

# OREGON STATE BANK

## PUTTING OUR MONEY TO WORK FOR US

**Why a State Bank?** There are numerous advantages to a State Bank, as shown by the experience of the Bank of North Dakota (BND), the nation's only state-owned bank, which has been in business successfully for over 90 years.

### What could an Oregon State Bank accomplish?

- **Stimulate the state's economy:** A prudently run State Bank will have the ability to leverage the liquid assets of government entities to stimulate investment in the state's economy and can do so in a way that strengthens the state's fiscal position over the medium and long terms.
- **Provide stability for local financial institutions:** The financial crisis of the last several years has shown just how vulnerable our local economy is to speculation and panic in the global financial markets. A rare and welcome exception to this has been in North Dakota where not a single North Dakota bank has failed or is in danger of failing.
- **Be an important partner to state-chartered banks:** As the current financial crisis started to move through worldwide financial markets, BND helped provide stability and strengthen the capital position of community banks operating in the state by purchasing loans from their portfolios and investing in bank stock. The state bank's ability to step in on the front end preserves local banking capacity and maintains the viability of credit-worthy local businesses.
- **Provide an alternative to bank consolidation:** If we want to arrest the trend of mergers and consolidation in the financial industry – a trend that we now know all too well leads only to “Too-Big-To-Fail” – and if we instead want to preserve the viability and vibrancy of local banks, and with them the resiliency of our local economy, then we should support a State Bank.
- **Through low costs allow for mission-driven economic development lending:** Because of lower overhead, no exorbitant bonuses, and no shareholder dividends, the BND has remained profitable while maintaining a low Net Interest Margin – 2.5% versus an average of 4% required by commercial banks.
- **Facilitate effective economic development for the state:** BND leverages the income earned through more lucrative market-driven activities to subsidize economic development activities that may carry somewhat higher risks or where borrowers have difficulty accessing capital. In this way, the Bank acts as an effective economic development program for the State – *without costing the State anything*.
- **Help the state's budget:** Annually, the Bank of North Dakota typically retains half its profits - which have averaged 26-27% of its equity in recent years – as capital, and returns the other half to the state's General Fund (\$350 mn in the last decade).

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## **Would a State Bank compete with private banks in Oregon?**

- **No, a state bank is not in competition with private banks.** Although the BND does accept a small amount in private deposits (1% of their total deposit base), the proposed Oregon State Bank would not have a retail presence, meaning it would not accept deposits from individuals or businesses nor offer direct loans.
- **A state bank would partner with local banks and credit unions.** Following the model of the Bank of North Dakota, the Oregon State Bank will engage in participation lending, participating in loans originated by local banks and credit unions, either by increasing the total size of the loan, buying down the interest rate, or providing loan guarantees. The State Bank could also serve as a banker's bank for local banks.

## **What money will be deposited in the State Bank?**

In North Dakota, all state funds are deposited with the Bank of North Dakota. This does not include pension funds or other trusts managed by the state; rather the deposits are the state's cash – revenue that the state collects before it is spent on payroll, contracts, procurement, etc. Even though they can deposit their funds in the BND, most municipalities in North Dakota choose to deposit their funds with private financial institutions in their communities. We assume that at least at the outset at least a portion of Oregon's short term funds will be deposited with the Oregon State Bank.

## **Why don't we simply deposit more state funds in community banks and credit unions?**

The State of Oregon requires that banks accepting deposits of public funds above FDIC insurance limits (i.e. \$250,000) post collateral for those deposits. The amount of collateral required depends on the FDIC's characterization of the bank's level of capitalization. For any bank that is deemed in less-than-perfect health, the collateral required must equal 100% or even 110% of the amount of deposits.

The practical effect of these requirements is that Oregon banks have not found it particularly useful to accept state deposits. For the last several months the Treasury has set aside \$200 mn from the Oregon Short Term Fund (OSTF) to be deposited with Oregon banks. Currently only about \$110 mn of this has actually been drawn down on. As things stand, simply depositing state funds with community banks will have a negligible effect on overall lending, and is not an adequate policy response to the lack of credit in the economy.

## **How would a state bank be capitalized, and how much lending will it be able to do?**

In order to be a proper bank, the state bank must start with capital. For private banks, this typically begins as "shareholder's equity," but since the state bank will not have shareholders, this will take the form of bonds issued for the purpose of capitalizing the bank or an appropriation of funds from the legislature. A bond issuance or other initial capitalization would be repaid from the bank's profits. The bank's capital is the limiting factor in the scale of its lending. Roughly speaking, commercial banks may make loans of up to 10 times their capital. Beyond that, as we saw in the recent financial meltdown, a bank becomes "over-leveraged" and is putting itself at risk of insolvency should too many of the loans go bad.

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The Bank of North Dakota has roughly \$250 mn in capital, with loans totaling \$2.8 bn. Of that \$250 mn in capital, only \$42 mn came from state-issued bonds. The remainder is 91 years worth of earnings from successful business operations.

### **Why is a State Bank preferable to economic development loan programs managed by state agencies?**

Many states, including Oregon, have loan programs administered by various state agencies. Often these take the form of “revolving funds,” where the Legislature allocates a certain amount of money to a loan fund. As borrowers repay those loans, additional loans can be made to new borrowers. Typically these are designed to provide below market rate loans to businesses engaging in specific types of economic activity that the state considers desirable.

Many states have had success with these loan programs. They are, however, substantially more limited than a State Bank. With a loan fund, the amount that a legislature appropriates into the fund is the total amount of financing that the fund can offer at any time. In other words, a \$10 million fund can do no more than \$10 million in lending at one time. A bank, on the other hand, has leverage. If a bank is capitalized at \$10 million, under typical regulations it can make as much as \$100 million in loans.

### **What effect would a State Bank have on the state’s fiscal health?**

In addition to being able to engage in more substantial lending operations, a State Bank also can be a limited but significant source of funding for state governments. The Bank of North Dakota has returned over \$350 million to the State of North Dakota’s General Fund in the last decade. The Oregon State Bank would return profits in excess of those needed for sound continuing capitalization of the Bank to the state’s Rainy Day Fund.

A State Bank can also perform basic banking services for the state, like writing checks and issuing EBT cards for state benefits, which can save millions every year.

### **How would a State Bank be governed?**

Following the example set by BND, which has worked well for nearly 100 years, the State Bank should have two boards. The Governing board would be made up of 3 statewide officials: the Governor, State Treasurer, and Labor Commissioner. This board would set the broad policies of the bank.

The advisory board would have a greater focus on the business end of banking activities including receiving reports from the Bank’s management, supervising audits, and participating in lending decisions. Members should include officers of locally owned banks and representatives from areas of the economy where the state bank does substantial lending.

### **How would a State Bank be managed?**

It has been repeated often that the Bank of North Dakota’s success has been due in large part to effective management by individuals with substantial expertise in banking and finance, and that its strong working partnerships with banks and businesses in North Dakota is largely a function of the strong customer relations skills of BND’s employees and their knowledge of the business of banking. We are certain that there is no shortage of public-spirited individuals in Oregon who have such expertise, and we would recommend that the State of Oregon look to such individuals to manage this Bank.

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