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GREAT SEAL STATE OF NORTH DAKOTA

ROLL NUMBER

DESCRIPTION

2306

2005 SENATE INDUSTRY, BUSINESS AND LABOR

SB 2306

2005 SENATE STANDING COMMITTEE MINUTES

BILL/RESOLUTION NO. SB 2306

Senate Industry, Business and Labor Committee

☐ Conference Committee

Hearing Date 1-24-05

Tape Number	Side A	Side B	Meter #
1		x	2120-4549
Committee Clerk Signature Lisa VonBerkom			

Minutes: **Chairman Mutch opened the hearing on SB 2306. All Senators were present.**

SB 2306 relates to capitalization requirements of the Bank of North Dakota.

Senator Warner, introduced the bill. See attached testimony.

Senator Espegard : What do you mean by the fact that the significant progress will be made this session in restoring the equity position of the bank?

Senator Warner: My understanding is that the position of the bank is at 7.2% equity right now. And the bank expected to be at 8%.

Senator Espegard : That wouldn't be a recommendation from the Governor, that would be because more money than the allocation that is being taken out of it. In other words, the capital ratio would be increased.

Senator Espegard : In what regards, in other questions that you might have, would believe that the Bank of North Dakota ought to have a ten percent capital ratio.

Senator Warner: As many of the small community banks in my area have said that the ten percent expectation is what a private bank should have. I realize that the Bank of North Dakota is not a retail bank.

Senator Espegard : Small bank generally will have a higher capital ratio than a large bank. The most important thing on the Bank of North Dakota, which would speak well to the capital ratio in which they operate is the degree of risk taking. They don't have the bank that a normal bank has.

Senator Warner: The Bank of North Dakota is forced to take bigger risks. At a higher equity position, and it could be more experimental.

Senator Espegard: Taking more risk, you mean losing more money?

Senator Warner: The rewards go to those who take the greatest risk.

Senator Espegard : This bill also says that you want it to be at ten percent, it's now at seven percent. There would be quite a few years while you are building it back up. What percent is being retained now?

Senator Warner: None, that I know of.

Chairman Mutch allowed opposition at this point.

Eric Hardmeyer, President of the Bank of North Dakota, spoke in opposition to the bill.

See attached testimony.

Senator Espegard : I think we are going to see a bill that says all additional money over and above the sixty thousand goes to economic development. In other words, you will see another bill here that will say that that won't happen. And that every dollar that that bank makes is taken out. You can't say both things.

Senator Heitkamp : I'm not so sure that we aren't seeing a bill here that has to do with the frustration that legislators feel. About the profits of the bank going in to a general fund and being used for day to day expenses. Whereby, if we kept some dollars back at the bank, we might be able to put some of those out there on certain investments, renewable fuels, etc. I would like your take on that.

Eric: My own personal belief on your point is that I think that the sixty million dollar transfer that we provide the general fund is reasonable and something that we can manage. How you utilize the money, is your call. I have talked before about the money being used for economic development, rather than the general fund. That is what would happen if I had any say in it.

Senator Espegard : If you had more capital, could you make more loans?

Eric: Generally, what would happen if our capital went up is that our lending limit is pegged to our capital. Our capital right now is at one hundred and fifty-three million. Our lending limit to any one borrower is at ten percent of the capital. We can do roughly about a fifteen million dollar loan per borrower. If we retain capital, we go up to one hundred sixty and our lending limit goes up to sixteen million. As this bill states, that we go to two hundred million of capital, then our limit goes up to twenty million. So that helps up put more credit out per borrower, up to three to four million more.

Senator Nething : Senator Warner's testimony said that he believed that the way we are taking funds out of the bank now, hurts the bank's ability to finance large scale projects. Have we missed out on any projects because of our inability to reach them with our current structure?

Eric: Not in my opinion. I think that we have met the test of time. We have done the economic development, and I can't think of a project that has gone undone because of our tight lending.

Senator Espegard : How many maximum loans do you have requests for or make?

Eric: We go up to our lending limit occasionally, I would say that that is the exception more than the rule. I would guess that we have a hand full to ten loans that are up at our lending limit.

Senator Heitkamp : Where you said that we haven't missed opportunities, are you talking about the opportunities where people knock on the door, or are you talking about the ones where we never even stepped up to the plate?

Eric: The ones that I am talking about are the deals that come to the bank.

Senator Espegard : The dollars to make the loan don't come from the capital. They come from the deposits and other funding sources. The sixty million dollars that we are giving to the state is not taking from our loan fund. That what protects the bank.

Eric: Senator Espegard is right. We are no where near the end of our potential. We have another three to four hundred million dollars for lending capacity.

Senator Heitkamp : I don't dispute that. When you continually put a burden on the Bank of North Dakota to put money into the general fund, biennium after biennium to pay for the day to day running of government, those are dollars that you potentially cannot put out as risk for other investments.

Senator Espegard : If you leave the sixty million dollars in there, all of the sudden the capital ratio would be fifteen percent. What benefit is that to making loans? You have to understand the difference between capital and cash to make loans.

Eric: The capital comes at a zero percent cost of money. Free money to the bank. There is only cost associated with deposits. When you have that sixty million dollars in free money, which lowers your cost of funds, has nothing to do with the ability to make loans.

Senator Heitkamp: And it does make funds available that could be invested in Richardton?

Eric: It makes cheaper money, not more money.

The hearing was closed. No action was taken.

2005 SENATE STANDING COMMITTEE MINUTES

BILL/RESOLUTION NO. SB 2306

Senate Industry, Business and Labor Committee

☐ Conference Committee

Hearing Date 1-26-05

Tape Number	Side A	Side B	Meter #
3	xx		900-1178
Committee Clerk Signature Lisa VanBerkom			

Minutes: **Chairman Mutch opened the discussion on SB 2306. All Senators were present.**

SB 2306 relates to capitalization requirements of the Bank of North Dakota.

There was no discussion from the committee.

Senator Espegard moved a DO NOT PASS recommendation.

Senator Klein seconded.

Roll Call Vote: 6 yes. 1 no. 0 absent.

Carrier: Senator Espegard

FISCAL NOTE

Requested by Legislative Council
01/24/2005

REVISION

Bill/Resolution No.: SB 2306

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.*

	2003-2005 Biennium		2005-2007 Biennium		2007-2009 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues			($7,500,000)		($6,000,000)	
Expenditures						
Appropriations						

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

2003-2005 Biennium			2005-2007 Biennium			2007-2009 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.*

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.*

Senate Bill 2306 requires Bank of North Dakota to maintain a leverage ratio of 10%. Based on 2004 year-end financial statements, BND had approximatley $2 billion in assets. A 10% leverage ratio would require $200 million in capital. BND projects to have captial of $160 million at the end of the 2003-05 biennium. Therefore, to obtain the necessary capital ratio BND would have to increase capital by $40 million (assuming the bank stays at the same asset structure).

The impact to the general fund would be approximatley $7.5 million for the 2005-07 biennium and $6 million for the 2007-09 biennium. BND estimates its earnings for the 2005-07 biennium to be $70 million. This bill retricts the amount of earnings that the BND may transfer to the general fund to 75% of earnings. This would mean that only $52.5 million could be transfered to the general fund rather than the $60 million as required in HB 1015. For the 2007-09 biennium we estimate earnings to be $72 million, and with the same restriction of 75%, only $54 million could be transferred. Assuming the general fund transfer from BND was again $60 million for the 2007-09 biennium, the general fund would be shorted by $6 million.

   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.*

   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.*

Name:	Eric Hardmeyer	**Agency:**	Bank of North Dakota
Phone Number:	328-5674	**Date Prepared:**	01/24/2005

FISCAL NOTE

Requested by Legislative Council
01/19/2005

Bill/Resolution No.: SB 2306

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.*

	2003-2005 Biennium		2005-2007 Biennium		2007-2009 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues			$7,500,000		$6,000,000	
Expenditures						
Appropriations						

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

2003-2005 Biennium			2005-2007 Biennium			2007-2009 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.*

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.*

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   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.*

   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.*

Name:	Eric Hardmeyer	**Agency:**	Bank of North Dakota
Phone Number:	328-5674	**Date Prepared:**	01/21/2005

Date: 1-26-05
Roll Call Vote #: 1

2005 SENATE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. 2306

Senate Industry, Business and Labor Committee

☐ Check here for Conference Committee

Legislative Council Amendment Number

Action Taken DO NOT PASS

Motion Made By Espegard Seconded By Klein

Senators	Yes	No	Senators	Yes	No
Senator Mutch, Chairman	X		**Senator Fairfield**	~~X~~	X
Senator Klein , Vice Chairman	X		**Senator Heitkamp**	X	
Senator Krebsbach	X				
Senator Nething	X				
Senator Espegard	X				

Total (Yes) 6 No 1

Absent 0

Floor Assignment Espegard

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

REPORT OF STANDING COMMITTEE

SB 2306: Industry, Business and Labor Committee (Sen. Mutch, Chairman) recommends **DO NOT PASS** (6 YEAS, 1 NAY, 0 ABSENT AND NOT VOTING). SB 2306 was placed on the Eleventh order on the calendar.

2005 TESTIMONY

SB 2306

OPPOSED

TESTIMONY TO THE SENATE INDUSTRY, BUSINESS & LABOR COMMITTEE

JANUARY 24, 2005

SENATE BILL 2306

ERIC HARDMEYER - BANK OF NORTH DAKOTA

Senate Bill 2306 requires Bank of North Dakota to maintain a leverage ratio of 10%. This ratio is calculated by dividing total capital by total assets. While the bill is well-intentioned, I believe it is unnecessary and will most definitely impair BND's ability to make its $60 million transfer to the general fund per HB1015.

Capital and reserves are necessary to protect financial institutions from losses resulting from bad loans, unforeseen operating expense, or other extraordinary events. At year end 2004, the Bank of North Dakota was capitalized at 7.75%. According to Federal Reserve regulations, to qualify as "well-capitalized", a financial institution must have at least 5% capital. A nation-wide comparison of capital for banks of similar size is 8.16%, while the North Dakota average for all banks is 9.96%. Our internal goal is for BND to have equity of 8%. Further, I estimate that by the end of the 2003-05 biennium, we will reach that goal.

In addition to the capital that BND maintains, it also has a loan loss reserve. This reserve protects the banks capital from loan losses. BND reserves a percentage of each loan for possible losses. BND's reserve is 1.8% compared to the average for all North Dakota banks of about 1.75%.

As can be seen on the next page, assets have remained fairly constant over the last four years, although loan volume has increased each year. The loan portfolio is diversified into four main categories: business, agriculture, student loans, and residential. The breakdown is as follows: business - $480 million, agriculture - $236 million, student loans - $417 million, and residential - $322 million. Because of the composition of BND's portfolio, over 50% of the portfolio carries a federal loan guaranty. This of course also reduces loan losses.

Without issuing stock, there are basically two ways to enable BND to reach this 10% capital position requirement. One is to grow its equity accounts through retained earnings. In this case, $40 million of earnings would have to be retained to reach 10% capital ($200 million which is 10% of $2 billion). This would impact BND's ability to transfer $60 million to the general fund for the 2005-07 biennium as required in HB 1015. According to the bill, the Industrial Commission could only transfer up to 75% of BND profits if it does not meet the 10% leverage ratio.

The other way to achieve a 10% leverage ratio is to shrink the size of the Bank to a level that then meets the requirement. Based on 2004 year-end numbers, BND assets and liabilities would have to shrink by approximately $400 million. This would have an adverse impact on the income statement, possibly reducing income by as much $8 million a year.

BND Financial Highlights (millions)

	2001	2002	2003	Unaudited 2004	Projected 2005
Assets	$2,107	$1,974	$1,953	$2,015	$2,000
Capital	$ 170	$ 149	$ 153	$ 153	$ 160
Ratio	8.07%	7.55%	7.83%	7.75%	8.00%
Loans	$1,276	$1,330	$1,392	$1,456	$1,506
LL reserve	$ 24.0	$ 25.1	$ 25.3	$ 25.9	$ 27.3
Ratio	1.9%	1.9%	1.8%	1.8%	1.8%
Income	$33.1	$32.2	$31.7	$34.2	$35.0
GF transfer	$50.0	$30.0	$34.0	$30.0	$30.0
ROE	19.5%	21.6%	20.7%	22.4%	21.9%

In November, 2004, Moody's Investor Service, a national rating agency, raised ND's issuer rating to Aa2 from Aa3. They cited as reasons: a history of conservative management, strong financial results, and a low debt burden. They also stated "the upgrade is based on a reassessment of benefits and potential risk from the operations of the Bank of North Dakota, the nation's only state-owned financial institution".

Testimony of Sen. John Warner - Intro
On SB 2306
Relating to Capitalization Requirements of the Bank of North Dakota
Industry, Business and Labor Committee
Sen. D. Mutch, Chairman

Senator Mutch, Members of the Committee,

This bill has been presented to bring focus to a concern voiced by legislators across the entire political spectrum that the revenues of the Bank of North Dakota are being used to finance the day to day functions of government rather than being used to develop critical infrastructure and promote economic development.

I want to emphasize that this is not a criticism of the management of the bank. I think there is a general consensus that the bank is efficient and well run. It is intended as a criticism of both the executive branch and the legislative branch when they use the bank as a cash cow whenever demand for services exceeds tax income. In the long haul I believe this hurts the Bank's ability to finance large scale projects.

This bill would state the goal that the state should have a 10% equity position in the Bank and that 25% of the revenues would need to be left in the Bank until that goal was met.

Mr. Chairman, I ask that you pass this bill and keep the issue alive during the legislative session. This early in the session it seems likely, given the Governor's budget, that significant progress will be made this session in restoring the equity position and in any event we in the 59th Legislative session have a limited ability to bind the actions of future legislatures but I hope that by having this provision in statute we will establish a gold standard for the management of what has been one of the most successful and innovative institutions in North Dakota history.