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Testimony of the Department of Commerce and Consumer Affairs

**Before the
House Committee on Economic Development
Friday, February 4, 2022
10:00 a.m.
Via Videoconference**

**On the following measure:
H.B. 2219 RELATING TO A BANK OF THE STATE OF HAWAII**

Chair Quinlan and Members of the Committee:

My name is Iris Ikeda, and I am the Commissioner of the Department of Commerce and Consumer Affairs' (Department), Division of Financial Institutions. The Department offers comments on this bill.

The purpose of this bill is to establish the Bank of the State of Hawaii working group to propose legislation to establish a state-operated bank of the State of Hawaii.

In 2012, the DFI issued a white paper entitled "Should Hawaii Establish a State Bank?".¹ The white paper considered various factors, including:

- (1) The Bank of North Dakota;
- (2) The Federal Reserve Bank of Massachusetts research report;

¹ This white paper is available at: <http://cca.hawaii.gov/dfi/learn-more-banks/>.

- (3) Access to credit by local businesses;
- (4) The lending capacity of local banks;
- (5) Stabilization of the state economy and finances;
- (6) Start-up costs; and
- (7) Public policy issues.

Notably, the Bank of North Dakota is the only state-operated bank in the United States and was established due to the lack of credit available to farmers. In 1919, farmers in North Dakota were unable to obtain loans for farm equipment or loans to expand their agricultural acreage. Today, the Bank of North Dakota continues to act as a correspondent bank (not a commercial bank) and has expanded its loan portfolio to include student loans.

American Samoa, a U.S. government territory, established a territorial bank in 2016 when all commercial banks left the marketplace. The territorial bank was unable to get Federal Deposit Insurance Corporation (FDIC) insurance, and the government had to back all assets with the full faith and credit of the territorial government. It took 18 months before the Federal Reserve Bank issued a master account number and granted access to the U.S. payment system. The Territorial Bank of American Samoa opened in 2019.

To establish a state-operated bank, the State must consider several factors, including the purpose of the bank. The purpose of the state bank will, in turn, guide the consideration of: (1) managerial factors, including the competence, experience, integrity, and financial ability of the bank organizers and management; and (2) financial factors, including the viability of the business plan and the ability to maintain profitability.

Finally, a minimum capital of approximately \$20 million is needed to address current funding and future growth and earnings. More capital may be required depending on the purpose of the bank.

In Hawaii, all banks must have FDIC insurance. Both the Bank of North Dakota and the Territorial Bank of American Samoa are not insured by the FDIC, but are instead backed by the full faith and credit of the government. In addition, state law requires banks to match, dollar for dollar, all assets of the bank as collateral.

The DFI's white paper concluded that the State must first determine what a state-operated bank would accomplish and be used for before it can analyze the managerial factors, financial factors, and capital requirements involved in establishing this financial institution.

Finally, the Department notes that it is not a member of the working group, but is designated as the administrator of the working group.

Thank you for the opportunity to testify on this bill.

DAVID Y. IGE
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EMPLOYEES' RETIREMENT SYSTEM
HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
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MANAGEMENT DIVISION
FINANCIAL ADMINISTRATION DIVISION
OFFICE OF FEDERAL AWARDS MANAGEMENT (OFAM)

WRITTEN ONLY
TESTIMONY BY CRAIG K. HIRAI
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
TO THE HOUSE COMMITTEE ON ECONOMIC DEVELOPMENT
ON
HOUSE BILL NO. 2219

February 4, 2022
10:00 a.m.
Room 312 and Videoconference

RELATING TO A BANK OF THE STATE OF HAWAII

The Department of Budget and Finance (B&F) opposes this bill.

This bill, last proposed in both the 2020 and 2021 Legislative Sessions, intends to: 1) establish the Bank of the State of Hawai'i (BSH) Working Group (Group) within the Department of Commerce and Consumer Affairs for administrative purposes, consisting of members from five State agencies; 2) require the Group to conduct a comprehensive review of the State's laws for the purpose of developing proposed legislation to establish a BSH; 3) require the Group to submit an interim report to the Legislature in 2023 detailing its findings, recommendations, proposed legislation, and a graduated schedule of State funds to be transferred to the BSH from financial institutions that are serving as depositories for the State; and 4) appropriate an unspecified amount of general funds for FY 23 for the purposes of this bill.

B&F questions the use of any State funds for these purposes and opposes the intention of the Group's final report in Section 1, Part (c), to produce a schedule for the future transfer of all State funds into the proposed BSH. One of the primary statutory

functions and responsibilities of B&F is for the safekeeping, management, investment, and disbursement of funds deposited into the State Treasury by all State departments. Regulated and insured commercial financial institutions utilized by the State have the capacity, experience, security and technology to carry out the banking needs of the State. Furthermore, keeping State funds at these financial institutions supports the local economy. Management of the State's funds ensures that cash is available as needed to cover the multitude of activities and programs at all State departments and the Legislature.

Although the bill does not state what the intended outcomes and goals of the proposed BSH are to be, the establishment and operation of the BSH would be a significant and expensive undertaking.

B&F notes that, with respect to the general fund appropriation in this bill, the federal Coronavirus Response and Relief Supplemental Appropriations Act requires that states receiving Elementary and Secondary School Emergency Relief (ESSER) II funds and Governor's Emergency Education Relief II funds must maintain state support for:

- Elementary and secondary education in FY 22 at least at the proportional level of the state's support for elementary and secondary education relative to the state's overall spending, averaged over FYs 17, 18 and 19; and
- Higher education in FY 22 at least at the proportional level of the state's support for higher education relative to the state's overall spending, averaged over FYs 17, 18 and 19.

Further, the federal American Rescue Plan (ARP) Act requires that states receiving ARP ESSER funds must maintain state support for:

- Elementary and secondary education in FY 22 and FY 23 at least at the proportional level of the state's support for elementary and secondary education relative to the state's overall spending, averaged over FYs 17, 18 and 19; and
- Higher education in FY 22 and FY 23 at least at the proportional level of the state's support for higher education relative to the state's overall spending, averaged over FYs 17, 18 and 19.

The U.S. Department of Education has issued rules governing how these maintenance of effort (MOE) requirements are to be administered. B&F will be working with the money committees of the Legislature to ensure that the State of Hawai'i complies with these ESSER MOE requirements.

Thank you for your consideration of our comments.

LATE

HB-2219

Submitted on: 2/4/2022 8:20:37 AM
Testimony for ECD on 2/4/2022 10:00:00 AM

Submitted By	Organization	Testifier Position	Remote Testimony Requested
Pamela Tumpap	Individual	Oppose	No

Comments:

The Maui Chamber of Commerce opposes this measure. At this point, we don't see this as a good idea. We do not understand why this is being proposed and why the state would want to compete with our existing financial institutions. Therefore, we recommend deferral of this bill. Mahalo.



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LATE

Presentation to The
Committee on Economic Development
February 4, 2022, 10:00 AM
State Capitol, Via Videoconference

LATE

Testimony in Opposition to HB 2219

TO: The Honorable Sean Quinlan, Chair
The Honorable Daniel Holt, Vice Chair
Members of the Committee

My name is Neal Okabayashi, Executive Director of the Hawaii Bankers Association (HBA). HBA represents seven Hawaii banks and three banks from the continent with Hawai`i branches.

HBA opposes the idea of establishing a state bank after a study made by various state departments and agencies rather than a consultant familiar with the obstacles to organize a bank. Based on the preamble, it appears that the state bank would engage in mortgage lending, housing development, agricultural development, and land use, among other activities, which activities may be done by a non-bank. The State has done some of that activity in the past although it partners with a bank at times. It appears that the bill does not permit the working group to conclude that a state bank is not warranted.

Is A State Bank Needed?

There is no evidence that the Hawaii banks are unable to meet the depository or credit needs of our businesses and residents. Just last year, according to SBA data, Hawai`i banks made well over \$3 billion in PPP loans resulting in being ranked as one of the top ten states in meeting the credit needs of small businesses.

Hawai`i banks survived and even thrived during economic crises such as the Great Recession and during this pandemic. Can the State afford to be propping up a state bank when faced with a financial crisis?

Costs to the State

A bank is required to have capital to remain operational. The capital necessary for a state bank to be adequately capitalized may depend on the risk-weighted assets of the state bank which will depend on its lending activity. The Federal Reserve Bank of Boston drafted a report in 2011, when studying the possibility of a state bank, which analyzed the costs of organizing a state bank in Massachusetts and concluded that the required capitalization would be \$3.6 billion which would be 21% of Massachusetts' direct debt. Hawaii's needs would be smaller but still materially quite large.

The City and County of San Francisco recently conducted a study on a potential public bank for the city and its study estimated that an investment between \$184 million to \$3.9 billion would be needed

to operate a public bank, and that it would take between 10 and 56 years before it would break even. The State is larger than the city and county of San Francisco. Such expenses could not be borne by the State. The cost of starting and maintaining a state bank could be better used to fund the activities described in the preamble.

Startup Costs

There are always startup costs for any bank which are not trivial because of need for facilities, equipment, hardware, software, employees, and other necessary assets. The infrastructure and cybersecurity costs of the bank will be significant, as well as the cost of compliance with a myriad of banking regulations, such as the Patriot Act, Bank Secrecy Act, and anti-money laundering laws. Cybersecurity is one of the biggest risks to banks, and Federal Reserve Chairman Jerome Powell testified before Congress in February 2020 that: “The thing we worry about a lot is cyberattacks. I think we have a great game plan for traditional issues like bad loans and things like that. It’s more cyberattacks is really the frontier where you worry.” The recent SolarWinds cyberattack on US industries is evidence of the operational cost and threat to a bank and other industries from cyberattacks.

Experience of other State Banks

Over the years, there have been many public banks which were formed and then closed, mainly in the 19th century, because after the 19th century, state banks to close hardly existed. Recently, at least 10 states and municipalities have considered the concept but did not follow through. Today, only two state banks exist. Both born out of dire circumstances. One is the Bank of North Dakota, formed in 1919, which does not function as a bank but more as a correspondent bank. Its purpose is to partner with local financial institutions not to compete with them. Its lending program is through local financial institutions and throughout its history, it has faced challenges and political pressure. The other is a startup bank in American Samoa whose existence was necessitated by the absence of any American bank in American Samoa.

Other Costs to the State

The bill provides for a withdrawal of state funds from banks. The Federal Reserve Bank of Boston concluded that if the state sought to withdraw funds from private depositories, it would be disruptive and would lead to a negative impact on the Massachusetts economy. Also, by impacting the Hawaii banks, there would be an adverse impact on Hawaii tax revenue as the franchise tax paid to the State would be based on a lower revenue base.

A state bank will also lead to a diminution of interest rate funds received by the state. Currently, the state funds are deposited in the bank that is the highest bidder at a public auction based on the interest rate the bank is willing to pay. Also, the state is protected from risk of loss because the deposit is collateralized which is protection to the State in addition to FDIC insurance. These protections will disappear with a state bank and it remains to be seen where the cash of the State will be kept, if not in a bank, and how the State will clear checks sent to the state bank or paid by the state bank.

If the state bank is going to engage in debit cards, checks, or making payment to employees, and other activity that requires access to the Federal Reserve payment system, there is a serious question whether it will be eligible to use the Federal Reserve payment system or FedNow (the soon fully operational Federal Reserve payment system). Thus, the state bank may not be able to operate as desired, and without access to the federal payment system, it will not be able to operate as a bank.

Every bank needs a source of funds to make loans which usually means deposits, reserve funds, capital, or shareholder capital. For the State, its source of funds will primarily be tax receipts that are

now deposited in banks located in Hawai`i or on the continent; often for a short-term because those funds are needed for state expenses, such as payroll, the State's biggest expense. The State could borrow from the credit market but that has consequences to the State as the credit needs to be repaid. Thus, the use of state funds for loans will be limited as state funds are generally short-term funding while banks have both short-term and long-term funding.

Risks to State Funds

Hawai`i banks are examined by both the federal and state examiners (unless you are nationally chartered which banks are examined only by federal examiners) to determine if the bank is compliant with regulations and especially if there is a safety and soundness issue which endangers the financial soundness of the bank.

However, since the state bank would likely not have FDIC deposit insurance, they will not have the supervisory benefits of bank regulators. Thus, there will be no independent, and experienced bank regulator that provides oversight to help assure no loss to the bank. The Bank of North Dakota does not enjoy FDIC insurance and they are backed by the full faith and credit of the state. If the State plans on having customers who will place their deposits in the state bank, those customers will not enjoy the protection of the FDIC and without access to the payment system, check writing will be near impossible.

It is crystal clear that a study is not needed because all other studies have shown the imprudence of a state bank. If the need is for credit to the public, there are other alternatives within the state including through the Hawaii Finance and Development Corporation. An example of that is the Hula Mae program which is made through financial institutions. The state can use existing loan programs and government agencies, working with the private sector, which is a faster and more effective means to accomplish this goal than establishing an entirely new state bank.

Thank you for the opportunity to submit this testimony in opposition to HB 2219. Please let us know if we can provide further information.

Neal K. Okabayashi
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TO: Members of the Committee on Economic Development

FROM: Natalie Iwasa, CPA, CFE
808-395-3233



HEARING: 10:00 a.m. Friday, February 4, 2022

SUBJECT: HB 2219, State Bank of Hawaii Working Group - **OPPOSED**

Aloha Chair Quinlan and Committee Members,

Thank you for allowing me the opportunity to provide testimony on HB 2177, which would establish a working group to propose legislation for a state-operated bank and appropriate money.

I oppose this bill. Please vote "no" or defer.