North Dakota | Financial Institutions

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DATE: March 9, 2023

TO: Senate Appropriations Committee

FROM: Lise Kruse, Commissioner

SUBJECT: Testimony in Support of HB 1008

Chairman Wanzek and members of the Appropriations Committee, thank you for the opportunity to provide testimony regarding the Department of Financial Institutions Appropriation request for the 2023-2025 biennium, HB 1008.

1. ***NORTH DAKOTA CENTURY CODE CHAPTERS AND STATUTORY RESPONSIBILITIES***

North Dakota Century Code Titles 6, 13, and 51 are associated with the Department of Financial Institutions.

The Department supervises the following state-chartered and licensed financial corporations:

- Banks,
- Credit unions,
- Trust companies,
- 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.

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) non-depository licensees. Banks, trust companies, and credit unions pay annual assessments that cover all direct examination costs and allocated overhead for the respective cost centers. In addition, trust companies pay examination fees for their safety and soundness examinations. Non-depository licensees pay fees for processing and supervisory responsibilities related to that cost center: investigation fees upon initial licensing, annual license fees, and examination fees when an examination is performed. Again, the examination fee is set at an amount sufficient to recover all costs.

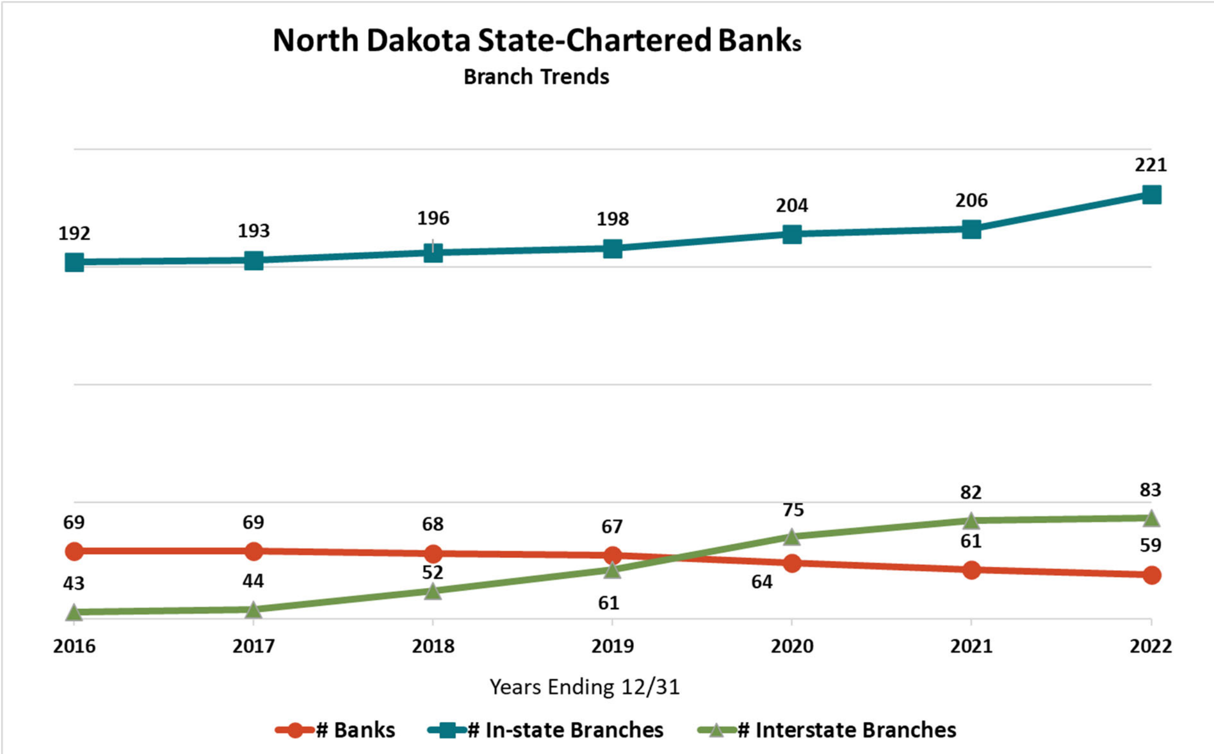
2. ***DEPARTMENT PURPOSE***

The Department has oversight over banks, credit unions and non-depository financial institutions. Indirectly, every citizen of North Dakota is impacted since 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 oversee, which then results in financial services being available to the North Dakota citizen.

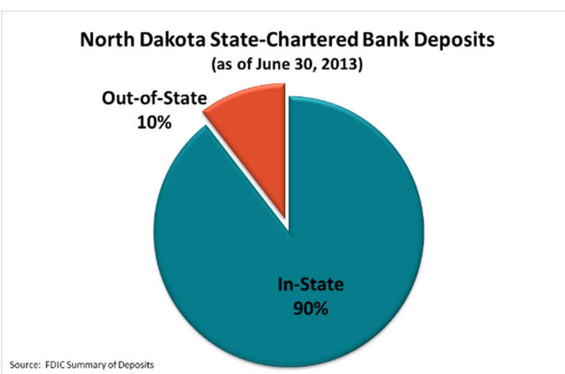
A community bank and credit union are central to economic development. Since our institutions are closely connected to their local markets, they are directly affected when the economy weakens. Our objective is to ensure institutions are financially strong and in compliance with applicable laws and regulations. Strong institutions can take targeted risks that can help their communities.

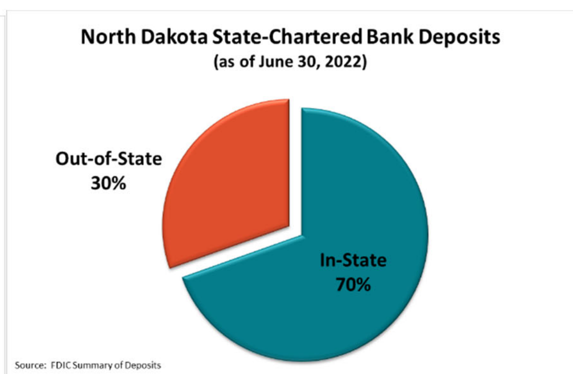
State-Chartered Banks

North Dakota has 59 state-chartered banks, plus the Bank of North Dakota. 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.

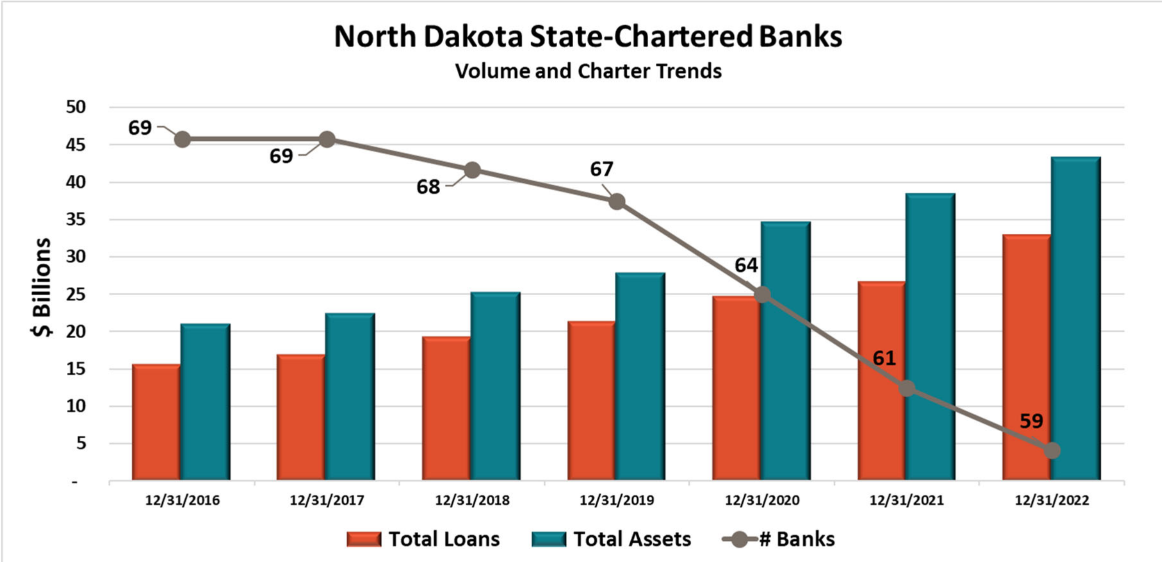


Our banks are expanding outside of North Dakota borders. This pie chart shows the banks' deposit percentage that comes from outside of North Dakota.





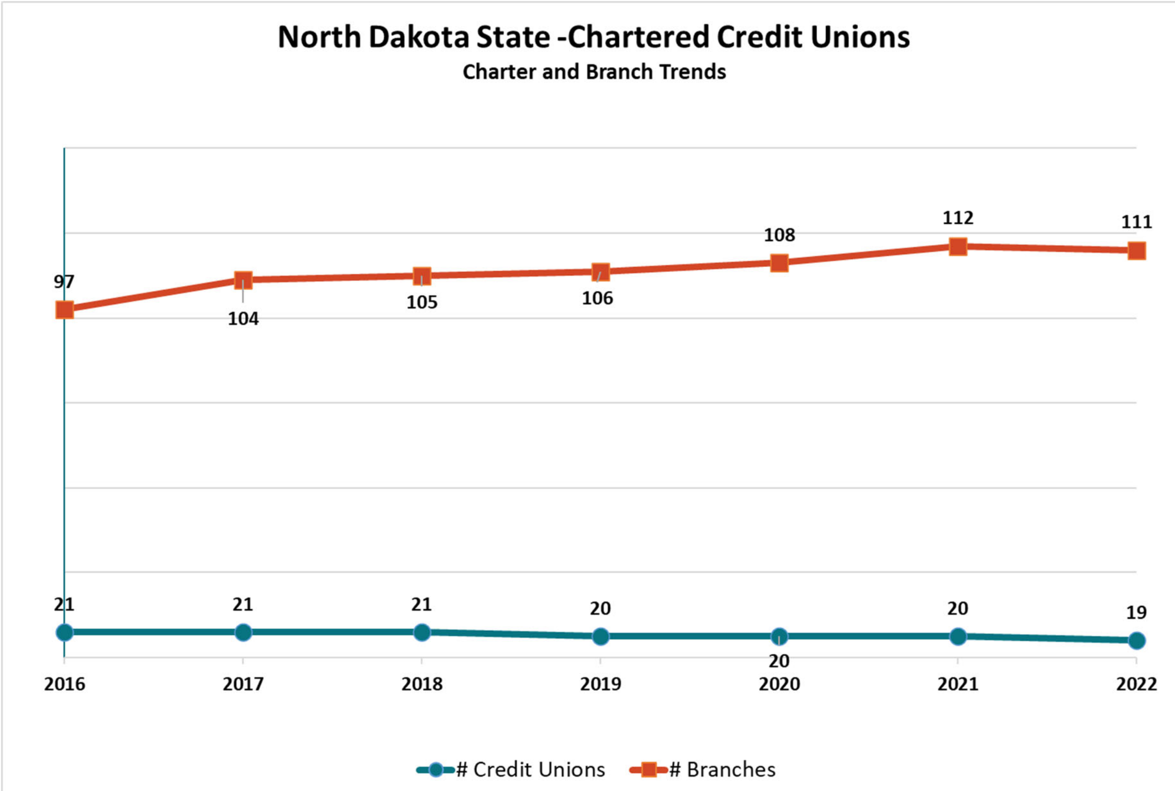
Our banks have merged with out of state banks and have elected to keep the North Dakota charter.



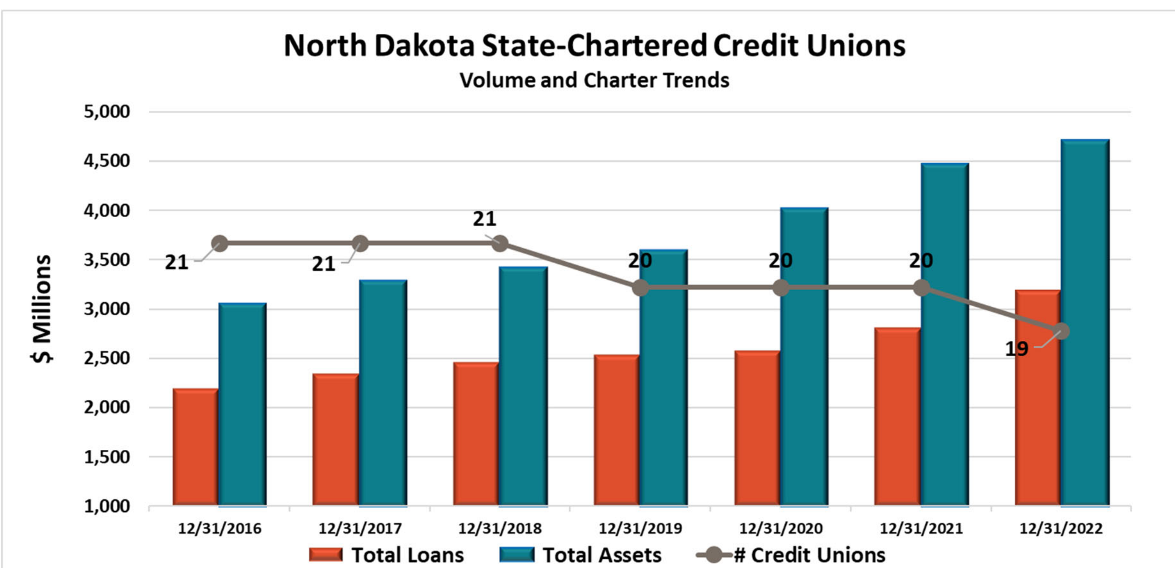
Assets increased 23% from $35 billion on December 31, 2020, to $43 billion on December 31, 2022. The continued asset growth increases the Department's responsibilities and time needed to conduct examinations. A majority of examination time is spent on loan review, and loans, especially commercial loans, are becoming more complex, which therefore requires experienced examiners. 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 19 state-chartered credit unions. As with banks, credit union branches are increasing.

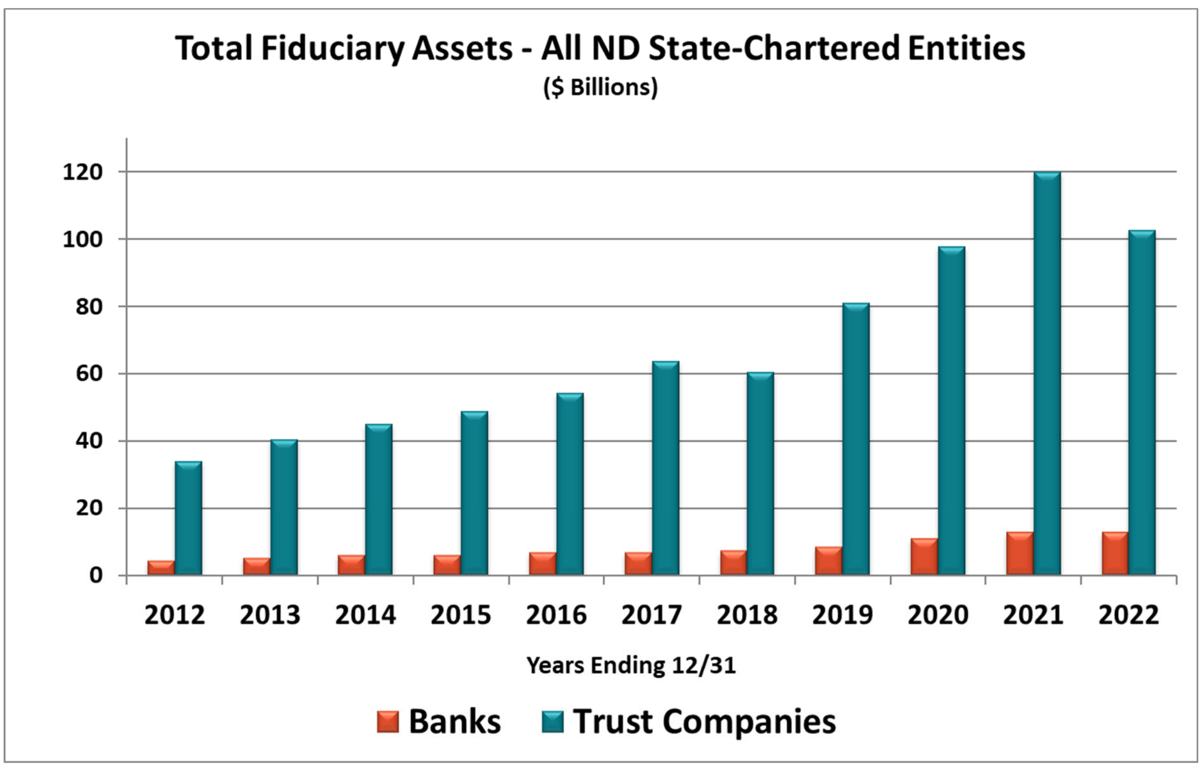


Credit unions also continue to show asset growth, with total assets increasing 18% from $4 billion as of December 31, 2020, to $4.7 billion as of December 31, 2022.



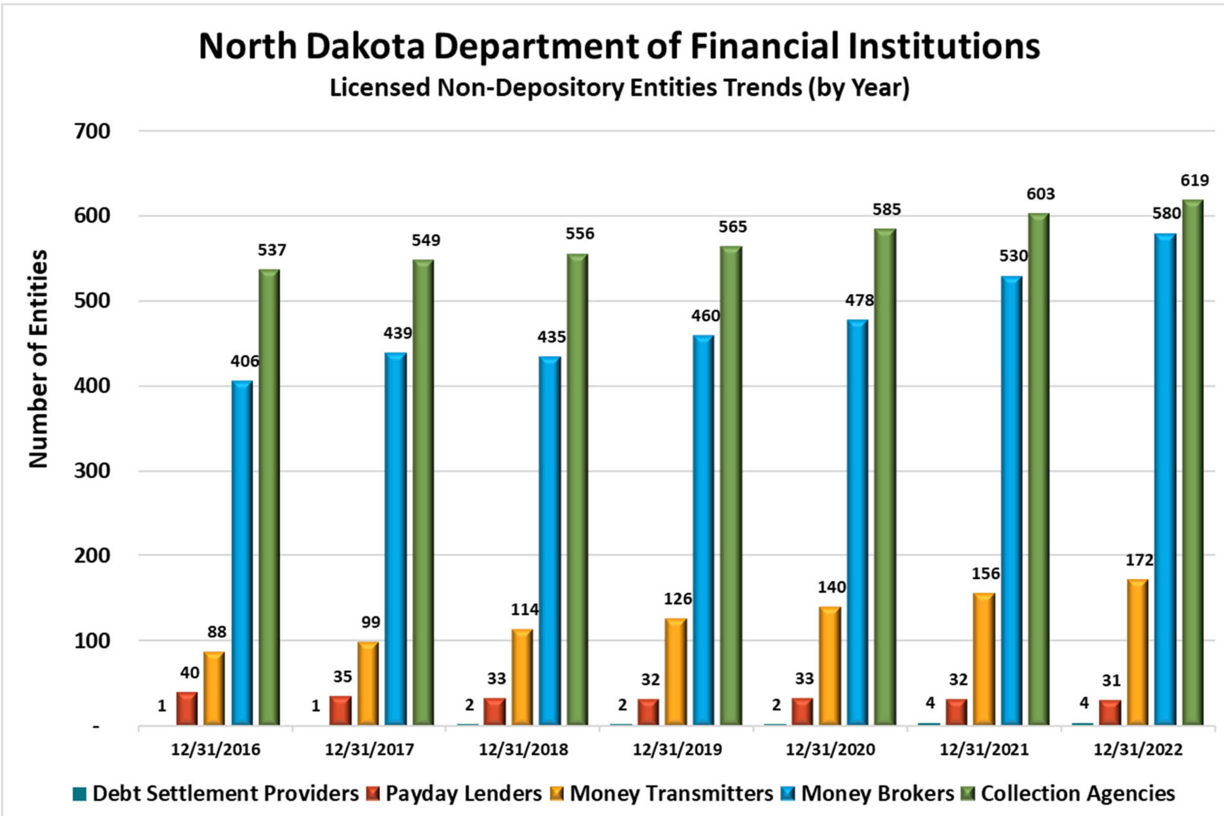
State-Chartered Trust Companies and Bank Trust Departments

There are four state-chartered independent trust companies for which the Department has oversight responsibility; we also have 13 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 of the four independent trust companies totaled $103 billion as of December 31, 2022, a 17% decrease from the year prior. The banks with trust powers had combined fiduciary assets of $12.6 billion as of December 31, 2022, the same as the year prior (but with one additional bank reporting due to an acquisition).



Consumer Licenses

As of December 31, 2022, the consumer division had active licenses totaling a combined 8,595 entities (compared to 7,061 two years ago). The breakdown of the licenses is as follows:



Not included in the graph above are the 7,189 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 currently 2 vacancies that we are in the process of filling (interviews conducted last week). 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 continues to engage in dialogue with federal regulators to discuss national policy matters and its effect on people in North Dakota. For example, in January 2022, the federal credit union regulator, in an effort to address climate change, issued its strategic plan with language discouraging credit unions from lending to agricultural borrowers. As we all know, that would have a detrimental impact on access to credit for one of the most important economic drivers in North Dakota. We reached out to the regulator to ensure they understood the ramifications of their proposal. Additionally, elected officials such as Governor Burgum, AG Commissioner Goehring, and our Congressional delegates all issued letters urging the removal of language that would affect agriculture and our farmers in such a negative way. These efforts succeeded and our Department continues to meet with the federal agency officials to discuss these matters. The Department believes it is important to continue dialogue to seek lasting solutions, and most importantly ensure equal access to credit for all North Dakota citizens.

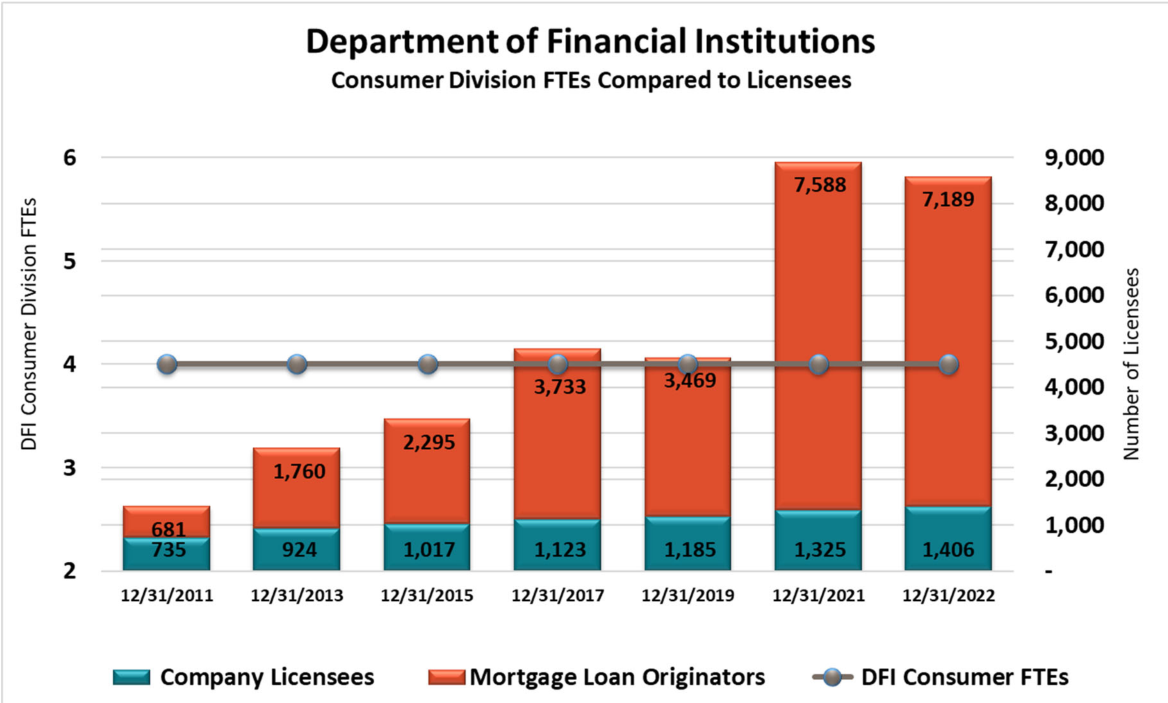
The Department's banking division has maintained accreditation through the Conference of State Bank Supervisors (CSBS) since 1992, the credit union division through the National Association of State Credit Union Supervisors (NASCUS) since 2000 and the consumer division through the CSBS/AARMR (American 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 their savings and personal finances. It assures the industries that we are 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. Lastly, strong state oversight keeps an important balance between state and federal supervision, limiting the risk of increased federal government preemption of state government authorities.

To ensure the safety of our financial system, the Department has taken action against bad actors. In recent years, there has been an increase in fraud and scams throughout our nation. For example, financial exploitation of our elderly citizens is far too common with a low estimate of 1 in 5 being victims with an average loss of $120,000 a person. It is important that our Department has the resources to educate and assist financial institutions when citizens are taken advantage of.

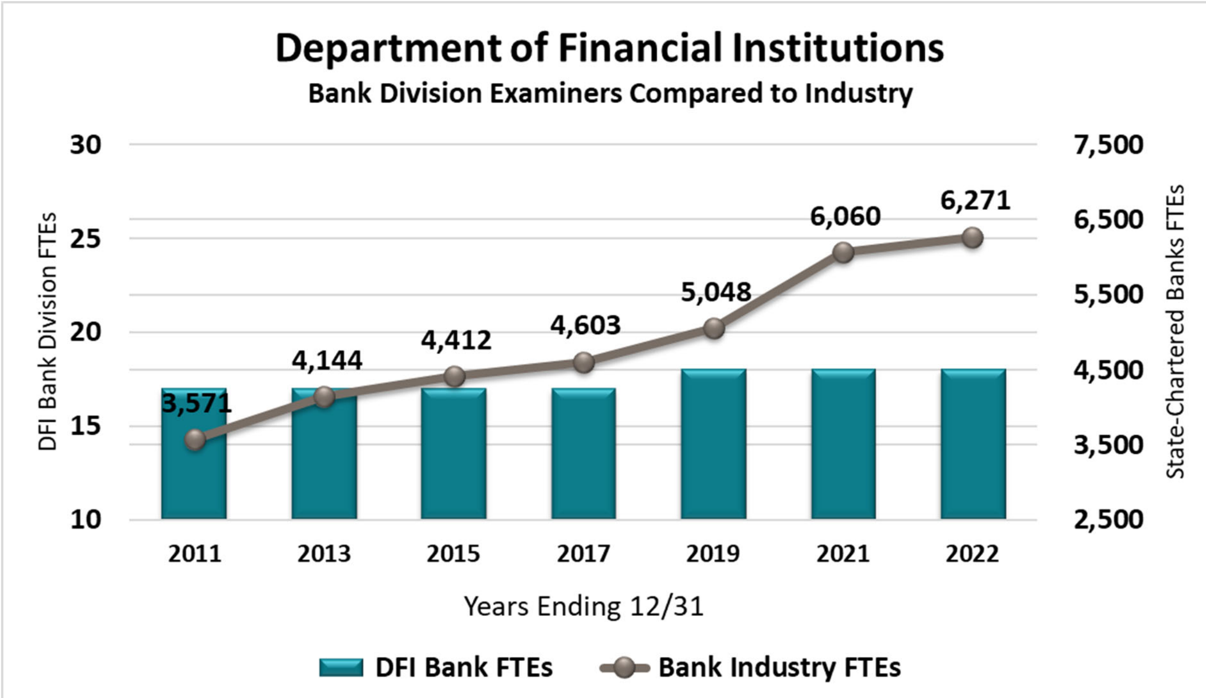
The Department continues its involvement on a national basis to ensure North Dakota's voice is heard – not only with our federal counterparts, but as a network with other state regulators across the nation. I was elected to serve on the CSBS Executive Board in March 2020, and I am currently the Chair-Elect. Corey Krebs, the Department's assistant commissioner, serves as a member at large on the NASCUS Board and serve on several of their committees. In addition, I also serve on the FDIC Regulatory Advisory Board. This involvement ensures that North Dakota interests are represented on the national stage.

Challenges

One of the greatest challenges is to make sure the Department has enough staff of skilled employees to meet our mandates, and it has been difficult to keep up with the large industry growth. Therefore, we are requesting additional FTEs this session. I want to emphasize that we are not growing government, rather we are responding to the explosive growth in the industries we are overseeing. 2011 was the last time we added an FTE in the non-depository division when we had 1,400 licenses. Today we have the same FTE number but over 8,000 licenses. Examinations for money transmission is covered by bank examiners. We are using automation to the extent possible, and also networking with states across the nation to improve efficiencies and reduce redundancies. However, to prevent federal intervention, it is crucial that our Department has the resources to oversee these entities.



Banks and credit unions have also grown considerably and are becoming more complex with expanding product lines and partnerships. The skill and time needed to oversee financial institutions' cyber security measures puts pressure on our Department. The following graph shows the number of FTEs added by the banking industry to correspond with their growth, compared to ours. Banks have had to increase staffing by 70% to manage their growth while Department staffing has only increased by 7%. Since one of our banks is now more than $10 billion in asset size, we need to dedicate an FTE to its oversight. We work in partnership with our federal counterparts, and we need to be a credible partner. It is important to ensure a strong state presence to protect our community banks and limit federal preemption of state authority.



Since our examiners must be competent in every aspect of banking, it takes 3 to 5 years for an examiner to be fully proficient. In the last few years, we have had two bank examiners retire, each with more than 30 years of experience. Retention has also been an issue with about 30% of employees joining our Department within the last two years, and many employees not staying with the department long enough to even achieve proficiency. Most employees who leave go to the private industry (banks or credit unions). The skills Department staff acquire are highly valued by the very same industries we regulate, and these industries often pay a premium that we are unable to compete with. Therefore, I strongly support the efforts by OMB and the Governor's budget recommendations to re-evaluate salary levels for equity. For our part, data shows that our federal regulators pay 20% to 50% more, with more significant discrepancies when examiners are more experienced. The average federal bank examiner salary is 41% higher than our state examiner salary. Based on statements given in exit interviews, employees are offered anywhere from a 10% to 30% increase in salary. Employees that left our agency 5 to 10 years ago are now making between 18% to 112% more than they were making with our Department. Therefore, the efforts of OMB and the Governor's office to address compensation issues are important for our Department to adequately oversee these industries at the state level, and limiting the risk of federal government preemption.

Goals

The Department goals include the following:

1) Retain and protect strong and stable oversight to prevent federal preemption of state law. We need to make sure states retain its piece of the regulatory environment.
2) Keep pace with growth and expansion of financial institutions and services. We need the skills and resources to properly assess our institutions for risk, which has become more demanding due to new financial products and partnerships between banks and non-banks as well as the continued growth of the banks and credit unions we oversee.
3) Manage increases in non-depository institutions (non-banks).
4) Ensure state oversight of financial industry IT vendors and service providers. Since most community banks outsource for IT services, vendor management and our oversight over these entities are important.

5) Enhance data analytics capabilities to assist us in being more predictive and proactive in our oversight.
6) Continue enhancing our industry and general public communication, which includes our financial literacy program.
7) Retain and educate sufficient staff to oversee the industry, and be proactive and responsive. Providing opportunities for growth with competitive salaries and a great work environment should help us succeed in attaining our goals.

5. ***BUDGET REQUEST/RECOMMENDATION***

Line Item	**Base Level**	***Proposed budget request***	**Governor's Exec. Budget**	**House Appropriation**	**Increase (Decrease) from Base Level**
Salaries	$7,415,098	*$9,225,219*	$8,794,603	$8,457,556	$1,379,505
Operating	$1,671,409	*$2,649,389*	$2,114,862	$2,083,917	$443,453
Contingency	$20,000	*$20,000*	$20,000	$20,000	$0
Total	**$9,106,507**	***$11,894,608***	**$10,929,465**	**$10,561,473**	**$1,822,958**
FTE	31.00	*39.00*	34.00	33.00	3.00

The difference between the Governor's recommendations and the House Appropriations was the removal of 1 FTE and the associated cost with that FTE. The Governor's recommendations include the following:

1) Additional FTEs

Three additional FTEs are added to allow us to provide stable oversight to prevent federal regulator preemption, keep pace with growth and expansion of financial institutions and services, and manage the increase in non-depository institutions (non-banks). One FTE is added for licensing of non-depository institutions, and one FTE for examinations. One FTE is added to examine large banks (over $10 billion in assets). In addition to these 3 FTEs, there are two additional FTEs that were included as part of a fiscal note to HB 1068, which, if passed, will task the Department with oversight over mortgage servicers. Mortgage servicers would be a new industry for the Department to oversee, and due to the size and complexity of the mortgage servicer entities, additional resources are necessary. In the Department's initial request, another three FTEs were included for examiners to oversee money transmitters, which includes virtual currency specialization, data analytics, and IT service providers. These FTE positions ultimately were not included in the Governor's budget. The salary increase of $1,379,505 includes $668,895 for the three FTEs we are requesting; $117,069 for temporary salaries as the Department occasionally needs the assistance and expertise of former employees due to current staff turnover and inexperience; and $593,541 expected increases to salary and benefits due to employee growth and subsequent promotions. Operating costs related to these FTEs covering NDIT costs, travel, and professional development total $92,835.

2) Assistant Attorney General $250,000

The Department is in need of increased attorney assistance and is requesting resources to fund a full-time Assistant Attorney General to specialize in financial matters. With thousands of non-banks that operate on a national basis, there has been an increase in need of attorney insight and representation. This has a direct impact on North Dakota citizens since the Attorney General needs the resources and abilities to represent our cause when bad actors are preying on our citizens.

3) Dynamics Ongoing Maintenance $100,000

The Department uses an IT Dynamics system, which provides a portal for institutions to submit applications and correspond with the Department in a safe manner. NDIT is providing the support and maintenance for the system, and the $100,000 is the estimated cost.

The remaining difference from the base budget is $618 associated with increased NDIT costs.

6. __FUNDING EXPLANATION__

The largest component of the Department's budget is salaries at 81% of the current total budget, which in the proposed budget is decreasing slightly to 80%. Our largest operating expenses are as follows:

i. Travel - 27.8% of current operating/24.0% of proposed
ii. Data Processing - 21.1% of current operating/ 22.1% of proposed
iii. Professional Development - 21.7% of current operating/18.8% of proposed
iv. Rental/Lease-Bldg - 14.7% of current operating/11.6% of proposed

The Department has high travel expenses since examiners must travel to the institutions to conduct examinations. With 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, travel costs are 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. 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 and state 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. 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.

7. ***ONE-TIME FUNDING FOR CURRENT BIENNIUM***

There were no one-time funding items for the current biennium.

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 the last few years, the industries received discounts due to limited expenditures. The non-bank fees are set in statute and fluctuate depending on the number of companies we license.

10. ***OTHER REQUEST***

Since our Department is a small, special fund agency, having flexibility within our appropriated budget makes sense. Therefore, we would request that the Committee consider granting us to have only one line item, just as WSI, another special fund agency. At the very minimum, we would request, as approved by the House, transfer authority between line items. The 2021-2023 Legislative Assembly granted the Department authority to transfer between line items during the biennium, with a report to Legislative Council. If one line-item budget is not possible, the Department requests that the transfer authority will again be granted in the 2023-2025 budget. This allowance allows 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 available. 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 at a public meeting such as to the Emergency Commission, for example for legal costs related to a bank closure or an ongoing investigation, is difficult when such information must be confidential to prevent a bank run, protect the integrity of the investigation, and protect the North Dakota citizen and community. It should be noted that 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 introduced four agency bills: HB 1068, SB 2090, SB 2092, and SB 2119. HB 1068 is related to the oversight of mortgage servicers and included a fiscal note from the Department of $463,000 and 2 FTEs. The cost is completely related to the FTEs. The

House cut 1 FTE and picked $225,000 to be the cost (instead of $463,000/2). The Department is not aware of any other bills considered by the Legislative Assembly with a budgetary impact.

As mentioned earlier, HB 1068 is adding mortgage servicers as a new industry for the Department to oversee. This Bill has passed both House and Senate policy committees unanimously, and the House. Since the financial crisis in 2007 to 2009, mortgage lending has shifted from banks and credit unions to nonbanks. Nonbanks issued 68% of all mortgages in the U.S. in 2020, and seven of the 10 largest mortgage lenders were non-banks. Similarly, nonbank mortgage servicing has grown from 6% to 60% of the government agency mortgage market in the last 10 years, and about 45% of the $11 trillion single-family residential mortgage market is serviced by nonbank servicers. Bank mortgage servicers are regulated by bank regulators under federal law; the nonbank servicers are primarily overseen by states as established in state law.

The typical structure for residential mortgages includes a lender who originates the loan and a servicer who services the loan. Companies may originate loans, service loans, or both. In North Dakota only the loan originators are required to have a license. HB 1068 would also require servicers to be licensed. All our surrounding states license this industry. A mortgage servicer is the company responsible for the administration of the loan, and would be the entity that initiate foreclosure proceedings, for example. Without local, North Dakota oversight, the only venue for citizens when there is a problem, is to contact the federal Consumer Financial Protection Bureau (CFPB) in Washington DC.

The fiscal amount for two FTEs is $463,000, which covers salaries and benefits, examination travel, examiner training, and related NDIT costs. Adding supervisory authority without the resources to execute the law gives a false indication of consumer protection, which is why additional resources are necessary. It is important to note again, that our Department is completely self-funded, and the additional resources required will be funded by licensing and examination fees.

12. CHANGES AGENCY IS REQUESTING TO HOUSE APPROPRIATION

Our request is for this Committee to add back the following that the first chamber removed:

- 1 FTE in the general budget bill for non-depository division
- 1 FTE for HB 1068 and corresponding cost.

As noted in section 5 above, the Department requested 6 additional FTEs as part of our budget bill. The executive budget includes 3 FTEs covering large bank supervision, non-bank licensing and examinations. The executive budget did not include the requested FTEs for cryptocurrency money transmission examinations, IT vendor examinations, or data analytics. Since our initial request was already reduced in the executive budget, we kindly request that it is not cut any further but that we at least would be granted the 3 + 2 FTEs as stated in the executive recommendation.

13. FEDERAL STATE FISCAL RECOVERY FUNDING

Not applicable

14. FEDERAL FUNDING AVAILABLE

Not Applicable

15. ADDITIONAL INFORMATION

The importance of the state supervisory role in the financial regulatory environment is recognized by our federal counterparts. Attachment 2 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 oversight of state-chartered banks. A reduced role of state governments' oversight of state-charted banks would necessitate greater involvement by federal government regulators.

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

NORTH Dakota | Financial Institutions
Be Legendary.™

- **Lise Kruse** – Commissioner – Appointed by the Governor
  - **State Banking Board** – Chairman – Commissioner; Secretary – Asst. Commissioner
  - **State Credit Union Board** – Chairman – Commissioner; Secretary – Asst. Commissioner
  - **Megan Sauer** – Administrative Examiner
  - **Corey Krebs** – Assistant Commissioner
    - **Ryan Spah** – Chief Examiner
      - **Alex Jacobsen** – Acting Supervisor – Bismarck
        - **Noah Anderson** – Examiner I
        - **Scott Bruns** – Examiner I
        - **Katie Hauser** – Examiner I
        - **Stephen Hillerud** – Examiner I
        - **Chris Clark** – Examiner I
      - **Taylor Harms** – Supervisor – Fargo
        - **Lacey Buchholz** – Examiner III
        - **Jared Hoglin** – Examiner II
        - **Josh Rachels** – Examiner II
        - **Jen Washnieski** – Examiner I
        - **Vacant** – Examiner I
      - **Jared Person** – Supervisor – Grand Forks
        - **Kaitlin Reyna** – Examiner II
        - **Bea Dalmi** – Examiner I
        - **Vacant** – Examiner I
      - **Dave Hatton** – Supervisor – Credit Unions
        - **Tammy Egeland** – Examiner II
        - **Zachary Schell** – Examiner II
        - **Michaela Volk** – Examiner II
    - **Angie Mills Fischer** – Review Examiner
    - **Chris Ludwig** – Supervisor – Non-Depository
      - **Daphne Borth** – Non-Depository Examiner II
      - **Brad Fleck** – Non-Depository Examiner II
      - **Marlene Krebsbach** – Non-Depository Examiner II
    - **Heidi LaBree** – Business Manager II
      - **Lisa Kirschmann** – Administrative Assistant III

1/5/2023

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,

Michael S. Gibson
Director
Division of Supervision and Regulation