

MEMORANDUM

DATE: January 6, 2021
TO: Senate Industry, Business and Labor Committee
FROM: Lise Kruse, Commissioner
SUBJECT: Testimony in Support of Senate Bill No. 2101

Chairman Klein and members of the Senate Industry, Business and Labor Committee, thank you for the opportunity to testify in support of Senate Bill No. 2101.

Mr. Chairman and members of the Committee, Senate Bill No. 2102 includes amendments to Chapters 6-01, 6-03, 6-05, 6-06, and 6-08 of the North Dakota Century Code relating to financial institutions. I would like to note that prior to filing this bill, the department met with various staff and committee members of the North Dakota Bankers Association, Independent Community Banks of North Dakota, and the Dakota Credit Union Association, and had discussions with several bankers and credit union officials to review our proposed legislation.

Section 1 of the Bill would amend Subsection 3 of 6-01-01.1, eliminating the department's 20% limitation to carry over the remaining balance of the financial institutions regulatory fund to the succeeding biennium. This fund is the assessments that have been charged to the industry for the operation of the department. The department's industry assessments are set by the State Banking Board and State Credit Union Board far in advance, and since future needs can be challenging to predict, it is better fiscal management to allow the carry-over of these funds to be spent in the succeeding biennium, resulting in reduced assessments to the industry the following year. The department will not be able to spend beyond what has been appropriated.

Section 2 of the Bill provides for an amendment to 6-01-04.3, removing and replacing outdated statutory references for credit union loan limitations and violations.

Also, the amendment would increase the civil money penalty the commissioner or board can impose from \$5,000 to \$100,000 for each occurrence and from \$100 to \$1,000 per day. Recognizing that this looks like a big increase, 10 times higher per day, and 20 times higher for the maximum, the following facts must be considered: When these amounts were set in 1989, the average size of a bank was \$29.7 million versus today's

average of \$485 million. This is 16 times higher average asset size. The average size of a credit union was \$6.8 million versus today's \$193 million, which is 28 times the size. South Dakota and Montana are both at \$1,000, so our amendment would be equal to our neighboring states. Minnesota is higher at \$10,000 and also include imprisonment. The reason the department has the authority to issue civil money penalties, is to hopefully force compliance with law, and it is one more way to ensure an institution returns to a satisfactory condition without us having to take more disruptive measures such as taking possession. The amounts must be such that it can be an effective tool for a \$5 million credit union and a \$10 billion bank. Please note that this is not used often; from what our records show, it was last used in the banking division around 1990. However, it is important that we have this as an effective option if necessary.

Section 3 of the Bill is to amend 6-01-09 regarding the examination of financial institutions. The word "visit" is not as clear as an examination. It also implies "in-person," which is an outdated requirement since examinations may be conducted remotely. The timeframe of 36 months is also removed. Federal rules require that a bank is examined approximately every 18 months, and we alternate with our Federal counterparts. The reason for the work approximate is that if a bank is in good condition, the

examination may be delayed a few weeks if higher risk examinations must take precedence. The 36-month requirement has a negative consequence for our banks since the schedule is driven by federal examinations. If the federal examination is later than 18 months, the state ends up earlier than 18 months from the prior examination to comply with this statute.

This amendment also addresses credit union service organizations (CUSO). The department has authority to examine bank subsidiaries since these can impact the condition of the bank. The North Dakota Administrative Code, which outlines the CUSOs framework, gives similar authority, but it is less specific on the reporting of these examination findings and the role of the state credit union board. Since CUSOs of credit unions can impact the condition of a credit union, it makes sense to clarify this authority for these subsidiaries.

Section 4 of the Bill is to amend 6-01-17 increasing the frequency of assessments from annual to semi-annual. Since the department is a special funds agency whose income is assessments paid by the regulated industries, it is important that these assessments are calculated accurately. Changing the frequency allows for flexibility and better responsiveness to the budgetary requirements. Semi-annual is utilized by the Office of the Comptroller of the Currency (OCC) for national banks, therefore this

amendment will make our banks consistent with their national chartered counterparts.

To add clarity, the language referring to trust department assets is removed. The trust assets are typically low for these bank subsidiaries since the real value is in the fiduciary assets. The 11 banks with trust powers are billed for the trust examination separately.

This amendment will also remove the language saying if the department has not examined the institution for three years, the banks do not pay a fee. This is dated language since the department is doing offsite monitoring on a regular basis and as mentioned above, this requirement has a negative consequence for the bank when the state is forced to go in earlier than the 18-month interval since the prior examination, depending on the federal schedule.

The amendment will change the language for delinquent payments from “may make an order suspending the functions” to “may seek other administrative remedies.” As written, the department would have to suspend the ability of a bank to be open if their payment is delinquent. Having other options such as civil money penalties would be more consistent with other actions available to the department and would be better for the bank and its customers. The amendment will also change the penalty for non-payment

from \$5 to 1% of the outstanding assessment fee. The average asset size of a bank is \$493 million and with 8 banks with over \$1 billion in assets, \$5 a day is not an effective penalty.

Section 5 of the Bill amends Subsection 1 of section 6-03-05 updating language to equal the federal requirement for a real estate appraisal. The amount has increased from \$250,000 to \$400,000.

Section 6 of the Bill amends section 6-03-11 relating to bank mergers. This would also give the commissioner authority to approve a merger in addition to the State Banking Board. The intent is to speed up the process and remove unnecessary barriers for applications that are considered competitively neutral when sister banks merge or other straight forward applications. If a bank prefers their application to be heard by the State Banking Board, that is still an option.

Section 7 of the Bill amends section 6-03-13.3 relating to facts considered for approval for new bank branches. The requirement to consider whether other banks will be injured is highly subjective and is counter to allowing the marketplace to decide. It makes most sense to look at the community banking function and the strength of the bank. Also, an interested party filing a protest of a new branch seems to provide limited, if any, value for the State Banking Board to consider or be able to act upon.

Section 8 of the Bill amends 6-03-15.1 relating to temporary relocations. It appears an unnecessary burden to require an application for temporary relocations when a notice is sufficient. A bank may need to relocate temporarily due to repairs or remodeling. Providing notice to the commissioner is consistent with Section 1-03-04, which covers bank business days. Notice to customers would make sense since customers are most impacted.

Section 9 of the Bill amends Section 1 of section 6-03-47.2 regarding the quality of a bank's investment in corporate bonds. After the last financial crisis, regulatory agencies moved away from a strict reliance on bond ratings. The new language mirrors the OCC language for national banks. The limitation remains unchanged.

Section 10 of the Bill amends section 6-03-49.1 regarding bank investments in service corporations. In the current marketplace it appears to make more sense to also allow banks to invest in service corporations outside of North Dakota. This applies to investments only, not a general partnership with a Fintech (Financial Technology) company for example or the purchase of services. The investment would be limited to within the borders of the United States to avoid high risk jurisdictions and to ensure compliance with United States privacy rules. The investment, as with any

subsidiary, must be approved by the State Banking Board. This section was also rewritten for clarity, so it is easier to read and understand.

Section 11 of the Bill amends 6-05-15.4 regarding trust company branches. The statute was silent on branch relocations and new branches were treated the same as new charters, which is an extensive process. Again, to remove unnecessary red tape, if a trust company wants to open another branch, the authority for approval is extended to the commissioner since the commissioner is already authorized to approve bank branches throughout the United States. The time requirements were also removed. There are only time requirements in this section and in the bank sale section covered below. Although timeliness is important, it is better to have that as policy, not in law, since exceptions may be necessary for lengthy or complex applications. These applications should be thoroughly reviewed to protect the North Dakota citizen, and additional information should be requested when necessary.

The amendment also removed the “automatic approval” if an application is not acted upon. To protect citizens against bad actors, an application to provide these financial services should always be approved or denied, not be rushed to a decision of denial just to avoid automatic approval.

Section 12 of the Bill will amend section 6-06-06 regarding credit union loans. The change makes the statutory language clear that loans associated with employee benefit plans are permissible. The investment side of the plan was clearly authorized, the loan side was less clear.

The amendment is also making the other real estate owned section comparable to the bank statute and ensuring that the credit union is consistent with Generally Accepted Accounting Principles (GAAP). GAAP requires that the value of the real estate is established when transferred, and such value is established by an appraisal, which may be done internally. The amendment also allows a credit union to apply to the commissioner to establish an LLC to hold the real estate. The amendment would also allow this protection for credit unions.

Section 13 of the Bill will amend Subsection 4 of section 6-06-08 increasing the frequency of credit union assessments from annual to semi-annual. As mentioned earlier, more frequent assessments allow for a more responsive and accurate budget. As with the bank statute, allowing the department to use other remedies for non-payment rather than closing the institution would be most beneficial to all stakeholders. The fee is also changed to equal the bank amendment. Finally, this removes references to

corporate credit unions as North Dakota has not authorized state chartered corporate credit unions for some time.

Section 14 of the Bill will amend section 6-06-11 regarding the notice requirements for credit union board memberships. Rather than duplicating the credit unions reporting, if the notice has been made to the National Credit Union Association (NCUA), no additional notice to the department is necessary. The numbering was added to make it easier to read the statute.

Section 15 of the Bill will amend section 6-08-08.1 regarding the sale or purchase of banks or bank holding companies. The amendment gives the commissioner the ability to grant approval. Many of the change of control applications the department receives are members within the same family or current owners increasing their ownership percentage. In addition, when all the criteria are met so there are no reasons for denial, these applications would be acted on faster if the commissioner can grant approval. If the commissioner denies an application, the applicant can appeal to the State Banking Board. Again, as mentioned earlier, the time limitations would make more sense to be set in policy rather than law. On occasion, the application may be so complex and contain hundreds of pages. That these applications are scrutinized and acted upon with care and consideration should be the most important objective. The time constraints risk hurried decisions.

Section 16 of the Bill will create and enact section 6-06-14.1 regarding loan administration for credit unions. This section replaces 6-06-14, which is being repealed. The primary reason for this new section is to improve the structure and wording of the current requirements to make it easier for the industry to understand. Twenty-six consecutive lines of text from the 6-06-14 have been divided into four individual topics, two with further divisions. This should help to make the rule easier to read and understand for the reader. Many of the basic concepts remain from the original rule including the structure of the loan administration, duties of the credit committee or credit manager, and documentation requirements, although the language used differs somewhat to fit with the new format or current underwriting standards. Finally, the change makes the statutory language clear that loans associated with employee benefit plans are permissible and not prohibited under this section, similar to the proposed changes to 6-06-06.

Section 17 of the Bill will repeal section 6-06-14, which was replaced by 6-06-14.1

Mr. Chairman, thank you for the opportunity to provide this testimony. I would be happy to answer any questions the Committee may have.