

MEMORANDUM

DATE: January 24, 2023

TO: House Industry, Business and Labor Committee

FROM: Lise Kruse, Commissioner

SUBJECT: Testimony in Opposition of House Bill No. 1283

Chairman Louser and members of the House Industry, Business and Labor Committee, thank you for the opportunity to testify on House Bill No. 1283.

House Bill No. 1283 is related to fair access to financial products and services. Although the department is opposed to House Bill No. 1283, we understand the frustration and concern that this Bill is trying to address. The Bill is seeking to prevent discrimination by financial institutions based on political ideology. The department agrees that discrimination of any kind is

unacceptable, and that fair and equal access to financial services is of utmost importance.

Our department strives to be a regulatory agency with common sense. We want to take a balanced approach between making sure institutions are safe and sound and consumers are protected, and being business friendly. I believe we proved that last legislative session when we removed red tape and modernized our statute to ensure our financial institutions can operate without unnecessary regulatory burdens while at the same time not sacrificing the safety and soundness of our institutions. It is also evident since 92% of banks and 59% of credit unions headquartered in North Dakota have elected to be state-chartered. As I have testified before this Committee before, and as I am sharing in most of my testimonies this session, I am working very hard to prevent federal preemption.

It appears this Bill in particular is trying to stop unreasonable demands related to ESG, or environmental, social, and governance criteria. In North Dakota, of specific concern would be anything that limits our energy and agricultural industries. In the last few years on a national basis there has been a notion from certain segments wanting financial regulators like myself to make institutions restrict lending to certain industries that are not climate friendly. I disagree with that concept. First, I believe it infringes on a private business' right to choose who they do business with. Second, our examiners, who would be tasked with enforcing these restrictions, have finance and accounting backgrounds, they are not environmental scientists. Lastly, we need to focus on our main objective, to ensure the safety and soundness of our institutions, and leave political issues to you, our legislators and congressional delegates.

To date, federal bank and credit union regulators are not mandating any particular ESG policies for our institutions (SEC is not a bank regulator). Although, we expect institutions to have adequate risk management policies in place, I believe the institutions in North Dakota are well equipped to serve their customer base while balancing risk, and do not need any additional government intervention to ensure financial services are available to citizens. Our institutions have served their communities through droughts, floods, hailstorms, and tornadoes, and they have always shown up through the tough times, even operating out of a cash box when the electricity is out and systems are down. Climate challenges are something our institutions have always lived with, and they are familiar with how to mitigate those risks.

I am not aware of our department receiving any complaints from a citizen or a company in North Dakota, against any of the institutions we oversee related to ESG. It does not seem to be a problem with our local institutions. We are aware of some large national banks that have adopted ESG-related policies, which appears to be the intended target of this bill. Unfortunately, due to the federal government's preemption of state law, these large national banks would not be subject to this law. These additional regulations and the costs associated with them will be primarily felt by the local financial institutions who are not the group creating these ESG policies.

This Bill seems to make the government mandate that private businesses engage in specific financial transactions and force our local banks and credit unions to make loans they are not equipped for or have the expertise to manage, which cause a higher risk to the overall financial system. Our non-bank companies, most are not headquartered in North Dakota, operate across the nation and are subject to various states' laws and regulations. With the punitive nature of this Bill, and due to our small

population compared to the 38 million and 22 million population numbers in CA and NY, it is likely the national companies will refrain from doing business in North Dakota. The unintended consequence of this Bill is that it would make fewer financial services available to North Dakota citizens.

Overall, the language of this Bill is vague, which makes it difficult to enforce. Looking at Section 1 subsection 1, it is introducing a new definition of “financial institution.” Although it states it is specific to this chapter, it causes confusion due to the definition of financial institution in 6-01-02, which appears in statute over 700 times. As mentioned earlier, a national bank will not need to follow any of the mandates set forth in this Bill due to the federal government’s position that federal banking laws preempt state law. In line 10 it refers to “nondepository service provider,” and I am not certain what that would be referring to. Is it a financial service provider such as payday lenders? Are other entities under the department’s oversight included, such as collection agencies? Or is it a technology service provider so it is including supporting industries? Also, in line 15, financial institutions are now including insurance companies and anyone providing investment services. That means that our department will now regulate industries in conjunction with the Insurance Commissioner and the Securities Commissioner. Making industries operating in North Dakota subject to several financial regulators is adding red tape and bureaucracy, which seems incredibly inefficient.

Subsections 2.b and 2.c seem unclear, and I am uncertain how to enforce those sections. What does “financial interest” in line 24 mean? 2.c seems to be an incomplete sentence, but I am not sure what it intends to say for us to fix it.

Subsection 3, lines 2 and 3 appears to say that an institution cannot say no to a loan based on non-financial criteria. Banks and credit unions use

numerous criteria when they review a loan, and some of these are non-financial. Lenders will typically use something we refer to as the 5 Cs of credit when underwriting a loan (or 5 Ps, which are essentially the same). These have been in place for a long time, and some of these are non-financial. The 5 Cs are character (credit history, faithfulness in meeting financial obligations), capacity (repayment ability), capital (down payment ability), collateral (securing a loan), and conditions (length of time at employment, industry experience, future job stability, loan purpose). As you can see, the ones based on character and condition include non-financial standards. Also, does this Bill remove an institution's ability to refuse to do business with certain industries? Our financial institutions operate in various communities and have various levels of expertise and specializations. We have some institutions lacking expertise in hotel loans for example, and will likely decline lending to hotels. It does not mean that they dislike hotels or are discriminating. They lack the required expertise, and even capital, to manage such a loan. The same is true for energy-related loans. This bill seemingly makes it illegal to say no to a transaction simply because it is not a product or service the bank is capable of offering.

Subsection 3 a. requires institutions to report if they have ESG-related policies, which is then included on a published list. Section 2 of this bill made it illegal to have ESG related policies. Section 3 a. seems to be telling companies to essentially admit guilt, self-report the violation of section 2, which is then published. That is unusual in any regulatory framework I am familiar with.

Subsection 4 requires the department to publish a list of institutions that have "adopted standards or guidelines based on nonfinancial, nontraditional, and subjective measures." As explained earlier, lenders have

always used nonfinancial standards, so one can assume that every lender will be included on this list. If the bill is amended to be specific to any ESG policy, the list may not include every local company; however, one can assume many institutions may choose to have such a policy, especially if they operate outside of North Dakota. For our non-banks, it is especially likely that large public companies may have such policies if they need to appease investors. These policies could be internally focused, ensuring a diverse corporate board of directors for example, or they could be externally focused, dictating the business activity they are involved in. Enforcement of this bill could be problematic since the definitions of ESG are not standardized to know what type of policies are included.

Subsection 4 and the penalties section are where our fiscal note comes in. This will require an increase to our budget, and since we are a special funds agency, with the only source of revenue being assessments, licensing fees, and examination fees, we need to adjust what we charge to the industries. Historically, we have focused on safety and soundness and do not have a compliance team in our agency to examine for ESG policy or ESG loan denials. That changes with this Bill, and our exams will need to be expanded, both in team members and hours, to ensure compliance with this statute. Our department would need to hire additional FTEs – both for website maintenance and upkeep, and also for enforcement. We have oversight of over 7,000 entities, and adding estimates from the insurance and securities departments, we are looking at 12,195 entities. We would need to find out which company has a policy, what does that policy state, and has there been any denials. Therefore, we need to look at initial setup as well as ongoing oversight, and we tried to take a conservative approach in this estimate. To obtain the information from over 12,000 entities, and if

we assume 50% needs to be listed on our website, we are estimating a cost of \$172,734 for initial set up. For the ongoing oversight and enforcement and assuming a standard exam cycle of once every 5 years, the estimated ongoing cost would be about \$1.5 million. That is a 16% increase over our current budget.

To cover this additional cost, and since our fees are in statute, we will be requesting amendments to our nonbank statutes if this goes forward. It could be that our revenues would decrease due to companies no longer desiring a license in North Dakota, so we need to plan for that possibility, and we are trying to figure out what the correct amount could be for the increase. For sure, the assessments of our local banks and credit unions will need to go up. I am not aware of any other way to pay for this. We also need to establish a framework for reimbursement from the insurance and securities industries.

While well intentioned, this bill is subjecting companies to a blacklist and subjecting them to a punitive enforcement regulator. That may result in fewer financial services available. Since this statute will not apply to national banks, and the state assessments would increase, it could cause a charter switch. The bank could opt into the federal banking framework instead of the state banking framework, especially when the state government would add additional regulatory burden on our institutions which are not required by the federal government. I believe this bill will not have the effect of what we are trying to accomplish in North Dakota, and we need to make sure financial services are available to all our citizens. Creating a government blacklist of local financial institutions could shake the public's confidence in their financial institutions and cause a bank-run, which is what banking regulators should protect against. A bank failure is devastating for our

communities, and any North Dakota citizen with money deposited in excess of the insured limit could lose their money. We need to prevent that from happening.

Finally, North Dakota legislators have always recognized the necessity of keeping consumer financial transactions private, as evidenced in North Dakota's strong privacy laws in Chapter 6-08.1 covering disclosure of customer information. Similarly, disclosure of examination information by our department can cause undue harm on citizens as well as undermine trust in our financial institutions and the safety of our financial system. North Dakota Century Code 6-01-07.1 prohibits the department from sharing examinations and reports provided by financial institutions. This Bill, if passed, would cause a conflict with the two statutes, and I hope this committee will honor our citizens' and private businesses' right to financial privacy.

I will close by again saying I do appreciate the intention of this bill. This department has a long history of fighting federal preemption and pushing back against regulatory overreach such as ESG-related mandates. We understand the importance of all legal businesses to our economy. However, we don't see that this bill will be applicable to those companies discriminating against North Dakota businesses. Due to the many unintended consequences of this Bill, the Department respectfully opposes House Bill No. 1283.

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