

**STATE BANK
PROPOSED ADVANTAGES AND RESPONSES**

In response to the request of the Senate Government Operations Committee, we have identified proponent stated advantages of a state bank and have provided responses and concerns.

Stated Advantage:

- Create new jobs and spur economic growth.

Response/Concern:

- Existing economic development lenders already assist in creating jobs.
 - Our economic development lenders make loans and take a second position, which would not be prudent with state funds.
 - VEDA currently accepts a higher risk position with their loans than the Bank of North Dakota (BND).
 - What would a state bank do differently than what we are already doing today?
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Stated Advantage:

- Generate new revenues for state directly.

Response/Concern:

- Is the purpose of a state bank to generate revenue to the state or to act as an economic development tool?
 - In states such as Vermont, there is a clear dividing line between state instrumentalities such as VEDA, VHFA, VMBB and VSAC that provide services addressing economic and social needs. These are not used to augment state revenues but funds are retained and kept focused on the mission. The political tug of war between capital needs and budget is eliminated.
 - It took many years for BND to generate a profit.
 - Franchise tax collections will be lower due to a state bank capturing state and municipal deposits.
 - Debt is a financing mechanism, not a revenue source.
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Stated Advantage:

- The Gund Institute's study seems to suggest that capitalization of the state bank could come from unrestricted assets of VEDA, VHFA, VMBB and VSAC.

Response/Concern:

- VEDA, VHFA, VMBB and VSAC assets and reserves are already pledged to support existing credit facilities, or are used for operations, new initiatives, or to support potential loan defaults.
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Stated Advantage:

- Taking state funds and investing them locally.
- BND does not imperil state funds or tax money but is self-funding and self-sustaining.

Response/Concern:

- The mission of all identified instrumentalities is local investment for Vermonters.
 - It is not financially prudent to fund long-term lending with short-term capital.
 - State funds deposited within TD Bank are protected by an irrevocable letter of credit from the Federal Home Loan Bank of Pittsburgh.
 - Any losses associated with a state bank's portfolio ultimately would be borne by the taxpayers of Vermont.
 - If bonds are issued to finance the state bank, they will be Private Activity Bonds and therefore will not be tax exempt, resulting in higher interest rates.
 - Today we can invest state funds without creating a public bank.
 - The Treasurer recently sold \$25M in bonds to Vermonters and approximately 80% of VMBB financing are sold to Vermont investors. Other instrumentalities have significant local investment.
 - If funds are deposited in a state bank, there will be a need for an investment vehicle for monies that cannot be loaned out immediately.
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Stated Advantage:

- No bank fees, state bank would earn interest on loans made.

Response/Concern:

- State may earn below market interest rates on deposits.
 - It would cost the state considerably more to replicate the banking services currently being offered by the bank of record for the state. We do not currently have staff or operations in place, and would need to create services from scratch.
 - The state bank would not be able to meet the daylight overdraft needs of the state.
 - The state would have to borrow funds from some source to pay its bills when cash became tight. There would be borrowing costs associated with such transactions.
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Stated Advantage:

- Lower debt costs for local governments.

Response/Concern:

- BND does not provide bond financing to North Dakota's municipalities. A separate state instrumentality, modeled after VMBB, does so.
- Municipal governments and school districts will experience a higher cost of funds if the bond rating of the state is downgraded.
- Municipal governments already enjoy an economy of scale with VMBB at very low costs.
- VMBB already receives all of the "state advantages" that a state bank would receive.
- A state bank would have to use the same types of consultants VMBB uses and in all likelihood at the same cost.
- Short-term borrowing needs of municipalities after Tropical Storm Irene were met by the banks in Vermont.
- Aggregating municipal deposits in a state bank will have a negative impact on other banking services provided to municipalities.
- Aggregating municipal deposits will reduce the amount of deposits banks have to lend in their local communities.

Stated Advantage:

- Strengthen local banks and even out credit cycles, and preserve real competition in local credit markets.
- Banks in North Dakota thrive because of BND.

Response/Concern:

- Vermont has been fortunate to not have a bank failure in many decades.
- Unit banking laws in North Dakota forced a one town one bank approach whereas Vermont has a strong branching environment.
- Banks in North Dakota found themselves in need of correspondent banking services. Banks in Vermont have no such needs due to partnerships with organizations like the Federal Reserve and the Home Loan Bank System.
- VEDA, VHFA and VMBB already work closely and partner with the banks in Vermont.
- BND was and is subject to credit and market cycles – i.e. suffered during the 1980s agricultural bust, but is benefiting during the current oil boom.

Stated Advantage:

- Build up small businesses.

Response/Concern:

- Currently banks in Vermont have funds to lend.
- The challenge is finding bankable projects.
- Demand is low because many businesses are still concerned about the economy.
- If a state bank were to lend to businesses that are currently not bankable, then the state would be holding onto a higher risk portfolio.
- The issue is matching small business needs with the right sources of capital.
- Capital financing needs have to be matched with the proper source of capital.

Stated Advantage:

- A state-owned bank on the BND model would not compete with community banks.

Response/Concern:

- As contemplated in S.204, a state bank making direct loans to individuals and businesses would be in competition with banks.
- A state bank providing banking services to the state is in direct competition with banks.
- Short-term needs of VEDA, VHFA, VMBB and VSAC are already being met by local and regional banks doing business in Vermont.
- VMBB is prohibited in statute from competing with banks per legislative intent.

Stated Advantage:

- BND does not compete for loans or for commercial deposits.

Response/Concern:

- Public deposits are not defined, so if they include municipal deposits the state bank would be in competition with banks.
 - BND does take limited private deposits.
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Stated Advantage:

- Although BND is a member of the Federal Reserve System, it is insured by the state rather than by the FDIC.

Response/Concern:

- Extending the state's full faith and credit or moral obligation to support the state bank will hurt the state's and VMBB's bond ratings.
 - State funds deposited within TD Bank are protected by an irrevocable letter of credit from the Federal Home Loan Bank of Pittsburgh.
 - Any losses associated with a state bank's portfolio would ultimately be borne by the taxpayers of Vermont.
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Stated Advantage:

- Advocates for a Vermont state bank state that BND is run by bankers, not politicians bent on funding their favorite development projects or bestowing political favors.

Response/Concern:

- BND is run by the industrial commission, which includes the governor, commissioner of agriculture, and the attorney general.
 - The current system of state instrumentalities, VEDA, VHFA, VMBB and VSAC, are run by individuals with financial expertise and boards with members selected for their experience and expertise.
 - The Treasurer's office is concerned about losing independence, and about the ability to utilize the prudent investor rules incorporated in statute.
 - There are concerns the state bank would circumvent the due diligence of existing boards when reviewing projects.
 - Each existing organization has a statutory standard of care they must adhere to; the state bank proposal does not.
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Stated Advantage:

- Partnering with BND allows community banks to fund local projects in which Wall Street is not interested, leveraging municipal government funds that would otherwise not be available for loans.

Response/Concern:

- Banks in Vermont currently fund municipal projects at favorable rates.
- Banks work closely with VMBB to meet long-term municipal needs.
- There will still be a need to go to the capital markets as evidenced in North Dakota.
- BND does not offer all the products necessary for long-term financing.
- Transaction size is a challenge that will not be solved by a state bank.