REPORT OF THE COMMISSION TO STUDY THE FEASIBILITY OF ESTABLISHING A BANK OWNED BY THE COMMONWEALTH

As authorized by SECTION 180 of Chapter 240
of the Acts of 2010

August 8, 2011

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Executive Summary

The Commission to Study the Feasibility of Establishing a Bank Owned by the Commonwealth was authorized by SECTION 180 of Chapter 240 of the Acts of 2010 (see Appendix A). The Commission conducted a study of the feasibility of establishing a bank owned by the Commonwealth or by a public authority constituted by the Commonwealth by:

- Examining the technical, legal and financial feasibility of establishing a Commonwealth-owned bank, including but not limited to a Commonwealth-owned bank for infrastructure investment purposes.

- Evaluating the experiences of other states with state-owned banks, identifying the financial performance of such banks and evaluating the lending practices of such banks to show whether such banks successfully fill lending gaps not filled by the private sector.

- Evaluating the manner in which public funds are invested or deposited by the Commonwealth and its political subdivisions including funds managed by the state Treasurer, the Massachusetts Municipal Depository Trust, and state and local pension funds.

- Examining the infrastructure investment activities conducted by other states with state-owned banks.

- Examining the lending practices, including lending to support infrastructure, of the existing public agencies in the Commonwealth that perform lending services.

The Commission consisted of 21 members including appointees of the Executive Office of Administration and Finance, the Executive Office of Housing and Economic Development, the Office of the Treasurer and Receiver General of Massachusetts, the State Comptroller's office, the Senate (2), the House of Representatives (2), MassDevelopment, MassHousing, the Massachusetts Growth Capital Corporation, and 8 appointees of the Governor. The appointees of the Governor included representatives from the Massachusetts Bankers Association (3), the Associated Industries of Massachusetts, the Small Business Association of New England, as well as a professor at an institution of higher education in the Commonwealth who has researched and published articles on banking.

The Commission conducted a total of six meetings and three public hearings (See Appendix B and C). The Commission's research included information prepared by the Federal Reserve Bank of Boston, the Treasurer and Receiver General of Massachusetts, the quasi-public agencies (MassDevelopment, MassHousing, Massachusetts Growth

Capital Corporation), and the Quasi-Public Coordinating Council. The Commission's public hearings occurred on June 15, 2011 in Springfield, July 12, 2011 in Boston, and July 19, 2011 in Plymouth. The Commission received testimony from a total of sixteen individuals, including testimonies from several individuals who testified on multiple occasions, through the public hearing process. The testifiers included representatives of the Massachusetts Bankers Association, a regional nonprofit economic development corporation, a private forestry company, the Senate President's Office, as well as a number of private researchers and individuals.

The Commission recommends that the Legislature not pursue establishing a bank owned by the Commonwealth or by a public authority constituted by the Commonwealth. The primary reasons for the Commission's recommendation are that (1) a state-owned bank would require significant initial capital investment and it remains unclear that there is a proven need to justify the investment; (2) the only existing model of a state-owned bank is that of North Dakota which is inadequate given the vast differences in the banking industries and economies of North Dakota and Massachusetts; (3) the public funds of the Commonwealth would be exposed to unacceptably high risk if deposited in a state-owned bank, the public funds would be used to provide risky gap financing, and the rate of return would need to match that currently earned under the management of the Treasurer; (4) the infrastructure investment activities in Massachusetts are substantially more established than in North Dakota; and (5) Massachusetts has a prominent network of public agencies, quasi-public agencies, and non-profits which offer various lending programs and services, including lending to help support infrastructure. We believe that bolstering these programs, policies and agencies is a faster and more effective way to meet gaps in our capital markets than establishing an entirely new organization.

Specifically, the Commission recognizes that there remain unmet needs in the Commonwealth including access to capital for very small businesses and infrastructure needs such as forest lands, waterways, farm lands and other forms of the environment. The Commission does not find that a state owned bank would be the best solution to resolve these remaining needs. The Commission therefore recommends a number of possible actions that the Commonwealth could take to further improve access to capital for small businesses. The Commission suggests further review of public infrastructure including the adequacy of current public policies and programs for "non-built" environments, and whether additional policies and programs are needed in the Commonwealth.

I. Background and Format of Report

SECTION 180 of Chapter 240 of the Acts of 2010 authorized a Commission to study the feasibility of establishing a bank owned by the Commonwealth or by a public authority constituted by the Commonwealth.

The Commission is responsible for conducting a study which includes the following:

State-Owned Bank

Examine the technical, legal and financial feasibility of establishing a Commonwealth-owned bank, including but not limited to a Commonwealth-owned bank for infrastructure investment purposes.

Seek participation in its deliberations from the President of the Federal Reserve Bank of Boston or the President's designee.

Evaluate the experiences of other states with state-owned banks, identifying the financial performance of such banks and evaluating the lending practices of such banks to show whether such banks successfully fill lending gaps not filled by the private sector.

Section III of this Report examines the feasibility of creating a state-owned bank in the Commonwealth, including the experience of the Bank of North Dakota.

Public Deposits and Investments

Evaluate the manner in which public funds are invested or deposited by the Commonwealth and its political subdivisions including funds managed by the state Treasurer, the Massachusetts Municipal Depository Trust, and state and local pension funds.

Section IV of this Report evaluates the public deposits and investments of the State Treasurer's Office.

Lending and Infrastructure Investment

Examine the infrastructure investment activities conducted by other states with state-owned banks.

Examine the lending practices, including lending to support infrastructure, of the existing public agencies in the Commonwealth that perform lending services.

Section V of this Report examines lending practices of several quasi-public agencies in Massachusetts, including infrastructure lending activities.

II. Members of the Commission

The members of the Commission, including the appointed seat positions, are:

Co-Chairs

David Cotney, Commissioner of Banks, Designee of the Secretary of Housing and Economic Development

Ronald Marlow, Assistant Secretary of Administration and Finance, Designee of the Secretary of Administration and Finance

Members

Peter Anderson, President of Rockport National Bank, Senate Minority Leader Appointee

Bob Baker, President of the Smaller Business Association of New England (SBANE)

Ben Branch, Professor of Finance at the University of Massachusetts Amherst

Martin Benison, State Comptroller

Representative Michael Costello

Nancy Howard, Chief Operating Officer of MassDevelopment

Bob Gallery, Market President of Bank of America, Massachusetts Bankers Association Representative

Richard Gavegnano, Chief Executive Officer of East Boston Savings Bank, Appointee of the Speaker of the House of Representatives

Thomas Gleason, Executive Director of MassHousing

Al Gordon, Assistant Treasurer, Designee of the Office of the State Treasurer

Chuck Grigsby, President of the Massachusetts Growth Capital Corporation

Joe Kriesberg, President and Chief Executive Officer of the Massachusetts Association of Community Development Corporations (MACDC), Governor's Appointee

Jack Meehl, Central Bank, Senate President Appointee

Joseph O'Leary, Jr., Senior Vice President of Flagstar Bank, Associated Industries of Massachusetts Representative

Barry Sloane, Chief Executive Officer and President at Century Bank, Massachusetts Bankers Association Representative

Senator Karen Spilka

Julieann Thurlow, President and Chief Executive Officer of Reading Co-operative Bank, Appointee of the Minority Leader of the House of Representatives

Doreen Treacy, Director of DotWell Civic Health Institute, Governor's Appointee

Michael Tucker, President and Chief Executive Officer of Greenfield Co-operative Bank, Massachusetts Bankers Association Representative

III. Examination of the Feasibility of a State-Owned Bank

The Commission examined the technical, legal and financial feasibility of establishing a Commonwealth-owned bank, including but not limited to a Commonwealth-owned bank for infrastructure investment purposes. In its examination, the Commission received participation in its deliberations from the designee of the President of the Federal Reserve Bank of Boston. The Commission evaluated the experiences of the only state with a state-owned bank, North Dakota. The Commission identified the financial performance of the Bank of North Dakota and evaluated its lending practices to show whether the Bank of North Dakota successfully fills lending gaps not filled by the private sector.

FEDERAL RESERVE BANK OF BOSTON

The New England Public Policy Center of the Federal Reserve Bank of Boston prepared a research report titled "The Bank of North Dakota: A model for Massachusetts and other states?" (See Appendix D). In the report, the Federal Reserve analyzed the benefits of having a state-owned bank.

Advocates for a state-owned bank commonly cite four potential benefits: (1) stabilizing the state's economy, (2) providing local businesses improved access to credit, (3) augmenting the lending capacity of community banks, and (4) helping fund state government through profits.

As noted below, the report confirmed that the Bank of North Dakota helped support the lending capacity of community banks in the state. However, the report found that data did not support the other stated benefits.

REPORT SUMMARY

A summary was prepared for the Commission and presented on May 28th at the open meeting. In summary, the report and presentation included the following:

Information on Publicly-Owned Banks

Publicly-owned banks are not uncommon abroad, but in the United States there is only one state-owned bank, the Bank of North Dakota (BND). Since the 1970s, the last time the formation of a state-owned bank was seriously considered, the trend has been towards governments easing control over the banking sector.

Bank of North Dakota

The Bank of North Dakota formed in 1919 due to farmers in the state having difficulty securing adequate credit at a reasonable cost. The state designed the original capitalization and operations to avoid competing directly with private banks. The researchers determined through available data that the Bank of North Dakota has been consistently profitable and is perceived as being conservative and well managed. In recent decades, the Bank of North Dakota shifted toward a greater emphasis on lending and economic development.

The Bank of North Dakota has $4 billion in assets and about 15% of the deposits are held by banks in North Dakota. The Bank of North Dakota is the largest bank in North Dakota but it is significantly smaller in asset size then the largest bank in Massachusetts. In North Dakota, all state cash reserves must be deposited in the state-owned bank. However, the deposits of the Bank of North Dakota are not insured by the Federal Deposit Insurance Corporation (FDIC).

The Bank of North Dakota has $2.8 billion in loans, half of which are loan participations and loan purchases from community banks. The Bank's loan portfolio is as follows: student (37.1%), commercial (36.3%), residential (16.7%), and agricultural (9.8%). Approximately 50% of the Bank's loan portfolio is guaranteed by federal and state agencies. The Bank returns on average two-thirds of its profits to the state.

Benefits of a State-Owned Bank

The study examined the evidence of the four most commonly cited potential benefits and analyzed the relevance for Massachusetts and other states.

Stabilizes the state's economy

While North Dakota fared exceptionally well during the recent recession, the state's overall performance is mostly attributable to oil and natural gas extraction and high commodity prices. In the long run, the North Dakota economy shows volatility. North Dakota's economy suffered when agricultural commodity prices plummeted in the 1980s. Further, North Dakota's economy has not consistently outperformed South Dakota's –South Dakota is similar to North Dakota in geographic location, size, population, and industry mix but has a very different banking structure with one private bank accounting for over two-thirds of total bank deposits. The implication is that the Bank of North Dakota's role in stabilizing the state's economy seems fairly minor.

Provides local businesses improved access to credit

When bank lending fell nationwide during the financial crisis and recession of 2007-2009, North Dakota was less exposed to "Wall Street"-type problems other states faced. During this time, the agricultural and energy sectors remained strong and the small community banks accounted for a large share of lending. However, in North Dakota, the banks had to satisfy regulatory guidance that called for comprehensive liquidity planning. The Bank of North Dakota's willingness and capacity to serve as a liquidity backstop are limited. The Bank assisted the state's banks through loans, letters of credit, and federal funds market borrowing but the Bank viewed economic development lending as its core mission and backup credit as secondary. The Bank was wary of duplicating existing federal programs which have been expanded further since the crisis hit. The study found that state agencies perform some of the same functions as the Bank of North Dakota and, in particular, Massachusetts has a particularly rich array of public and quasi-public agencies that fulfill similar economic development and financing objectives as the Bank of North Dakota. Therefore, reforms of existing Massachusetts economic development agency structure may be a viable approach to meeting small business lending goals.

Augments the lending capacity of small community banks

As much of the Bank of North Dakota's lending derives from participating in or purchasing business loans originated by smaller banks, the study found that serving as a lending partner for small banks in North Dakota is the Bank's most important current role. In North Dakota, small banks account for a large share of the banking market. This banking structure reflects the state's geographic and population characteristics as well as the state's history of bank regulation and deregulation. The study found that the North Dakota public bank model may not be appropriate elsewhere as smaller banks might view a new public bank as a partner, but larger financial institutions would see it as a competitor. The study proposed that private bankers' banks, which are owned by and provide services to member institutions, are an alternative partnership model.

Helps fund state government through profits

On average, the Bank of North Dakota transfers two-thirds of its profits to the state. This amounts to under one percent of total state revenue and total state expenditure. In recent years, the Bank has returned about $30 million per year to the North Dakota state general fund. The study found that states should not overestimate the revenue contributions from having a state-owned bank as (1) the net revenues to the state are less than the bank transfers, (2) revenue risks exist and the state is liable for any public bank losses, and (3) traditional revenue stabilization tools remain important.

FINDINGS SUMMARY

Benefits

The study found that the evidence on the benefits of having a state-owned bank is mixed. The Bank of North Dakota has arguably increased the lending capacity of North Dakota's small banks but, the researchers ask, is this a key objective for other states?

The willingness and capacity of a state-owned bank to offset a serious credit crunch has not been shown. Lastly, the Bank of North Dakota's contributions to stabilizing the state economy and finances appear to be relatively minor.

Startup Costs

The study estimated that the initial capital required to set up a state-owned bank could be substantial, depending on the desired scale. The Bank of North Dakota was capitalized through a $2 million bond issue in 1919 and today's equivalent in Massachusetts would be about $3.6 billion, or about 21% of the state's direct debt outstanding. A schedule for depositing state funds would have to be worked out as an aggressive schedule of withdrawing funds from private institutions could disrupt the economy and a gradual phase-in would delay any benefits of state-owned bank lending. Also, additional legal and regulatory hurdles could arise in some states.

Recommendations

The study recommended the Commission (1) identify the specific market failure it wishes to address and the degree to which a state-owned bank would address this failure and (2) investigate ways to leverage the already existing network of quasi-public agencies to fulfill its objectives.

INFRASTRUCTURE BANK

As mentioned above, the Commission examined both the technical, legal and financial feasibility of establishing a Commonwealth-owned bank, and also looked at the viability of establishing a state infrastructure bank. In its examination, the Commission received participation in its considerations from the Executive Office for Administration and Finance, which had been examining the feasibility of an infrastructure bank.

A state infrastructure bank (SIB) functions much like any other bank or revolving loan fund. The SIB requires equity capital to get started. Once capitalized, the state infrastructure bank is able to offer a range of loans and credit options, such as loan guarantees and lines of credit, for the projects to be undertaken. One benefit of a state infrastructure bank is that it offers a mechanism for a public-private partnership as it seeks to attract capital from private investors. According to a 1997 Government Accounting Office (GAO) Report, once the capital project is built, project-based revenues (such as tolls) or general revenues (such as dedicated taxes) would need to be generated and used to repay the loans with interest. As loan funds are repaid they would replenish the fund so that new loans could be made.[1]

[1] GAO/T-RCED-97-83, March 6, 1997

Benefits and Drawbacks

The state infrastructure bank concept is intended to complement traditional funding mechanisms to provide increased flexibility vis-à-vis the financing of infrastructure projects. As a result, proponents indicate that projects could be completed more quickly; some projects that might otherwise be delayed if reliant on conventional financing could be completed sooner; and, private investment in the development or redevelopment of public infrastructure could be facilitated. Additionally, loans can be recycled and used as a source of funds for future infrastructure projects.

Although a state infrastructure bank offers a creative mechanism for the financing of the development or redevelopment of infrastructure projects, it does have one, potential drawback. As identified by the Governmental Accounting Office, for the SIB to be viable, it would have to support projects that had the potential to generate dedicated revenue streams to support the repayment of the loans. As such, policymakers would be forced to define and develop the most appropriate way to implement the necessary revenue source(s) for the repayment of state infrastructure bank loans made to specific projects.

IV. Evaluation of Public Deposits and Investments

The Commission evaluated the manner in which public funds are invested or deposited by the Commonwealth and its political subdivisions including funds managed by the State Treasurer, the Massachusetts Municipal Depository Trust, and state and local pension funds.

OFFICE OF THE STATE TREASURER AND RECEIVER GENERAL

The Treasurer's office is responsible for managing the Commonwealth's $40 billion annual cash flow, its banking accounts, its nearly $20 billion in general obligation bonds, and its other depository instruments such as the $9 billion Massachusetts Municipal Depository Trust (MMDT). Massachusetts' cash is deposited in more than 100 accounts, and daily "sweeps" are performed to move funds from satellite accounts into the state's central account.

Further, the Treasurer is Chair of the $50 billion Pension Reserves Investment Management (PRIM) Board, which oversees the investment of pension funds for the state, teachers, and in all or in part, for more than 90 local systems.

This is a complex process that the Treasurer's Office undertakes with three fundamental principles in mind to protect the public's money:

- Funds must be secure, either through insurance or collateralization, or through review of the underlying depository instruments.
- Funds must receive a competitive interest rate.
- The process of allocating deposits and the terms of the agreements with the banks must be undertaken through an open and transparent process.

The Treasury is in the midst of a Request for Proposal (RFP) process for its core banking services, including its main account and its "lockbox" account, which is responsible for the complicated process of collecting funds such as tax receipts and moving them to the proper accounts. The Treasurer's Office expects MMDT to be up for bid in the fall.

The banking services the Commonwealth requires are extensive, sophisticated, and costly. Banks that do business with the Commonwealth, for example, must have the financial capability to pay millions in state bills at times when the bank balance is temporarily negative, which happens routinely during the course of a business day. Not every financial institution can provide the necessary services, and it would be expensive to replicate them in a new institution. Moreover, any alternative institution – if it were to protect the public's money according to the Treasurer's principles – would have to secure its deposits and provide an adequate rate of return.

Small Business Banking Partnership

The Small Business Banking Partnership is part of Treasurer Grossman's policy objective to boost lending to small businesses.

The Partnership provides state deposits of up to $5-million each to smaller local, regional, and community banks to support loans to creditworthy small businesses. These financial institutions have been stepping up on small business lending in recent years and gaining market share – according to a statewide study by the Massachusetts Bankers Association and a national study by the Federal Reserve Bank of Kansas City. The program's guidelines were posted for public comment and were revised to reflect concerns from the banking community, among others. It was crafted to avoid red tape and thereby encourage bank participation.

Under the current system, the Treasurer has the flexibility to allocate funds among multiple institutions rather than being limited to a single source. Generally Treasury awards contracts through competitive bidding. However, the Small Business Banking Partnership program, while subject to a Request for Quotation (RFQ)/Memorandum of Understanding (MOU) process, is not strictly speaking competitive as Treasurer Grossman's policy is to deposit funds with any qualified bank that seeks to participate.

More than 50 banks are in some state of negotiation. A total of $106 million has been deposited, exceeding the original goal of $100 million, and the Treasurer has announced he will commit another $100 million to the program.

Pension Reserves Investment Management

PRIM has made a strong commitment to Massachusetts through its venture capital portfolio. PRIM has backed two managers through its Economically Targeted Investment Program, creating 1,085 jobs in Massachusetts. PRIM also has traditional venture capital investments with nine Boston based VC firms. In total, PRIM's private equity portfolio has sponsored 189 unique Massachusetts companies representing $232.6 million in market value. This portfolio has created approximately 6,038 jobs.

Water Pollution Abatement Trust

Finally, with respect to infrastructure investment, the Treasury oversees the Massachusetts Water Pollution Abatement Trust. The program leverages federal grants through a State Revolving Fund to provide low-interest loans for the construction of clean water and safe drinking water projects in Massachusetts. Since 1989 MWPAT has loaned $4.6 billion to cities and towns within the Commonwealth, dealing with 292 entities, encompassing an estimated 97% of Massachusetts's citizens. This revolving fund approach is a model that could be adapted to meet other infrastructure needs.

Massachusetts Bond Rating

Massachusetts general obligation bonds are currently are rated AA+ by Fitch and Aa1 (their equivalent of AA+) by Moody's. Standard & Poor's rates our bonds at AA, but earlier this year gave the Commonwealth a positive outlook (one of only two states since 2007 to get one), which could lead to a AA+ rating from them as well. The financial market's receptivity to Massachusetts bond reflects its belief that the state has shown fiscal discipline and is not taking undue risks.

V. Examination of Lending and Infrastructure Investment by Quasi-Public Agencies

The Commission examined the infrastructure investment activities conducted by other states with state-owned banks as well as the lending practices, including lending to support infrastructure, of the existing public agencies in the Commonwealth that perform lending services.

INFRASTRUCTURE INVESTMENT ACTIVITIES BY THE BANK OF NORTH DAKOTA

Based upon examinations of the Bank of North Dakota website, the materials indicate that there are limited infrastructure activities by the Bank. The infrastructure activities which the Bank of North Dakota participates in are similar to those of the quasi-public agencies in Massachusetts; however, the Bank of North Dakota's are on a much smaller scale. Examples of infrastructure activities by the Bank of North Dakota include:

- A business incentive program that provides microloans to small businesses. In partnership with an originating lender, the Bank of North Dakota takes a lead role in providing loan programs to encourage the creation of new wealth, expanded employment opportunity, and farm income diversification

- A Community Water Facility Loan Fund which was established to provide financing for community water projects when the project is above the maximum loan limits set by the USDA Rural Development.

- A Health and Information Technology Fund which provides low-interest loans to health care entities to assist those entities in improving health information technology infrastructure. This fund is a revolving loan fund.

The infrastructure activities by the Bank of North Dakota are limited compared to similar activities by the quasi-public agencies in Massachusetts.[2]

MASSDEVELOPMENT FINANCE AGENCY

Created in 1998 when the Massachusetts State Legislature enacted MGL Chapter 23G and merged the Massachusetts Government Land Bank with the Massachusetts Industrial Finance Agency, MassDevelopment is the state's finance and development

[2] BND Lending Services. Accessed online at http://www.banknd.com/lending_services/index.html.

authority. Chapter 240 of the Acts of 2010 merged the Massachusetts Health and Education Facilities Authority into MassDevelopment effective October 1, 2010.

With five regional offices across the state, MassDevelopment works with businesses, nonprofits and local, state and federal officials and governmental agencies to strengthen the Massachusetts economy. Through this collaboration MassDevelopment helps create jobs, increase the number of housing units, eliminate blight and address the overarching challenges that limit economic growth, such as transportation, energy and other infrastructure deficiencies.

Offering a wide range of finance programs and real estate development services, MassDevelopment supports growth, development and investment across all sectors of the Massachusetts economy: public and private, commercial, industrial and residential and nonprofit, including healthcare, educational, cultural, and human service providers.

Finance Programs

The Agency's Finance Programs department seeks to deliver a continuum of low-cost, aggressive financing products to support each phase of larger, timelier capital investments in Massachusetts by businesses and nonprofits, consistent with MassDevelopment's overall mission. Finance Programs departments include Investment Banking, Lending, New Markets Tax Credits and Community Development.

Investment Banking

MassDevelopment is a "conduit" bond issuer, delivering federal tax benefits to eligible capital investment projects, matching private projects to private capital. No public sector risk is assumed. Investment Banking services include: outreach and education; analysis of financing options; and identification of underwriter and bond purchaser. Those sectors eligible for tax exempt bonds include manufacturing, affordable rental housing, 501(c)3 nonprofits, government projects, public infrastructure, waste disposal and recycling.

There is an annual limit on certain new tax-exempt "private activity" bonds, known as volume cap. In 2011, the federally imposed limit was $95.00 per capita. In Massachusetts, volume cap is allocated and administered by the Administration and Finance secretariat. Governmental and 501(c)3 bonds, as well as refinancings are not subject to volume cap. Mass Development was awarded $300 million in volume cap for calendar year 2011.

New bonding capabilities for public infrastructure include: District Improvement Financing, which provides financing against incremental municipal property taxes, (regulations pending); Special Assessments, financing against special property assessments (currently only available under special legislation); and I-cubed, under which the state pays bondholders , but receives special property assessments and then new taxes.

During fiscal year 2011, the Investment Banking group issued $3.583 billion in bonds.

Lending and Community Development

MassDevelopment provides real estate and equipment financing with higher advance rates and low interest rates to help for-profit and nonprofit organizations grow their businesses and organizations. By providing financial and technical assistance, the agency fosters real estate and business projects that generate economic benefits for local communities and the state as a whole. Direct loans, participations with banks and guarantees are offered. Loan products offer terms generally unavailable from other public or private lenders, often with higher loan to value ratios and poorer credits, to fill gaps in the lending market.

Loans are capitalized from retained earnings or from segregated funds established either by the state or the federal government for specialty programs. Such programs include: the Brownfields Redevelopment Fund, the Charter School Loan Guarantee Fund, the Emerging Technology Fund and the Export Financing Fund.

Earnings on loans and investments made from segregated funds must be reinvested in the funds. Loans capitalized from MassDevelopment’s unrestricted funds generate income to support salaries and other agency programs.

Credit management mirrors practices in the private sector. Loans are risk rated on a seven grade scale and loan loss reserves are taken accordingly. Third- party, loan review professionals examine the portfolio annually and their report, in turn, is reviewed by the agency’s auditors.

At fiscal year- end 2011, total loans outstanding were $128.81 million.

New Markets Tax Credits (NMTC)

The NMTC Program was created specifically to stimulate investment in designated low-income communities by giving federal tax credits to investors in projects in designated low-income census tracts. MassDevelopment evaluates potential NMTC projects for both for-profit and nonprofit businesses, including, but not limited to, community health centers, retail and office space projects, performing arts centers, mixed-use projects and light industrial use centers. Since 2004, MassDevelopment received $242 million in NMTC awards.

MASSACHUSETTS GROWTH CAPITAL CORP.

Mass Growth Capital Corp. (MGCC) was created by an act of the legislature in 2010 and signed into law by Governor Patrick in September 2010. Formation of MGCC involved consolidation of the Massachusetts Community Development Finance Corp. (CDFC) and the Economic Stabilization Trust (EST).

The Mission of MGCC is to create and preserve jobs at small businesses, women and minority owned businesses, and to promote economic development in underserved gateway municipalities and in low and moderate-income communities.

MGCC builds on the work of its predecessor agencies by working with traditional financial institutions to make "un-bankable" loans bankable and by working with community development corporations and other non-profits to provide financing for job-producing projects.

There are two main strategies which guide MGCC lending:

- The recognition that working with traditional financing institutions will produce the greatest number of loans, over all regions of the state, thereby helping the most small businesses create and maintain jobs for Commonwealth residents. To execute this approach MGCC provides subordinated debt financing, over-advances, lines of credit, and limited guarantees for seasonal borrowing. MGCC does not offer a "loan product", but instead seeks to solve each financing problem on its own merits.

- The recognition that micro lending (loans under $100,000) are vital to the development of very small businesses. MGCC's role will be to provide seed capital to intermediaries engaged in micro lending and to assist with the development of best practices in early stage intermediaries. The medium term goal is an increased and strengthened network of micro lenders.

In both strategies, MGCC provides "targeted" technical assistance to solve specific company operational or management problems, sharing 50% of the cost with the company.

Since the operational beginning in November 2010 (the Interim President was hired in December), through June 2011, MGCC has made loan commitments totaling $12.2 million to 38 small businesses, leveraging $63 million in bank lending, involving 1,700 employees, expected to grow by 15%. Among the borrowers, 26% are women owned and minority owned, while 18% of the borrowers are in gateway cities.

MASSHOUSING

The Massachusetts Housing Finance Agency (d/b/a MassHousing) was created by an act of the legislature in 1966 and began lending to developers of affordable rental housing in 1971. In 1982, the Massachusetts Home Mortgage Finance Agency was merged into MassHousing, with homeownership lending beginning that year.

MassHousing raises its capital through the sale of tax-exempt and taxable bonds to individuals and institutional investors. It receives no support from state resources for its operations and, in fact, has been a net contributor to support the state's affordable housing programs in recent years. MassHousing is strictly a portfolio lender, keeping risk on its balance sheets and providing extensive oversight to the assets financed.

Over its 45-year history, MassHousing has loaned nearly $12 billion for both homeownership and multifamily programs. In all, 65,000 homeowner loans have been made and 103,000 mixed income rental units have been financed. As a result, MassHousing has financed more than 4% of the Commonwealth's housing stock.

When MassHousing lends to affordable housing initiatives it does not compete with existing banks. Homeownership lending is done through a network of more than 160 banks throughout the state. Multifamily lending is done directly to borrowers with banks and investors participating through the tax credit side of most transactions.

Current Value Proposition

The tie between housing and the economy is undeniable. MassHousing is focused on making sure that there has been a steady supply of attractively-priced financing with reasonable terms available throughout all segments of the real estate cycle. This has led to an emphasis on sustainable lending decisions across all of its programs.

Through this dual focus on sustainable lending decisions and a steady supply of capital, MassHousing has recently had some of its largest lending years in its history. In FY 2010, MassHousing had its single greatest lending year ever with more than $800 million in closed loans. In the year just ended (FY 2011), MassHousing had its second greatest lending year with more than $750 million in total lending. This amount was paced by a record multifamily lending year which eclipsed $450 million.

Portfolio performance has remained strong throughout this very difficult economic period. MassHousing's multifamily portfolio, representing more than 550 developments throughout the state, has a delinquency rate of roughly 1%. MassHousing's homeownership portfolio has a delinquency rate of roughly 4.5%, which compares very favorably with the FHA delinquency rate in Massachusetts (as of April 2011) of more than 16%.

Lessons Learned

MassHousing does not undertake any type of infrastructure or business lending as its charter limits its lending to affordable housing only. However, lessons learned from those experiences may be valuable in any new lending endeavor.

First, gap financing is absolutely needed in the current market because the cost of new development cannot be completely absorbed by the cash flow generated by these new activities. These gap resources can still reflect sound investments because of the long-term benefits that may be derived from these loans.

Second, locational analysis is critical to lending decisions. Investment decisions are not made in a vacuum and the "where" of any decision is as important as any other aspect of the process.

Third, sound underwriting standards must be developed and implemented for each investment or lending decision that is made. These investments are being made for the long term and a focus on long-term outcomes is essential.

Lastly, the selection of borrowing and investment partners is particularly important to any overall decision. The stability of the team has been a key component in long-term loan performance.

COORDINATION ACTIVITIES OF THE EXECUTIVE OFFICE OF HOUSING & ECONOMIC DEVELOPMENT

On June 30, 2011, Michael Hunter, Undersecretary for Business Development at the Executive Office for Housing & Economic Development (EOHED), gave a presentation before the Commission. Undersecretary Hunter described some of the changes as a result of Chapter 240 as well as some of the efforts by the Administration to coordinate economic development activities.

Quasi-Public Coordinating Council

In March of 2008, EOHED created a document used to collect summary information and findings from the many governmental and quasi-governmental organizations and corporations devoted to economic development throughout the Commonwealth. These findings were later published in the first Annual Report of the Massachusetts Quasi-Public Corporation Planning Council. As stated in the Report, the goal was "to afford EOHED an opportunity to evaluate how quasi-public agencies address their statutory missions, deploy the Commonwealth's resources and measure effectiveness, as well as identify redundancies in their services or constituencies."

EOHED subsequently reviewed the data submitted for the 2008 and 2009 Annual Reports and identified the following financial products and services offered by state agencies or quasi-public agencies in the Commonwealth:

- Working Capital and asset based loans
- Subordinated loans
- Lines of credit
- Limited and partial guarantees
- Venture Capital
- Bond financing
- Real estate financing
- Equipment financing
- Technical assistance

EOHED identified the following areas where gaps existed or where further study was warranted:

- Micro loans
- Mezzanine financing (patient capital)
- Greater emphasis on strategic advice and technical assistance

- Need for greater communication, coordination, and collaboration between state economic development agencies

Highlights of the Economic Development Legislation

Undersecretary Hunter described some of the highlights of Chapter 240, the Economic Development Legislation which also created the present Study Commission. Portions of Chapter 240 sought to address the gaps noted above. Highlights include:

- The creation of the Massachusetts Growth Capital Corporation (MGCC) (as described earlier in this Report), and a capitalization of $35 million

- The recapitalization of the Mass Technology Development Corp ($5 million)

- The merger of the Health and Educational Facilities Authority into MassDevelopment

- A requirement that the Secretary of EOHED convene the various agencies devoted to economic development in the technology and life sciences areas to ensure agency coordination

- A requirement that the Secretary of EOHED coordinate all economic development activities and that he now chair six quasi-public corporation boards

- The creation of the Economic Development Planning Council to develop and implement a comprehensive development policy and strategic plan with goals and measurable benchmarks in the first year of each gubernatorial administration

Chapter 240 also created the Office of Performance Management and Oversight in EOHED which shall develop performance measurement metrics in consultation with the private sector for the purpose of measuring the performance of all public and quasi-public entities engaged in economic development. The Office will have performance management oversight for 14 agencies.

MassWorks Infrastructure Program

Finally, Undersecretary Hunter described a recent announcement by the Administration regarding the MassWorks Infrastructure Program. The MassWorks Infrastructure Program provides a one-stop shop for municipalities and other eligible public entities seeking public infrastructure funding to support economic development and job creation. The Program represents an administrative consolidation of six former grant programs:

- Public Works Economic Development (PWED)
- Community Development Action Grant (CDAG)
- Growth Districts Initiative (GDI) Grant Program
- Massachusetts Opportunity Relocation and Expansion Program (MORE)
- Small Town Rural Assistance Program (STRAP)
- Transit Oriented Development (TOD) Program

The MassWorks Infrastructure Program provides public infrastructure grants that support four project types:

- Housing development at density of at least 4 units to the acre (both market and affordable units)
- Transportation improvements to enhance safety in small, rural communities
- Community revitalization and sustainable development
- Economic development and job creation and retention.[3]

[3] The MassWorks Infrastructure Program. Accessed online at http://www.mass.gov/?pageID=ehedterminal&L=4&L0=Home&L1=Economic+Analysis&L2=Executive+Office+of+Housing+and+Economic+Development&L3=Massachusetts+Permit+Regulatory+Office&sid=Ehed&b=terminalcontent&f=permitting_massworks_program_mainpage&csid=Ehed.

VI. Findings and Recommendations

The Commission finds no compelling rationale, at this time, to establish a state-owned bank in Massachusetts. As such, the Commission recommends that the Legislature ***not*** create a state-owned bank, including that contemplated in House Bill No. 01192 Bank of Massachusetts (see Appendix E included for informational purposes only).

The Commission finds that access to capital remains a challenge for small businesses of the Commonwealth, although access to capital has improved due to various policy actions approved or already implemented. The Commission recommends the following actions:

- Policymakers should monitor the efforts and activities of the Massachusetts Growth Capital Corporation, a quasi-governmental corporation created and capitalized pursuant to Chapter 240 of the Acts of 2010 to meet the credit needs of small businesses, including the adequacy of its lending capital and the adequacy of its resources for funding available technical assistance to entrepreneurs.

- The Treasurer should monitor and report on the outcomes of the Small Business Banking Partnership program, a program in which the Treasurer is depositing state monies with community bank partners for the purpose of incenting such banks to increase their lending to small businesses.

- In enacting Chapter 240, the Legislature authorized the use of pension funds to bolster access to capital on the part of small businesses. Once this programmatic effort has been fully launched and been in effect for at least one year, the Legislature should seek a report on the outcomes of the efforts.

- The Legislature, acting through the Joint Committee on Community Development and Small Business, should seek to assess (a) how the policy prescriptions, whether authorized in Chapter 240 of the Acts of 2010 or elsewhere in general or special law, are meeting the capital needs of small businesses and (b) whether additional prescriptions are needed to address any gaps within the current private and public markets.

- Promote the availability of current small business lending and assistance programs by enhancing coordination and outreach efforts as well as creating a centralized web-based resource center listing details of the current small business lending and assistance programs offered through the quasi public agencies, private sector, and non-profit agencies. The Commission is aware that such an effort is underway by the MGCC and encourages such efforts.

- Policymakers should explore tools, policies, strategies and funding options for strengthening the CDFIs and other non-profit small business lenders that help to fill capital gaps in the market place to ensure that the entire Commonwealth has access to a diverse and well capitalized network of alternative lenders.

The Commission understands that the availability of financial resources to meet the needs to invest and re-invest in public infrastructure is constrained. Given the benefits a state infrastructure bank can provide relative to financing infrastructure projects and the challenges that would need to be addressed as part of moving forward, the Commission recommends that the Executive Office for Administration and Finance continue to explore the feasibility of a state infrastructure bank.

Lastly, the Commission finds that the state's ability to meet the needs of its public infrastructure, although challenging, is largely well-served by existing means of public financing mechanisms. The Commission, in its review, adopted a more traditional definition of public infrastructure to mean roads, bridges, other public transportation nodes, sewers, public buildings, etc. However, the Commission also finds that it may be useful for the state to consider expanding the public infrastructure definition.

During the public hearings, the Commission received testimony in which the members were challenged to look beyond the traditional definition of infrastructure. Specifically, testimony was received that focused on the importance of the non-built infrastructure such as forest lands, waterways, farm lands and other forms of the environment, both from an economic development perspective as well as from the perspective of enhancing the health, safety and general well-being of residents of the Commonwealth. The public testimony acknowledged, as does the Commission, that there are various public programs whose purposes are to maintain, sustain and/or improve upon these various forms of "public infrastructure;" however, the testimony also focused on the perceived limitations of such programs. Finally, testimony focused on the fact that access to private capital is limited due to the long time horizon of the return on investments in these non-built environments Traditional capital markets may also unwittingly drive private land owners toward developing land in ways that are contrary to the public interest; alternative lending capital that supports the preservation of these non built environments might mitigate this concern. The Commission determined that further exploration of these particular matters was beyond the scope of its charge. However, the Commission finds that further investigation is warranted. Therefore, the Commission recommends that the appropriate committees of the Legislature should:

- Undertake a review the current operational definition of "public infrastructure" and consider amending the definition to include non-built infrastructure such as forests, farm lands, waterways, etc.

- Undertake a study to determine the adequacy of current public policies and programs that support the "non-built" environments (as defined in the findings) and determine whether additional policies and programs are needed.

State Senator Karen Spilka could not attend the final meeting of the Commission. In order to ensure the Senator's viewpoints were included in the final Report of the Commission to Study the Feasibility of Establishing a Bank Owned by the Commonwealth, the letter submitted to the Co-Chairs of the Commission is attached as an Addendum.

VII. Conclusion

The Commission appreciates all of the participation from the various government officials, government agencies, quasi-publics, private companies, non-profits, and private citizens in helping the Commission to complete our study. The presentations, reports, and documents provided throughout our study were crucial to the Commission's findings and recommendations. While the Commission recommends that legislature not pursue the creation of a state-owned bank, the Commission recommends further actions and studies that could help better meet any unmet needs within the Commonwealth.

VIII. Addendum

COMMONWEALTH OF MASSACHUSETTS
MASSACHUSETTS SENATE
STATE HOUSE, BOSTON, MA 02133-1053

SENATOR
KAREN E. SPILKA
SECOND MIDDLESEX AND NORFOLK DISTRICT

ROOM 511C
BOSTON, MA 02133
TEL. (617) 722-1640
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KAREN.SPILKA@MASENATE.GOV
WWW.MASENATE.GOV

COMMITTEES
ECONOMIC DEVELOPMENT & EMERGING TECHNOLOGIES
SENATE COMMITTEE ON ETHICS AND RULES, VICE CHAIR
SENATE COMMITTEE ON WAYS AND MEANS
SENATE COMMITTEE ON GLOBAL WARMING & CLIMATE CHANGE
REVENUE
TRANSPORTATION
SPECIAL JOINT COMMITTEE ON REDISTRICTING

August 8, 2011

Dear Commissioners:

I would like to thank all of my fellow commissioners for their hard work on this report and I appreciate all the time spent exploring this issue. During these tough economic times, businesses rely on banks and lenders to provide the capital they need to expand and to maintain or create jobs. Lending gaps can exist that hinder a business' ability to expand. The commission's examination of whether to establish a state-owned bank becomes more important because the state-owned bank has the potential to fill these lending gaps. I am not able to support the final conclusion expressed in this report, but I none-the-less think the analysis of our existing programs will be useful. I offer the following suggestions to make this analysis more accurate:

MassDevelopment section: The commission's report should provide a short discussion about the Emerging Technology Fund. Sections 54 and 56 of Ch. 240 of the Acts of 2010 clarified that MassDevelopment had the power to make working capital loans and that the Emerging Technology Fund should be used to finance the operations of emerging technology companies. Working capital lending is an important source of funding for fasting growing emerging technology companies. The Emerging Technology Fund is one of the only places that specifically provides for this type of lending.

Massachusetts Growth Capital Corporation section: The commission's report does not adequately reflect the broad mission of the Mass Growth Capital Corporation in Ch. 240 of the Acts of 2010. The mission of the MGCC has been expanded to serve more companies than its predecessors.

The statute authorized the new entity to participate in financing projects that promote economic development, revitalization or stability. It is directed to promote jobs for all residents of the Commonwealth. Unlike the CDFC, it is not limited to companies that are located in particular geographic areas nor is it limited to projects which enhance the employment opportunities of only low and moderate income residents. These changes were made to ensure that economic development was supported in all regions of the Commonwealth and that all fast growing industries have the possibility to access this capital source.

In section 45 of Chapter 240 of the Acts of 2010, the Employee-Ownership Revolving Loan Fund was moved within the Massachusetts Growth Capital Corporation. This revolving loan fund is another important lending tool and should also be referenced in the MGCC description. This revolving loan fund provides low-interest long term loans to individuals for the purchase of the individual's ownership interest in an employee-owned business.

In the paragraphs on the two main strategies which guide MGCC lending, the first bullet should be expanded to include information on the MGCC's full lending activities and services. The statute contemplates a three tiered approach to financial and managerial consulting: (1) referrals to technical assistance provided in collaboration with Small Business Development Network; (2) using a monetary grant program to engage private consultants, and (3) requiring MGCC to maintain a list of organizations and consultants available without also providing financial assistance. Often these services are as valuable as capital to a growing small business.

Additional Sections: The report does not mention a few additional changes that were made by Ch. 240 of the Acts of 2010. First, the report should include a reference to the changes to the Capital Access Program, which was enhanced by Ch. 240 of the Acts of 2010. Second, the report should also include the changes made to the definition of 'small business.' Ch. 240 of the Acts of 2010 sought to expand and make the definition of small business uniform across all programs statewide.

Findings and Recommendations section: In the Findings and Recommendations section, the fourth bullet makes recommendations to the legislature, particularly specifying the Joint Committee on Community Development and Small Business. I suggest that this reference be changed to "The legislature should seek". It is not appropriate for the commission to direct a recommendation to a particular committee of the legislature.

Ultimately, I believe that more analysis is needed to make a completely informed decision on whether to create a state-owned bank in the Commonwealth and I cannot support the conclusion to stop further examination of a state-owned bank. We heard from many businesses during the Joint Committee on Economic Development and Emerging Technologies listening tour last session on the need for capital. At that time, the legislature decided to explore a state-owned bank as a new source of capital to fill this gap. The inapplicability of the North Dakota state-owned bank model should not be the main basis for evaluation of the Massachusetts situation. Instead, we should further evaluate whether a state-owned bank that is molded to the Commonwealth's needs would work for Massachusetts.

I also believe that there should be further careful consideration of the usefulness of an infrastructure bank. It is important that we exercise great caution when designing new models to support the financing of public infrastructure. The Commonwealth's built infrastructure provides wide-ranging economic benefit and the financing of these investments should be similarly broad. Our past experience in Massachusetts with charging tolls to one group of citizens in order to finance a project that brought economic benefits to the entire state must not be repeated. We create an inherent inequity when some regions are able to rely on infrastructure paid for by general revenues and in other regions our residents must pay a user fee to enjoy the same type of public infrastructure.

If you have any questions, please feel free to contact me or my office at (617)722-1640. Thank you.

Sincerely,

Karen E. Spilka

Karen E. Spilka
2nd Middlesex and Norfolk

APPENDIX A: SECTION 180 of Chapter 240 of the Acts of 2010

SECTION 180. (a) There shall be a commission to study the feasibility of establishing a bank owned by the commonwealth or by a public authority constituted by the commonwealth.

(b) The commission shall consist of the secretary for administration and finance and the secretary of housing and economic development or their respective designees, who shall serve as co-chairs of the commission; the state treasurer or the treasurer's designee; the state comptroller or the comptroller's designee; 2 persons to be appointed by the president of the senate, 1 of whom shall be a member of the senate; 1 person to be appointed by the minority leader of the senate; 2 persons to be appointed by the speaker of the house of representatives; 1 of whom shall be a member of the house of representatives; 1 person to be appointed by the minority leader of the house; the executive directors of the Massachusetts Development Financing Agency and the Massachusetts Housing Finance Agency or their designees; president of the Massachusetts Growth Capital Corporation or the president's designee; and 8 persons to be appointed by the governor who shall not be employees of the executive branch, 3 of whom shall be drawn from a list of 5 names submitted by the Massachusetts Bankers Association, at least 1 of whom shall be a representative of a community bank operating in the commonwealth, 1 of whom shall be drawn from a list of 3 names submitted by the Associated Industries of Massachusetts, 1 of whom shall be drawn from a list of 3 names submitted by the Small Business Association of New England and 1 of whom shall be a professor at an institution of higher education in the commonwealth who has researched and published articles on banking. Of the governor's remaining appointments, not more than 1 may be a representative of a financial services firm located in the commonwealth. The governor shall ensure geographic diversity in the governor's appointments to the commission. The members of the commission shall be appointed not later 90 days after the effective date of this act.

(c) The commission shall examine the technical, legal and financial feasibility of establishing a commonwealth-owned bank, including but not limited to a commonwealth-owned bank for infrastructure investment purposes. The commission shall seek participation in its deliberations from the president of the Federal Reserve Bank of Boston or the president's designee. The commission shall evaluate the experiences of other states with state-owned banks, identifying the financial performance of such banks and evaluating the lending practices of such banks to show whether such banks successfully fill lending gaps not filled by the private sector. The commission shall also evaluate the manner in which public funds are invested or deposited by the commonwealth and its political subdivisions including funds managed by the state treasurer; the Massachusetts Municipal Depository Trust and state and local pension funds. The commission shall examine the infrastructure investment activities conducted by other states with state-owned banks. The commission shall also examine the lending practices, including lending to support infrastructure, of the existing public agencies in the commonwealth that perform lending services. The Massachusetts development finance agency, Massachusetts Housing Finance Agency, Health and Educational Facilities Authority, Massachusetts Growth Capital Corporation and any other public authority in the commonwealth that lends money shall cooperate fully with the commission and shall supply information reasonably required by the commission to carry out its charge.

(d) The commission shall hold at least 3 public hearings in distinct geographic regions of the commonwealth.

(e) The commission shall publish its findings and recommendations, together with drafts of legislation, if any, necessary to carry those recommendations into effect, in a written report not later than 1 year after the effective date of this act. The report shall be published on the official website of the commonwealth, and shall be contemporaneously filed with the house and senate committees on ways and means and the house and senate chairs of the joint committee on financial services.

APPENDIX B: Meeting Notices, Agendas, and Minutes

MASSACHUSETTS COMMISSION TO STUDY THE FEASIBILITY OF ESTABLISHING A BANK OWNED BY THE COMMONWEALTH

Notice of Meeting

The Commission to Study the Feasibility of Establishing a Bank Owned by the Commonwealth will hold a meeting as follows:

Time: 2:00 p.m.

Date: Tuesday, May 3, 2011

Location: 1000 Washington Street, 1st Floor, Room 1B, Boston, MA 02118

List of Topics Expected to be Discussed at Meeting:

- Member introductions
- Open Meeting Law
- Mission and charter
- Schedule of meetings
- Schedule of hearings

This notice is provided pursuant to Massachusetts General Laws Chapter 30A, Sections 18 – 25 and 940 CMR 29.00 et al.

Date Posted to Website: April 28, 2011 at 3:45 p.m.

Commission to Study the Feasibility of Establishing a Bank Owned by the Commonwealth

Meeting Agenda

May 3, 2011

- **Welcome & Introductions**
- **Open Meeting Law**
- **Mission / Charter**
- **Administration and Finance Review of State Infrastructure**
- **Schedule of Meetings**
- **Schedule of Hearings**
- **Wrap-Up**

COMMISSION TO STUDY THE FEASIBILITY OF ESTABLISHING A BANK OWNED BY THE COMMONWEALTH

MEETING MINUTES

MAY 3, 2011

Start Time: 2:00PM

Present at Meeting:

Commission Members	
Name	**Seat**
Co-Chairs	
Sec. Gonzalez/Ron Marlow	Secretary of ANF or Designee
Sec. Bialecki/David Cotney	Secretary of HED or Designee - Co-Chair
Members	
Thomas Gleason	Executive Director or Designee of the Massachusetts Housing Finance Agency
Chuck Grigsby	MA Growth Capital Corporation President or Designee
Nancy Howard	Executive Director or Designee of the MA Development Finance Agency
Martin Benison	State Comptroller
Al Gordon	State Treasurer or Designee
Julieann Thurlow	Minority Leader of the House Appointee
John Meehl	Senate President Seat 1
Senator Karen Spilka	Senate President Seat 2 (Member of Senate)
Peter Anderson	Senate Minority Leader Appointee
Richard Gavegnano	Speaker Seat 1
Joseph O'Leary, Jr.	Associated Industries of MA
Doreen Treacy	Governor Seat 2
Bob Gallery	MA Bankers Association Seat 1
Barry Sloane	MA Bankers Association Seat 2
Michael Tucker	MA Bankers Association Seat 3 (Community Bank Rep)
Ben Branch	Professor at Higher Education Institution
Bob Baker	Small Business Association of New England Seat

Other Attendees	
Name	**Affililation**
Maria Gonzalez	ANF
Jennifer Gordon	DOB
Cark Abate	Office of State Representative Costello
Adam Martignetti	Office of State Representative Costello
Kevin Kiley	Massachusetts Bankers Association
David Snieckus	Public Banking Institute

Next Meeting: May 25, 2011 at 2:00PM (1000 Washington Street, Room 1-E)

I. Welcome & Introductions

A. Co-chairs welcomed all members and requested the members introduce themselves.

B. Provided a copy of SECTION 180 of Chapter 240 of the Acts of 2010 to all members.

IX. Open Meeting Law

A. Provided and explained the Open Meeting Law Guide to all members.

B. Requested Certificate of Receipt of Open Meeting Law Materials document be signed and returned by all members.

X. Mission / Charter

A. Provided and discussed the Project Charter (Version 1) to all members.

B. Provided sign-in sheet for all member contact information in order to update the Charter member information.

XI. Administration and Finance Review of State Infrastructure

A. Discussed how Assistant Secretary Scott Jordan is conducting research relative to State Infrastructure Banks. He will be attending a future commission meeting to provide an update and report on his research.

XII. Schedule of Meetings

A. Decided the next meeting will be held on Wednesday May 25th at 2:00PM at 1000 Washington Street. The agenda will include a briefing by the Federal Reserve Bank of Boston on their research into the Bank of N. Dakota. In addition, Scott Jordan of Administration and Finance will be invited to brief the Commission on his research relative to state infrastructure.

B. Determined a meeting will be held on Thursday June 30th at One Ashburton 21st Floor to meet with the Treasurer's Office regarding how public funds are invested or deposited by the Commonwealth. Also, MassHousing, MassDevelopment, and Massachusetts Growth Capital Corporation will be invited to discuss their lending practices, including infrastructure lending.

XIII. Schedule of Hearings

A. Agreed that the three public hearings will take place in Springfield, Plymouth, and Boston.

B. Discussed the anticipated attendees to the hearings and proposed to have staggered times to accommodate all possible attendees.

C. Planned the first public hearing for Wednesday June 15th at 3:00PM in Springfield.

XIV. Wrap-Up

A. Agreed that members should send any research or other materials to the co-chairs for distribution to all members prior to the next meeting.

MASSACHUSETTS COMMISSION TO STUDY THE FEASIBILITY OF ESTABLISHING A BANK OWNED BY THE COMMONWEALTH

Notice of Meeting

The Commission to Study the Feasibility of Establishing a Bank Owned by the Commonwealth will hold a meeting as follows:

Time: 2:00 p.m.

Date: Wednesday, May 25, 2011

Location: 1000 Washington Street, 1st Floor, Room 1E, Boston, MA 02118

List of Topics Expected to be Discussed at Meeting:

- Federal Reserve Bank of Boston (Publicly-owned Bank research)
- Executive Office of Administration and Finance (State Infrastructure Banks research)
- Defining the work of the Commission
- Planning for public hearings

This notice is provided pursuant to Massachusetts General Laws Chapter 30A, Sections 18 – 25 and 940 CMR 29.00 et al.

Date Posted to Website: May 13, 2011 at 1:30 p.m.

Commission to Study the Feasibility of Establishing a Bank Owned by the Commonwealth

Meeting Agenda

May 25, 2011

- **Opening Remarks by Co-Chairs**

- **Federal Reserve Bank of Boston**

  Yolanda Kodrzycki, Vice President & Director

  Publicly-owned bank research

- **Executive Office of Administration and Finance**

  Scott Jordan, Assistant Secretary

  State infrastructure banks research

- **Defining the work of the Commission**

- **Planning for Public Hearings**

- **Wrap-Up**

COMMISSION TO STUDY THE FEASIBILITY OF ESTABLISHING A BANK OWNED BY THE COMMONWEALTH

MEETING MINUTES

MAY 25, 2011

Start Time: **2:05PM**

Present at Meeting:

Commission Members	
Name	**Seat**
Co-Chairs	
Ron Marlow	Assistant Secretary of ANF (Designee of the Secretary of ANF)
David Cotney	Commissioner of Banks (Designee of the Secretary of HED)
Members	
Thomas Gleason	Executive Director or Designee of the Massachusetts Housing Finance Agency
Chuck Grigsby	MA Growth Capital Corporation President or Designee
Nancy Howard	Executive Director or Designee of the MA Development Finance Agency
Al Gordon	State Treasurer or Designee
Julieann Thurlow	Minority Leader of the House Appointee
John Meehl	Senate President Seat 1
Peter Anderson	Senate Minority Leader Appointee
Richard Gavegnano	Speaker Seat 1
Joseph O'Leary, Jr.	Associated Industries of MA
Bob Gallery	MA Bankers Association Seat 1
Barry Sloane	MA Bankers Association Seat 2
Michael Tucker	MA Bankers Association Seat 3 (Community Bank Rep)
Ben Branch	Professor at Higher Education Institution
Other Attendees	
Name	**Affiliation**
Jennifer Gordon	Division of Banks
Tal Elmatad	Federal Reserve
Yolanda Kodrzycki	Federal Reserve
David Snieckus	Public Banking Institute
Adam Martignetti	Office of State Representative Costello
Carl Abate	Office of State Representative Costello
Kevin Kiley	Massachusetts Bankers Association
Danial O'Brien	The Brennan Group
Dave Luca	Donoghue, Barrett, and Singal, P.C.

Next Hearing: Wednesday June 15, 2011 at 3:00PM (Springfield, MA)

Next Meeting: Thursday June 30, 2011 at 2:00PM (One Ashburton Place, 13th Floor, Boston)

I. Opening Remarks by Co-Chairs

B. Co-chairs provided a brief introduction to the meeting speakers and their research.

XV. Federal Reserve Bank of Boston

A. Yolanda Kodrzycki and Tal Elmatad presented the New England Public Policy Center research on "The Bank of North Dakota: A model for Massachusetts or other states?"

B. All members received a hard copy of the PowerPoint presentation and the Research Report. The report will also be posted online to bostonfed.org and a link from the Commission's site will be created.

C. In the report, the Federal Reserve analyzed the benefits of having a state-owned bank. Advocates commonly cite four potential benefits of having a state-owned bank: (1) stabilizes the state's economy, (2) provides local businesses improved access to credit, (3) augments the lending capacity of small community banks, and (4) helps fund state government through profits. The report confirmed that the Bank of North Dakota has helped support the lending capacity of community banks in the state. However, the report found that data did not support the other stated benefits. The Federal Reserve report suggested the Commission considers the following question: What particular market failure(s) could be addressed by a state-owned bank?

D. Members of the Commission raised questions about the Bank's structure, governance, and lending activity as well as North Dakota's quasi-public agencies,

XVI. Executive Office of Administration and Finance

A. Assistant Secretary Scott Jordan presented his findings relative to Lending Programs: State Revolving Funds and State Infrastructure Bank. The presentation included information on how the state can act like a bank through lending programs, the basic revolving fund structure, the State Infrastructure Bank (SIB) pilot program, and H3355 - SIB Legislation Filed in 2009.

B. The presentation will be e-mailed to all members of the Commission.

C. Co-Chair Marlow discussed the unmet need for infrastructure and requested Mr. Jordan assist in quantifying the needs for which there is not a quasi-public or other vehicle to meet the un-met needs.

XVII. Defining the Work of the Commission

A. The Co-Chairs proposed that the Commission focus the work as narrowly as possible to what is required consistent with the statute. There was no immediate opposition by the members however this can be discussed further as the work gets underway.

B. Discussed the meeting scheduled for Thursday June 30th at One Ashburton 21st Floor to meet with the Treasurer's Office regarding how public funds are invested or deposited by the Commonwealth.

C. In addition to inviting the quasi-publics (MassHousing, MassDevelopment, and Massachusetts Growth Capital Corporation) to discuss their lending practices, including infrastructure lending, Co-Chair Cotney will also invite the Executive Office of Housing and Economic Development (EOHED) to briefly discuss how they coordinate activities.

D. If possible, depending upon available time and the number of Commission members present, the Commission may hold a meeting subsequent to the first public hearing in Springfield.

XVIII. Planning for Public Hearings

A. Discussed the first public hearing planned for June 15th at 3:00PM. The tentative location is the Central Library Community Room in Springfield, Massachusetts (Jennifer Gordon will confirm).

B. Planned the second public hearing for Tuesday July 12th at 5:30PM in Boston. The tentative location is the State House (Ron Marlow will confirm)

C. Agreed that members should send any suggested questions for the public to the Co-Chairs. The Project Charter will be posted on the Commission's website for public viewing.

XIX. Wrap-Up

A. Requested all Commission members return the Open Law Receipts. You may e-mail the receipts to Jennifer.Gordon@state.ma.us or mail to Jennifer Gordon, 1000 Washington St. 10th Floor, Boston, MA 021

MASSACHUSETTS COMMISSION TO STUDY THE FEASIBILITY OF ESTABLISHING A BANK OWNED BY THE COMMONWEALTH

Notice of Meeting

The Commission to Study the Feasibility of Establishing a Bank Owned by the Commonwealth will hold a meeting as follows:

Time: 2:00 p.m.

Date: Thursday, June 30, 2011

Location: One Ashburton Place, 13th Floor, Boston, MA 02108

List of Topics Expected to be Discussed at Meeting:

- Infrastructure lending and investment by the quasi-public agencies
    - MassDevelopment
    - MassHousing
    - Massachusetts Growth Capital Corporation
- Treasurer and Receiver General of Massachusetts
- Quasi-Public Coordinating Council and the amendments under Chapter 240 (the Economic Development Bill)

This notice is provided pursuant to Massachusetts General Laws Chapter 30A, Sections 18 – 25 and 940 CMR 29.00 et al.

Date Posted to Website: June 23, 2011 at 4:00 p.m.

Commission to Study the Feasibility of Establishing a Bank Owned by the Commonwealth

Meeting Agenda

June 30, 2011

- **Opening Remarks by Co-Chairs**
- **Infrastructure lending and investment by the quasi-public agencies**
  - **MassDevelopment**
  - **MassHousing**
  - **Massachusetts Growth Capital Corporation**
- **Treasurer and Receiver General of Massachusetts**
- **Quasi-Public Coordinating Council and the amendments under Chapter 240 (the Economic Development Bill)**
- **Springfield Public Hearing**
- **Planning for Public Hearings**
- **Meeting Minutes - Approvals**
- **Wrap-Up**

Commission to Study the Feasibility of Establishing a Bank Owned by the Commonwealth

Meeting Minutes
June 30, 2011

Start Time: 2:00PM

Present at Meeting:

Commission Members – June 30, 2011	
Name	**Seat**
Co-Chairs	
Ron Marlow	Assistant Secretary of ANF (Designee of the Secretary of ANF)
David Cotney	Commissioner of Banks (Designee of the Secretary of HED)
Members	
Thomas Gleason	Executive Director or Designee of the Massachusetts Housing Finance Agency
Chuck Grigsby	MA Growth Capital Corporation President or Designee
Nancy Howard	Executive Director or Designee of the MA Development Finance Agency
Al Gordon	State Treasurer or Designee
John Meehl	Senate President Seat 1
Peter Anderson	Senate Minority Leader Appointee
Richard Gavegnano	Speaker Seat 1
Joseph O'Leary, Jr.	Associated Industries of MA
Joe Kriesberg	Governor Seat 1
Doreen Treacy	Governor Seat 2
Barry Sloane	MA Bankers Association Seat 2
Michael Tucker	MA Bankers Association Seat 3 (Community Bank Rep)
Ben Branch	Professor at Higher Education Institution
Other Attendees	
Name	**Affiliation**
Maria D. Gonzalez	ANF
Joe Mullins	Comptroller's Office
Kathy Sheppard	Comptroller's Office
Stan Mavromates	PRIM Board
David Snieckus	Public Banking Institute
Adam Martignetti	Office of State Representative Costello
Carl Abate	Office of State Representative Costello
Nikki Muradian	The Brennan Group
W.Drew Smith	MWPAT
Colin MacNaughty	Treasury
Enrique Zuniga	MWPAT
Henry Clay	Treasury
Kevin F. Kiley	Mass Bankers Assn.
Allan C. Page	Green Diamond Systems

Next Meeting: July 12, 2011 at 4: 00 (1000 Washington St, 1st Floor, Room 1E, Boston, MA)

I. Welcome & Introductions

B. Co-chairs welcomed all members and requested the members introduce themselves.

XX. Approval of Meeting Minutes

A. Correction to be made to attendance sheet to reflect that Mr. Ben Branch was in attendance on May 25th

B. Meeting Minutes approved

XXI. Treasurer and Receiver General of MA

A. Provided material and discussed PRIM (Pension Reserves Investment Management)

B. Provided information on open Solicitations for services (RFRs)

C. Presentation on State cash flow, debt services and how transactions are recorded via MMARS (Massachusetts Management Accounting and Reporting System)

D. Small Business Banking Partnership, an initiative that invests state reserve funds into Massachusetts community banks with the understanding that the financial institutions will use the deposits to make new loans to small credit worthy businesses

E. Presentation by Enrique Zuñiga on MWPAT (Mass. Water Pollution Abatement Trust)

XXII. Infrastructure Lending & Investment by the Quasi –Public Agencies

A. MassDevelopment

1. Nancy Howard – COO for MassDevelopment provided information on the areas in which the agency is involved:

a) Real Estate

b) Finance Programs

c) Bonding Finance

d) Loans & Guarantees

e) Specialty Programs

B. Mass Housing:

1. Tom Gleeson – Executive Director provided information on the areas in which his agency is involved:

a) Home ownership

b) Rental Housing

c) Development

XXIII. Quasi-Public Coordinating Council and the Amendments under Chapter 240 (Economic Development Bill)

A. Michael Hunter – Under Secretary for Business Development provided information about the areas his agency handles:

1. Working capital and Asset based loans

2. Lines of credit

3. Venture capital

4. Bond financing

5. Real Estate

6. Equipment Financing

7. Technical Assistance

B. Highlights of Economic Development legislation:

1. Creation of Mass. Growth Capital Growth

2. Recapitalization of Mass. Technology Development Corp

3. Merger of HEFA into MassDevelopment

4. Creation of Economic Development Planning Council

5. Creation of Office of Performance Management & Oversight

6. MassWorks infrastructure Program

XXIV. Schedule of Meetings and Hearings

A. July 12th at 4 pm – 5 pm Commission Meeting 1000 Washington St, Room 1E

B. July 12th at 5:30 pm Public Hearing 1000 Washington St, Room 1E

C. July 19th Public Hearing ~ Plymouth Town Hall, Mayflower Meeting Rooms 1 & 2 Lincoln St, Plymouth, 02360

XXV. Agenda Items not covered (lack of time)

A. Massachusetts Growth Capital Corporation ~ Mr. Chuck Grigsby

B. Springfield Public Hearing overview

MASSACHUSETTS COMMISSION TO STUDY THE FEASIBILITY OF ESTABLISHING A BANK OWNED BY THE COMMONWEALTH

<u>Notice of Meeting</u>

The Commission to Study the Feasibility of Establishing a Bank Owned by the Commonwealth will hold a meeting as follows:

<u>Time</u>: 4:00 p.m.

<u>Date</u>: Tuesday, July 12, 2011

<u>Location</u>: 1000 Washington Street, 1st Floor, Room 1E, Boston, MA 02118

<u>List of Topics Expected to be Discussed at Meeting:</u>

- Infrastructure lending and investment by the Massachusetts Growth Capital Corporation
- Report Outline
- Planning for public hearings

This notice is provided pursuant to Massachusetts General Laws Chapter 30A, Sections 18 – 25 and 940 CMR 29.00 et al.

<u>Date Posted to Website</u>: July 7, 2011 at 10:30 a.m.

COMMISSION TO STUDY THE FEASIBILITY OF ESTABLISHING A BANK OWNED BY THE COMMONWEALTH

MEETING AGENDA

JULY 12, 2011

- **OPENING REMARKS BY CO-CHAIRS**
- **INFRASTRUCTURE LENDING AND INVESTMENT BY THE QUASI-PUBLIC AGENCIES**
  Chuck Grigsby, President
  Massachusetts Growth Capital Corporation
- **REPORT OUTLINE**
- **SPRINGFIELD PUBLIC HEARING OVERVIEW**
- **PLANNING FOR PUBLIC HEARINGS**
- **WRAP-UP**

Commission to Study the Feasibility of Establishing a Bank Owned by the Commonwealth

MEETING MINUTES
JULY 12, 2011

Start Time: 4:06PM

Present at Meeting:

Name	**Seat**
Co-Chairs	
Ron Marlow	Assistant Secretary of ANF (Designee of the Secretary of ANF)
David Cotney	Commissioner of Banks (Designee of the Secretary of HED)
Members	
Chuck Grigsby	MA Growth Capital Corporation President or Designee
Jack Meehl	Senate President Seat 1
Peter Anderson	Senate Minority Leader Appointee
Joseph O'Leary, Jr.	Associated Industries of MA
Joe Kriesberg	Governor Seat 1
Doreen Treacy	Governor Seat 2
Barry Sloane	MA Bankers Association Seat 2
Michael Tucker	MA Bankers Association Seat 3 (Community Bank Rep)
Ben Branch	Professor at Higher Education Institution
Other Attendees	
Name	**Affiliation**
Jennifer Gordon	Division of Banks
Maria Gonzalez	Administration & Finance
David Snieckus	Public Banking Institute
Kathy Sheppard	Comptroller's Office
Craig Stepno	Office of the State Treasurer
Kevin Kiley	Massachusetts Bankers Association
Alan Page	Green Diamond Systems

Next Hearing: Tuesday July 19th at 3:00PM - Plymouth Town Hall, Mayflower Meeting Rooms #1 and #2, 11 Lincoln St., Plymouth, MA 02360

Next Meeting: Tuesday July 26th at 2:00PM - One Ashburton Place, Charles River Room, Room 1002, Boston, MA 02108

I. Opening Remarks by Co-chairs

A. Co-chairs welcomed all members and requested the members introduce themselves.

II. Infrastructure Lending and Investment by the Quasi-Public Agencies

A. Chuck Grigsby, President of the Massachusetts Growth Capital Corporation (MGCC) discussed his agency's role in helping to make micro-lenders become more credit worthy and helping banks make "unbankable" loans. The MGCC primarily works with community banks to help make loans.

B. The MGCC has the ability to partner with non-profits in the state. However, they have not yet pursued this avenue.

C. In response to questions from the Commission, Mr. Grigsby stated that from his perspective (1) there are not unmet needs except perhaps infrastructure and (2) a state-owned bank would not be helpful to his agency.

III. Approval of Meeting Minutes

A. Correction to be made to attendance sheet to reflect that Kathy Sheppard was in attendance on behalf of Martin Benison, State Comptroller.

B. Correction to be made to the address of the July 12th meeting location to 1000 (not 100) Washington Street.

C. Meeting Minutes approved.

IV. Report Outline

A. The drafted report outline was provided in hard copy to all Commission members.

B. The co-chairs discussed how the intention of the outline was to get started on the Commission's report (due by August 5th) without making assumptions about the recommendations the Commission will make in the final report.

C. The co-chairs requested all Commission members begin to think about their final recommendations which will be discussed at the next meeting on the 26th.

D. To be included in the outline as an appendix is the bill to authorize a state-owned bank as filed in 2011. This bill will also be e-mailed out to all Commissioner members.

V. Springfield Public Hearing Overview

A. Discussed how the hearing was a helpful experience to hear different viewpoints on what is in the public interest, the reasoning in favor of a state-owned bank, and the assumptions around the topic.

VI. Planning for Public Hearings

A. Discussed how the Commission plans to, if necessary, limit the time for a testimony especially if a testifier begins to repeat what was provided in Springfield.

MASSACHUSETTS COMMISSION TO STUDY THE FEASIBILITY OF ESTABLISHING A BANK OWNED BY THE COMMONWEALTH

Notice of Meeting

The Commission to Study the Feasibility of Establishing a Bank Owned by the Commonwealth will hold a meeting as follows:

Time: 2:00 p.m.

Date: Tuesday, July 26, 2011

Location: One Ashburton Place, Charles River Room, Room 1002, Boston, MA 02108

List of Topics Expected to be Discussed at Meeting:

- Overview of Public Hearings
- Meeting Minutes
- Discussion on Recommendations
- Report Outline and Planning

This notice is provided pursuant to Massachusetts General Laws Chapter 30A, Sections 18 – 25 and 940 CMR 29.00 et al.

Date Posted to Website: July 19, 2011 at 4:45 p.m.

Commission to Study the Feasibility of Establishing a Bank Owned by the Commonwealth

Meeting Agenda

July 26, 2011

- **Opening Remarks by Co-Chairs**
- **Overview of Public Hearings**
- **Meeting Minutes**
- **Discussion on Recommendations**
- **Report Outline and Planning**

Commission to Study the Feasibility of Establishing a Bank Owned by the Commonwealth

Meeting Minutes
July 26, 2011

Start Time: 2:09PM

Present at Meeting:

Commission Members	
Name	**Seat**
Co-Chairs	
Ron Marlow	Assistant Secretary of ANF (Designee of the Secretary of ANF)
David Cotney	Commissioner of Banks (Designee of the Secretary of HED)
Members	
Thomas Gleason	Executive Director or Designee of the Massachusetts Housing Finance Agency
Chuck Grigsby	MA Growth Capital Corporation President or Designee
Nancy Howard	Executive Director or Designee of the MA Development Finance Agency
Martin Benison	State Comptroller
Al Gordon	State Treasurer or Designee
Jack Meehl	Senate President Seat 1
Peter Anderson	Senate Minority Leader Appointee
Joe Kriesberg	Governor Seat 1
Doreen Treacy	Governor Seat 2
Bob Gallery	MA Bankers Association Seat 1
Barry Sloane	MA Bankers Association Seat 2
Michael Tucker	MA Bankers Association Seat 3 (Community Bank Rep)
Other Attendees	
Name	**Affiliation**
Jennifer Gordon	Division of Banks
Maria Gonzalez	Administration & Finance
Mia Waldron	Administration & Finance
Kathy Sheppard	Comptroller's Office
Michael H. Wright	Office of Senator Karen Spilka
David Snieckus	Public Banking Institute
Kevin Kiley	Massachusetts Bankers Association
Michael H. Wright	Office of Senator Karen Spilka
John E. Root Jr.	Common Good Finance Inc.

Next Meeting: Monday August 8th at 2:00PM - 1000 Washington Street, 1st Floor, Room 1-D, Boston, MA 02118

I. Opening Remarks by Co-chairs

C. Co-chairs welcomed all members and discussed how they intend to have each of the Commission members provide his/her recommendation later in the meeting.

D. Co-chairs reiterated that the intention of the report outline was to get started on the Commission's report without making assumptions about the recommendations the Commission will make in the final report.

II. Overview of Public Hearings

A. Co-chair Marlow discussed the final hearing in Plymouth and the various testimonies heard including representatives from Senate President Therese Murray's Office, Mass Bankers, and SEED.

III. Approval of Meeting Minutes

A. The updated drafted report outline was provided in hard copy to all Commission members, including the most recent Meeting Minutes.

B. Meeting Minutes approved.

IV. Discussion on Recommendations

A. The co-chairs requested the Commission members provide their recommendations and, lastly, the co-chairs would provide their thoughts.

B. The written recommendations submitted by Ben Branch, Joseph O'Leary, and Barry Sloane were provided in hard copy to all Commission members.

C. The following members spoke about their recommendations: Peter Anderson, Jack Meehl, Michael Tucker, Barry Sloane, Joe Kriesberg, Chuck Grigsby, Bob Gallery, Doreen Treacy, Nancy Howard, Co-chair David Cotney, and Co-Chair Ron Marlow.

D. A motion was made and seconded to recommend to the legislature not to create a state-owned bank. Twelve members verbally agreed, no member opposed, and two members abstained. The members who abstained felt they needed additional information prior to making a recommendation.

E. Co-Chair Ron Marlow provided all members with copies of a written recommendation he drafted and made a motion to include the recommendation in the final report. Discussion resulted in a determination that additional considerations for further study could be incorporated into the final draft without a form vote on each issue.

V. Report Outline and Planning

A. Requested members submit written statements to the co-chairs for inclusion in the final report.

B. Planned to have the final report sent by e-mail to all members by the middle of next week. After review, any recommended edits should be e-mailed to the co-chairs no later than Friday August 5th.

C. Planned to hold the final meeting to sign-off on the final report on Monday August 8th at 2:00PM at 1000 Washington Street.

MASSACHUSETTS COMMISSION TO STUDY THE FEASIBILITY OF ESTABLISHING A BANK OWNED BY THE COMMONWEALTH

Notice of Meeting

The Commission to Study the Feasibility of Establishing a Bank Owned by the Commonwealth will hold a meeting as follows:

Time: 2:00 p.m.

Date: Monday, August 8, 2011

Location: 1000 Washington Street, 1st Floor, Room 1-D, Boston, MA 02118

List of Topics Expected to be Discussed at Meeting:

- Final review of the Commission's report
- Final sign-off on the report by all Commission members
- Closing comments

This notice is provided pursuant to Massachusetts General Laws Chapter 30A, Sections 18 – 25 and 940 CMR 29.00 et al.

Date Posted to Website: August 2, 2011 at 12:00 p.m.

Commission to Study the Feasibility of Establishing a Bank Owned by the Commonwealth

Meeting Agenda

August 8, 2011

- **Opening Remarks by Co-Chairs**
- **Meeting Minutes**
- **Final review of the Commission's Report**
- **Final Sign-Off on the Report by all Members**
- **Closing Comments**

APPENDIX C: Public Hearing Notices and Summaries

MASSACHUSETTS COMMISSION TO STUDY THE FEASIBILITY OF ESTABLISHING A BANK OWNED BY THE COMMONWEALTH

Notice of Public Hearing

The Commission to Study the Feasibility of Establishing a Bank Owned by the Commonwealth will hold a public hearing as follows:

Time: 3:00 p.m.

Date: Wednesday, June 15, 2011

Location: Springfield Central Library Community Room, 220 State Street, Springfield, MA 01103

List of Topics Expected to be Discussed at the Hearing:

The Commission is requesting comment on the study of the feasibility of establishing a bank owned by the Commonwealth or by a public authority constituted by the Commonwealth. As authorized by SECTION 180 of Chapter 240 of the Acts of 2010 the study includes the following areas:

State-Owned Bank

- The technical, legal and financial feasibility of establishing a Commonwealth-owned bank, including but not limited to a Commonwealth-owned bank for infrastructure investment purposes.
- The experiences of other states with state-owned banks, including the financial performance and lending practices, to show whether such banks successfully fill lending gaps not filled by the private sector.

Public Deposits and Investments

- The manner in which public funds are invested or deposited by the Commonwealth and its political subdivisions including funds managed by the state Treasurer, the Massachusetts Municipal Depository Trust, and state and local pension funds.

Lending and Infrastructure Investment

- The infrastructure investment activities conducted by other states with state-owned banks.
- The lending practices, including lending to support infrastructure, of the existing public agencies in the Commonwealth that perform lending services.

While the Commission appreciates comment on all of the above, the Commission specifically requests comment on what particular market failure(s) could be addressed by a state-owned bank?

This notice is provided pursuant to Massachusetts General Laws Chapter 30A, Sections 18 – 25 and 940 CMR 29.00 et al.

Date Posted to Website: June 7, 2011 at 9:00 a.m.

COMMISSION TO STUDY THE FEASIBILITY OF ESTABLISHING A BANK OWNED BY THE COMMONWEALTH

HEARING SUMMARY

JUNE 15, 2011

Start Time: 3:20PM

Present at Hearing:

Co-Chairs
David Cotney, Designee of the Secretary of Housing and Economic Development
Ronald Marlow, Designee of the Secretary of Administration and Finance

Members
Ben Branch, Professor at Higher Education Institution
Representative Martin Benison, State Comptroller
Bob Gallery, Massachusetts Bankers Association Seat 1
Joseph O'Leary, Jr., Associated Industries of Massachusetts representative
Barry Sloane, Massachusetts Bankers Association Seat 2
Julieann Thurlow, Minority Leader of the House Appointee

Other
Maria Gonzalez, Administration and Finance
Jennifer Gordon, Division of Banks

Provided Testimony:

Name	Affiliation
Richard Collins	President and CEO of United Bank, Representative of the Massachusetts Bankers Association
David Snieckus	Self
Alan Page	PUBI, MAPF, MFLA, MWPA, and Diamond Systems
Herb Kline	Self
John E. Root Jr.	Private researcher
S.D. Maye	American, poet, grandfather

End Time: 5:00PM

MASSACHUSETTS COMMISSION TO STUDY THE FEASIBILITY OF ESTABLISHING A BANK OWNED BY THE COMMONWEALTH

Notice of Public Hearing

The Commission to Study the Feasibility of Establishing a Bank Owned by the Commonwealth will hold a public hearing as follows:

Time: 5:30 p.m.

Date: Tuesday, July 12, 2011

Location: 1000 Washington Street, 1st Floor, Room 1E, Boston, MA 02118

List of Topics Expected to be Discussed at the Hearing:

The Commission is requesting comment on the study of the feasibility of establishing a bank owned by the Commonwealth or by a public authority constituted by the Commonwealth. As authorized by SECTION 180 of Chapter 240 of the Acts of 2010 the study includes the following areas:

State-Owned Bank

- The technical, legal and financial feasibility of establishing a Commonwealth-owned bank, including but not limited to a Commonwealth-owned bank for infrastructure investment purposes.
- The experiences of other states with state-owned banks, including the financial performance and lending practices, to show whether such banks successfully fill lending gaps not filled by the private sector.

Public Deposits and Investments

- The manner in which public funds are invested or deposited by the Commonwealth and its political subdivisions including funds managed by the state Treasurer, the Massachusetts Municipal Depository Trust, and state and local pension funds.

Lending and Infrastructure Investment

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While the Commission appreciates comment on all of the above, the Commission specifically requests comment on what particular market failure(s) could be addressed by a state-owned bank?

This notice is provided pursuant to Massachusetts General Laws Chapter 30A, Sections 18 – 25 and 940 CMR 29.00 et al.

<u>Date Posted to Website</u>: July 7, 2011 at 10:30 a.m.

COMMISSION TO STUDY THE FEASIBILITY OF ESTABLISHING A BANK OWNED BY THE COMMONWEALTH

HEARING SUMMARY

JULY 12, 2011

Start Time: 5:30PM

Present at Hearing:

Co-Chairs

David Cotney, Designee of the Secretary of Housing and Economic Development
Ronald Marlow, Designee of the Secretary of Administration and Finance

Members

Chuck Grigsby, MA Growth Capital Corporation President or Designee
Jack Meehl, Senate President Seat 1
Peter Anderson, Senate Minority Leader Appointee
Joseph O'Leary, Jr., Associated Industries of MA
Joe Kriesberg, Governor Seat 1
Doreen Treacy, Governor Seat 2
Barry Sloane, MA Bankers Association Seat 2
Michael Tucker, MA Bankers Association Seat 3
Ben Branch, Professor at Higher Education Institution
Craig Stepno, Office of the State Treasurer

Other Attendees

Jennifer Gordon, Division of Banks
Maria Gonzalez, Administration & Finance
Cynthia Begin, Division of Banks
David Snieckus, Public Banking Institute
Kathy Sheppard, Comptroller's Office
Kevin Kiley, Massachusetts Bankers Association
Alan Page, Green Diamond Systems

Provided Testimony:

Name	Affiliation
Kevin Kiley	Massachusetts Bankers Association
David Snieckus	Self and PBI
Alan Page	Green Diamond Systems

End Time: 6:40PM

MASSACHUSETTS COMMISSION TO STUDY THE FEASIBILITY OF ESTABLISHING A BANK OWNED BY THE COMMONWEALTH

Notice of Public Hearing

The Commission to Study the Feasibility of Establishing a Bank Owned by the Commonwealth will hold a public hearing as follows:

Time: 3:00 p.m.

Date: Tuesday, July 19, 2011

Location: Plymouth Town Hall, Mayflower Meeting Rooms #1 and #2, 11 Lincoln St., Plymouth, MA 02360

List of Topics Expected to be Discussed at the Hearing:

The Commission is requesting comment on the study of the feasibility of establishing a bank owned by the Commonwealth or by a public authority constituted by the Commonwealth. As authorized by SECTION 180 of Chapter 240 of the Acts of 2010 the study includes the following areas:

State-Owned Bank

- The technical, legal and financial feasibility of establishing a Commonwealth-owned bank, including but not limited to a Commonwealth-owned bank for infrastructure investment purposes.
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Public Deposits and Investments

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This notice is provided pursuant to Massachusetts General Laws Chapter 30A, Sections 18 – 25 and 940 CMR 29.00 et al.

Date Posted to Website: July 7, 2011 at 10:30 a.m.

Commission to Study the Feasibility of Establishing a Bank Owned by the Commonwealth

HEARING SUMMARY

July 19, 2011

Start Time: **3:10PM**

Present at Hearing:

Co-Chairs

David Cotney, Designee of the Secretary of Housing and Economic Development
Ronald Marlow, Designee of the Secretary of Administration and Finance

Members

Representative Martin Benison, State Comptroller
Jack Meehl, Senate President Seat 1
Richard Gavegnano, Speaker Seat 1
Bob Gallery, Massachusetts Bankers Association Seat 1
Michael Tucker, Massachusetts Bankers Association Seat 3 (Community Bank Representative)
Craig Stepno, Office of the State Treasurer

Other

Maria Gonzalez, Administration and Finance
Jennifer Gordon, Division of Banks

Provided Testimony:

Name	Affiliation
Christopher Wells	President and CEO of Martha's Vineyard Savings Bank, Representative of the Massachusetts Bankers Association
Monica Mullin	Representative from Senate President Therese Murray's Office
John E. Root Jr.	Common Good Finance Inc.
David Snieckus	Family
Alan Page	Green Diamond Systems
Maria Gooch-Smith	Seed Corp
Justin Gray	Self

End Time: **5:16PM**

APPENDIX D: “The Bank of North Dakota: A model for Massachusetts and other states?”

New England Public Policy Center
Research Report 11-2
May 2011

Research Report

The Bank of North Dakota: A model for Massachusetts and other states?

By Yolanda K. Kodrzycki and Tal Elmatad

FEDERAL RESERVE BANK OF BOSTON™

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New England Public Policy Center

Staff
Robert Clifford
David Coyne
Julia Dennett
Tal Elmatad
Yolanda Kodrzycki
Darcy Rollins Saas
Alicia Sasser Modestino
Jennifer Weiner
Bo Zhao

For more information about the New England Public Policy Center, please visit:
http://www.bostonfed.org/neppc

Table of Contents

Acknowledgements
The authors are grateful for the valuable input they received from David Coyne, Julia Dennett, Patricia DiNocco, DeAnna Green, Sandra Hackman, Jane Lawrence, Paul Marcotte, James Nolan, Darcy Rollins Saas, Philip Strahan, Geoff Tootell, Christina Wang, Michael Watson, Jennifer Weiner, and other colleagues in the Federal Reserve System, as well as from officials at the Bank of North Dakota and the state government of North Dakota, and legislative and executive branch staff in the New England states.

The Bank of North Dakota: A model for Massachusetts and other states?

Introduction

In August 2010, Massachusetts enacted legislation (Chapter 240 of the acts of 2010) pertaining to the state government's role in economic growth and development. The law restructures state agencies that finance development projects, and introduces new mechanisms to address the credit needs of small businesses in particular.

The law merges two funding sources into a new entity called the Massachusetts Growth Capital Corporation, which provides capital and advice to small businesses, and calls for enhanced oversight of all the state's public and quasi-public economic development agencies. The law also institutes new requirements for the state treasurer to report the names of institutions where the Commonwealth's cash reserves are deposited, and it encourages the state treasurer to deposit those funds in institutions with an above-average orientation toward small business lending. Going beyond these immediate reforms, the law further calls for the creation of "a commission to study the feasibility of establishing a bank owned by the commonwealth or by a public authority constituted by the commonwealth."

This study provides background information and analysis pertaining to state-owned banking for the Massachusetts commission. Despite a worldwide trend toward privatization, publicly owned banks continue to exist in many foreign nations. State-owned banks were common in the United States during the nineteenth century, and have been proposed in response to various economic and financial crises in the twentieth and early twenty-first centuries. However, the only U.S. state with an existing publicly owned bank is North Dakota. In the wake of the recent national financial crisis and economic recession, advocates of state-owned banking have touted the North Dakota model and various media reports have cited it, but it has not been examined comprehensively. This study contributes to discussions among policymakers by reviewing the evolution of the Bank of North Dakota (BND) since its founding in 1919, and considering lessons that are relevant today to other states, particularly Massachusetts.

Study focus and findings

The express mission of BND is "promoting agriculture, commerce and industry" in North Dakota. That is a broad but relatively uncontroversial mandate. To help inform discussions outside North Dakota, this study considers several specific objectives for a public bank: stabilizing the state economy, providing local businesses with greater access to credit, augmenting the lending capacity of private banks, and contributing revenues to help fund state government.

In the wake of the financial crisis and Great Recession of 2007–09, advocates of state-owned banks in states other than North Dakota have emphasized these objectives. This study provides evidence on the contributions of the Bank of North Dakota—and of other institutions and circumstances in North Dakota—to each of those objectives.

The most pertinent findings on the North Dakota experience are as follows:

- Unlike some foreign public banks, which have been accused of poor management or political bias, BND enjoys a largely favorable reputation in North Dakota.
- In financing projects that foster economic development in North Dakota, BND puts a strong emphasis on safe and sound lending

practices. Potentially riskier activities, such as community development funding and equity investments, are the purview of quasi-public agencies in North Dakota, as in other states.

- BND partners with community banks in North Dakota for much of its lending. Community banks originate the loans, and BND either participates in the loans or purchases them from the originators. The existence of BND likely enhances the viability of small banks in North Dakota. By partnering with BND, they can make loans that exceed their legal or internal lending limits.
- During the financial crisis and economic downturn of 2007–09, BND increased its loans and letters of credit to North Dakota banks that needed to develop comprehensive liquidity plans. However, BND signaled that its ability to meet additional credit demand was limited, given its own liquidity needs and its other funding obligations. Had North Dakota felt the full brunt of the financial and economic stresses hitting other parts of the nation, North Dakota banks would likely have relied more on national sources of credit.
- The state of North Dakota has sometimes used revenues from the Bank of North Dakota to help balance its budget given shortfalls in other sources. However, there is no guarantee that a state-owned bank will generate profits during periods of fiscal stress, especially if its finances depend on the health of the state's economy. BND's poor performance during North Dakota's severe agricultural crisis and recession of the 1980s exacerbated the state's fiscal stress. Rather than routinely tapping BND to fill budget shortfalls, state government maintains fiscal stabilization funds similar to those in other states.
- Experiences during the founding of BND suggest that the costs of starting up a state-owned bank would be considerable. They would likely involve a very sizable bond issue and/or the possibility of disrupting the operations of existing banks.

Drawing lessons from these findings for Massachusetts and other states is challenging. Ideally, we would want to analyze the experiences of more than one state-owned bank in the United States. Moreover, North Dakota is an unlikely state from which to draw policy lessons for Massachusetts: it is a sparsely populated rural state with numerous small, relatively isolated banks.

Absent a range of examples of state-owned banks from which to draw—or an example of such a bank in a state that bears greater resemblance to Massachusetts—this study is necessarily eclectic in its methods. For example, it compares the economic performances of South Dakota and North Dakota over the past several decades, to draw conclusions about the effects of a state-owned bank on economic stability. It identifies agencies in Massachusetts that perform functions similar to the core activities of the Bank of North Dakota. The study also provides statistics comparing the banking industries in the two latter states, to identify market weaknesses that a public bank potentially could be called upon to fill.

The report recommends that the Massachusetts study commission proceed in two steps. The first is to identify the economic and financial goals that reforming public or quasi-public institutions are intended to achieve. The second step is to consider the merits of different types of efforts to address the identified goals. One reasonable goal, for example, might be to improve access to credit for small businesses when banks are capital-constrained or otherwise unwilling to lend. For reasons that this study will show, the North Dakota experience turns out to be less helpful than some commentaries have suggested. Massachusetts policymakers would be better off studying the federal programs that have been augmented since the crisis, and then considering whether the state could adopt policies to complement the federal programs, or expand their availability locally.

Private versus public banking institutions: Guiding principles

A key principle that guides the structure of the U.S. economy is that government action is justified only when private markets produce suboptimal results. The effect of applying that principle is that federal, state, and local governments account for a substantially smaller share of overall economic activity than private businesses and other nongovernmental entities. In cases where government and the private sector share responsibilities—such as public-private partnerships—roles are assigned according to what each sector does best.

The founding of the Bank of North Dakota reflected this guiding principle. As the study will show in further detail, BND was created to address market failures associated with monopoly power among large financial and business institutions in North Dakota in the early twentieth century. This market power meant that small farming operations had inadequate access to credit.

Other market failures that could justify government intervention in banking markets include externalities, costly information, and nonexistent markets. Externalities exist, for example, if bank credit benefits a substantially larger community or segment of the economy than just the borrower. Private banks may not take these additional benefits into account when making lending decisions, and therefore their total lending might fall short of the socially optimal level.

Costly information refers to a situation where private lenders have difficulty evaluating the creditworthiness of some categories of borrowers, and therefore forgo some lending that would likely be socially desirable. Nonexistent markets are situations where lending institutions are either absent altogether (as in the early stages of economic development) or inadequately capitalized (as might occur in an advanced economy during an economic or financial crisis).

According to this logic, banks should be privately owned and operated unless such an arrangement results in market failures that government intervention could correct. Furthermore, even if government intervention is warranted, policymakers need to consider the form of that intervention carefully. For example, would public ownership yield better results than other changes in how government interacts with private banks—such as information, insurance, regulation, taxes, and subsidies? A related question is whether government intervention should be contingent or permanent. For example, government involvement may be justified during periods of crisis but not on an ongoing basis.

The past several years have exposed major failures of markets and the regulatory environment of financial institutions. Policymakers have already taken several steps to address those failures. At the national level, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 overhauled the financial regulatory structure. New programs of the U.S. Treasury Department, and the Small Business Job and Credit Act of 2010, were also designed to remedy credit shortfalls for bank-dependent businesses.

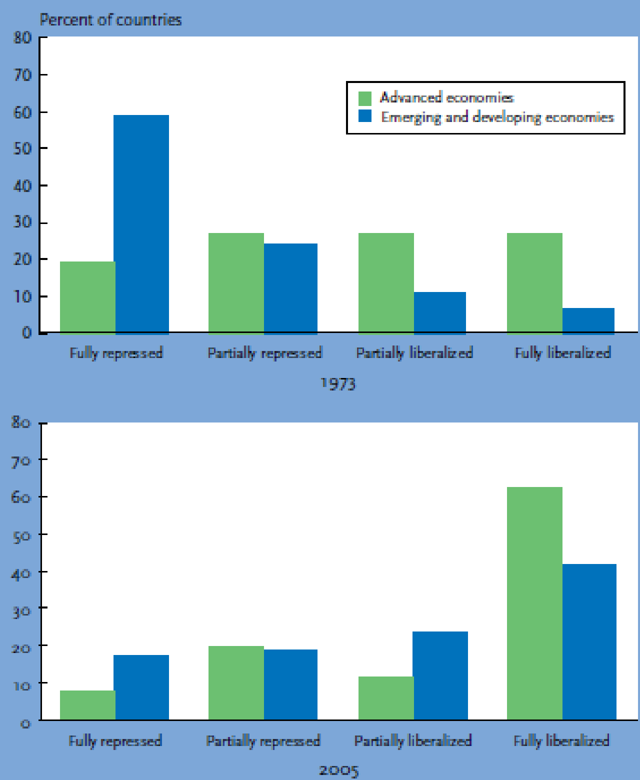
These reforms and other federal regulatory changes are still in the implementation stage, so it is too early to assess their effectiveness. In the meantime, state governments are in the throes of considering other corrective actions. These changes include establishing publicly owned banks.

The context for considering a state-owned bank

Banks are entities that accept deposits and make loans. North Dakota is unique among the U.S. states in having a publicly owned bank. State governments in the other 49 states deposit their cash reserves in private institutions that also serve a wide array of other customers. These private depositories are subject to federal and state regulations and oversight, but their lending and investment decisions are based on their own independent assessments of risks and returns, and are not under the direct control of public officials.

Advocates of state-owned banks argue that they provide a mechanism whereby state governments can use public funds to support local economic development, and particularly to improve access to credit for small businesses. These advocates also cite the potential fiscal benefits of state-owned banks to state governments. Just as corporate shareholders may earn dividends, state governments are entitled to a share—if not all—of the profits of any bank they own. These purported

Figure 1. Over the past three decades, governments have reduced their ownership stakes in the financial sector.
Trends in governmental involvement in the financial sector based on ownership stakes



Source: NEPPC calculations, based on Abdul Abiad, Enrica Detragiache, and Thierry Tressel, Financial Reform Dataset, International Monetary Fund, 2008.
Note: Economies were defined using the World Economic Outlook, International Monetary Fund, September 2005. Advanced economies included 26 countries across 1973 and 2005. Emerging and developing economies included 46 countries in 1973, and 65 in 2005.

benefits of state-owned banks are particularly salient during credit crunches and recessions, when small businesses are likely to have cash-flow problems, and state coffers are likely to be depleted.

The severe financial crisis and recession of 2007–09 heightened interest outside of North Dakota in forming publicly owned banks. Besides Massachusetts, at least eight other states have considered legislation to either study or create a state-owned bank.[1]

This interest in state-owned banks has historical precedents. During the Great Depression, Oregon voted on a referendum to create a state-owned bank.[2] At least six states explored starting a state-owned bank during the 1970s.[3]

New York provides the best documented example from that era. As a result of its near-insolvency in the mid-1970s, New York City faced great difficulty in getting private banks to purchase its bonds or invest in neighborhood development. The city's struggles prompted the speaker of the New York State Assembly to file legislation to establish a state-owned bank. The bill passed through the Assembly but was opposed by the New York Stock Exchange and the New York Chamber of Commerce, and failed to become law.[4]

Publicly owned banks are more prominent in many other nations than in the United States. However, to our knowledge, these foreign government-owned banks were established when countries had less well developed private financial markets. There are no examples of recently formed government-owned banks in developed nations. Moreover, the market share of public banks has fallen over time.

According to the International Monetary Fund, the 1970s and 1980s were marked by a large divide between the banking industries of developing and developed nations.[5] While developed nations were fairly evenly distributed between "liberal" (free of government control) and "repressed" (government-controlled) banking systems, banking sectors in developing nations were more often characterized by a stronger state presence (Figure 1).[6]

During the past three decades, developed and developing nations alike have shifted toward more liberal banking sectors. Still, some major economies—such as China, India, Germany, and South Korea—maintain significant state involvement in the financial sector.[7]

While no U.S. state other than North Dakota has a state-owned bank that serves as a depository for state funds, all states (including North Dakota) have public or quasi-public lending entities that intervene in the private sector to address market failures or support social goals. Unlike banks, these lending entities do not accept deposits. Moreover, in contrast to the arrangement with BND, the earnings of these quasi-public entities typically are not transferred to state governments to augment general fund revenues. These quasi-public lending agencies fund their operations through retained earnings and bond offerings. They either never or only occasionally receive state appropriations after their initial formation.

The most ubiquitous quasi-public lending entities are the state housing finance authorities (SHFAs), which exist in every state. For example, MassHousing is the SHFA in Massachusetts. These authorities arose starting in the 1960s with the goal of increasing the supply of affordable housing beyond what the private sector would likely provide.[8] While their structure varies from state to state, the majority of SHFAs issue tax-exempt bonds, and use the proceeds to finance low-interest mortgages and support the production of affordable rental apartments.

Besides SHFAs, many U.S. states have specialized agencies that promote the development of particular industries, or that provide financing for certain categories of businesses that are unlikely to receive adequate financing from the private sector alone. (See Providing Credit for Small Businesses, page 14, for Massachusetts examples.) Like SHFAs, these quasi-public agencies function somewhat independently of the state, and finance their operations by issuing bonds based on their own credit. Some receive supplementary funding through state appropriations, while others have dedicated revenue streams, such as special taxes or mandatory contributions from private industry.[9]

Evolution of the Bank of North Dakota

Much like current interest in state-owned banks, the founding of the Bank of North Dakota (BND) in 1919 came in the wake of economic hardship that led to heightened anti-big-bank and anti-big-business sentiment.[10] In the early 1900s, most North Dakotans made their living from agriculture. Most of the available credit facilities, however, were based outside the state, in money centers such as Minneapolis, Chicago, and New York.

North Dakota's farmers complained that out-of-state financiers were providing insufficient credit and charging usurious rates. Farmers also accused powerful owners of grain mills, grain elevators, and railroads of engaging in fraudulent and discriminatory practices that held down farm incomes. A populist movement developed that pushed for institutions to support agricultural interests. Among its achievements was the creation of BND, which was charged with "promoting agriculture, commerce and industry" in North Dakota.

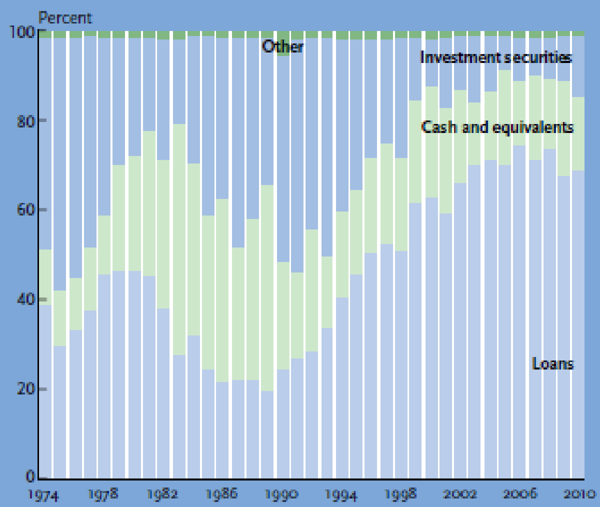
Members of the North Dakota banking community initially feared that a state-owned bank would drive small local banks out of business. To soothe those concerns, the North Dakota legislature imposed limits on BND activities. The bank was initially prohibited from opening branches, engaging in retail banking, and providing commercial lending other than farm real estate loans. Although these restrictions were relaxed in later years, to this day BND operates out of a single location in Bismarck, which limits the degree to which it can compete for customers.

To further calm private-sector fears of competition from a publicly owned bank, the state used a $2 million bond offering to provide the initial capital for BND, rather than withdrawing existing deposits at local banks. However, when this initial capitalization proved inadequate several years later, the state withdrew funds from banks in western North Dakota, leading to 18 bank failures in the following three weeks. As explored below, over time BND came to play a more supportive role with respect to private banks in North Dakota.

BND's actions during the Great Depression reflected its populist roots and public purpose. In the wake of unprecedented farm foreclosures, BND leased back farms to their prior occupants on reasonable terms, and later sold back the farms to the occupants' heirs at below-market prices.[11] The bank also helped counties and cities meet their fiscal needs by financing government projects and investing

Figure 2. BND's balance sheet holdings have shifted away from investment securities and cash equivalents toward loans.

Breakdown of BND's assets



Source: NEPPC calculations, based on Bank of North Dakota, *Annual Report*, 1975-2010.
Note: Due to changes in the format of the annual report, prior to 1989 cash and equivalents were calculated by summing Cash and due from banks as well as Federal funds sold.

in municipal bonds. In the 1940s and 1950s, BND became more passive, shifting its focus from farm lending to managing state investments and providing services to local banks.[12]

In the 1960s and 1970s, BND once again assumed a more active role in promoting economic development in North Dakota. This shift included issuing the nation's first federally insured student loan, and participating in commercial and residential mortgage loans.[13]

Starting in the early 1990s, BND focused even more strongly on lending and less on investing in securities (Figure 2). Loans now account for nearly 70 percent of BND's balance sheet—a slightly higher fraction than at comparably sized private banks nationally and in Massachusetts.[14]

During its first several decades, BND did not make transfers to the state general fund. Such transfers—essentially dividend payments—began in 1945.

The bank today

In 2010, BND had total assets of $4 billion and total deposits of $3.1 billion.[15] It was comparable in size to the 180th-largest private bank in the nation, making it slightly smaller than Middlesex Bancorp (headquartered in Natick, Massachusetts).[16]

BND has shown a profit each year, according to data available since 1971. In fact, BND has consistently produced high returns on its assets compared to similarly sized private banks (Table 1). This could indicate that BND, on average, is more successful in its lending and investments than its private-sector peers, has a lower cost of funds or operations, or benefits from its tax-exempt status—or some combination thereof.

BND accounts for about 15 percent of the total deposits of banks with operations in North Dakota—more than any other bank in the state.[17] Almost all of BND's deposits are attributable to state government, which is required to deposit its cash reserves in BND. Although the bank is allowed to accept deposits from many other sources, it does not actively market its services to individuals, businesses, or local governments.

BND has a diversified loan portfolio, of which the largest shares are student loans (37 percent) and commercial loans (36 percent) (Figure 3). Roughly 50 percent of the bank's loan portfolio consists of loan participations and loan purchases from community banks.[18]

Loan participations are arrangements where a lead bank (in this case, a smaller institution) originates and services a loan, and another bank (in this case, BND) is involved in some capacity.[19] This involvement can take various forms, including guarantees, capital contributions for the initial loan, and interest rate buy-downs (contributions to payments during the early years of a loan, to reduce costs to the borrower). Some 50 percent of BND's loan portfolio is guaranteed by federal and state agencies.[20]

The only major area where BND actively competes with other banks is student loans. However, as a result of the Health Care and Education Reconciliation Act of 2010, the federal government will originate future student loans. Without a dramatic increase in other business, the overall loan portfolio of BND will shrink as existing student loans are repaid.

BND's loan performance and capitalization remained robust even during the recent financial crisis and recession. In the past five years, BND saw smaller shares of its loans fall into delinquency than comparably sized banks across the nation. BND's risk-based capital ratio and Tier 1 leverage ratio also rose during the past three years, indicating strong bank capitalization.[21]

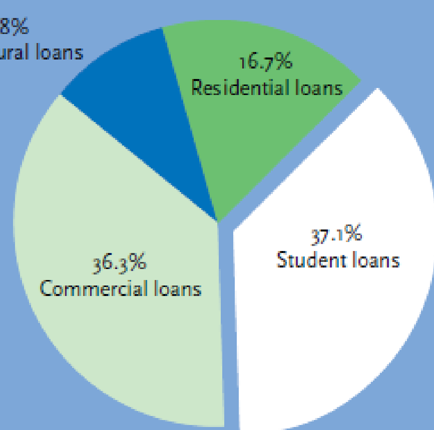
BND is overseen by the Industrial Commission of North Dakota, composed of the governor, the attorney general, and the agriculture commissioner. The governor also appoints an advisory board of seven banking and finance experts. BND deposits are backed by the full faith and credit of the state of North Dakota, and are not insured by the Federal Deposit Insurance Corporation (FDIC).[22] BND is examined annually by an independent auditor, and every 24 months by the North Dakota Department of Financial Institutions.[23] Much like any other government institution, BND's budget (including decisions on salaries, employee headcount, and major capital projects) is controlled by the legislature.

Table 1. BND has seen a decline in its ROAA while still outperforming its peers.
Percent return on average assets

	1995	2000	2005	2010
Bank of North Dakota	2.20	1.87	1.78	1.55
Similarly-sized private banks				
U.S. banks	1.15	1.23	1.41	0.49
Massachusetts banks	1.04	1.05	0.79	0.75

Source: Calculations by authors and supervision, regulation, and credit department of the Federal Reserve Bank of Boston based on Bank of North Dakota *Annual Reports* and Federal Financial Institutions Examination Council, *Uniform Bank Performance Reports*, selected years.
Note: Private banks include commercial and savings banks with between $2 and $5 billion in total assets.

Figure 3. BND's loan portfolio is heavily concentrated in commercial and student loans.
BND loan portfolio breakdown



Source: NEPPC calculations, based on Bank of North Dakota, *Annual Report*, 2010.
Note: Total loan portfolio value was $2.8 billion in 2010. Student loans have been separated to show the effect of the Health Care and Education Reconciliation Act of 2010, which eliminated the Federal Family Education Loan program (FFEL). FFEL loans had amounted to approximately $120 to $130 million in annual loan originations in recent years. BND will continue its supplementary Dakota Education Alternative Loan program.

BND's contribution to state finances

The finances of BND and the state of North Dakota are inextricably linked. The state budget that the governor presents to the legislature includes a proposed transfer from BND to the general fund (or sometimes a specialized fund). In consultation with BND's president, the legislature then approves or changes the proposed transfer.[24]

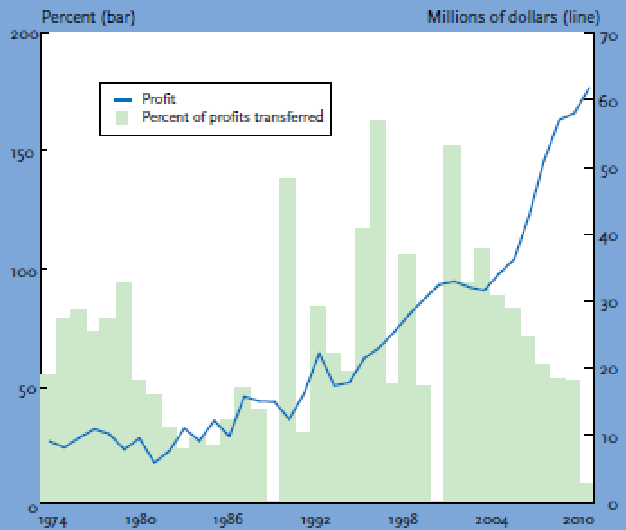
During the past 35 years, the bank has returned roughly two-thirds of its profits to the state, on average. However, this share has been quite variable, ranging from a low of near zero in 1989 and 2000 to more than 150 percent in 1996 and 2001 (Figure 4).

Although the average share of profits that BND transfers to the state is large, the overall share of state expenditures financed by this means is fairly small. From 1971 to 2009, transfers from BND were equivalent to 0.75 percent of state expenditures, on average. The highest share—1.82 percent—occurred in 1996.[25]

These transfers have helped state government balance its budget when other revenues have fallen during recessions. During the 2001–03 biennium, the state turned to BND to plug $25 million of its $43 million budget shortfall, mitigating the need for spending cuts and tax increases.[26]

Figure 4. BND transfers varying portions of its profits to the state.

BND transfers as a share of profits



Source: NEPPC calculations, using Bank of North Dakota, *Annual Reports*, 1975-2010.
Note: Transfers include both payments to the General Fund as well as other funds.

On the other hand, financial difficulties at BND can exacerbate state fiscal problems. In the mid-1980s, bonds issued by the state to purchase BND farm loans began to sour because of difficulties in the farm sector, and state policymakers considered imposing a new tax to make up for shortfalls in debt service. BND appears to have absorbed much of the revenue loss by drawing down its capital reserves, avoiding the need for a general levy.[27]

North Dakota maintains a rainy day fund similar to those of other states. Transfers from BND to the General Fund have ranged between $15 million and $50 million throughout the 2000s; contributions from the Rainy Day Fund to the General Fund have varied considerably more. For example, in 2002 the state withdrew $15 million from its rainy day fund, while in both 2005 and 2007 it added $100 million (Figure 5).

These patterns suggest that the state views BND transfers primarily as a revenue source rather than a fiscal stabilization tool. In this respect, the bank is akin to government-operated enterprises such as state-owned liquor stores and gaming establishments in some other states.

Finally, it is important to keep in mind that BND's net contributions to state revenues are lower than its transfers. The interest rates paid by BND are said to be about 25 basis points lower than those paid on equivalent deposits at private banks.[28] Furthermore BND is a tax-exempt institution, and a state with a public bank forgoes the tax revenues it would otherwise collect from any banks the public bank displaces.[29]

BND's relationship with other banks and its role during crises

The North Dakota banking market has a robust small bank presence. Banks with less than $500 million in deposits account for almost one-half of total bank deposits in the state. In this environment, BND plays the role of sharing risk with smaller banks, ensuring that larger-scale projects can get funding.

Smaller banks and state government tend to turn to BND for funding during crises. During the financial crisis of 2007–08, for example, BND used its access to the federal funds market to purchase loans from smaller banks in North Dakota, providing liquidity to the market. In the wake of natural disasters such as flooding or drought, the bank has channeled its resources to affected areas.[30] During disasters, BND is said to react more quickly than the federal government.[31]

Overall assessment of BND

The informal consensus in North Dakota appears to be that BND lending activities are managed professionally, conservatively, and fairly independently of political forces, and are similar in many ways to those of private banks.[32] Although BND interacts extensively with North Dakota's officeholders and executive agencies, its financial accounts are separate from those of other state-sponsored entities tasked with undertaking risky or politically sensitive projects.

However, while BND appears to enjoy a favorable reputation in North Dakota, its activities do not necessarily correspond to what other states would want a publicly owned bank to do. The available analysis and anecdotal evidence indicate that BND puts a high priority on managing public funds prudently. BND is said to operate conservatively within an overall environment in North Dakota that favors conservatism.[33] The formal separation between the financial accounts of BND and those of the state's housing finance and economic development agencies serves as evidence that a key priority for BND is to maintain a strong and stable balance sheet.

An alternative mission for a state-owned bank might be to emphasize loans and investments that serve a social purpose but that the private sector would find too risky.[34] A logical starting point for discussions regarding establishing a public bank in other states, therefore, is to identify the specific purposes of such an institution.

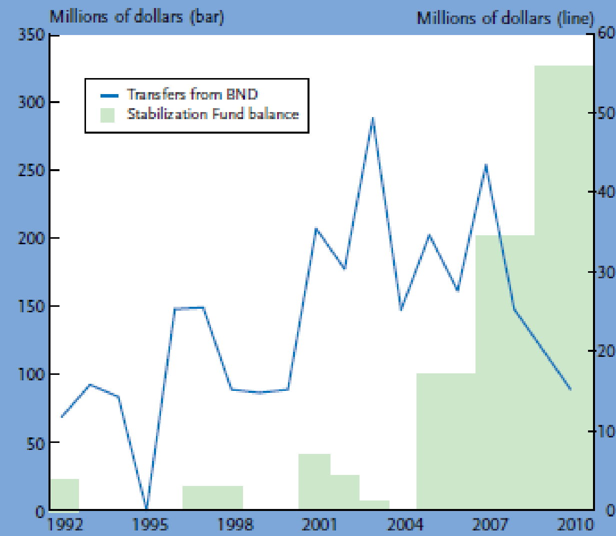
BND's success is not necessarily indicative of what stakeholders should expect of a state-owned bank in a different political or social environment. Numerous studies have compared the performance of public and private banks within countries; the performance of a banking system before and after bank privatization; or bank performance in countries with different mixes of public and private banking. The findings for publicly owned banks in developing or socialist nations—the subject of the bulk of these studies—are arguably not very relevant for decision makers in the United States.

The more limited evidence on state-owned banks in advanced market-oriented economies is mixed. Some studies have found that public and private banks perform similarly, while others have found that public banks are less efficient in allocating credit than private banks.

On the whole, a common theme of these studies has been that management quality seems to be more important than whether a bank is publicly or privately owned in determining its performance.[35] Thus, states or other jurisdictions considering a public bank should weigh the feasibility of creating the structure needed to ensure that it meets its established purposes.

Figure 5. North Dakota continues to receive transfers from BND while building up a separate stabilization fund.

Transfers to the North Dakota general fund and stabilization fund



Source: NEPPC calculations, based on The National Association of State Budget Officers, "The Fiscal Survey of States." Fall 1991- Fall 2010, data provided by Eileen Holwegner of the North Dakota Office of Management and Budget, and North Dakota *Comprehensive Annual Financial Report*, 2004 - 2010.

Note: The transfer data used here will differ from data found in BND *Annual Reports* because they are based on fiscal year.

Lessons for Massachusetts and other states

Present-day advocates of state-owned banks have advanced a variety of arguments concerning the advantages of creating such an institution, drawing heavily on North Dakota's experience. This section explores the role of a public bank in addressing four objectives cited in recent proposals. These include stabilizing the state economy, providing local businesses with greater access to credit, augmenting the lending capacity of private banks, and contributing revenues to help fund state government.

For each objective, this study provides perspectives on the contributions of BND and other institutions or circumstances in North Dakota, as well as the relevance of the North Dakota model for Massachusetts and other states. The section ends by examining the costs of starting up a public bank, based on extrapolating North Dakota's experiences in the early twentieth century to the circumstances facing Massachusetts and other states today.

Table 2 summarizes key demographic, economic, and banking data relevant for the comparison of Massachusetts and North Dakota. Similar information is readily available for other states.

The overall conclusion is that while North Dakota offers a unique and intriguing model, states should recognize that the benefits of a publicly owned bank are hard to quantify, depend on the bank's specific objectives, and likely vary depending on the structure of a state's economy and banking system.

BND's role in stabilizing North Dakota's economy

As the nation's unemployment rate hovered near 10 percent in late 2009, North Dakota's unemployment rate stayed below 4.5 percent. Some policymakers in other parts of the nation have surmised that North Dakota's relatively benign recession might be attributable in part to the existence of a state-owned bank. North Dakotans and economists, on the other hand, tend to be skeptical of that view. They are more likely to attribute North Dakota's recent economic resilience to the strong performance of industries such as agriculture and energy, which play a much more important role in North Dakota than in most other parts of the United States.

This section provides suggestive evidence on BND's contribution to the stabilization of the North Dakota economy by comparing the state's economic performance to that of other states over the past several decades. The general conclusion is that North Dakota's economy has not been marked by unusual stability, notwithstanding any positive effects BND may have had.

Figures 6 to 8 show selected economic data for North Dakota, South Dakota, Massachusetts, and the United States as a whole. South Dakota is selected for comparison because of its proximity to North Dakota, and because

Table 2. Massachusetts and North Dakota have very different demographic, labor, and banking landscapes.

Selected statistics for Massachusetts and North Dakota

	Massachusetts	North Dakota
Population and income		
Population	6,631,280	653,778
Area (square miles)	7,840	68,976
Population density (persons per square mile)	845.8	9.5
Median income (2008 dollars)	65,304	45,996
Employment shares: full-time and part-time employees (percent)		
Health care & social assistance	13.7	11.9
Government	11.1	16.6
Professional & technical services	9.6	3.9
Retail trade	9.5	10.8
Manufacturing	6.6	5.0
Accommodation & food services	6.6	6.7
Farming	0.3	6.4
Mining & natural gas extraction	0.1	1.9
Other	42.7	36.7
State finances		
General revenue from own sources (millions of 2008 dollars)	31,560	3,422
Debt outstanding (millions of 2008 dollars)	71,892	1,952
Share of deposits within state (percent)		
Held by top three banks	48.1	29.6
Held by banks with less than $500 million in deposits	16.0	46.2

Source: NEPPC calculations, based on U.S. Bureau of the Census, U.S. Bureau of Economic Analysis, Federal Deposit Insurance Corporation, Haver Analytics, and Bank of North Dakota *Annual Report*, 2010.
Note: Employment data include individuals classified as proprietors in addition to payroll employees. Debt outstanding includes both public debt for unspecified purposes and public debt for private purposes. Indebtedness also includes all interest-bearing obligations incurred in the name of the government and its dependent agencies. Latest data available used: population (2010), area (2000), population density (2010), median income (2008), employment shares (2009), state finances (2007-08), and share of deposits (2010).

analysis by the Minnesota Federal Reserve indicates that it is the state most similar to North Dakota on key indicators such as size, population, and industry mix.[36] Yet South Dakota's banking industry is very different from North Dakota's: in South Dakota, a single private bank accounts for more than two-thirds of all bank deposits.[37]

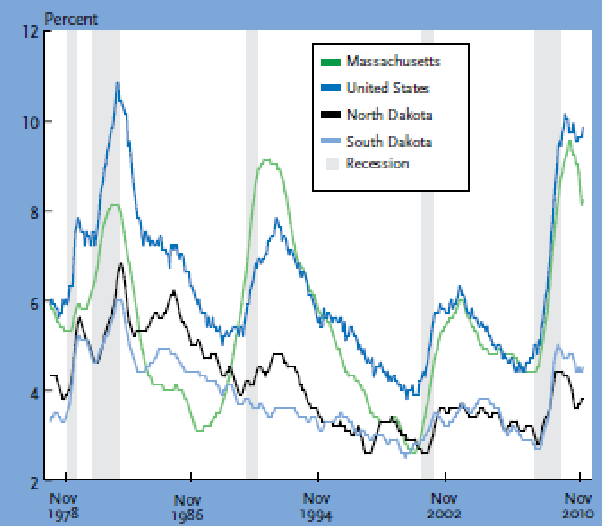
North Dakota has posted a lower unemployment rate than the nation every year since the late 1970s. In most years, its unemployment rate was below that of Massachusetts (Figure 6). South Dakota's unemployment rate, in contrast, has been very similar to that of North Dakota throughout this period. That suggests that the presence of a state-owned bank may not be the major explanation for North Dakota's low jobless rate relative to other parts of the nation. A plausible alternative hypothesis is that the low unemployment rates in the Dakotas are due to demographic and geographic characteristics that influence the structure of their economies.

Other indicators show that North Dakota's economy has been quite volatile, especially during the sharp swings in commodity prices in the late 1970s through the late 1980s. Measured by real personal income, North Dakota's economy has been more cyclical than South Dakota's, Massachusetts', or the nation's (Figure 7).

Mortgage foreclosures reached particularly high levels in North Dakota in the 1980s, almost equaling rates in the current foreclosure crisis nationwide (Figure 8). The high foreclosure rates stemmed from problems in the agricultural sector throughout the Midwest. Encouraged by high commodity prices, farmers incurred significant debt during the 1970s, but had difficulty repaying those loans when commodity prices plunged in the 1980s. BND had a program in the 1980s to provide financing for farmland foreclosed by other lenders, but it was relatively small, resulting in only 18 loans.[38]

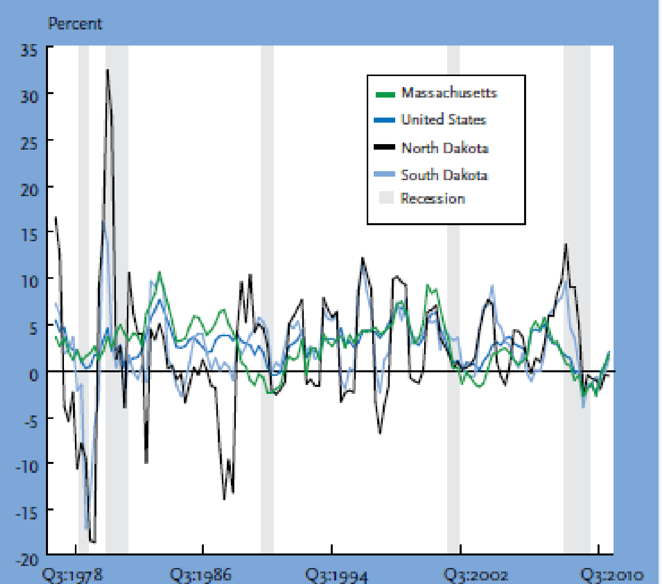
Even the head of BND tends to downplay the bank's role in stabilizing the North Dakota economy. He noted: "I think that we've played a significant role in the state's recent success, but to quantify a role and tell

Figure 6. North and South Dakota have historically experienced very similar unemployment rates.
Historic unemployment rates



Source: U.S. Bureau of Labor Statistics and NBER/Haver Analytics.
Note: Graph displays seasonally adjusted unemployment rates.

Figure 7. North Dakota's personal income has historically been more volatile than South Dakota's.
Historic real personal income growth rates



Source: U.S. Bureau of Economic Analysis and NBER/Haver Analytics.
Note: Data present percentage change over previous four quarters.

you what that is would be difficult. But certainly to lay the success of the state's economy at our feet wouldn't be appropriate either."[39]

Providing credit for small businesses

A key impetus for renewed interest in state-owned banks has been the contraction in credit during the financial crisis and recession of 2007–09, particularly for smaller firms that depend heavily on banks. In national surveys of small businesses by the National Federation of Independent Business, the percentages reporting that their credit needs were being met has fallen from a range of about 35–40 percent in the decade preceding the crisis to just above 25 percent today (Figure 9). Responses from New England firms show similar patterns, although the much smaller sample size results in considerably more volatility from month to month.

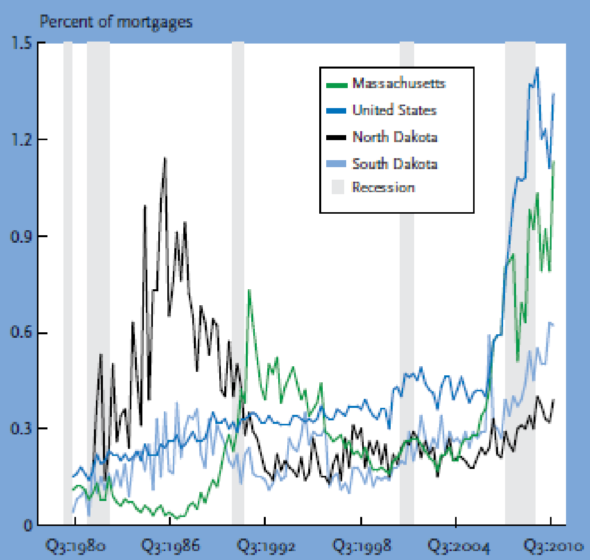
A study of small business lending in New England by the Federal Reserve Bank of Boston noted that during the financial crisis, community banks appeared to have been largely unable or unwilling to offset the contraction in the credit supply stemming from the actions of large banks.[40] The community bankers surveyed by the Boston Fed indicated that the combination of deteriorating borrower qualifications and shrinking demand for new loans reduced their lending.[41] The Boston Fed study did not specifically address the degree to which bank lending to small businesses was constrained by a lack of access to capital.

As noted, North Dakota's economy and financial system were buttressed by strong performance in the agricultural and energy sectors during this period, so we lack hard evidence on the effectiveness of BND in lowering the sorts of credit barriers that arose throughout much of the nation. Still, we do have indirect evidence that BND viewed federal agencies as having the primary responsibility and capacity for providing a liquidity backstop.

Given the national situation in mid-to-late 2008, regulatory agencies urged North Dakota banks to evaluate their exposure to fluctuations in real estate prices, and to develop and test comprehensive liquidity plans. BND did assist North Dakota banks through "record loan growth, letters of credit for public deposits, and a record amount of fed funds borrowed." However, BND warned that "our continued efforts to assist North Dakota banks with this liquidity issue must be tempered with existing federal programs including the Federal Home Loan Bank, FDIC, and the Department of Treasury (so as not to duplicate efforts). Additionally, *we will need to consider our liquidity situation and ensure that we have adequate funding for our mission-critical programs*" [emphasis added].[42]

As implied by BND's statement, the Federal Home Loan Bank (FHLB) system was an important source of liquidity nationwide during the financial crisis. The FHLB system provides "advances" to banks, thrifts, and other institutions to support small business and home lending when other sources of capital are lacking.[43] In the early days of the financial crisis, overall FHLB lending far outstripped emergency lending through the various facilities set up at the Federal Reserve Bank of New York.[44]

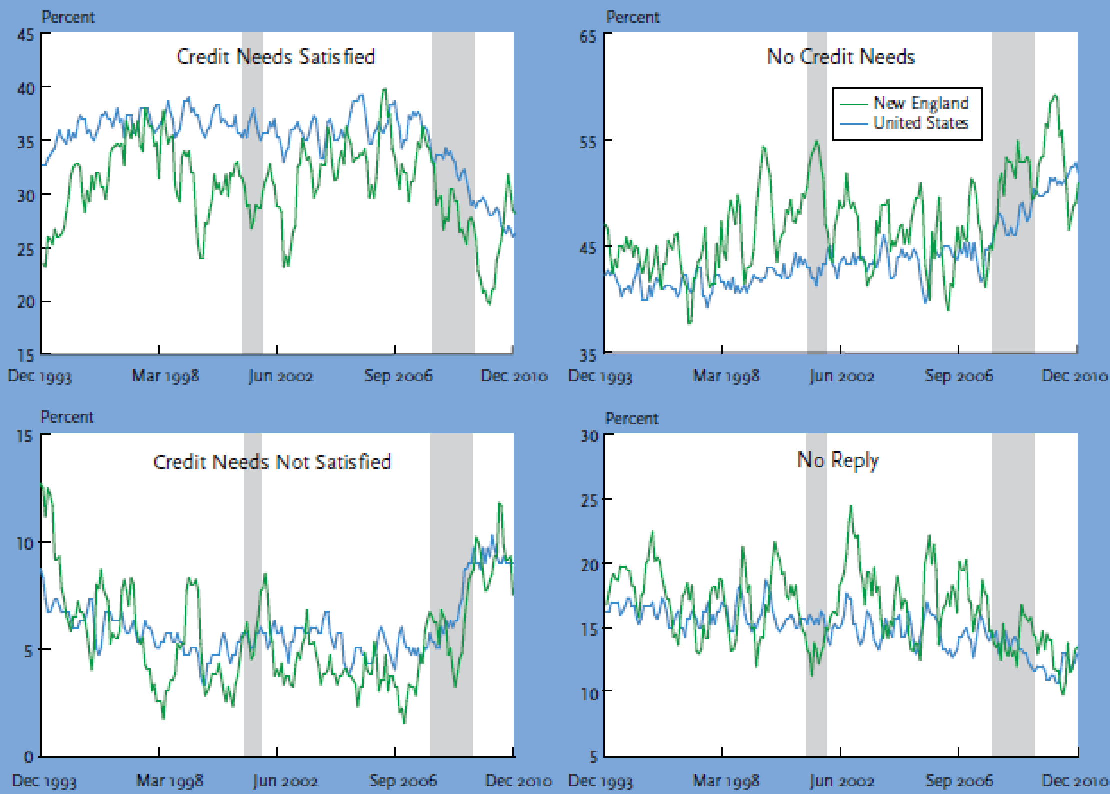
Figure 8. North Dakota saw a large spike in foreclosures in the 1980s.
Historic mortgage foreclosure starts



Source: Mortgage Bankers Association/Haver Analytics.
Note: Rates are not seasonally adjusted.

Figure 9. Since 2007, a growing share of small businesses has been unable to satisfy its credit needs.

Credit needs of surveyed small businesses



Source: NEPPC calculations based on National Federation of Independent Business, Small Business Economic Trends Survey, and NBER/Haver Analytics.

Note: U.S. and New England data based on three- and six-month moving averages, respectively.

Expanded federal support for small business lending

In the wake of the financial crisis, the U.S. Treasury Department has introduced two new vehicles to bolster lending to small businesses. The first, the Small Business Lending Fund, will use up to $30 billion for purchasing preferred stock or equivalents from banks with less than $10 billion in assets. Participating banks are then expected to increase their overall lending to small businesses. The dividend rate paid by the participating bank to the treasury is then determined by the amount by which the bank increases—or alternately fails to decrease—its small business lending.[45] Larger increases lead to dividend rates as low as 1 percent. The second vehicle is the State Small Business Credit Initiative (SSBCI), which provides $1.5 billion to strengthen state programs that support lending to small businesses.[46]

While the Treasury and the FHLB focus on providing liquidity to credit markets, other programs have supported lending by enhancing the credit of potential borrowers who may not otherwise meet loan criteria. The Boston Fed's study of New England found that expansions of several Small Business Administration (SBA) loan guarantee programs since the crisis have ameliorated possible credit constraints on small businesses. Further expansions may occur, given that the Small Business Jobs Act of 2010 relaxed various SBA loan eligibility requirements.

State-level alternatives to public banking

Many of BND's lending and development roles are the responsibility of quasi-public agencies in other states.[47] Massachusetts, in particular, has a richer array of quasi-public lending agencies than North Dakota.

The largest entity, MassDevelopment, aims to promote economic growth and prosperity, and arranges tax-exempt bond issues for the benefit of private parties.[48] Other, smaller authorities provide credit to specialized sectors that are unable to secure competitive rates in the private market. For example, the Massachusetts Clean Energy Center specializes in arranging loans to environmentally friendly technology firms, while the new Massachusetts Growth Capital Corporation focuses on small businesses.

A full evaluation of the quasi-public agencies in Massachusetts is beyond the scope of this study. However, the analysis of BND's lending role and the need for additional liquidity during a financial crisis suggest some avenues for Massachusetts policymakers to explore.

Consolidating the functions of the quasi-public agencies in a single entity could potentially improve transparency and increase lending efficiency. Reporting standards vary among Massachusetts agencies, making it difficult to assess their scale, scope, and performance. Their criteria for evaluating projects may also vary, which may increase the likelihood that public funds are not allocated optimally. Chapter 240 of the acts of 2010 imposed new reporting requirements on the state's economic development agencies, which should clarify their role and help determine appropriate steps for either integrating or coordinating their activities.

State policymakers could also explore ways to expand state lending-related programs at times when banks are capital-constrained or particularly averse to making risky loans. This would amount to state-level countercyclical policy to offset credit supply constraints in the private sector.

To be effective, such a policy would have to rely on funds set aside before a crisis, and on a clear framework for encouraging crisis-period lending. In Massachusetts, such a countercyclical policy might entail restructuring the existing Capital Access Program (CAP). Through CAP, state government contributes to a loan-loss reserve for small business loans, facilitating access to credit. CAP has received $15.5 million in appropriations and facilitated over 4,400 loans with a total value of roughly $280 million during the past 17 years. More than 60 banks in Massachusetts participate in CAP.[49] Developing more specific plans for restructuring CAP—or designing a separate entity to address crises in the credit supply—would require considerable study.

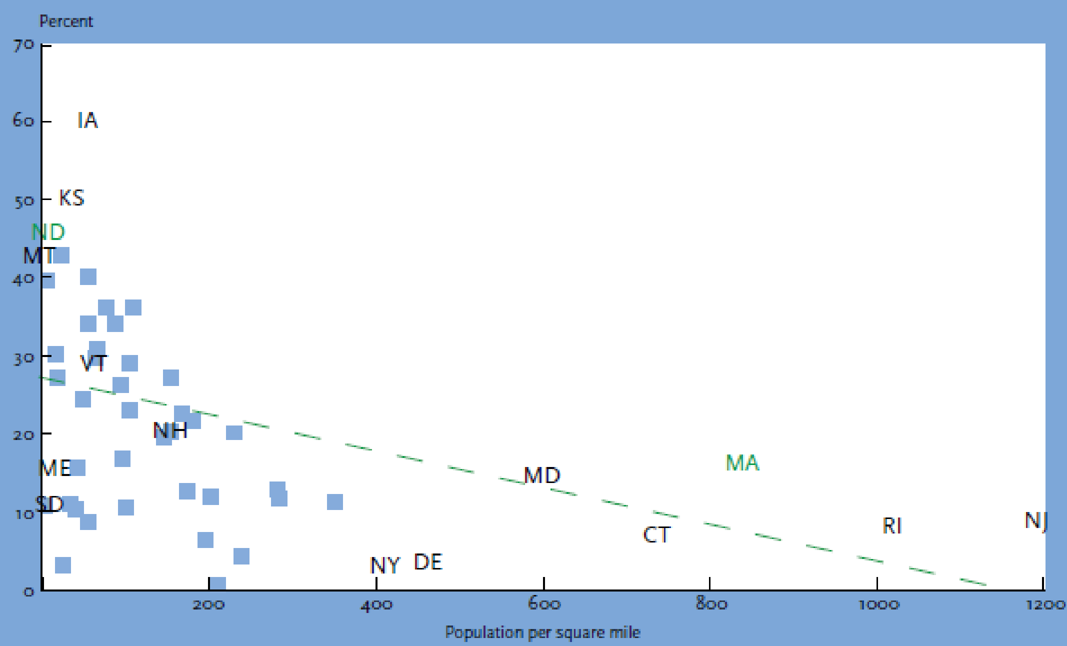
State-owned bank as a partner for community banks

As noted, BND participates in business loans largely originated by other North Dakota banks. This arrangement implies that local private banks have an informational advantage over BND in determining the creditworthiness of North Dakota borrowers. However, without the participation of another lender such as BND, local banks might be unable to meet the demand for relatively large-scale loans.[50]

In other states, community banks face competition from large private banks that have greater lending capacity and offer a wider array of services to business customers. Since BND does not compete in the same ways as private banks, its presence may strengthen the role of community banks in North Dakota and limit the presence of nationwide and international banks.

In some other states, starting with Minnesota in 1975, community bankers decided on a different institutional arrangement to serve the same purpose: bankers' banks, which are owned by their member institutions. Those banks provide both traditional and nontraditional banking services for their members. They do not take deposits from or make loans to the general public, unaffiliated

Figure 10. Small banks tend to account for a low share of deposits in densely populated states.
Correlation of deposits in banks with less than $500 million in total deposits to population density



Source: NEPPC calculations based on Federal Deposit Insurance Corporation, Summary of Deposits, 2010, Bank of North Dakota, *Annual Report*, 2010, and U.S. Census Bureau.
Note: Selected states highlighted. Regression line was included to illustrate relationship between population density and deposits in small banks. "Specialty" banks were excluded. These banks were defined as banks with more than 1 percent of deposits and fewer than five offices within a given state. These criteria may not remove all specialty banks, and may in fact remove traditional banks. Rather than operating like a traditional bank, these institutions provide specialized services, and are often located in particular states to take advantage of favorable state laws. For instance, CitiBank South Dakota is responsible for CitiBank's credit card division. Delaware, Nevada, and Utah had unusually high concentrations of such institutions. Additionally, a list of "Limited-Purpose" institutions available through an internal Federal Reserve Federal Reserve database was used to remove bankers' banks, cash management banks, cooperative banks, credit card banks, industrial loan companies, internet banks, nonbank banks, depository trust companies, and wholesale banks.

corporations, or government, and they are FDIC-insured. Bankers' banks now exist in about one-half of the states.[51]

The structure of banking markets in Massachusetts is very different from that in North Dakota. In Massachusetts, the top three banks account for nearly one-half of bank deposits, and banks with less than $500 million in deposits account for only about 16 percent of total deposits. Thus, larger private banks already exist to meet the credit and other service needs that smaller banks are unable to satisfy.

This contrast between Massachusetts and North Dakota is in keeping with a nationwide pattern: smaller banks tend to account for lower shares of overall bank deposits in densely populated states than in sparsely populated states (Figure 10). In fact, Massachusetts is a prime example of a state with a high population density and a low share of deposits in smaller banks (as are two other New England states, Connecticut and Rhode Island), while North Dakota occupies the opposite end of the spectrum.

Among sparsely populated states, banking concentrations vary considerably. In Iowa and Kansas, banks with less than $500 million in deposits account for more than one-half of total bank deposits—even more than in North Dakota. In Maine and Vermont, small banks account for 16 percent and 29 percent of total bank deposits, respectively—less than in North Dakota but more than in some other sparsely settled states.

These disparate banking structures across states reflect a combination of market forces and state regulations. Small banks are likely to provide services well-suited to the needs of remote areas with many small businesses and little commuting to and from those areas. On the other hand, big banks are likely to dominate in urban markets that have concentrations of larger businesses with multiple locations and sophisticated financial needs.

State-specific barriers to entry into the banking market—and the timing of their relaxation—influence the degree to which state banking structures have evolved in line with market forces. Most states began relaxing restrictions on intrastate branching and interstate banking in the 1970s and 1980s. New England states were relatively early adopters of bank deregulation, which allowed out-of-state and larger banks to enter their markets. At the other extreme, Kansas, Montana, and North Dakota—states where small banks predominate—were among only four states that did not allow out-of-state bank holding companies to enter their markets as of the beginning of 1991.[52]

To summarize, the strong presence of small banks in North Dakota largely reflects its population and business patterns, as well as its historical antipathy to out-of-state banks. As a result of inherent economic and geographic characteristics and its regulatory stance, Massachusetts has a greater presence of relatively large financial institutions with the capacity to fund sizable projects. In this market environment, existing private-sector banks would likely view a new public bank as an undesired competitor rather than a welcome partner.

Role of a state-owned bank in state finances

The possibility of using a state-owned bank to provide supplemental rainy day funds may be appealing to states struggling with budget shortfalls. Over the past decade, BND has returned about $30 million per year to the state general fund. The economy of Massachusetts is about 11 times the size of the North Dakota economy, so an equivalently scaled entity in Massachusetts might have contributed more than $300 million per year.[53]

By comparison, Massachusetts pulled $1.9 billion from its rainy day reserves to fill large budget gaps from the end of FY 2007 to the end of FY 2010, and is expected to draw down another $175 million in FY 2011.[54] Rainy day reserves at the end of FY 2011 are expected to fall far short of the projected budget shortfall for FY 2012. As a result, the state will have to make further spending cuts or raise revenues in the coming fiscal year. Having access to additional resources would have allowed the Commonwealth to adopt more stable budgets during this period.

As noted, North Dakota relies primarily on a separate fiscal stabilization fund to meet revenue shortfalls rather than counting on transfers from BND. The likely reason is to give BND relative autonomy in its lending decisions. A state bank that managed its activities with an eye toward optimizing its transfers to state government would likely fall short in its basic mission to provide credit to qualified borrowers to promote economic development. This point is especially pertinent in times of economic difficulty, when state coffers often drain, and a state bank would have to serve the competing goals of stabilizing state budgets and providing credit to a sluggish economy.

North Dakota also seems especially focused on maintaining fiscal stability, and as such has a variety of tools besides BND to respond to revenue shocks. These include the Permanent Oil Tax Trust Fund,[55] the newly created Legacy Fund,[56] and the newly expanded rainy day fund.[57] In fact, North Dakota expects to receive roughly 16 percent of its revenue from transfers from various funds and miscellaneous sources—about the 73 percent of the amount it will derive from individual income taxes, and about 43 percent of what it will derive from sales and use taxes. A large portion of these transfers come from oil- and gas-related revenues.

Massachusetts and most other states obviously cannot rely on revenues from natural resources to the same degree as North Dakota. However, the North Dakota example shows that states intent on stabilizing their finances can design a variety of methods to reserve revenues for future use. Massachusetts' recent decision to allocate abnormal capital gains tax receipts to its rainy day fund is one such option.[58]

Startup considerations

Creating a state bank would entail significant startup costs. BND was capitalized initially through a $2 million bond issue in 1919. Adjusting for inflation, that amounts to a state bond issue of approximately $25 million. However, that calculation does not adjust for growth in the size of the economy between 1919 and today. Assuming a 13-fold expansion—the growth in the national economy over the past 70 years—puts the required capitalization at $325 million.[59] Scaling up that amount to reflect the larger size of the Massachusetts economy yields a required capitalization in the range of $3.6 billion. That is equivalent to some 21 percent of the state's outstanding direct debt, and would be an especially ambitious amount of debt to issue when state finances remain under pressure.[60]

Beyond the initial capitalization, the state would need to determine a schedule for depositing funds in the newly created public bank. Massachusetts state government deposits in private financial institutions total $522 million.[61] Another $3.5 billion in state funds are managed by the Massachusetts Municipal Depository Trust, an investment fund overseen by the state treasurer. (These figures do not include the funds of state institutions, such as the University of Massachusetts System.) An aggressive timetable that required the state to withdraw such deposits from private institutions would be disruptive, as it would require them to reduce their lending and investment portfolios, which would likely have a negative impact on the Massachusetts economy.[62] A gradual phase-in would mitigate these disturbances but limit the capacity of the new bank in its startup years.

Finally, the recently enacted Dodd-Frank Act gives federal agencies new authority over large and systemically important institutions. Due to its potential size, a fully capitalized state-owned bank in Massachusetts would likely pose supervisory and regulatory challenges. BND has not spurred questions regarding federal oversight of state institutions because it is relatively small and its deposits are not FDIC-insured.

Conclusions

The Bank of North Dakota is a unique institution. Although it has played various roles since its founding in 1919, **BND's most important role in 2011 is serving as a lending partner for North Dakota's numerous small banks.** Over one-half of BND's current loan portfolio consists of loan participations and loan purchases from community banks. Student loans account for most of the remainder. In about 20 other states, some community banks have chosen to join private bankers' banks that provide similar lending-related services, albeit on a smaller scale than the Bank of North Dakota. Furthermore, unlike in North Dakota, the banking sectors in many U.S. states are marked by a strong presence of relatively large institutions that can take on complex lending projects. Massachusetts, in particular, offers a natural setting for larger institutions because it is densely populated, and because the state relaxed restrictions on intrastate branching and interstate banking comparatively early.

The willingness and capacity of a state-owned bank to offset a serious credit crunch has not been shown. This study confirmed that BND served as a source of backup credit in North Dakota during the financial crisis and economic recession of 2007–09. However, the strong performance of North Dakota's core agricultural and energy sectors limited the stresses on its private banks compared with those in other parts of the nation. BND also viewed its backup credit functions as secondary to its core economic development lending programs. Whether states should attempt to set up their own facilities to mitigate future credit crunches—in addition to programs available nationally through the

Federal Home Loan Bank system, the U.S. Treasury Department, and the Small Business Administration—is an intriguing question, but beyond the scope of this study.

With the possible exception of the Great Depression, BND's contributions to stabilizing the state economy and finances appear to have been relatively minor. The North Dakota economy has exhibited considerable sensitivity to commodity prices. Judging by indicators such as unemployment, personal income, and mortgage foreclosures, the state's economy has not been more stable than that of South Dakota, which has many similar characteristics but no state-owned bank. While the government of North Dakota receives dividend-type payments from the Bank of North Dakota, it relies much more heavily on traditional fiscal stabilization funds to smooth out its overall revenue stream. These findings suggest that Massachusetts and other states should continue to pursue their stabilization goals primarily by encouraging a diversified mix of economic activities and revenue sources, and by maintaining or even augmenting their use of rainy day funds to smooth public service provision during the business cycle.

The potential costs of starting up a state-owned bank could be significant. Capitalizing a new bank along the lines of the initial size of BND—but scaled up to reflect the current size of the Massachusetts economy—would require funds roughly equal to one-fifth of the state's general obligation debt. Transferring funds from existing private bank accounts and the investment fund of the Massachusetts Municipal Depository Trust would result in cutbacks in existing sources of credit. To the extent that these funds are now used to finance activities in Massachusetts, the state economy would be affected.

Although much of this analysis has focused on evidence from North Dakota, it is important to emphasize that **Massachusetts and other states should start any discussions of financial-sector reforms by identifying the problems that public policy needs to address.** Depending on which market failures need correcting, the appropriate solutions could include establishing a public bank that differs from the one in North Dakota, further reform of the structure of public and quasi-public economic development and financing agencies, or some other form of government intervention such as enhanced information or regulation.

Endnotes

1 These states are Hawaii, Illinois, Michigan, Missouri, New Mexico, Vermont, Virginia, and Washington.

2 *New York Times*, "State Bank for Oregon; Proposal to Be Voted on Opposed by the Local Bankers," October 18, 1936.

3 These states included Colorado, Maine, New York, New Jersey, Oregon, and Washington.

4 *Palm Beach Post*, "Bank of North Dakota: Only One of Its Kind," November 8, 1975.

5 Abdul Abiad, Enrica Detragiache, and Thierry Tressel, A New Database of Financial Reforms, International Monetary Fund, 2008.

6 Nations were categorized as one of the following: fully liberalized, if no state banks existed, or state-owned banks did not constitute any significant portion of banks, and/or public banks had less than 10 percent of total banking assets; largely liberalized, if most banks were privately owned and/or the public banks had 10 to 25 percent of total banking assets; partially repressed, if many banks were privately owned but major banks were still state-owned, and/or public banks had 25 to 50 percent of total banking assets; or fully repressed, if major banks were all state-owned and/or public banks had 50 to 100 percent of total banking assets.

7 Recent estimates indicate that Indian public-sector banks own 75 percent of total Indian banking assets, and that banks in which the Chinese government has a majority share account for nearly 70 percent of total Chinese banking assets. Germany and South Korea were found to have majority stakes in companies that hold 40 percent and 19 percent of the assets in the national banking system, respectively. See A. Michael Andrews, "State-Owned Banks, Stability, Privatization, and Growth: Practical Policy Decision in a World Without Empirical Proof," International Monetary Fund, 2010; and World Bank, *Bank Regulation and Supervision*, 2007 (revised June 2008).

8 Alex F. Schwartz, *Housing Policy in the United States: An Introduction*, Routledge, 2006.

9 For example, the Clean Energy Trust Fund of the Massachusetts Clean Energy Center is funded by a small charge on each kilowatt purchased by consumers in designated areas, and the Massachusetts Housing Partnership is funded by statutorily mandated contributions from companies that acquire Massachusetts banks.

10 Much of the information in this section is from Prairie Public Broadcasting, "History of Bank of North Dakota: Introduction."http://www.banknd.nd.gov/about_BND/prairie_public_history_of_BND/index.html.Accessed 01/21/2011.

11 Peter S. Fisher, "The Role of the Public Sector in Local Development Finance: Evaluating Alternative Institutional Arrangements," *Journal of Economic Issues*, March 1983.

12 BND performs correspondent bank services (such as check clearing and coin and currency provision) for financial institutions in North Dakota that the regional Federal Reserve Banks also offer. This study does not cover those services.

13 Although BND maintains some small direct lending programs, a study in the early 1990s reported that North Dakota manufacturers seeking loans found BND less cooperative than other banks and financial institutions, the federal Small Business Administration, and other government-sponsored agencies. Manufacturers rated these institutions from 1 to 5, with 1 the most cooperative and 5 the least. BND received an average rating of 3.07, while "government programs" were rated 2.73. BND received a score of 5 nearly four times more often than the next-highest institutional group. These patterns may reflect BND's intentionally narrow direct lending programs. See F. Larry Leistritz and Janet K. Wanzek, *North Dakota Manufacturers: Attributes and Needs Assessment*, Agricultural Economics Report no. 23322, Department of Agribusiness and Applied Economics, North Dakota State University, 1992.

14 In fiscal-year 2010, U.S. commercial and savings banks with assets of $2 billion to $5 billion had an overall loan-to-asset ratio of 65.4 percent. In Massachusetts, the ratio for such banks was 67.3 percent.

15 Bank of North Dakota, *Annual Report*, 2010.

16 These rankings are based on total assets. December data were used for comparability with BND annual reports. U.S. bank assets include foreign holdings, while foreign bank assets are limited to assets held in the United States. American Banker, "Banks and Thrifts with the Most Assets." http://www.americanbanker.com/rankings/bt-most-assets-1037667-1.html. Accessed 05/17/11.

17 Calculations by the New England Public Policy Center (NEPPC), based on Federal Deposit Insurance Corporation, *Summary of Deposits*, 2010, and Bank of North Dakota, *Annual Report*, 2010.

18 BND videoconference transcript from May 5, 2010, provided by James Barnhardt, BND communications and marketing director, November 19, 2010.

19 BND started providing liquidity to North Dakota financial institutions in 1972, and now offers three liquidity programs. See "Established Programs at BND Provide Liquidity," *BND Exchange* 7(1) (2009).

20 In early 2010, 97 percent of student loans, 83 percent of residential loans, 7 percent of agricultural loans, and 5 percent of commercial loan were guaranteed. NEPPC calculations, based on data from Standard and Poor's, "Global Credit Portal: Ratings Direct—Bank of North Dakota," July 2010.

21 The findings on loan losses and capitalization are based on the same sources and peer groups used to construct Table 1.

22 Bank of North Dakota, "About Us." http://www.banknd.nd.gov/about_BND/index.html. Accessed 01/21/2011.

23 Standard and Poor's, "Global Credit Portal: Ratings Direct—Bank of North Dakota," July 2010.

24 E-mail correspondence with Pamela Sharp, director of the North Dakota Office of Management and Budget, February 15, 2011.

25 NEPPC calculations, based on Bank of North Dakota, *Annual Reports*, 1975 to 2010.

26 Federal Reserve Bank of Minneapolis, "After the Fiscal Gold Rush," January 2004.

27 The losses relating to these bonds persisted until 1995, when BND transferred $23 million to the North Dakota Real Estate Trust. See Bank of North Dakota *Annual Reports*.

28 CBS News, "State-Owned Banks a Blueprint for Future?" February 16, 2010.

29 The following formula illustrates the net impact on state revenue of a state-owned bank: Net revenue = (net transfers from state bank to state government) + (weighted average state tax rate) X (change in state tax base) + (state bank interest rate – prevailing market interest rate) X (total state government deposits in state bank). In Massachusetts, for example, a state-owned bank would be exempt from the excise tax on financial institutions. In FY 2010, Massachusetts derived nearly $235 million, or 1.2 percent of its overall revenues, from taxes on financial institutions. See Massachusetts Department of Revenue, "Monthly Report of Collections and Refunds," June 2010.

30 BND may respond to other emergencies as well. In 1976 the only bank in Towner, North Dakota was closed while it was being examined. BND opened a temporary branch in Towner to handle local banking needs. See *Deseret News*, "Residents in Financial Bind as Town's Only Bank Closes," December 1976.

31 BND teleconference transcript from July 2010, provided by James Barnhardt, BND communications and marketing director, November 19, 2010.

32 Rick Clayburgh, president of the North Dakota Bankers Association and former state tax commissioner and state legislator, has said: "Our legislature… has kept their politics

out of the governance of the Bank of North Dakota." BND president Eric Hardmeyer has indicated that the bank has been willing to voice its concerns to the state legislature, and to stress sound business practices over other motivations. "Legislators ... are very mindful of running this bank in a very prudent and solvent manner." BND videoconference transcript from May 5, 2010, provided by James Barnhardt, BND communications and marketing director, November 19, 2010.

[33] Peter S. Fisher, "The Role of the Public Sector in Local Development Finance: Evaluating Alternative Institutional Arrangements," *Journal of Economic Issues*, March 1983; David Fettig, "Banking on the Government: The Bank of North Dakota Turns 75," *The Region*, March 1994.

[34] Despite its separate financial accounting, BND interacts extensively with state agencies. For example, the North Dakota Development Fund administers the state's New Venture Capital Program, which provides debt and equity for new or expanding businesses, through BND. North Dakota Department of Commerce, "Business Support."http://www.business.nd.gov/businessInformation/nd-development-fund/new-venture-capital-program/. Accessed 01/21/2011. The North Dakota Housing Finance Agency, which facilitates about one-fifth of the home mortgage loan volume in the state, has a $60 million line of credit with BND.

[35] Research has shown that the lending of Italian banks owned by public authorities is sensitive to political processes, and that state-owned banks favor firms in depressed areas as well as large firms. See Paola Sapienza, "The Effects of Government Ownership on Bank Lending," *Journal of Financial Economics*, May 2004. One study documents inferior lending decisions by public banks in Germany during the recent crisis. See Harald Hau and Marcel Thum, "Subprime Crisis and Board (In-) Competence: Private vs. Public Banks in Germany," *Economic Policy*, October 2009. Another study found the lending of state-owned banks less responsive to macroeconomic shocks than the lending of private banks—meaning that state-owned banks play a credit-smoothing role. See Alejandro Micco and Ugo Panizza, "Bank Ownership and Lending Behavior," *Economics Letters*, October 2006. Other research has reaffirmed this credit-smoothing role but also found that state-owned banks may not allocate credit optimally. See Eduardo Levy Yeyati, Alejandro Micco, and Ugo Panizza, "A Reappraisal of State-Owned Banks," *Economia*, Spring 2007.

[36] E-mail correspondence with Tobias C. Madden, regional economist at the Federal Reserve Bank of Minnesota, January 4, 2011.

[37] In 2010, Wells Fargo accounted for 73 percent of total bank deposits in South Dakota. The second-largest bank, Great Western Bank, held only 2.4 percent of deposits. These data exclude banks with fewer than five branches that held more than 1 percent of state bank deposits. The most notable example is CitiBank South Dakota, a credit card processor and the largest bank by deposit holdings. NEPPC calculations, based on Federal Deposit Insurance Corporation, *Summary of Deposits*, 2010.

[38] E-mail correspondence with James Barnhardt, BND communications and marketing director, January 25, 2011.

[39] Federal Reserve Bank of Minneapolis, "Interview with Eric Hardmeyer", October 2010.

[40] Jihye Jeon, Judit Montoriol-Garriga, Robert K. Triest, and J. Christina Wang, "Evidence of a Credit Crunch? Results from the 2010 Survey of First District Community Banks," Federal Reserve Bank of Boston, September 2010.

[41] A more recent study of Massachusetts cited declines in small business demand for loans during this period. See "Funding Economic Recovery: Trends in Small Business Lending in Massachusetts," by Polecon Research for the Massachusetts Bankers Association, April 2011.

[42] Eric Hardmeyer, "President's Message," *BND Exchange* 7(1) (2009), p. 2.

[43] John A. Tuccillo, Frederick E. Flick, and Michelle R. Ranville, "The Impact of Advances on Federal Home Loan Bank Portfolio Lending: A Statistical Analysis," JTA LLC, February 2005.

[44] Federal Reserve Bank of New York, *The Federal Home Loan Bank System: The Lender of Next-to-Last Resort?* November 2008.

[45] This program defines small business lending as commercial and industrial loans, owner-occupied nonfarm, nonresidential real estate loans, loans to finance agricultural production and other loans to farmers, and loans secured by farmland that are less than $10 million in value and are provided to companies with less than $50 million in annual revenues.

[46] Programs eligible for these funds include Capital Access Programs (CAPs) similar to Massachusetts' CAP program, discussed in this study. All New England states except Massachusetts are expected to receive about $13 million through the SSBCI. Massachusetts is expected to receive $22 million. See U.S Department of the Treasury, "Small Business Programs." http://www.treasury.gov/resource-center/sb-programs/Pages/default.aspx. Accessed 05/17/2011.

[47] For example, Vermont uses the Vermont Economic Development Authority, the Vermont Municipal Bond Bank, and the Vermont Housing Finance Agency to fill some of the roles that BND plays in North Dakota.

[48] Chapter 240 of the acts of 2010 rolled the Health and Educational Facilities Authority (HEFA) into MassDevelopment. HEFA has a similar financing model but focuses on institutions such as universities and hospitals. Based on annual financing facilitated, the second- and third-largest authorities, respectively, are MassHousing (the state housing finance authority) and the Massachusetts Educational Financing Authority (MEFA). MassHousing and MEFA issue revenue bonds to finance their activities. MassHousing lends directly to borrowers, while MEFA purchases loans originated by participating educational institutions.

[49] While CAP has facilitated a fairly moderate amount of overall lending, the data imply that for every dollar appropriated by the state, the program funds $18 in small business loans. It is unclear what proportion of these loans would not have been funded in the absence of CAP. Conversation with David Harrington, CAP director of business development, February 24, 2011.

[50] One piece of supporting evidence is an analysis by the Center for State Innovation indicating that North Dakota's small and medium-sized banks are characterized by higher loan-to-asset ratios and lower rates of non-accruing assets than their regional counterparts in Montana, South Dakota, and Wyoming. See Center for State Innovation, "Oregon State Bank Analysis, Revised," December 2010. One important caveat is that the center's analysis does not consider whether the relatively high lending rates of North Dakota banks are an artifact of the time period examined (the late 2000s).

[51] Federal Reserve Bank System, "FRB Seasonal Credit for Bankers' Banks," January 2003.

[52] This group also included Hawaii. See H. Simih Yildirim and Sunil K. Mohanty, "Geographic Deregulation and Competition in the U.S. Banking Industry," *Financial Markets, Institutions, and Instruments*, April 2010.

[53] NEPPC calculations, based on 2009 gross domestic product data from Bureau of Economic Analysis.

[54] Massachusetts Budget and Policy Center, "Saving for that Rainy Day: The Stabilization Fund," March 2010.

[55] The Permanent Oil Tax Trust Fund receives all taxes on oil extraction and production collected and deposited in the general fund in excess of $71 million. The state treasurer transfers interest earnings from the trust fund to the general fund at the end of each fiscal year. The principal may be spent only after approval by two-thirds of each house in the Legislative Assembly. A $1 million transfer from BND to the state is forecast in the current biennium. The state's

specialized funds will transfer a total of some $476 million to state government. The estimated transfer from the Permanent Oil Tax Trust Fund is $435 million, or about 91 percent of the expected transfers from specialized funds. This far exceeds any historical transfers from BND. Transfers have at least doubled every biennium since 2001–03—the result of the explosive growth of North Dakota's energy sector. See North Dakota, Legislative Appropriations, 2009–2011 Biennium.

[56] North Dakota's recently established Legacy Fund will receive 30 percent of all state taxes on oil and gas production and extraction beginning July 1, 2011. The State Investment Board will invest the principal. The fund will retain interest and investment earnings until June 30, 2017, after which they will be transferred to the general fund once each biennium. For biennia 2011–13 through 2015–17, interest earnings will be added to the fund principal. Roughly $615 million will be deposited in the Legacy Fund in the 2011–2013 biennium, according to estimates. See North Dakota, Executive Budget, 2011–2013 Biennium.

[57] Chapter 54-27.2 of North Dakota's Century Code indicates that, as of July 1, 2009, the limit on the balance of the rainy day fund rose from 5 percent to 10 percent of the current biennial general fund budget.

[58] Massachusetts derived 6 percent of its revenue from its capital gains tax in FY 2007. This revenue source has proven especially volatile over the years. See MassINC, "Capital Gains: Avoiding Harm to the State Budget," 2008. To curb the fiscal impact of this volatility, Chapter 131 of the Acts of 2010, Section 19, calls for placing 95 percent of capital gains revenue in excess of $1 billion in the state's rainy day fund, and placing the remaining 5 percent in the State Retiree Benefits Trust Fund.

[59] U.S. gross domestic product was about 13 times higher in 2009 than in 1929, in constant dollars. Earlier data are unavailable.

[60] There is some question as to whether existing statutes would permit the state to issue this amount of debt in a single year. Because a state-owned bank would essentially be an agent of the state, its debt might count against the state's statutorily set debt limit. BND has a debt limit of 70 percent of total assets, and that limit does not count against the state's debt limit. E-mail correspondence with James Barnhardt, BND communications and marketing director, December 2, 2010. Current Massachusetts law limits debt service to no more than 10 percent of overall appropriations, and direct debt to no more than 105 percent of the prior year's limit. In FY 2010 this limit was about $17.2 billion, and total outstanding direct debt subject to this limit was about $14.7 billion. Debt service that year was $1.58 billion. A similar service-to-debt ratio implies that issuing $3.6 billion in debt would require an additional $386 million in annual debt service payments. See Commonwealth of Massachusetts, "Statutory Debt Limits." http://www.mass.gov/bb/cap/fy2009/exec/hdebtafford_3.htm. Accessed 02/18/2011.

[61] Only $2 million of the $522 million is deposited in Massachusetts-based banks. E-mail correspondence with Henry Clay, director of investments, Massachusetts Department of the State Treasurer, March 11, 2011.

[62] An analysis by the Vermont Legislative Joint Fiscal Office noted that Vermont's trust funds are handled by fund managers whose fiduciary responsibilities could pose an obstacle to redepositing those funds in a state-owned bank. Whether that would be true of state funds deposited in the Massachusetts Municipal Depository Trust is unclear. See Vermont Legislative Joint Fiscal Office, "Preliminary Review of Issues in Adopting a Bank of North Dakota (BND) Model in VT," January 2010.

New England Public Policy Center
Federal Reserve Bank of Boston
600 Atlantic Avenue
Boston, MA 02210

The New England Public Policy Center was established by the Federal Reserve Bank of Boston in January 2005. The Boston Fed has provided support to the public policy community of New England for many years; NEPPC institutionalizes and expands on this tradition. The Center's mission is to promote better public policy in New England by conducting and disseminating objective, high-quality research and analysis of strategically identified regional economic and policy issues. When appropriate, the Center works with regional and Bank partners to advance identified policy options.

You can learn more about the Center by contacting us or visiting our website:

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Web: http://www.bostonfed.org/neppc

APPENDIX E: House No. 01192 Bank of Massachusetts

HOUSE DOCKET, NO. 01815   FILED ON: 01/20/2011

HOUSE . . . . No. 01192

The Commonwealth of Massachusetts

PRESENTED BY:

Kay Khan

To the Honorable Senate and House of Representatives of the Commonwealth of Massachusetts in General Court assembled:

The undersigned legislators and/or citizens respectfully petition for the passage of the accompanying bill:

BANK OF MASSACHUSETTS.

PETITION OF:

NAME:	DISTRICT/ADDRESS:
Kay Khan	*11th Middlesex*
David Snieckus	*99 CRESCENT STREET* *NEWTON, MA 02466*

HOUSE . . . . No. 01192

By Ms. Kay Khan of Newton, petition (accompanied by bill, House, No. 01192) of Kay Khan relative to creating the bank of Massachusetts. Joint Committee on Financial

Services.

The Commonwealth of Massachusetts

In the Year Two Thousand Eleven

BANK OF MASSACHUSETTS.

Be it enacted by the Senate and House of Representatives in General Court assembled, and by the authority of the same, as follows:

An Act Declaring the Purpose of the State of Massachusetts to Engage in the Banking Business and Establish a System of Banking Under the Name of the Bank of Massachusetts, Operated by the State of Massachusetts, Defining the Scope and Manner of its Operation, and the Powers and Duties of the Persons Charged with its Management; Making an Appropriation, and, Providing Penalties for the Violations of Certain Provisions Thereof.

Be it Enacted by the Legislative Assembly of the State of Massachusetts:

SECTION I:

Massachusetts General Laws is hereby amended by inserting 167I after section 167H the following:

Sec. 1. For the purpose of encouraging and promoting agriculture, commerce and industry, the State of Massachusetts shall engage in the business of banking, and for that purpose shall and does hereby, establish a system of banking owned, controlled and operated by it, under the name of the Bank of Massachusetts.

Sec. 2. The Public-Banking Commission shall operate, manage and control the Bank of Massachusetts, locate and maintain its places of business of which the principal places shall be within the state. And make and enforce orders, rules regulations and by-laws for the transaction of business. The business of the Bank, in addition to other matters herein specified, may include anything that any bank may lawfully do, except as herein restricted; but this provision shall not be held in any way to limit or qualify either the powers of the Public-Banking Commission herein granted, or the functions of said Bank herein defined. The Public-Banking Commission shall meet twenty days after the passage and approval of this Act to begin the organization of the Bank of Massachusetts.

Sec. 3. To accomplish the purposes of this Act, the Public-Banking Commission shall acquire by purchase, lease, or by exercise of the right of public domain, all requisite property and property rights, and may construct, remodel and repair buildings; but it shall not invest more than ten percent of the capital of the bank in furniture, fixtures, lands and buildings for office purposes.

Sec. 4. The Public-Banking Commission shall obtain such assistance as in its judgment may be necessary for the establishment, maintenance and operation of the Bank of Massachusetts. To that end it shall appoint a manager, and may appoint such subordinate officers and employees as it may judge expedient. It may constitute such Manager its general agent, in respect to the functions of said Bank, but subject, nevertheless, in such agency, to the supervision, limitation and control of the commission. It shall employ such contractors, architects, builders, attorneys, cashiers, tellers, clerks, accountants, computer technicians and other experts, agents, and service providers as in the judgment of the Commission. The interests of the state may require, and shall define the duties, designate the titles, and fix the compensation and bonds of all such persons so engaged; provided, however, that subject to the control and regulation of the Commission, the Manager of the Bank shall appoint, and employ such duties, cashiers, tellers, and other subordinates, and such contractors, architects, builders, attorneys, clerks, accountants, computer technicians and other experts, agents and servants, as he shall in his judgment, deem are required by the interests of the Bank. The total compensation of such appointees and employees, together with other expenditures for the operation and maintenance of the Bank, shall remain with the appropriation and earnings lawfully available in each year for such purpose. All officers and employees of the Bank engaged upon its financial functions shall, before entering upon their duties, respectively furnish good and sufficient bonds to the state in such amount and upon such conditions as the commission may require and approve; but the bond of the Manager shall not be less than one million dollars. Such bond shall be filled with the Secretary of the State.

Sec. 5. The Public-Banking Commission may remove and discharge any and all persons appointed in the exercise of the powers granted by this Act, whether by the Commission or by the manager of the Bank, and any such removal may be made whenever in the judgment of the Commission the public interests require it; provided, however, that all appointments and removals contemplated by this Act shall be so made as the Commission shall deem most fit to promote the efficiency of the public service.

Sec. 6. The Bank shall be opened and shall proceed to transact business whenever there shall be delivered to the Public-Banking Commission bonds in the sum of one billion dollars issued by the state as maybe provided by law for such purpose. The transaction of these bonds is hereby designated and shall be known as the capital of the said Bank.

Sec. 7. All state, county, township, municipal and school district funds, and funds or all penal, educational, and industrial institutions and all other public funds shall be, by the person having control of such funds, deposited in the Bank of Massachusetts within three months from the passage and approval of this Act, subject to disbursement for public purposed on check drawn by the proper officials in the manner now or hereafter to be provided by law; provided, however, that on a proper showing made by any official having control of public funds, the Public-Banking Commission may permit a postponement of the deposit of such funds or any part thereof in the Bank of Massachusetts, the period of such postponement not to exceed six months. And provided, further, that if any such funds are now loaned by authority of law under contract terminating at a future time, the deposit of such funds in the Bank of Massachusetts shall not be required until two months after time of expiration of such contract. Any person who shall violate any of provisions of this section shall be guilty of a misdemeanor and upon conviction thereof shall be punished by imprisonment in a county jail for not less than ninety days, and by a fine not less than one hundred thousand dollars.

Sec. 8. Whenever, any of the public funds hereinbefore designated shall be deposited in the Bank of Massachusetts, as hereinbefore provided, the official having control thereof, and the sureties on the bond of every such official, shall be exempt from all liability by reason of loss of any such deposited funds while so deposited.

Sec. 9. The Bank of Massachusetts may receive deposits from any source, including the United States Government and any foreign or domestic individual, corporation, association, Municipality, bank or government. Including reasonable fees from the transactions occurring within Massachusetts from the buying and selling of goods and services with a credit card issued by the Bank of Massachusetts. Funds may be deposited to the credit of the Bank of Massachusetts in any bank or agency, approved by the Public-Banking Commission.

Sec. 10. All deposits in the Bank of Massachusetts are hereby guaranteed by the State. Such deposits shall be exempt from State, Country and Municipal taxes of any and all kinds.

Sec. 11. Funds deposited by State Banks in the Bank of Massachusetts shall be deemed "available funds." For banks that make the Bank of Massachusetts a reserve depository, it may perform the functions and render the service of a clearinghouse, including all facilities for providing domestic and foreign exchange, and may re-discount paper, on such terms as the Public-Banking Commission shall provide.

Sec. 12. The Public-Banking Commission, unless otherwise limited by law, shall from time to time fix the rates of interest allowed and received in transactions of the Bank. Such rates shall be as nearly uniform and constant as practicable, and shall not be fixed or changed to work any discrimination against or in favor of any person or corporation. But in respect to time deposits received by the Bank, transactions may be reasonably classified as to the amounts and duration of time involved, and a reasonable differentiation of interest based on such classification may be allowed. When interest is allowed on any deposits it shall not be less than one or more than six percent. The Public-Banking Commission shall also fix reasonable charges, without unjust discrimination, for any and all services rendered by the Bank.

Sec. 13. All checks and other instruments and items of exchange payable on demand, sent by the Bank of Massachusetts to any State Bank or banking association in Massachusetts, for collection, shall be by such State bank or banking association remitted for at par to the Bank of Massachusetts. Any person or corporation who shall violate any of the provisions of this section shall be guilty of a misdemeanor.

Sec. 14. The Bank of Massachusetts may deposit funds in any such bank or banking association within or without the state upon such terms and conditions as the Public-Banking Commission shall determine.

Sec. 15. The Bank of Massachusetts may transfer funds to other departments, institutions, utilities, industries, enterprises or business projects of the state, which shall be returned with interest to the Bank. It may make loans to countries, cities, or political subdivisions of the stare, or to state or national banks on such terms, and under such rules as the Public-Banking Commission may determine; but it shall not make loans or give its credit to any individual, association or private corporation, except that it may make loans to any individual, association or private corporation, secured by duly recorded first mortgages on real estate in the State of Massachusetts in amounts not to exceed one-half the value of the security, or secured by warehouse receipts issued by the Public-Banking Commission or by any licensed warehouse within the state, in amounts not to exceed ninety per cent of the value of the commodities evidenced thereby. It shall not, however, loan on real estate security more than thirty percent of its capital, nor in addition thereto, more than twenty percent of its deposits. Additional funds, that may be required for such real estate loans shall be procured from the sale of state bonds as may be provided by law.

Sec. 16. The Public-Banking Commission shall prescribe the forms of application for a mortgage loan on real estate, and shall provide for appraisal of the proposed security.

Sec. 17. Every such mortgage shall contain an agreement providing for the re-payment of the loan on an amortization plan by mean of a fixed number of annual installment sufficient to cover, first, a charge on the loan, at a rate not exceeding the interest rate in the last series of real estate loan bonds issued, if any, by the State of Massachusetts; second, a charge for administration and surplus, at a rate not exceeding one per cent, per annum on the unpaid principal, said two rates combined constituting the interest rate on the mortgage; and, third, such amounts to be applied on the principal as will extinguish the debt in not less than ten or more than thirty years; provided however, that advanced payment of one of more annual installments, for the reduction of the principle, or the payment of the entire principal, may be made at any regular installment date; and, provided further, that in case of a crop failure which reduces the mortgagor's reasonable crop income by one-half, all payments under said mortgage may, in the discretion of the Public-Banking Commission, be extended for one year, upon condition that on the payment all the installments, such further annual payment shall be made as will pay the interest, with interest thereon, for the years for which no payment were made. The Public-Banking Commission shall determine whether a mortgagor is entitled to an extension of the payment of any installment, under the provisions of this section.

Sec. 18. Every such mortgage, and the note or other obligation thereby secured, shall run to the "Manager of the Bank of Massachusetts, his successors in office or his assigns," as payee and mortgagee, and shall contain a recital that it is executed and delivered in conformity with and upon the conditions expressed in this Act, designated by its title and the date of its approval. After having been duly recorded in each county in which the lands therein described are situated, every such mortgage shall be delivered to the Manager of the said Bank and together with said note or other obligation shall be held by the Manager as a part of the assets of the bank, or shall be otherwise disposed of, as hereafter provided. If so held, payments upon the note or other obligation secured by said mortgage shall be made to the Bank of Massachusetts, and whenever it shall have been fully paid, the Manager shall promptly satisfy and discharge the mortgage lien of record and deliver the mortgage cancelled, with a satisfaction thereof, to the person entitled to receive it.

Sec. 19. Every such mortgage, together with the note or other obligation thereby secured, may be sold and assigned upon the payment to the bank of the full value thereof, and upon such sale and assignment, the Manager may endorse either with or without recourse. In that case payments upon said note or other obligation shall be made to the persons entitled to receive them; but each such assignment shall be made subject to the provisions concerning extension of the time of payments on account of crop failures as provide in Section 17 of this Act, and subsequent action of the Public-Banking Commission in that regard shall be binding upon the assignee of such mortgage; provided, however, that after assignment of such mortgage extensions of payments for a yearly period shall be limited to total number to not more than one for every period of five years or fraction thereof during which such mortgage has to run after the date of assignment.

Sec. 20. Every such mortgage together with the note or other obligation thereby secured, may be assigned, and upon order of the Public-Banking Commission shall be assigned to the State Treasurer of Massachusetts as security for bonds to be issued by the state as provide by law. In case of such assignment all payments due upon said note or other obligation shall be made by the State Treasurer, and the money so by him received shall be by him held or disbursed as may be provided by law. If while any such mortgage so assigned to the State Treasurer is in his hands, the note or obligation thereby secured shall have been fully paid, the State Treasurer shall so certify to the manager of the bank, who shall thereupon proceed to satisfy said mortgage in the same manner as though said note or other obligation had been paid directly to the bank. In case of such assignment to the State Treasurer of any mortgage, the provisions contained in Section 19 of this Act, respecting extensions on account of crop failure shall be effective and shall be applied.

Sec. 21. All business of the bank may be conducted under the name of “The Bank of Massachusetts.” Title to property pertaining to the operation of the bank shall be obtained and conveyed in the name of “The State of Massachusetts, doing business as the Bank of Massachusetts.” Written instruments shall be executed by any two members of the Public-Banking Commission, of whom the Governor shall be one, or by the Manager of the Bank of Massachusetts within the scope of his authority as to do as defined by the Public-Banking Commission.

Sec. 22. Civil actions may be brought against the State of Massachusetts on account of causes of action claimed to have arisen out of transactions connected with the operation of the Bank of Massachusetts, upon condition that the provisions of this section are complied with: In such actions the state shall be designated as "The State of Massachusetts, doing business as Bank of Massachusetts," and the service or process therein shall be made upon the manager of the said Bank. Such actions may be brought in the same manner and shall be subject to the same provisions of the law as other civil actions brought pursuant to the provisions of the Code of Civil Procedure. Such actions shall be brought however, in the county where the Bank of Massachusetts shall have its principal place of business.

Sec. 23. The State Examiner shall personally or through deputy examiners visit the Bank of Massachusetts at least twice annually, and shall inspect and verify the assets in its possession and under its control, with sufficient thoroughness of investigation to ascertain with reasonable certainty whether the valuations are correctly carried on its books. He shall investigate its methods of operation and accounting.

Sec. 24. There is hereby appropriated out of the general funds of the State, not otherwise appropriated, one million dollars, or so much therefore as may be necessary, to carry out the provisions of this Act. This appropriation is hereby made available immediately upon the passage and approval of this Act. The Public-Banking Commission shall, out of the earnings of the bank, make provisions for accumulating a fund with which to replace in the general funds of the state, the amount received by the commission under this appropriation, as may be directed by the Legislative Assembly.

Sec. 25. All acts and parts of previous Acts inconsistent with this Act are hereby repealed.

Sec. 26. This Act is hereby declared to be an emergency measure and shall take affect and be in force from and after its passage and approval.

APPENDIX F: Useful Links

The Commission to Study the Feasibility of Establishing a Bank Owned by the Commonwealth:
http://www.mass.gov/?pageID=ehedterminal&L=3&L0=Home&L1=Economic+Analysis&L2=Key+Initiatives&sid=Ehed&b=terminalcontent&f=Commission+to+Study+the+Feasibility&csid=Ehed

Official Website of the Bank of North Dakota:
http://www.banknd.nd.gov/

Prairie Public Clip on the Bank of North Dakota:
http://www.prairiepublic.org/television/prairie-public-on-demand/bank-of-north-dakota

Federal Reserve Bank of Boston Report:
http://www.bostonfed.org/economic/neppc/researchreports/2011/rr1102.htm

The Public Banking Institute:
http://publicbankinginstitute.org/

MassDevelopment:
http://www.massdevelopment.com/

Massachusetts Growth Capital Corp.:
http://www.mcdfc.com/

MassHousing:
https://www.masshousing.com/portal/server.pt

Massachusetts Quasi Public Annual Reports:
http://www.mass.gov/?pageID=ehedmodulechunk&L=1&L0=Home&sid=Ehed&b=terminalcontent&f=Quasi_Public_Report&csid=Ehed

FDIC Applications for Deposit Insurance Statement of Policy:
http://www.fdic.gov/regulations/laws/federal/98applic.pdf