MICROFILM DIVIDER

OMB/RECORDS MANAGEMENT DIVISION
SFN 2053 (2/85) 5M

ROLL NUMBER

DESCRIPTION

2321

2001 SENATE INDUSTRY, BUSINESS AND LABOR

SB 2321

2001 SENATE STANDING COMMITTEE MINUTES

BILL/RESOLUTION NO. SB 2321

Senate Industry, Business and Labor Committee

☐ Conference Committee

Hearing Date January 31, 2001

Tape Number	Side A	Side B	Meter #
3	x		25.5 to 44.5
3		x	5.5 to 7.6
Committee Clerk Signature Dawn E Periz			

Minutes:

The meeting was called to order. All committee members present. Hearing was opened on SB 2321 relating to capitalization requirements for the Bank of North Dakota.

SENATOR D. MATHERN: Favors this bill. Purpose is to maintain the capital adequacy of the BND as stated in the capital plan and to ensure the financial stability of the bank. Written testimony attached.

ERIC HARDMEYER, Interim President, BND. Neutral, to inform. Written testimony attached. The issue is not the 10% requirement but writing it into the law. Assets can fluctuate, allow the bank management and the industrial commission flexibility to manage the bank.

SENATOR ESPEGARD: This is a very well capitalized bank. Since we are making economic development a priority more capital should be required, but the floor not the top should be regulated.

SENATOR D. MATHERN: Raising the floor not satisfactory, when you have astronomical growth the concern is capital drain. Percentage can limit growth but probably has to be done to maintain financial integrity.

Hearing concluded.

Committee reconvened. (Tape 3-B-5.5 to 7.6) Discussion held. SENATOR KREBSBACH: move do not pass. SENATOR ESPEGARD: second. Roll call vote: 5 yes; 2 no. Carrier SENATOR ESPEGARD.

FISCAL NOTE

Requested by Legislative Council
01/23/2001

Bill/Resolution No.: SB 2321

Amendment to:

1A. **State fiscal effect:** *Identify the state fiscal effect and the fiscal effect on agency appropriations compared to funding levels and appropriations anticipated under current law.*

	1999-2001 Biennium		2001-2003 Biennium		2003-2005 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues						
Expenditures						
Appropriations						

1B. **County, city, and school district fiscal effect:** *Identify the fiscal effect on the appropriate political subdivision.*

1999-2001 Biennium			2001-2003 Biennium			2003-2005 Biennium		
Counties	Cities	School Districts	Counties	Cities	School Districts	Counties	Cities	School Districts

2. **Narrative:** *Identify the aspects of the measure which cause fiscal impact and include any comments relevant to your analysis.*

Senate Bill 2321 requires that Bank of North Dakota (BND) maintain a primary capital ratio of at least 10%.

- Primary capital is defined as all capital (capital, surplus and undivided profits) plus loan loss reserves. Loan loss reserve is a reserve banks carry for potential losses they might incur in their loan portfolio.

- The primary capital ratio is determined by dividing primary capital by average total assets.

- Growth in capital is achieved in two ways; the issuance of stock or through retained profits.

On June 30, 2001, total capital for BND is projected to be $168 million with loan loss reserves of $22 million providing primary capital of $190 million. Assets at BND are anticipated to be approximately $1.7 billion. At that point the primary capital ratio would be 11.2% or 1.2% above the minimum 10% ratio. However, average total assets at BND can vary up to $150 million throughout the year. Based on a static primary capital amount of $190 million, average total assets at BND can increase to $1.9 billion with BND staying in compliance with SB 2321. Total average assets exceeding $1.9 billion with static primary capital of $190 million will cause BND to be out of compliance.

In Governor Hoeven's executive budget it is proposed that BND will provide $60 million to the general fund for the next biennium with a contingency of an additional $25 million if the North Dakota budget falls below certain thresholds. It is projected that the Bank will earn $32 million per year during the next

biennium, allowing the difference of the total earnings for two years ($64 million minus the $60 million transfer to the general fund = $4 million) to be used to increase the capital accounts. Consequently, it is projected that at the end of the 2001-2003 biennium BND capital will increase from $168 million to $172 million. assuming a static loan reserve of $22 million, BND will have primary capital of $194 million.

The concern for BND is the contingent draw of $25 million. If average total assets remain at $1.8 billion and SB 2321 requires 10%, primary capital of $180 million must be maintained. However, should the state coffers fail to meet expectations and all other assumptions noted above hold true, the maximum draw for the contingency could only be $14 million to maintain compliance with this bill.

3. **State fiscal effect detail:** *For information shown under state fiscal effect in 1A, please:*
   A. **Revenues:** *Explain the revenue amounts. Provide detail, when appropriate, for each revenue type and fund affected and any amounts included in the executive budget.*

See narrative.

   B. **Expenditures:** *Explain the expenditure amounts. Provide detail, when appropriate, for each agency, line item, and fund affected and the number of FTE positions affected.*

None identified.

   C. **Appropriations:** *Explain the appropriation amounts. Provide detail, when appropriate, of the effect on the biennial appropriation for each agency and fund affected and any amounts included in the executive budget. Indicate the relationship between the amounts shown for expenditures and appropriations.*

None identified.

Name:	Eric Hardmeyer	**Agency:**	Bank of North Dakota
Phone Number:	328-5674	**Date Prepared:**	01/29/2001

Date: 1/31/01
Roll Call Vote #: 1

2001 SENATE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. 2321

Senate Industry, Business and Labor Committee

☐ Subcommittee on _____
or
☐ Conference Committee

Legislative Council Amendment Number _____

Action Taken DNP

Motion Made By S. K. Krebsbach Seconded By S Espegard

Senators	Yes	No	Senators	Yes	No
Senator Mutch - Chairman	✓		Senator Every		✓
Senator Klein - Vice Chairman	✓		Senator Mathern		✓
Senator Espegard	✓				
Senator Krebsbach	✓				
Senator Tollefson	✓				

Total (Yes) 5 No 2

Absent _____

Floor Assignment S. Espegard

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE (410)
February 1, 2001 8:18 a.m.

Module No: SR-19-2058
Carrier: Espegard
Insert LC: . Title: .

REPORT OF STANDING COMMITTEE

SB 2321: Industry, Business and Labor Committee (Sen. Mutch, Chairman) recommends **DO NOT PASS** (5 YEAS, 2 NAYS, 0 ABSENT AND NOT VOTING). SB 2321 was placed on the Eleventh order on the calendar.

2001 TESTIMONY

SB 2321

Testimony – Senate Bill 2321

January 31, 2001

Several years ago the Industrial Commission set a capital plan for the state owned Bank of ND. At the time the assets of the bank were $1 billion. An amount of $100 million was set aside as capital, 10% of the total assets. Though the capital plan states that 10% of the BND assets without the allowance for loan loss reserve, would be set aside, the bank has not adhered to the capital plan.

The 12-31-2000 financial statements of BND had not been available to the public as of 1-30-2001, so the 3rd quarter statements (9-30-2000) were used for calculations. The purpose of this legislation is to maintain the capital adequacy of the BND as stated in the capital plan and to ensure the financial stability of the bank.

The capital of a financial institution is the very foundation, the cornerstones. The Bank of North Dakota provides so many valuable services to the citizens and businesses of ND, it's imperative the health and financial well being of the bank be maintained.

- As of 12-31-98 BND assets were over $1.6 billion with projected growth to $2 billion by the end of the biennium. Total equity capital was 8.75%

- Eighteen months later total equity capital had decreased to 8.2% with very little asset growth, $1,633,156,000.

* As of 9-30-2000 BND assets were $1,672,397,000 with total equity capital of 8.6%. I do not have the figures to determine what transfers were made out of BND after that date.

Without detailed financial records, I'm not certain the allowance for loan loss has not been added to the total equity capital. The asset growth of the bank has been limited to keep the capital ratio at a reasonable rate while we siphon the reserves of the bank to the general fund. If a bank or any business does not grow it will eventually die. The bank has maintained a healthy return on assets, in part because of the lack of growth.

I ask that we do our part in maintaining the health and integrity of our Bank of ND by helping the bank officials to reach the goal set in their capital plan. The health of our bank is crucial in providing continued service to businesses of ND. I request your support by passing SB 2321.

Senator Deb Mathern

Bank of North Dakota
Financial Data

(Dollar Amounts in Thousands)	9/30/00	6/30/00
Total Assets	$1,672,397	$1,633,156
Total Liabilities	1,526,931	1,493,718
Total Equity Capital	145,466	134,438
Net Income	8.6% 25,941	8.2% 16,929
Total Loans	1,150,917	1,109,468
Allowance for Losses	21,099	20,746
Other Real Estate Owned	53	197
Loans Past Due 90 Days or More	23,279	20,202
Non-Performing Loans	2,823	2,345
[illegible]n on Average Assets	2.10%*	2.05%*
Return on Average Equity	24.59%*	24.24%*
Average Total Equity/Average Total Assets	8.54%	8.48%
Average Non-Performing Loans/Average Total Loans	0.23%	0.21%
Average Non-Performing Loans and Investments/ Average Total Equity and Allowance for Losses	1.53%	1.41%
Average Non-Performing Loans and Investments and OREO/ Average Total Assets	0.17%	0.16%
Average Total Equity and Allowance for Losses/ Average Total Loans	14.75%	14.90%
Average Allowance for Loan Losses/ Average Total Equity	14.59%	14.53%
Average Allowance for Loan Losses/ Average Total Loans	1.88%	1.89%

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TESTIMONY TO THE
SENATE INDUSTRY, BUSINESS AND LABOR COMMITTEE
JANUARY 31, 2001

SENATE BILL 2321

ERIC HARDMEYER, BANK OF NORTH DAKOTA

Senate Bill 2321 requires that the Bank of North Dakota (BND) maintain a primary capital ratio of at least 10%.

- Primary capital is defined as all capital accounts (capital, surplus, and undivided profits), plus loan loss reserves. Loan loss reserve is a reserve banks carry for potential losses they may incur in their loan portfolio.

- The primary capital ratio is determined by dividing primary capital by average total assets.

- Growth in capital is achieved in two ways; the issuance of stock or through retained profits.

- According to the Capital Adequacy and Maintenance Policy as set forth by the Department of Banking and Financial Institutions the standard primary capital ratio generally shall be established and maintained at 7%.

On June 30, 2001 total capital for BND is projected to be $168 million with loan loss reserves of $22 million providing primary capital of $190 million. Assets at BND are anticipated to be approximately $1.7 billion. At that point the primary capital ratio would be 11.2% or 1.2% above the minimum 10% ratio. However, average total assets at BND can vary up to $150 million throughout the year. Based on a static primary capital amount of $190 million, average total assets at BND can increase to $1.9 billion with BND staying in compliance of SB 2321. Total average assets exceeding $1.9 billion with static primary capital of $190 million will cause BND to be out of compliance.

In Governor Hoeven's executive budget it is proposed that BND will provide $60 million to the general fund for the next biennium with a contingency of an additional $25 million if the ND budget falls below certain thresholds. It is projected that the Bank will earn $32 million per year during the next biennium, allowing the difference of the total earnings for two years $64 million minus the $60 million transfer to the general fund ($4 million) to be used to increase the capital accounts. Consequently, it is projected that at the end of the 2001-03 biennium BND capital will increase from $168 million to $172 million. Assuming a static loan reserve of $22 million, BND will have primary capital of $194 million.

The Bank of North Dakota for many years has had as its' goal to maintain a 10% capital ratio.

and as you can see from the spreadsheet in the last 10 years we have maintained a primary capital ratio in excess of 10%. I believe that this issue should be left to bank management and the Industrial commission and not be written into law. I think the Bank needs flexibility with this issue to deal with growth. Senator Solberg has informed me that he will issue an amendment to HB 1015 that deal with transfers from BND to the general fund. His intention is to provide an increase in the floor of BND capital from $100 million to $140 million.

BANK OF NORTH DAKOTA

(IN THOUSANDS)

YEAR	AVERAGE TOTAL ASSETS	LOANS	ALLOWANCE	CAPITAL	PRIMARY CAPITAL	PRIMARY CAPITAL RATIO	INCOME	TRANSFERS TO GENERAL FUND
12/31/91	884,184	266,854	12,162	92,917	105,079	11.88%	16,414	14,000
12/31/92	897,456	313,873	12,664	114,119	126,783	14.13%	22,340	
12/31/93	888,366	305,552	12,900	100,000	112,900	12.71%	17,530	23,217
12/31/94	945,952	393,756	15,348	100,206	115,554	12.22%	18,031	
12/31/95	951,410	487,297	17,214	76,000	93,214	9.80%	21,639	14,100
12/31/96	1,026,156	554,001	17,707	98,477	116,184	11.32%	23,191	
12/31/97	1,065,352	623,532	17,442	128,888	146,330	13.74%	25,544	50,215
12/31/98	1,356,982	835,654	18,921	139,931	158,852	11.71%	28,137	
12/31/99	1,583,866	1,056,232	20,106	139,275	159,381	10.06%	30,459	29,600
12/31/00	1,660,061	1,156,614	22,424	153,045	175,469	10.57%	32,582	
06/30/01 Est.	1,700,000 Est.	1,200,000 Est.	22,000 Est.	168,000 Est.	190,000 Est.	11.18% Est.	15,000	50,000
12/31/01 Est.	1,735,000 Est.	1,236,000 Est.	22,000 Est.	168,000 Est.	190,000 Est.	10.95% Est.	16,000	
12/31/02 Est.	1,770,000 Est.	1,316,000 Est.	22,000 Est.	168,000 Est.	190,000 Est.	10.73% Est.	32,000	
06/30/03 Est.	1,800,000 Est.	1,356,000 Est.	22,000 Est.	172,000 Est.	194,000 Est.	10.78% Est.	16,000 Est.	60,000

CAPITAL ADEQUACY AND MAINTENANCE POLICY

The following sets forth the Department of Banking and Financial Institutions' policy and guidelines on capital adequacy and maintenance. Such guidelines and desired standards shall be used in the evaluation of capital adequacy in the charter application process as well as in ongoing determinations of whether a bank is operating at a safe and sound capital level.

The standards set forth in this policy will apply to fundamentally sound and well-managed banks. Higher standards may be imposed on banks which are not fundamentally sound or well-managed.

The following definitions shall apply in the use of guidelines and desired minimum levels set forth in this policy:

1. "Average total assets" means the average of the following:
   (a) total assets required to be included in a bank's Report of Condition and Income, Schedule R-K, line 7, as of the most recent report date; and
   (b) allowance for loan and lease losses;

   less intangible assets.
2. "Bank" means a state-chartered banking association.
3. "Capital plan" means a comprehensive plan of mandatory capital infusion and/or restoration, the object of which is to bring a bank up to the minimum standards required by this chapter and to maintain said bank at a level which is equal to or better than the minimum standards required by this chapter.
4. "Primary capital" means a sum determined by the following formula. Add:
   (a) common stock;

(b) perpetual preferred stock;

(c) capital surplus;

(d) undivided profits;

(e) capital reserves;

(f) mandatory convertible debt, only to the extent of 20% of primary capital exclusive of such debt;

(g) minority interests in consolidated subsidiaries; and

(h) allowance for loan and lease losses;

and subtract intangible assets.

5. "Primary capital ratio" means a ratio determined by dividing primary capital by average total assets.

6. "Secondary capital" means a sum determined by the following formula. Add:

(a) mandatory convertible debt that is not included in primary capital pursuant to 13-02-10-01(1)(f);

(b) limited life preferred stock; and

(c) subordinated notes and debentures.

7. "Total capital" means the sum of primary and secondary capital.

8. "Total capital ratio" means a ratio determined by dividing total capital by average total assets.

The standard primary capital ratio generally shall be established and maintained at 7%. The Department and State Banking Board may in certain circumstances require a bank operating with a primary capital ratio less than the standard minimum to devise and implement a capital plan to bring its primary capital ratio to the standard or higher if

circumstances so warrant. The Department and State Banking Board will evaluate effects of troubled debt restructuring accounted for under Financial Accounting Standards Board Opinion 15 and the effects of widespread and pervasive economic conditions outside a bank's control, in determining minimum primary capital ratios for an individual bank.

The Department and the State Banking Board may permit a bank to operate with a primary capital ratio of 6 1/2%, so long as the bank has sufficient secondary capital to result in a total capital ratio of 7%.

Generally, a bank which exhibits any one or more of the following conditions may not be permitted to operate with a minimum primary capital ratio less than the standard set forth in this policy:

1. Mismanagement of the state banking association.
2. Insider transactions resulting in loss.
3. Fraudulent actions resulting in loss.
4. Excessive officer salaries and bonuses.
5. Excessive fees to affiliated associations.
6. Excessive declaration and payment of dividends.
7. Any other activities or transactions deemed by the State Banking Board to be unsafe and unsound banking procedures.