SENATE BILL REPORT
SB 5238

As of February 7, 2011

Title: An act relating to establishing the Washington investment trust.

Brief Description: Establishing the Washington investment trust.

Sponsors: Senators Prentice and Conway.

Brief History:
Committee Activity: Financial Institutions, Housing & Insurance: 1/25/11.

SENATE COMMITTEE ON FINANCIAL INSTITUTIONS, HOUSING & INSURANCE

Staff: Edward Redmond (786-7471)

Background: The 2007 recession severely impacted local economies across the United States. Various states, in response, have considered operating state-owned financial institutions as a means to provide needed capital resources to their local economies. The Bank of North Dakota (BND), the sole state-owned bank in the nation, provides the model that these states are examining for possible adoption. The BND (established in 1919 with initial capitalization of $2 million) operates as a banker's bank partnering to loan money to farmers, schools, and small businesses, and purchasing municipal bonds from public institutions. Today, the BND operates with an excess of $270 million in capital and, over the past ten years, has returned an annual average of $29.4 million to the state's general fund.

The Department of Financial Institutions (DFI) is the agency responsible for monitoring and regulating financial institutions operating in Washington State. To legally operate as a bank in the state, a financial institution must either be state or federally chartered. In addition to being chartered, banks must acquire and maintain deposit insurance from the Federal Deposit Insurance Corporation (FDIC) to protect deposits from potential bank failure. Examination reports obtained by DFI from financial institutions are confidential and exempt from public disclosure.

Under Washington law, the Treasurer is responsible for state funds and is the chair of the Public Deposit Protection Commission. As chair, the Treasurer must ensure that state funds deposited in public depositaries are backed by 100 percent collateral, liquid, and provides a return on investment. To date, there is approximately $5.5 billion in public depositaries, with

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$2.3 billion in community banks. In 2009 the Treasurer returned approximately $160 million to the state General Fund.

State agency personnel have raised constitutional concerns regarding the lending of the state's credit to private persons or businesses; investing state funds in private enterprise; and stockholder liability. Such concerns may need to be considered before a state-owned financial institution is created in Washington.

Summary of Bill: The Washington Investment Trust (Trust) is established as a new executive agency. The purposes of the Trust are to support economic development by increasing access to capital; provide financing for housing development, public works infrastructure, student loans; and reduce the costs paid by the state for banking services. The Trust becomes fully operational after various implementation stages have been completed. The following outlines the formation process of the Trust.

<u>The Investment Trust Blue Ribbon Taskforce (Taskforce).</u> The Taskforce is established to create an implementation plan for the Trust. The Taskforce reviews and makes recommendations which include:
- a strategic five-year plan aligned with the mission of the Trust;
- standards to ensure that loans result in the outcomes described in the approved loan application;
- cash management and banking needs of the state; and
- initial capitalization options for the Trust.

The Taskforce must report its findings, recommendations, and implementation plan to the Legislature by December 1, 2011. The Taskforce and its authority sunsets on June 30, 2012.

<u>Washington Investment Trust Commission (Commission).</u> Effective December 1, 2011, the Commission commences its duties. The Commission is comprised of the Governor, Lieutenant Governor, and the Treasurer. Responsibilities of the Commission include adopting rules regarding objectives of the Trust and eligibility for borrowing; beginning Trust operations by January 1, 2013, in accordance to the Taskforce Implementation Plan; appointing a president and other officers with experience in banking; and determining the annual amount of revenue from the Trust to be returned to the state General Fund.

<u>Advisory Board (Board).</u> Effective December 1, 2011, the Legislature and Governor must jointly assemble a 15-member Board. The Board must meet regularly to review the Trust's finances and its members must participate in committees created by the Commission.

<u>Capitalization of Trust.</u> The Taskforce must make recommendations for initial capitalization of the Trust by December 1, 2011. The Treasurer must deposit all state monies into the Trust by June 30, 2015. All income earned on state monies that are deposited in, or invested with, the Trust must be credited to, and become part of, the revenues and income of the Trust. The Trust must return any portion of its earnings, beyond what is necessary for its sound functioning, to the state General Fund on an annual basis.

<u>Trust Financial Operations.</u> The Trust is authorized to engage in various financial activities including the following, the Trust may:

- accept deposits of public funds, but is not a public depositary and is not subject to the statutory public funds requirements;
- exercise any power or authority permissible to a state-chartered bank including making loans and charging the same terms for loans or extensions of credit;
- invest state monies in any manner that ensures appropriate cash management;
- operate as a clearinghouse for financial institutions that make the Trust a reserve depositary; and
- receive deposits from any source and deposit such funds in any trust or other financial institution.

Security of Deposits. All deposits in the Trust are guaranteed by the full faith and credit of the state of Washington. The Trust is exempt from statutory requirements to hold deposit insurance from the FDIC and matching collateral as a public depositary.

Payment of Taxes. The Trust is exempt from paying all fees and taxes imposed by the state or any of its subsidiaries.

Reporting and Auditing Requirements. DFI must monitor the Trust to ensure it maintains capital adequacy and other standard indicators of safety and soundness. The Trust must submit quarterly reports to the Commission in accordance to the recommendations of the Taskforce. The Commission must then make an annual report by December 1 to the Legislature on the affairs of the Trust and any recommendations for legislative action.

Public Disclosure Exemption. The Trust is exempt from disclosing any financial and commercial information or records supplied by businesses or individuals during application for loans or programs services provided by the Trust. Additionally, examination reports and information obtained by the DFI from the Trust are exempt from public disclosure.

Appropriation: None.

Fiscal Note: Requested on January 18, 2011.

Committee/Commission/Task Force Created: Yes.

Effective Date: The bill contains several effective dates. Please refer to the bill.

Staff Summary of Public Testimony: PRO: The Trust may be a way to bring in additional revenue to the state. The bill is about using the state's money in a smart fashion; keeping it in state rather than exporting it as profits to multinational banking institutions. The bill before the committee does not have a constitutional problem because the Trust will not become operational until trailer legislation passes in 2012. The taskforce will be looking at this and will likely provide recommendations to address any constitutional issues. With regard to deposits, the intent of the bill is to model the success of North Dakota which permits personal deposits but does not market to individuals. Currently, when the state collects all of its tax revenue, most of it goes into the Bank of America. That is the state's main checking account that pays all of the state's bills. At any given time, there is approximately $2 billion in that account. Bank of America, as the holder of that account, gets to make money off of our money while it sits there on the float. The objective of the bill is to create our own institution and keep that money in our state.

Wall Street banks have cut way back on their lending to small businesses in Washington. Those banks are busy making money through high speed trades and are not thinking about the local communities. We need to look ahead and think about the state we want our kids to live in. Mainstreet Alliance conducted a survey of small businesses across the state and found challenges related to access to credit amongst other things. Seventy-nine percent of businesses surveyed supported the state bank idea. The Center for State Innovation conducted an analysis of the state bank. The analysis found that BND has had a positive effect on the banking industry and lending market. If applied to Washington, you would get increased lending in the state (assuming significant demand for the lending exists) which would lead to new job creation estimated at 7,500 to 10,000 new jobs created or retained in the state. Currently, students and health service workers are struggling to make ends meet because of an underfunded budget. Basic healthcare programs, education, and many other programs risk being cut as a consequence of the budget problem. This trust will help bring needed capital to the state and community programs.

CON: The State Treasurer is firmly committed to building on and extending Washington State's hard-won reputation for fiscal discipline. A reputation that at its core requires that public funds be safe and secure at all times, and that these funds are available to pay state's bills. This bill not only fails to achieve these important goals, but if adopted would place both public funds and the state as a whole at significant risk. Treasury attorneys are certain that Article 8, section 5 of the Washington State Constitution directly conflicts with the proposed Washington Trust, which either directly or through loans to banks, would loan public funds now safeguarded in the treasury for home mortgages, businesses, and students. The treasury has returned over $500 million to the state in short-term investments of two to four years rather than long-term mortgage or student loan investments. An alternative the Legislature should consider is enhancing the tools already available. This includes the state Housing Finance Commission, which provided $3.9 billion in private bonds to support affordable housing projects; the Economic Development Finance Authority, which provided $1 billion in private bonds to support manufacturing and nonprofit entities; and the Department of Commerce Public Works trust fund that would help finance $386 million in local government infrastructure.

Banks share similar interest as the state in terms of bringing more capital to the local communities and exploring collaborative opportunities for the public private sector to ensure proper flow of capital for both individuals and business. Unfortunately, the bill creates challenges for the bank. Section 8 of the bill, for instance, would allow the trust to compete directly with private sector banks for all products currently offered by both state and national banks. The trust would do so in an untaxed environment as stated in section 12 of the bill. There is also no provision for FDIC insurance, which is a significant cost for private banks to acquire.

OTHER: The BND has a long working relationship with the North Dakota community banks. There are approximately 94 financial institutions in North Dakota. The BND loan programs and state statute provide that the bulk of the banks lending cannot be done directly, it is done with the partnership of the lead lender which is a community bank. The BND programs get to the North Dakota residents through the community banks. By law, the BND does not compete with community banks. The BND takes additional credit risks on behalf of community banks, does participation loans, private liquidity, and contingency funding. The Treasurer deposits state funds into the BND, which operates like a federal reserve – it does all the clearinghouse work for banks. There are some state funds that are not deposited into the bank; retirement funds, for example, the statute allows them to be invested elsewhere under professional money management.

Persons Testifying: PRO: Senator Prentice, prime sponsor; Representative Hasegawa, prime sponsor House companion; Gene Lux, Puget Sound Alliance for Retired Americans; John Repp, Western Washington Fellowship of Reconciliation; Sarajane Siegfriedt, King County Democrats; Sam Munger, Centers for State Innovation; Joshua Welter, Mainstreet Alliance; Heather Villanueva, SEIU Healthcare 775 NW; Samuel Merrill, Friends Committee on Washington Public Policy.

CON: Denny Eliason, Washington Bankers Association; Wolfgang Opitz, State Treasurer's Office; Brad Tower, Community Bankers of Washington.

OTHER: Ed Sather, retired, Bank of North Dakota; Kirby Martz, citizen.