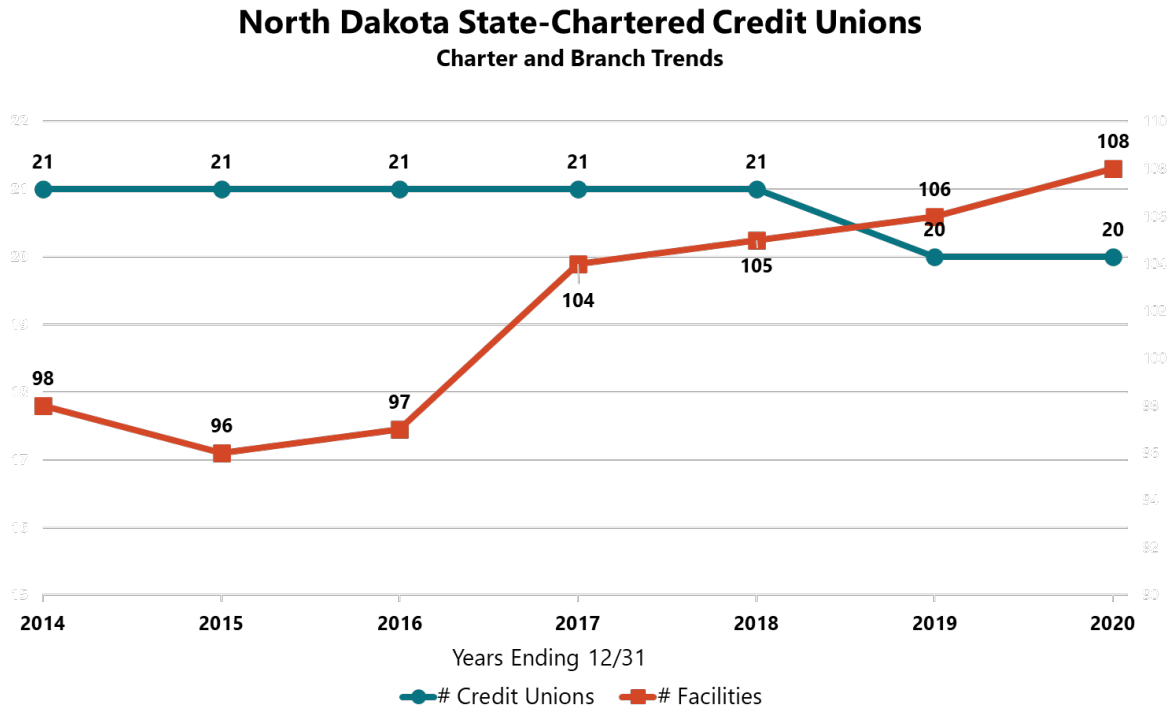
Our banks have merged with out of state banks and have elected to keep the North Dakota charter. We expect the June 2021 numbers to be closer to 30%.



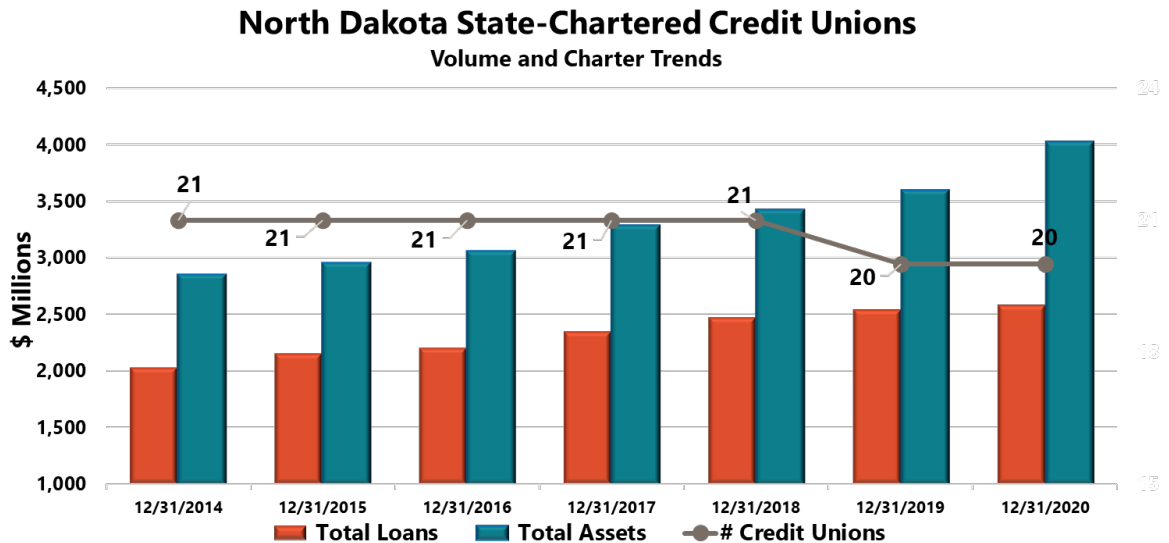
Assets increased 32% from \$25 billion on December 31, 2018, to \$35 billion on December 31, 2020. The continued asset growth increases the Department's responsibilities and time needed to conduct examinations. A majority of examination time is spent on loan review, and total loan volume grew 32% from \$19 billion on December 31, 2018, to \$25 billion on December 31, 2020. Commercial loans are becoming more complex, which requires experienced examiner review. Cybersecurity is a significant concern and therefore more time is dedicated to information technology review during our safety and soundness examinations.

State-Chartered Credit Unions

Currently, there are 20 state-chartered credit unions. As with banks, credit union branches are increasing.



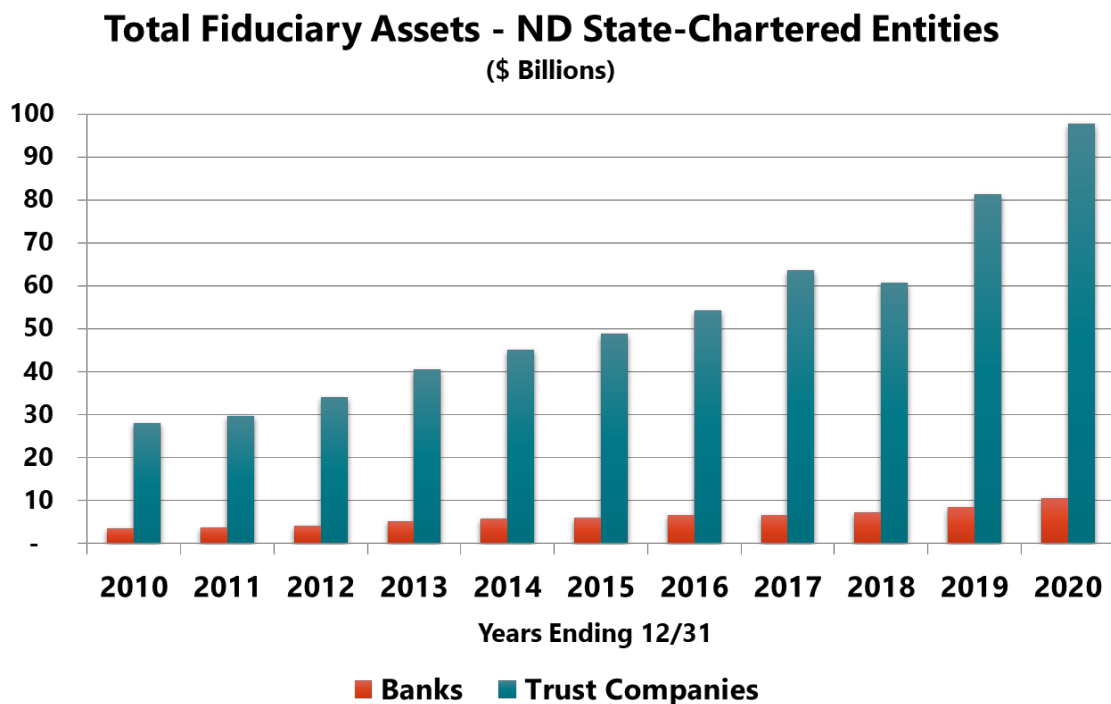
Credit unions also continue to show asset growth, with total assets increasing 18% from \$3.4 billion as of December 31, 2018, to \$4 billion as of December 31, 2020.



Again, asset growth translates into increased loan volume from \$2.5 billion on December 31, 2018, to \$2.6 billion as of December 31, 2020 (4%).

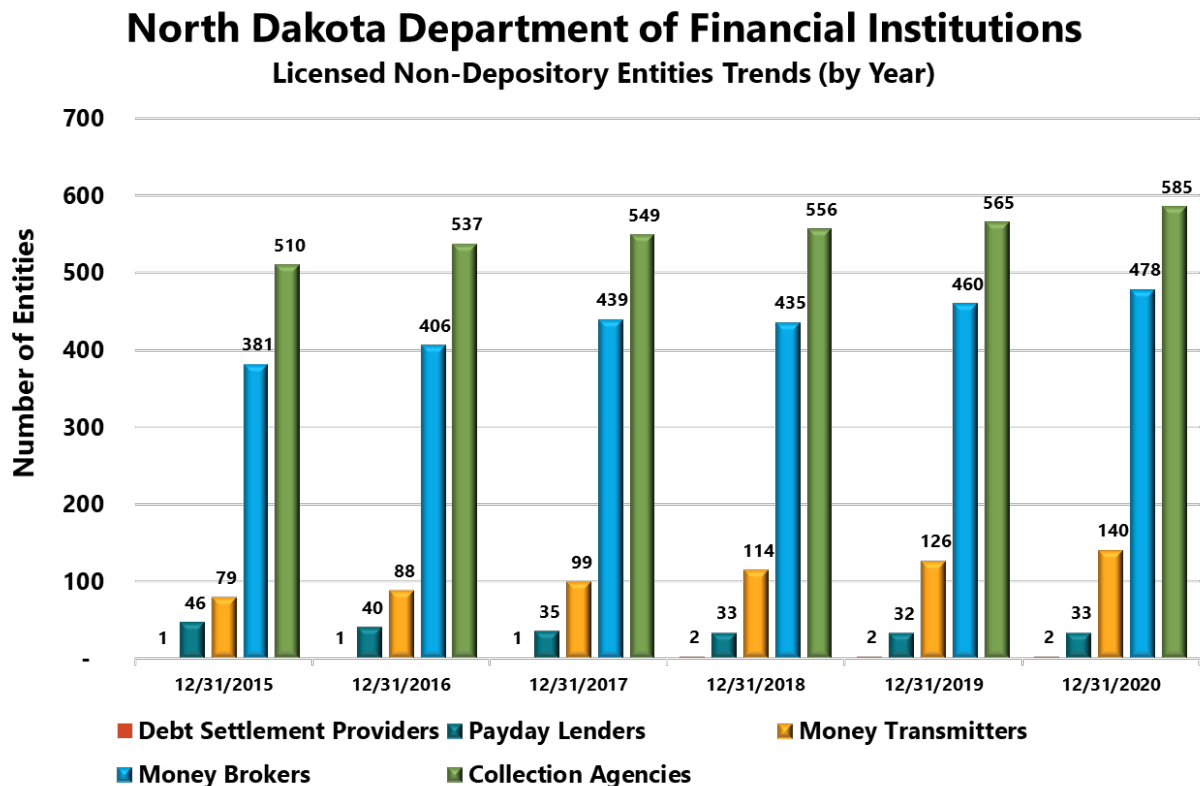
State-Chartered Trust Companies and Bank Trust Departments

There are four state-chartered independent trust companies for which the Department has oversight responsibility; we also have 11 banks which exercise trust powers. The independent trust company examinations are conducted by bank examiners who have acquired specialized trust examination training. The total combined fiduciary assets as of December 31, 2020, of the four independent trust companies total \$98 billion, which compares to \$61 billion as of December 31, 2018; this represents a 61% increase. The banks with trust powers had combined fiduciary assets of \$10.6 billion as of December 31, 2020, compared to \$7.1 billion two years earlier, a 49% increase.



Consumer Licenses

As of January 4, 2021, the consumer division has active licenses totaling a combined 7,061 entities (compared to 4,733 two years ago) including collection agencies, money brokers, mortgage loan originators, deferred presentment service providers (payday lenders), money transmitters, and debt-settlement service providers. The breakdown of the licenses is as follows:



Not included in the graph above are the 5,823 licensed mortgage loan originators, for which we are responsible to track pre-licensing and continuing education requirements.

Attachment 1 is our organizational chart, which shows the structure of our Department. The Department has 31 FTEs and is fully staffed. As you can see from the chart, the Department has 2 chief examiners, 17 bank examiners, 4 credit union examiners, 4 non-depository examiners, and 5 office staff to supervise and examine our regulated entities. The Department has 3 offices; in Bismarck, Grand Forks and Fargo.

3. FINANCIAL AUDIT FINDINGS

There were no audit findings in the most recent audit of our Department.

4. ACCOMPLISHMENTS AND CHALLENGES

Accomplishments

In order to help with the availability of financial services to North Dakota citizens, the Department and the Governor partnered with the banking and credit union associations and applied for a temporary waiver from appraisal credential requirements from the Appraisal Subcommittee in Washington D.C. The waiver is intended to help address the ongoing shortage of licensed appraisers in North Dakota, which has led to significant delays in obtaining appraisals for real estate transactions – especially in rural markets. A temporary waiver was granted in August 2019, the first one granted in nearly 30 years, and it was extended for another year in 2020. This waiver provides relief for North Dakota citizens by giving another option for real estate transactions, it has influenced national policy, and opened necessary dialogue to seek lasting solutions.

The Department received re-accreditation in 2020. The Department's banking division has maintained accreditation through the Conference of State Bank Supervisors (CSBS) since 1992, the credit union division through the National Association of State Credit Union Supervisors (NASCUS) since 2000 and the consumer division through the CSBS/AARMR (American Association of Residential Mortgage Regulators) Mortgage Accreditation Program since 2015. Accreditation signifies that our Department meets or exceeds comprehensive organizational and performance standards. It assures the public of the competency of the agency charged with supervising the safety and soundness of the financial institutions entrusted with the savings and personal finances of North Dakota citizens. It assures the industries that their regulator is effective and efficient with highly trained professionals. It also provides you, our legislators, with an independent validation of the quality and faithfulness to our mission.

The Department continues its involvement on a national basis to ensure North Dakota's voice is heard. I was elected to serve on the CSBS Executive Board in March 2020, and Corey Krebs, the Department's assistant commissioner, serves on the Legislative & Regulatory Affairs Committee and he is the Chair of the Accreditation Committee for NASCUS. In addition, I also serve on the FDIC Regulatory Advisory Board. This involvement ensures that North Dakota interests are represented on the national stage.

The Department has maintained bank and credit union examination frequency within the requirements set by statute and federal regulations. Examinations have continued throughout the pandemic and have been conducted remotely to ensure the safety of our institutions' employees and Department staff.

Challenges

One of the greatest challenges is to make sure the Department is fully staffed with skilled employees. With increased complexities in the financial industry and since our examiners have to be competent in every aspect of banking, it takes 3 to 5 years for an examiner to be fully proficient. Retention has been an issue with about 40% of employees joining our Department within the last two years. Most employees who leave go to the private industry (banks or credit unions) when they have been with our Department around 3 years, just when they are starting to learn the job. The skills Department staff acquire are highly valued by the very same industries we regulate, and these industries often pay a premium to lure away our examiners. The result is turnover and an inexperienced staff.

As we are entering a phase of economic challenges caused by the pandemic, financial institutions will be affected, which will cause a higher demand on our Department. We must identify and address problems quickly with enhanced monitoring and conduct proactive outreach to address problems as early as possible. When an institution deteriorates, our examination efforts must increase to help aid the institution back to health. This requires increased coordination

with our federal counterparts. Typically, for our banks, we alternate examinations every 18 months (every 12 months for larger institutions). When an institution's condition declines, our examination frequency increases with in-person visitations every 6 months and annual comprehensive examinations conducted jointly with our federal counterparts. We also require quarterly progress reports to ensure the institution is addressing weaknesses. In a normal year, on the bank side, we conduct between 25 to 30 examinations. In the last crisis, we conducted 35 to 40 examinations a year, plus semi-annual visitations. The goal is to restore the institution to a safe and sound condition since a healthy institution is better equipped and has more flexibility to serve customers.

Goals

We plan to expand our financial literacy program. Currently, our program is limited to a website and we speak at schools and other venues when invited. We believe the Department should be more intentional in reaching our citizens, especially with the increased fraud we are seeing, which often targets the elderly. Elder financial exploitation is exploding and with an aging population in North Dakota, it is very concerning. The Senate Special Committee on Aging found that older Americans lose approximately \$3 billion each year to financial scams and abuse; however, others estimates say \$36 billion a year. It is estimated that 1 in 5 are victims with an average loss of \$120,000 a person. More education and information can hopefully help our elderly citizens protect themselves. In addition, we have under-banked and non-banked populations that we can reach – where

financial education can help break the cycle of poverty when individuals learn basic financial best practices. The immigrant and refugee populations often come from countries where there is an unstable or non-existent banking system. More targeted outreach can help these individuals succeed within our financial system. Also, our Department has experience and knowledge about new financial products in the marketplace. Our goal would be to educate citizens on how to stay safe, and also combat money laundering through education. Our Department is here to protect citizens from financial exploitation and help our citizens safely navigate the many financial products available in the marketplace. We recognize that other entities and our financial institutions are doing great work in this area; we are not looking to duplicate efforts, rather fill holes where there is a need; partner with other entities; and provide credibility to educational efforts since, as a government agency, we are not selling anything. The Governor's budget recommendations include allocation to establish a line item in our operating budget for financial literacy.

Last legislative session we were granted an additional FTE to cover money transmitter/fintech oversight. We have started our examinations and are looking to enhance this area further. This requires extensive collaboration with other states due to many of these companies operating in many different states. To ensure North Dakota citizens are protected, it is important that our Department participates in these examinations. Although the examinations are paid for by the examined entity, it does not offset our examination expense – the expense is still falling under our overall allocated budget

appropriations. The Governor's budget recommendations include an allocation to ensure that we have the funds to conduct examinations.

As discussed during the last legislative session, we have engaged in automation projects with the goal of making us more efficient. We will continue to automate processes as opportunities become available, to deliver quality services conveniently and in an economical manner.

5. BUDGET REQUEST/RECOMMENDATION

Line Item	Base Level	<i>Proposed budget request</i>	Governor's Recommendation	Increase (Decrease) from Base Level
Salaries	\$7,022,654	\$7,396,463	\$7,475,874	\$453,220
Operating	\$1,641,913	\$1,668,104	\$1,671,409	\$29,496
Contingency	\$20,000	\$20,000	\$20,000	\$0
Total	\$8,684,567	\$9,084,567	\$9,167,283	\$482,716
FTE	31.00	31.00	31.00	0.00

**The above amounts exclude the 2019 one-time funding of \$451,305*

The Governor's budget guideline was for us to reallocate 5% of our budget, which totals \$434,228. We reallocated \$195,709 within our operating budget and \$208,155 within our salary line item. The lower impact areas that were reduced were primarily travel, rent, operating fees and services, and professional fees. The higher impact areas where these funds were re-allocated to include IT data processing and professional development. The IT costs allow us to be more efficient,

therefore we are able to spend time on tasks that make more of a difference to the citizens and industries we regulate. Due to efficiencies, we have been able to regulate expanding industries with less than half the resources used by some comparable federal agencies. With increased use of technology and electronic documents available from our financial institutions, we are able to reduce our travel costs and re-invest in professional development costs to provide our examiners additional training. Enhanced training ensures that we are up to date with current issues and can address problems quickly. Also, training is more costly for more seasoned examiners and specialty areas such as cyber security. With the increase in cyber security breaches and fraud, having educated examiners is important.

The Department has for many years planned to move its Bismarck office, which is why the rent allocation is reduced. With increased efficiencies we also reduced operating fees and services and lowered our professional fees.

The reallocation within the salary line item is within our administrative function. There are two administrative positions that currently spend much time on tasks such as copying, scanning, etc. The intent is to eliminate as many of these tasks as possible to redirect their time to high impact activities. One of our administrative employees will be moving into a "project manager" type role, overseeing the financial literacy program and other projects as they arise.

As you can see from the above table and Attachment 2 (Change Package Summary). The overall reallocation was \$608,037, which

included our 5% \$434,228 recommended reallocation and a base payroll change of \$173,809 for administrative position changes, scheduled promotions in the next biennium, and salary shortfall as described below. The net effect to our budget was \$0. The Governor's recommendations include the following:

1) Salary shortfall of \$50,000

One tool long employed by the Department to promote retention, reduce the loss of human capital investments, and to ensure compliance with industry accreditation standards is staff promotion tiers which are tied to the individual staff persons' performance and ability. If we are successful in retaining staff, we will have more staff reaching our higher performance tiers. If we achieve short term success with our strategic goal of improving staff retention, our salary budget line item will not be enough to continue with this tiered program as more staff reach the higher level of expertise. Our proposed budget request asked for \$200,000 to fund this difference, the recommendation presented here reflects an increase of \$50,000. The budget shortfall would effectively eliminate our ability to offer the promotion tiers based on performance and ability, which would reduce staff incentives for high levels of achievement, reduce our ability to retain our most talented staff members, and force us to operate outside of industry standards which may jeopardize accreditation and federal recognition of our work product.

2) Money transmitter examinations of \$160,000

The Department licenses 140 money transmitters operating in North Dakota, transmitting more than \$10 billion each year. Last year, we were granted another FTE to cover this area; however, although the examination costs are covered by the companies, we did not get corresponding authority to spend the money to conduct examinations. Most of these companies are out of state, and although we try to do examinations remotely, there are many times we need to be at the company in person. If we conduct 10 examinations a year, the biennium spending cost is \$160,000.

3) Financial literacy program of \$40,000

The establishment of a financial literacy program was covered above, focusing on educating citizens about basic financial principles and protecting citizens from fraud and financial abuse.

4) Office 365 increase of \$3,305.

The Department utilizes Office 365, and this is the increased fee for our Department.

5) Compensation increase of \$229,411.

This is the Governor's annual compensation adjustment, which is funding for salary increases that average 2% each year of the biennium.

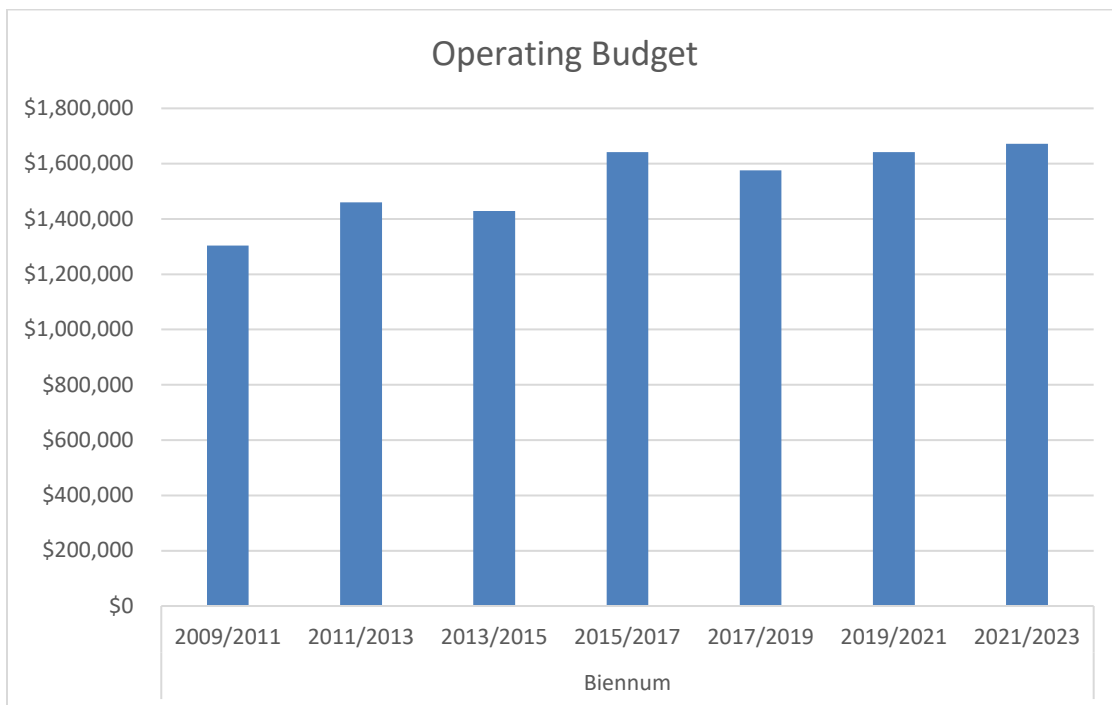
6. FUNDING AND BUDGET CHANGES

The largest component of the Department's budget is salaries at 81% of the current total budget, which in the proposed budget is increasing slightly to 82%. Our largest operating expenses are as follows:

- i. Travel-39.7% of operating/proposed 26.4%
- ii. Data Processing-15.3% of operating/proposed 23.7%
- iii. Rental/Lease-Bldg-13.3% of operating/proposed 10.4%
- iv. Professional Development-14.2% of operating/proposed 24.7%

**Base budget % is excluding the one-time funding for IT.*

The Department's operating budget has stayed relatively flat the last 10 years as shown in this graph:



This illustrates how the Department has strived for efficiencies, doing more with less, while regulating more entities than ever before, with more assets and complex financial products under our supervision. In

this time period, the North Dakota financial industry experienced growth and economic stability. The Department is expecting pressure on our industries, and our work must keep up to ensure depositor money stay safe and protected. In challenging times, the Department does not only experience increased examination costs, but also increased legal costs. The Department should not be put in a position of weak supervision due to limited authority to spend.

The Department has high travel expenses since examiners must travel to the institutions to conduct examinations. With the increasing use of technology, we are able to complete more offsite work; however, an onsite presence in the community institution will always be an important part of our safety and soundness examinations. For banks and credit unions, the travel increases if there is economic/industry deterioration, and therefore, reduction to travel is dependent on the economy and the condition of the institutions we supervise. If the economy deteriorates, and if any of our institutions struggle as a result, our examination frequency increases, and travel costs will also increase. Due to the pandemic, examinations have been completed remotely. After the pandemic, the expectation is to continue with more remote work; however, both the industry and the examiners recognize the importance of face-to-face interactions when discussing challenging topics.

Travel is also affected by training out of state. The work of an examiner is specialized, and significant training is necessary the first five years of an examiner's employment. Although we use online training tools,

much of the training for examiners is done in a classroom setting where simulations are utilized, making reductions to travel and professional development challenging. Training is conducted along with our federal counterparts, which keeps our examiners up to date on the most recent laws and regulations. Also, providing this specific training to examiners is crucial to remain competent and consistent with our federal counterparts, which also benefits our institutions. During the pandemic, training has been conducted virtually, which is expected to continue; however, as examiners become more seasoned, simulations are more valuable and face to face interaction is an important element to build a network of resources throughout the country. It is our priority to continue to hire well-qualified employees and invest significant time and financial resources into their training and development to ensure the entire workforce has the necessary experience and qualifications to effectively perform their duties. Also, regulatory, accounting, and legal changes require constant training, especially in areas such as anti-money laundering enforcement and information technology issues such as cybersecurity. With the enhanced risk posed by cyber and fraud, we are reallocating our travel funds to cover enhanced training.

7. ONE-TIME FUNDING FOR CURRENT BIENNIUM

Last legislative session the Department received one-time funding to replace our antiquated records management system and create a portal for our institution on our website. This project is still underway. A consumer complaint form was completed first, to make sure citizens can file complaints with the Department using a secure method. Forms have recently been rolled out to streamline the communication and

application process for our industries, and the records management piece is scheduled to be completed by June 30, 2021. To date, we have spent \$243,856 of the authorized amount. The Department has also invested additional funds from our operating appropriation in IT to ensure the Department's systems and processes are as efficient as possible.

8. ONE-TIME FUNDING REQUESTED

No one-time funding requested.

9. AGENCY COLLECTIONS

The Department is a special funds agency. Assessments are set by the State Credit Union Board and the State Banking Board for their respective areas. The assessments are set based on what the expected expenses are, which do not exceed our appropriated amount. For 2020/2021, the industries received discounts based on the reduced spending due to limited travel. The non-bank fees are set in statute and fluctuate depending on the number of companies we license.

10. OTHER REQUEST

Section 3 of the Governor's recommendation would allow the Department to transfer between line items during the biennium, with a report to OMB. This allowance will allow us to be responsive to changing circumstances as well as giving us the ability to operate in the most efficient and effective manner. If the economy deteriorates and travel costs increase related to examinations, it will be difficult to

meet our mandates unless we can transfer from salaries if able. Although we have the ability to go to the Emergency Commission, the concern is that matters we handle are often strictly confidential under law. Outlining a specific request, for example for legal costs related to a bank closure, is difficult when such information must be confidential to prevent a bank run and protect the North Dakota citizen and community. It should be noted that this transfer authority has previously been authorized for the legislative and judicial branches and without any limitation. It should also be noted that the Department's budget and expenses are reviewed by the State Credit Union Board and State Banking Board at every meeting. No other state agency has such oversight by groups of financial institution CEOs, whom are also the ones paying our expenses.

11. OTHER BILLS

The Department is not aware of any other bills considered by the Legislative Assembly with a budgetary impact. The Department did introduce three agency bills: SB 2101, SB 2102, and SB 2103. None of these bills include fiscal notes.

12. GOVERNOR BUDGET GUIDELINES

The budget impact from the Governor's 5% reallocation budget guidelines were discussed in detail above.

13. CHANGES AGENCY IS REQUESTING TO THE EXECUTIVE RECOMMENDATION

None

14. OPTIONAL ADJUSTMENT REQUESTS

Not applicable

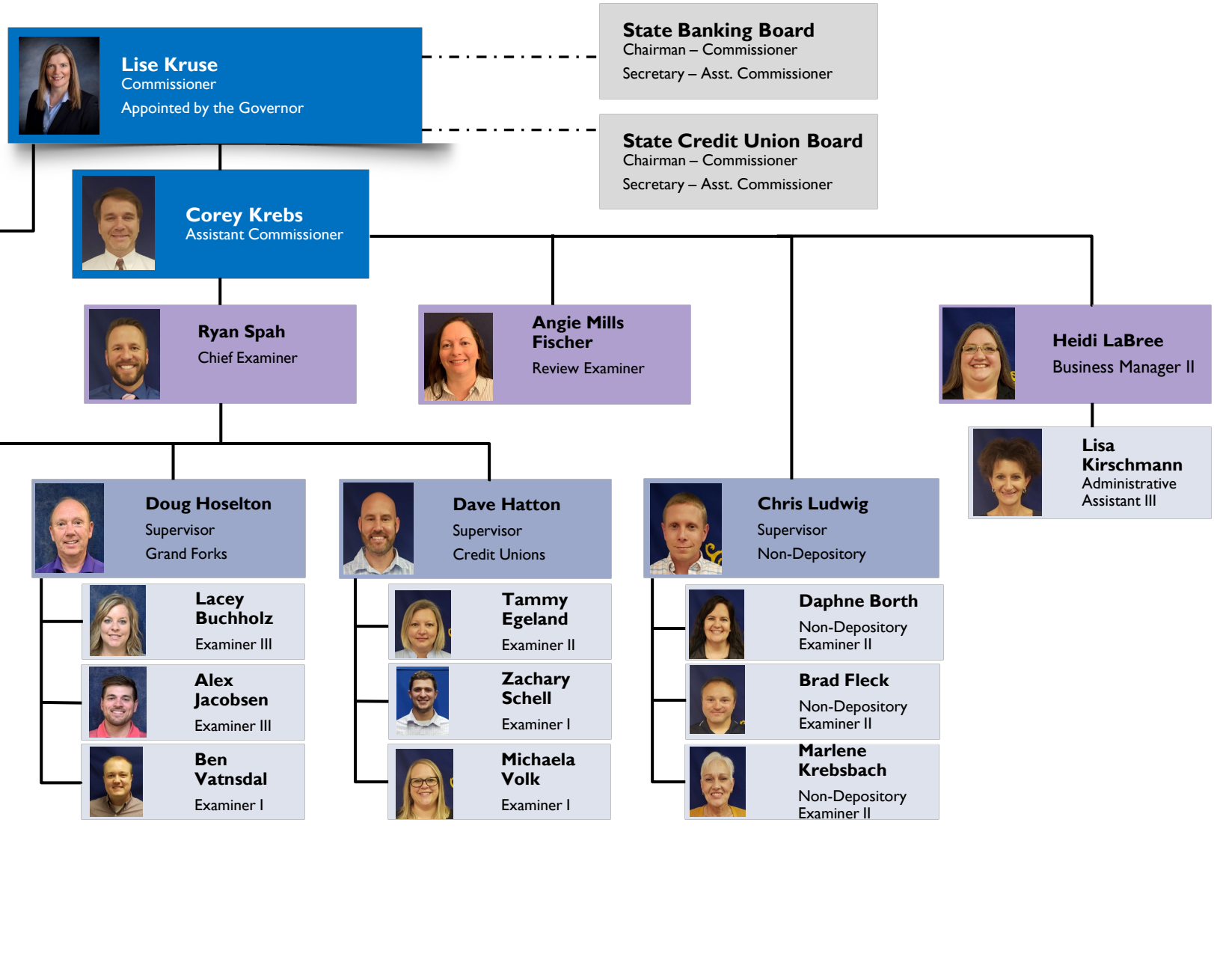
15. FEDERAL FUNDING RELATING TO COVID-19

Not Applicable

16. ADDITIONAL INFORMATION

The importance of the state supervisory role in the financial regulatory environment is recognized by our federal counterparts. Attachment 3 is a letter from the Director of the Division of Supervision and Regulation at the Board of Governors of the Federal Reserve System, which illustrates the importance of the states' role in the supervision and regulation of state-chartered banks.

Mr. Chairman and members of the Committee, I thank you for your time and I welcome any questions you may have.



CHANGE PACKAGE SUMMARY

00413 Department of Financial Institutions

Biennium:2021-2023

Description	Priority	FTE	General Fund	Federal Funds	Special Funds	Total Funds
<u>Base Budget Changes</u>						
Ongoing Budget Changes						
A-A 200 Reallocation Reduction		(1.00)	0	0	(608,037)	(608,037)
A-A 300 Reallocation Increase		1.00	0	0	434,228	434,228
R-A 1 Salary Shortfall		0.00	0	0	50,000	50,000
R-A 2 Money Transmitter Exams		0.00	0	0	160,000	160,000
R-A 3 Financial Literacy Program		0.00	0	0	40,000	40,000
R-A 100 Office 365		0.00	0	0	3,305	3,305
Base Payroll Change		0.00	0	0	173,809	173,809
Compensation Changes		0.00	0	0	229,411	229,411
Total Ongoing Budget Changes		0.00	0	0	482,716	482,716
Total Base Budget Changes		0.00	0	0	482,716	482,716



BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

DIVISION OF
SUPERVISION AND REGULATION

September 30, 2020

Mr. John Ryan
President & CEO
Conference of State Bank Supervisors
1129 20th St., N.W.
9th Floor
Washington, DC 20036

Dear John,

The COVID-19 pandemic has caused significant hardship across the United States and around the world, including continued severe disruptions to our economy. As Chair Powell has said, a full recovery is likely to come only when people are confident that it is safe to reengage in a broad range of activities, and the path forward will depend on keeping the virus under control and on policy actions taken at all levels of government.

Continued resilience of our financial system remains key to mitigating the hardships of the current situation and to enabling a strong recovery. Our role as bank regulators and supervisors helps to ensure that banks can continue providing credit and services to their customers and communities in a prudent and fair manner while meeting the challenges they face. Under our nation's dual banking system, the ability of the states to continue to play an important role in the supervision and regulation of state-chartered banks is a critical element for ensuring effective and coordinated supervision.

In this challenging time, it is vitally important that state banking agencies have sufficient resources and expertise to meet their responsibilities within the U.S. bank regulatory framework. We recognize that in the current environment, many state governments are facing significant budget pressures. We encourage the CSBS to continue to work with state banking commissioners to ensure sufficient resources going forward. As demonstrated most recently during the 2007-2009 financial crisis and its aftermath, significant resources are required at both the state and federal levels to

maintain stable banking conditions and ensure that banks are appropriately addressing their risks.

The Federal Reserve values its longstanding partnership with state banking agencies in supervising state member banks. We continue to appreciate state banking agencies' collaboration during these challenging times to ensure that our banking system remains safe, sound, and efficient.

Sincerely,

A handwritten signature in blue ink, appearing to read "Michael Gibson", is centered below the word "Sincerely,".

Michael S. Gibson
Director
Division of Supervision and Regulation