

# Department of Financial Regulation

Michael S. Pieciak, Commissioner

---

## SENATE COMMITTEE ON FINANCE

### S. 48

Sen. Ann Cummings, Chair  
Sen. Mark A. MacDonald, Vice Chair  
February 1, 2017



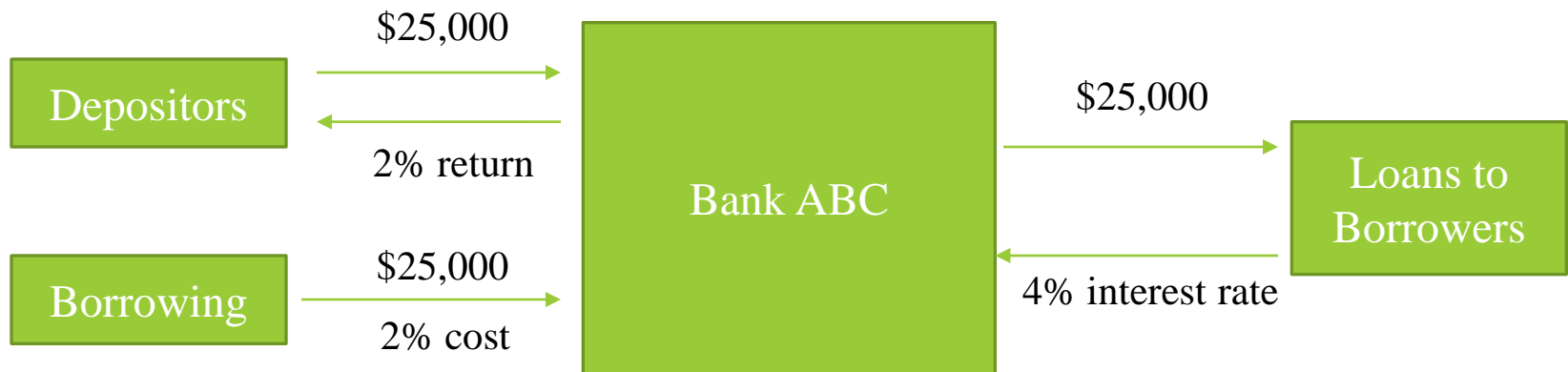
# Risks Regarding the Creation of a State Bank

---

1. Cost of Capitalizing the Bank and State Government Liquidity
2. Risk of Loss
3. Operations and Overhead
4. Risk to Vermont's Bond Rating
5. Disruption to Vermont's Community Banks and Credit Unions
6. Risk to State Tax Revenues
7. Timing: The Current Low Interest Banking Environment
8. Cautionary Tales from other State Banks

# Capitalization of the Bank and State Government Liquidity

---



# Capitalization of the Bank and State Government Liquidity

---

Bank of North Dakota (BND)

Founded in 1919

Based on Federal Reserve Bank of Boston Study

- **\$2 million** bond offering to capitalize
- **\$28.6 million** in 2017 inflation adjusted numbers
- **\$371.8 million** when accounting for growth in US GDP since 1919

Proved insufficient, and several years later North Dakota withdrew funds from state banks to further capitalize which lead to 18 bank failures within 3 weeks

26 years until BND made profit and contribution to North Dakota General Fund

# Capitalization of the Bank and State Government Liquidity

(Amounts in Thousands)

Institution	Date of FS	Loans to borrowings	Notes & Commerical Paper	Loans to borrowings
<b>VEDA</b>	<b>6/30/2016</b>	\$ <b>239,437</b>	\$ <b>211,267</b>	<b>113.33%</b>

Institution	Date of FS	Total Mortgage Portfolio (loans receivable and Mort Backed Sec.)	Bond and Note payable	Loans to borrowings
<b>VHFA</b>	<b>6/30/2016</b>	\$ <b>463,284</b>	\$ <b>447,007</b>	<b>103.64%</b>

Institution	Date of FS	Total Student Loan Portfolio (interest included)	Bond and Note payable (Interest Included)	Loans to borrowings
<b>VSAC</b>	<b>6/30/2016</b>	\$ <b>968,227</b>	\$ <b>876,453</b>	<b>110.47%</b>

Institution	Date of FS	Total Loan Portfolio	Bond and Note Payable	Loans to borrowings
<b>VMBB</b>	<b>12/31/2015</b>	\$ <b>534,506</b>	\$ <b>607,206</b>	<b>88.03%</b>

<b>Sum of Borrowing</b>	\$ <b>2,141,933</b>
-------------------------	---------------------

# Capitalization of the Bank and State Government Liquidity

<b>(Amounts in Thousands)</b>					
<b>Institution</b>	<b>Date of FS</b>	<b>Cash &amp; CE- Unrestricted</b>	<b>Cash &amp; CE- Restricted</b>	<b>Investments - Unrestricted</b>	<b>Investments - Restricted</b>
<b>VEDA</b>	<b>6/30/2016</b>	<b>\$3,890</b>	<b>\$3,417</b>	<b>\$4,500</b>	<b>\$24,066</b>
<b>Institution</b>	<b>Date of FS</b>	<b>Cash &amp; CE- Unrestricted</b>	<b>Cash &amp; CE- Restricted</b>	<b>Investments - Unrestricted</b>	<b>Investments - Restricted</b>
<b>VHFA</b>	<b>6/30/2016</b>	<b>\$248</b>	<b>\$62,008</b>	<b>\$7,267</b>	<b>\$4,371</b>
<b>Institution</b>	<b>Date of FS</b>	<b>Cash &amp; CE- Unrestricted</b>	<b>Cash &amp; CE- Restricted</b>	<b>Investments - Unrestricted, Interest included</b>	<b>Investments - Restricted</b>
<b>VSAC</b>	<b>6/30/2016</b>	<b>\$23,141</b>	<b>\$79,764</b>	<b>\$22</b>	<b>\$4,396</b>
<b>Institution</b>	<b>Date of FS</b>	<b>Cash &amp; CE- Unrestricted</b>	<b>Cash &amp; CE- Restricted</b>	<b>Investments - Unrestricted</b>	<b>Investments - Restricted</b>
<b>VMBB</b>	<b>12/31/2015</b>	<b>\$9,716</b>	<b>\$3,131</b>	<b>\$11,067</b>	<b>\$55,899</b>
<b>Totals</b>		<b>\$36,995</b>		<b>\$22,856</b>	
				<b>\$59,851</b>	

# Capitalization of the Bank and State Government Liquidity

---

In 2014, State Treasurer Beth Pearce testified that her office on average maintains \$350 million in funds.

However, only \$279 on average or unrestricted

Vermont \$223 million variance within 5 days (\$127 million)

Recent low points:

December 24, 2004	\$7.6 million
December 17, 2005	\$20.7 million
April 30, 2009	\$19.9 million

# Risk of Loss

---

## **Current Model**

State of Vermont Funds are Protected

- FDIC Insured up to \$250,000
- Remaining funds are protected by an irrevocable letter of credit with the Federal Home Loan Bank of Pittsburgh

## **State Bank Model**

State of Vermont Funds are at Risk through loans to individuals, businesses, non-profit entities etc.

Vermont tax payers would be providing “full faith and credit” guarantee



# Operations and Overhead

---

The Banking Industry is extraordinarily complex: operations, business, legal, regulatory, finance

BND has over 200 employees

State of Vermont receives 10s of thousands of wires, deposits and transfers that need to be appropriately segregated into the right accounts

IT related expenses (\$74 billion in US/\$188 billion internationally)

Increased threat/risk of cyber attacks

Underwriting subject to attempts to influence decisions based upon political concerns rather than strict financial and economic considerations

# Risk to Vermont's Bond Rating

---

Vermont has traditionally had one of the highest bond ratings in the country allowing the state to fund long term projects with relatively inexpensive capital

State Treasurer Beth Pearce previously provided analysis by Public Resources Advisory Group that found: \

“The State of Vermont will continue to need to access the capital market for its infrastructure needs. Adding additional debt and financial obligations associated with the funding of a state bank, guarantee of deposits, issuing new State debt to capitalize the bank and taking ultimate responsibility for covering riskier loans could make the State less credit worthy in the eyes of the rating agencies or investors.”

## Disruption to Vermont's Community Banks, Credit Unions and Economy

---

Shifting of deposits during the capitalization of the BND resulted in 18 bank failures in short order

2011 Massachusetts study found “an aggressive schedule of withdrawing funds from private institutions could disrupt the economy”

Community Banks and Credit Unions would be in direct competition with the state bank for deposits and loans

The current “V”s are already servicing the functions of a state bank and then some

# Disruption to Vermont's Community Banks, Credit Unions and Economy

---

Bank of ND Loan Portfolio breakdown as of 9/30/2016 quarter-end	
	Approx. (in Millions)
Student loans	\$ 1,372
1-4 Family Residential	\$ 778
Agriculture	\$ 693
Commercial/Business	\$ 1,890
Total Loans	\$ 4,735
Total Deposits	\$ 5,000
Total Assets	\$7,266
Loan to deposit	94.70%

	Total Assets	Net loans	Deposits	LtoD Ratio
<i>Vermont Charter Banks</i>	in 000's	in 000's	in 000's	
<b>Aggregate</b>	<b>\$4,795,537</b>	<b>\$3,545,566</b>	<b>\$3,744,010</b>	<b>94.70%</b>
<i>National Banks HDQ VT</i>				
<b>Aggregate</b>	<b>\$1,886,471</b>	<b>\$1,353,680</b>	<b>\$1,520,053</b>	<b>89.05%</b>
as of 9/30/2016				93.07%

# Lost of State Tax Revenue

---

Bank Franchise Tax: At .000096 of average monthly deposits

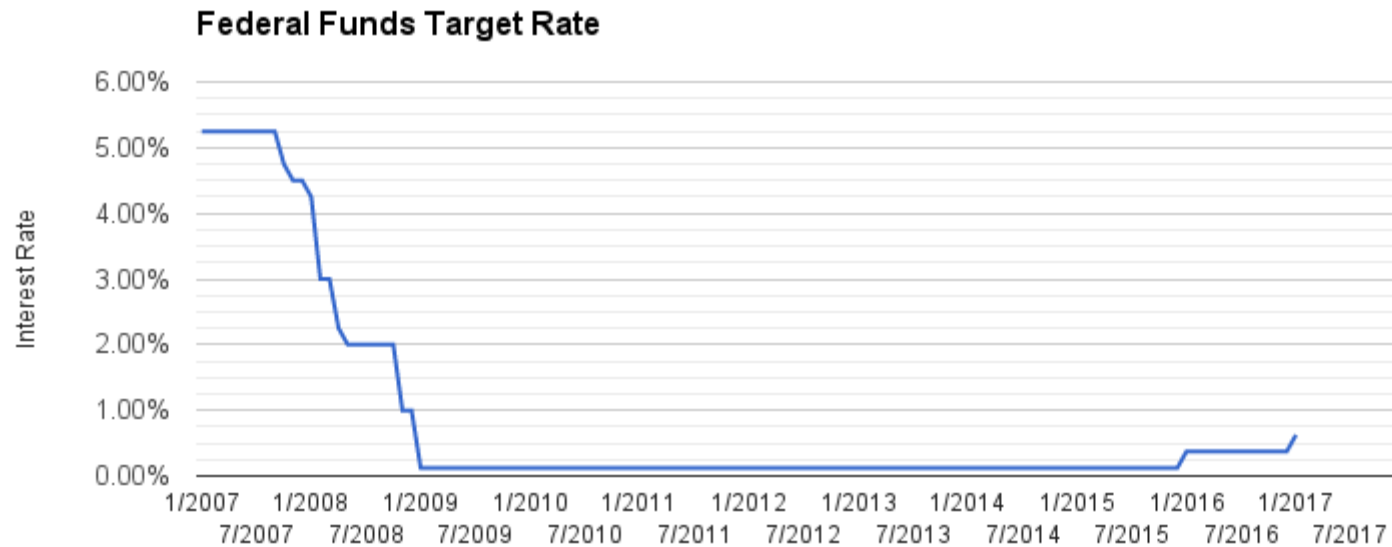
BND General Fund Contribution: \$30 million annually or .75% of state expenditures on average for the State of North Dakota

However BND's net contributions to state revenues are lower than its transfers: North Dakota earns roughly 0.25 percent less interest than state agencies would get from a commercial institution.

## Timing: The Current Banking Environment

---

- **1990 through 2010**: 2880 de novo bank applications
- **2011 though today**: 6 de novo bank applications



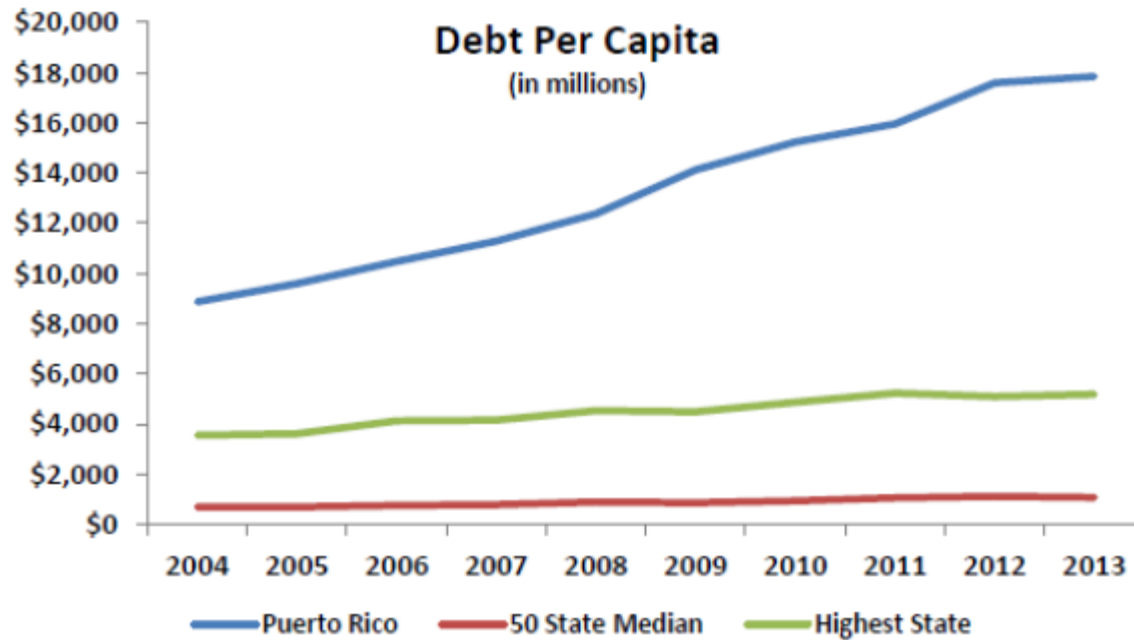
# State Banks: Cautionary Tales

---

- The Government Development Bank for Puerto Rico
- The Farmers Bank of the State of Delaware
- Bank of North Dakota

# The Government Development Bank for Puerto Rico

---





# The Government Development Bank for Puerto Rico

---

