Interview with Eric Hardmeyer, former CEO, Bank of North Dakota

Co-hosts: Ellen Brown and Earl Staelin

Ellen: I started an article on the Bank of North Dakota. North Dakota escaped this banking crisis of March. There were no runs on the banks. The economy's still doing well, etc, etc. And of course, I would like to say it's because they have a mini-Fed that backstops the banks. But I assume there weren't any runs to start with, right? So there was nothing the Bank of North Dakota had to do. But what if there were runs? What would it do? Would it help with liquidity, help with capitalization, etc?

Ellen: On a local bank I mean.

Eric: Oh, not on BND.

Ellen: No, I know you can't run on BND.

Eric: I am a director of a community bank. I am on another board. So I can answer from that standpoint. Why isn't there, why wasn't there a run? Well, largely, I think North Dakotans are a conservative bunch.

Ellen: Yeah.

Eric: And I don't think that people saw in Cornerstone Bank, which I'm now a director of, the same issues that were in these larger regional banks. To me, it came down to two things for those banks. One is quite frankly, horseshit management. Pure and simple. You know, looking at their balance sheet, looking at what happened in the case of significant interest rate increases, a very unique kind of deposit set up, which made it more likely that this could happen because of their concentrated deposit portfolio. And two, I think the regulators were asleep at the switch.

Ellen: Right?

Eric: Probably should have stepped in some time ago and said your model is fraught with risk and maybe did and nobody adhered to it. But I think it was a crisis of their own making.

Ellen: Yeah, well, that's fine. But what does the Bank of North Dakota do for local banks if they have liquidity issues, if they have capitalization issues? Does it step in the way the Fed could do if it wanted to?

Eric: Of course. Yeah. So banks have different avenues to get liquidity from BND. Of course, the easiest is they have a Fed funds line. We virtually have a Fed Funds line set up with every bank in the state that are all pre-approved -- annually reviewed and approved -- with dollar limits based on capital and performance. So every bank has got a different limit according to their size and everything else I just mentioned. So they have access to a Fed funds line from BND. We also look at their other alternative funding sources as we approve our own to make sure that they have other alternatives. And there's certainly the Federal Home Loan Bank is a good possibility for these banks for additional liquidity. They can go down the path of … other deposit gathering things. So but BND by and large does have the opportunity to not only provide them overnight funds and our Fed funds program, but also longer term liquidity. We can give them an extended Fed funds line, or we can just simply buy loans from them. And we've done that on occasion where they will say, "Well, okay, we need liquidity. Would you be willing to buy $20 million of loans from us?" And generally we would do that with quick turnaround. They would sell us some of their some of their best loans, which we could do quickly without a lot of analysis. Some of those loans we might be in already and we just take a bigger chunk. But I think that's the beauty of BND is our ability to provide different mechanisms for them to add liquidity to their balance sheet.

Ellen: Yeah. That's great. And you mentioned the Federal Home Loan Banks now. Is that something that the Fed draws on? Or it doesn't need. I'm sorry the BND draws on or it doesn't need to.

Eric: Yes. BND is an active member of the Federal Home Loan Bank. And you may know this from my background, but I was on the Federal Home Loan Bank Board of Directors for 11 years, the last of which I was the Vice Chair. And we have been members of the Federal Home Loan Bank since the late 90s and you know, access them in different ways with different products throughout my time there and found them to be a very resourceful, reliable partner in providing liquidity. And in fact, if you go back to 2008, you'll see that the Federal Home Loan Bank actually played a very heroic part in that banking crisis by really delivering on their liquidity mission. So BND has a strong relationship with the Federal Home Loan Bank and uses them for not only liquidity but hedging purposes as well.

Ellen: Okay. How do you mean? Hedging purposes?

Eric: Yeah. So I think BND's deposit portfolio is short term in nature, right? It's all state deposits and it's generally 90-day kind of variable for the most part, out maybe to two years. And it's laddered and so forth.

Earl: These are these are not your loans you're talking about, but investment.

Eric: These are advances from the Federal Home Loan Bank that we took down to help us with liquidity and with hedging. And so an advance is just a loan. It's a loan from the Federal Home Loan Bank to BND, a pre-approved collateralized loan that we can take down in different tranches.

Ellen: I've seen criticism that JP Morgan also uses the Federal Home Loan Banks and that that's not what it was set up for. That's so it is alleged.

Eric: But I think that's absolutely wrong, Ellen. I think they were set up for that.

Ellen: I think I like the whole model of the Federal Home Loan Banks. I mean, they should do that -- all share liquidity, basically, right?

Eric: Yeah, that was the big tool. So it was initially designed back in the 30s to help with mortgage lending, hence Federal Home Loan Bank.

Earl: Right.

Eric: They also are there as liquidity providers. And so. Yeah, I think that's a criticism that was inappropriate.

Ellen: Okay.

Eric: I think that's exactly why they're there.

Ellen: Okay, great. Yeah. Thought that. I mean, that's really what we should have for a national public banking model to be sharing liquidity nationally.

Eric: Well, you have central banks. Federal Reserve does the same thing, too.

Ellen: Yeah. Our immediate problem is we can't get them to provide or they won't go along with licensing unless we get FDIC insurance. And of course, you can't really get FDIC insurance for a state. In fact, apparently, this isn't in writing, but a representative of FDIC said that they were set up to cover private depositors, not public -- not states or cities or whatever. So we're kind of screwed.

Eric: Well, we're the exception.

Ellen: Yeah, you were grandfathered in, but we can't seem to get that same ...

Eric: Let me finish my hedging.

Ellen: Okay. Yeah.

Eric: Is how do we hedge? And so we have a sizable book, or did, of mortgages as part of our portfolio and also long term fixed rate student loans. And so when I talk about using the Home Loan Bank as a hedge, what we would do is take down in advance and it could be an amortizing advance, but it closely matches the portfolio characteristics of the student loan program. And so... , you don't want to fund a long term asset with short term deposits, right? That's the mismatch. That's why banks get into trouble. That's why banks fail. And so we would take down a sizable advance from the Federal Home Loan

Bank that would match the features, of a certain part of the student loan portfolio or the mortgage portfolio -- the last 10 or 15 years of the life of it, or I guess anything beyond five years. So we would use that as liquidity and as a hedge so we wouldn't be taking ... It would minimize interest rate risk by closely matching the advance to the asset. Does that make sense?

Ellen: Yeah. And if if we were to be able to use Federal Home Loan Bank today, wouldn't it be pretty... Interest anywhere for liquidity is pretty pricey right now, right? I saw that you, that BND said they paid comparable comparable interest on deposits. But what does that mean? I mean, currently it's 5%. So comparable to what?

Eric: Well, so what we would do, is, ... It was an interesting balance that we walked there because state agencies felt we had their money, we had their deposits, that they should earn a marketable rate of interest, not some low form of interest to help subsidize the state. And so what we would do is we would go out and look at CD rates across and deposit rates across the state which is available to everybody, and we would place our rates right smack dab in the middle. Say we're not going to be high. We're not going to be low. We're just going to average whatever we see the other banks paying.

Ellen: In North Dakota, local banks.

Eric: Yeah. And we would throw out the high rates and the low rates because there's always people, I'm not gonna say "scheming," but looking for deposits in certain areas that might they might be overly aggressive compared to where the rest of the markets were.

Ellen: Cool.

Eric: So that's how we price our deposits so they're marketable.

Ellen: Cool. I don't suppose you know what they're paying right now, do you?

Eric: So I know that I just met with the new CEO or my replacement. Yeah. And those are about average rates today, Ellen, 5%.

Ellen: Wow.

Eric: They may sound high to you. And historically, over the last 20 years, that is high. But I've been in banking since the 80s. And I started out when CD rates were 12, 14, 15%. And you probably recall those days as well.

Ellen: Yeah, well, our first mortgage was 12%. Yeah.

Eric: So I would argue that rates have been kept I don't know about "artificially" but have been low since the dot com crash 2003. Then after banking righted itself after 2008 rates crept back up and then a series of other events happened and so. ... historically rates aren't that high.

Ellen: Yeah. Okay.

Earl: So [question] number three: does BND have the answer to this banking crisis?

Eric: Yeah, I didn't see it as a crisis.

Earl: Okay.

Eric: How does three bank failures... It hardly compares to what we saw 2008. And I think those banks were unique as I said. I think they were managed poorly during a rapid interest rate rise. And and I haven't heard or seen a lot of issues with bank failures since those three.

Earl: Right.

Ellen: Right. Even though they have the same sort of portfolio or whatever. I mean, there are many banks that have a lot of long term securities that they bought when interest rates were so low and they had deposits and nothing else to do with them. Apparently there are 180 banks I saw that are in the same situation as Silicon Valley Bank, but they're not going down.

Eric: They all have, even our Cornerstone bank. Yeah when rates go up, your investment portfolio takes a hit, right?

Ellen: Yeah, but they just don't have runs. So they were actually targeted. First of all, their stock was targeted with short sales by someone, highly mysterious, but they were all crypto banks. And supposedly a certain committee in Congress and the SEC were going after crypto and the investors knew that, and so they short sold, etc. So it was a unique situation. Yeah.

Eric: Yeah, well and I mean, and that may be the inside baseball issues there. But on the surface it just looked like their portfolios were such that all banks took a drubbing in their investment portfolios when interest rates rose that quickly.

Ellen: Mhm.

Eric: ... and that's reflected in your equities as you make adjustments to those mark to market. If you don't hold those to maturity, you got to mark them down.

Ellen: Yeah. Well SVB I guess had 85% of their depositors tried to pull their money out in three days.

Eric: Yeah.

Ellen: So absolutely no bank could withstand that. It's just the banking model is not that.

Eric: Well, and they were pulling it out for a reason. They were afraid that it was going to fail.

Ellen: Yeah.

Eric: And you know, that's based on capital levels dropping precipitously, as you know, you had to mark down your portfolio, and the inability to talk to your depositors through that is an issue. And it's an issue for all banks. As you know, social media can scare the crap out of a lot of people and make these runs happen much quicker.

Ellen: Like Credit Suisse, that was amazing that they went down.

Eric: Yeah. So, I mean, that's a risk that banks have to deal with. Kind of a PR reputational risk that somebody gets on social media and says, "Hey, Bank X, Y and Z has got capital issues. It might be time to think about moving over to a different bank." And so, voila, you've got a run.

Earl: Wow.

Ellen: Okay, next question. You have a long list.

Earl: Okay. So it sounds like in answer to Question four, you're saying ... the principal actually reduces the loan balance, right? Payment of principal?

Eric: Yeah, of course.

Earl: And the interest counts as new cash, basically.

Eric: The interest... Well, you have net interest margin. And then you have net income. And so you take all your loans, and that's your interest income, against your interest expense, which is what you pay on your deposits and advances.

Eric: Well, and then you have net interest income.

Earl: Yeah.

Eric: And that's got to pay for ... plus whatever fees you collect in other monies you make in your other portfolios ... and you subtract your operating costs, and then you're going to get net income. So the big driver for banks for bottom line income is interest income.

Earl: Yeah. Interest payments.

Eric: No. Accruals, everything. Accruals are income. Including accruals, not just income you've received. But what is also accruing. Does that make sense to you?

Earl: I'm not sure what you mean by accruals. This is interest earned that you haven't received yet.

Eric: Yeah. So a guy has a home loan or car loan, you record the whole accrual as income ...

Earl: Mhm.

Eric: whether or not he's paid it or not. You account for all of that income that's due. And if you don't collect it all, then you have to put it on non-accrual. And if you never collect it, then you charge it off. So you're you're including whatever is expected to be earned that month as interest income. Not just what you have received specifically as a payment.

Earl: Okay. Yeah. That's because your accounting is on accrual accounting.

Eric: Yeah. I can't imagine going back to, you know.

Earl: Cash. Accounting.

Eric: Cash Accounting. Exactly.

Earl: Yeah. Well, Question five is how does a community bank record a payment of interest and principal on its joint loans with BND?

Eric: Well, the same way.

Earl: Yeah.

Eric: They account for the whole loan. The whole loan is on our books.

Earl: Yeah.

Eric: And whatever they have sold to BND they pay proportionately to us. But they do account probably separately the whole loan. But what they keep on their books in their portfolio goes to their books. But they have to keep track of both the loan and the participation. So they won't, for example, treat the part that goes to BND as income for that bank.

Earl: Okay.

Eric: Deposits form a pool of funds. [Loans are] not necessarily individually taken from that specific deposit. They're taken from the pool, which forms a cash basis. And so I don't think you'd ever go down that path of fungibility, where you have to specifically trace the loan to the deposit? Oh, that would be a nightmare of accounting. Except, as I said in the case of a CD. But you do track obviously the loan against your deposit base and you have to have sufficient liquidity to fund the loan. If not, you're going to have to go out and get an advance from the Home Loan Bank. And that's as simple as I can make it. Earl. It's a pool of funds, not specific to any one deposit, but a pool of money. And I should also say that you may have to liquidate investments. So with your excess liquidity first of all, you take the deposits, you make loans, you have some in cash. The extra you put into investments. You don't want money lying around, not earning anything.

Earl: Right.

Eric: So you invest those. You know, if a bank has a loan-to-deposit ratio of 60%, you've got 40% to play with, right?

Earl: Yeah,

Eric: Because only 60% are being used to fund loans with. So that 40%, you're wise to invest it and get a return.

Ellen: But invested in something where you can get your money out if you need it quickly.

Eric: Well, yeah, but banks are limited in what they can invest in. You know, you can't you can't invest in equities.

Ellen: Right.

Eric: You could take debt instruments, bond instruments and so BND and most other banks will will invest in US Treasuries or Munis or Mortgage Backed Securities that are backed by Fannie Mae or Freddie or some government entity. And so you don't want to take credit risk in your investment portfolio. That happened with the private label Mortgage Backed Securities back in 2008. That's why a lot of banks failed because they were taking credit risk in their investment portfolio. You do take interest rate risk. But you'd be foolish to take a lot of credit risk in your investment portfolio.

Ellen: Yeah, that's what I've seen. The difference between the banking crisis of the spring and the 2008 crisis was that was a ... This one is an interest rate crisis, and that was credit crisis.

Eric: Yeah. And so banks you can't use your excess investment monies and buy equities. That's sacrosanct. You can't do that.

Ellen: Right.

Eric: You're not allowed to.

Ellen: Unless you're the Central Bank of Switzerland. And you can.

Eric: Well.

Ellen: Apparently they own a lot of American stock.

Eric: Well, so does BND. We were able to. But we recognize the risk with being an owner of a company and lending money to it. Felt that was inappropriate. So we had a venture capital fund within the bank's assets and we would make equity investments. And I quickly realized that's a recipe for disaster, so we moved that off the books and had somebody else manage it. So, yeah, I mean, you're not going to ... banks aren't going to buy equities. For one they're too damn volatile.

Earl: You're referring to any bank? Not just BND.

Eric: Yeah, I'm referring to all other banks. Yeah. Too volatile. Too much credit risk.

Earl: Next question is: In 2008 and during the Great Depression, by what measures did BMD avoid recession? I've been saying [as well as] others in public banking, North Dakota avoided recession. And we've been saying [that it's] because of its bank. And someone asked me, well, by what measures did it avoid recession? Unemployment?

Ellen: Yeah. I started writing about that. And it was the only state that never went in the red.

Eric: Yeah. Believe me, I got a lot of credit for that. Or the bank did. And I've been very adamant about this. That's total nonsense. It was not because of the bank. We assisted. We played a part, but it wasn't the bank acting heroically that saved the state. No, we were fundamentally changing our economy at that time. And as you may recall, that's about the time, the oil boom hit North Dakota.

Ellen: So that's what *The Wall Street Journal* said it was.

Eric: I would agree. I don't think it was BND, but I will say we had a we had a role, but the major role was that our economy was different, fundamentally different, than a lot of others. We ... Again, I'll go back to the conservative nature of banking in North Dakota. You know, nobody was buying a lot of derivatives. We never had huge losses, private label securities. You know, we're just very conservative in this state in terms of lending practices. And so banks, I think, had a lot of capital at the time going in. We never felt the real estate bust that came throughout the rest of the country. We never felt it. So we never had write downs. We didn't have to work with our borrowers that much to restructure. And at the same time, we had you know, agriculture was going through some pretty damn good times back then. So Ag was strong. The oil economy was just breaking and it was breaking large and quick. And so we had a lot of money coming in.

And so I'm quick to say that while it's nice to be thought of as the savior, that wasn't really the case.

Ellen: Well, then another thing that I've written, it was that in 2014 there was an oil bust, and yet the Bank of North Dakota continued to report record profits. So the issue in The Wall Street Journal was why did the Bank of North Dakota do better than Goldman Sachs and JP Morgan Chase? And they said it was because of oil. And I argued the bank is not the government and that the bank thrived even when the oil collapsed.

Eric: Well, that's just management. I mean, it's diversification of your portfolio. I mean, if we had 80% of it directed towards oil ...

Ellen: You'd be screwed.

Eric: Yeah, we'd be in trouble. But we had a very disciplined, strong, diversified portfolio. Student loans. We had mortgages. We had Ag loans. We had good real estate loans. So yeah, we were we were ready. And it gets back to my point earlier about why those banks failed to begin with. And mostly it's management, it's seeing the future and it's being prepared for risk. And we were. You know, you just don't put all your eggs in one basket.

Earl: Yeah, those are all good points. I'm also thinking, though, that because you made loans jointly with all these community banks, and you were there kind of as a backstop, you enabled them to keep their lending going.

Eric: Absolutely. I will say this, though, that during the peak of the oil bust we did have some of the largest write offs / charge offs we've ever had in our history.

Earl: You mean 20? I think it was 2015. When?

Eric: Yeah, somewhere in there.

Earl: Uh huh.

Eric: But it was in the big scheme of things, it was minuscule. It was $10 to $12 million in total write offs, charge offs, and you had already reserved for those loans. You know, you have a bad debt reserve and we had a very strong reserve in place. So yeah, I mean, again. Management. Management. Management.

Earl: Yeah.

Eric: And so, yeah, but Earl, your point is right. I mean, we participated and shared in the risk with those banks and that's why we came to the aid of them at the beginning of the boom because they were quite frankly, afraid of what they had experienced back in 1985, 6, 7, with a huge farm and energy bust. And so we said, well, that's where we need to play. Is we got to help them get through this because those cities and communities need help right now. And if we're not going to rise to this occasion, what the hell are we here for?

Ellen: Yeah, that's great. Well, that's what we should argue now, it seems to me, I mean, banks are all, local banks are pulling back. They're afraid to lend because they're afraid a recession's coming and they're afraid that people aren't going to be able to pay the loans back, etc. But yeah, what they need is a backstop to step in and say, "Don't worry, we're here for you."

Eric: That's how I saw our role.

Ellen: That's great.

Earl: Yeah. Eric You mentioned that... I'm not sure exactly what time period... that you're loans-to-deposits ratio is about 60%.

Ellen: It is right now, I think.

Earl: Do you do you have a recollection of how high it got during the 2008 recession? I remember looking at your figures and seeing that you were lending out up to about ten times, ten to almost 12 times your capital back then. And I know it's much less now, more like five or something like that.

Eric: Well, as a measure of loans-to-deposits, we were above 100%. And so we said, "Well, how the hell do you do that?" Well, simply. You borrow from the Federal Home Loan Bank, which aren't deposits, they're advances.

Earl: Right.

Eric: That's how we would keep continuing to loan money is taking down Federal Home Loan advances. And so I think we may have peaked out at 108. 110. And at that point, you start catching the frown of the regulator. But we had plenty, plenty of capacity with the Federal Home Loan Bank. I mean, we had a we had an open ability to borrow up to I think $1,000,000,005.

Earl: From the Home Loan Bank, you mean?

Eric: Yeah. And sometimes we would reach 100. We'd reach a billion.

Ellen: Wow.

Eric: Yeah. So as I said ...

Ellen: What was the interest rate there?

Eric: Low. I mean it was market, It's all market. I don't know if you know how they price their advances, but it's, it's people in the marketplace buying bonds at market rates.

Ellen: So the Federal Home Loan Bank sells bonds.

Eric: Of course.

Ellen: Oh I didn't realize that.

Eric: That's how they fund themselves. They're a GSE. So their bonds are rated equivalent of US Treasury. 'Cause they have a an obligation to pay those back if they default. So, yeah, they borrow through the bond market at same rates that the US Treasury does. So then they mark it up a bit and sell it to us.

Ellen: So it's the same. You say through the bond market. But did they issue their own bonds? Like, can you go buy a Federal Home Loan bond? Okay.

Eric: Yeah. Well, they're mostly sold through institutional sales. I don't know how an individual would buy them, but they're, you know ...

Ellen: They're separately marked. Okay.

Eric: Yeah.

Ellen: Cool. I'm just thinking in terms of the National Infrastructure Bank, which I've done a lot of presentations for, we've got a funding problem. I mean, supposedly it's modeled on the Reconstruction Finance Corporation, but what they did was issue bonds, the same thing, and they're like government backed bonds. So I think that NAB's going to have to do that, too.

Eric: Yeah. Well, how do you think Farm Credit exists? Same thing.

Ellen: Who issues the bonds?

Eric: Farm Credit.

Ellen: It's an agency? I don't know farming.

Eric: They're just like Federal Home Loan Bank created at the same time.

Ellen: Oh, right.

Eric: And they supposedly were there at the time to help finance real estate issues.

Earl: I think another conservative practice you had ... When you made home loans, you were lending to people who were living in the home, right?

Eric: As opposed to what, Earl?

Earl: Well, for investment.

Eric: Oh. Yeah.

Ellen: You would't lend to Blackstone necessarily?

Earl: Yeah. Because one of the points Richard Werner makes is that these bubbles are created by banks pumping money to...

Eric: Like the hairdresser in Arizona they showed on *60 Minutes* who bought one property and then when this whole thing came to bust, she had 5 or 6. And they were giving her the money at the bank wherever she was banking without really looking at it because everybody was on the understanding that real estate only goes up in value. It doesn't come down. You know, we learned quite a lesson or they did. But we never engaged in that. We would never buy those types of loans. And again, most of those loans were made by other North Dakota banks and we would buy them whole. We'd buy the whole loan and service them directly.

Earl: Oh, okay.

Eric: But when I left, we were getting out of that business.

Ellen: And do you service the deposits of the state directly? I know in Los Angeles, when they were attempting to set up a LA public bank, that was a big issue, that it's pricey. You know, it's farmed out to Wells Fargo. It was then anyway.

Eric: Well, yeah. So all the money is funneled into the state Treasurer. So for the most part we're dealing with the Treasurer, not specific state agencies. We're dealing with one entity. And then we would work with her at the time and say here's how we establish our deposits, and these are the rates. And there wasn't much negotiation. These are the rates. And as I described how we would set our rates, it's just an average of what you'd get across the state. So there can be no criticism. We're not high. We're not low. If we're high we do have the ability to take private deposits then a lot of private deposits can come into the bank. And so we said we need to be fair, so we're going to go right down the middle. This is going to pay. And so you avoid criticism.

Ellen: Your local banks do take public deposits, though, right? So what would that be like? City deposits?

Eric: Yes.

Ellen: But not state. Okay.

Eric: No. All state deposits come to BND.

Ellen: And that's one thing, one problem we had.

Eric: I'm going to back off. Pension plans do not. So the legacy fund, PERs, those funds do not come to BND.

Ellen: Okay.

Eric: PERs, Public Employee Retirement.

Earl: Oh, yeah.

Eric: Yeah. Every every state has ...

Earl: I have just one other question.

Ellen: Can I say one other thing on that last point? One problem we have is that it's always the state treasurer that objects and says, "Well, I manage the funds I manage the state's funds," and they don't want to hand it over to the bank. But so you let the Treasurer handle the funds, right?

Eric: Well, money, by law, gets collected by agencies and funneled to the treasurer. I mean, that's I'm sure the way it's set up in every state, every state in the country. But it just so happens in our state that the state treasurer does not have the ability to go out and negotiate with Wells Fargo on buying a piece of that portfolio because it, by law, has to come to BND. And if you take that away from the bank, it's a recipe for disaster.

Ellen: Yeah.

Eric: I mean, that's what makes it work. A captive deposit base.

Ellen: Right.

Eric: That's the struggle that all these banks startups are going to have is, you know ... So we've been around for so long that state treasurer and the banks don't know any different.

Ellen: Right?

Earl: Yeah.

Eric: And so my advice and I'm just spoke to a group from San Francisco -- actually a reporter -- is, and I've spoken to New Jersey, New York just a ton of states. I said to me the easiest thing to do would be to identify you know, either a new source of tax revenue or a tax revenue that you'd say is specifically going to go to fund this. So you have a consistent deposit base. And a lot of these states, particularly since marijuana was becoming kind of legal throughout the country and a new source of revenue, I would say, why don't you start there? Because Wells Fargo, the state treasurer, nobody is... It's new money. It's not directed anywhere right now because it doesn't exist. So when you have a new tax form, new tax revenue, that's easy to spin off and say, okay, we're going to use that to fund this state bank or this municipal bank. Because I get it. I went out to New Jersey and got beat up by the bankers out there who said, well, we can't lose municipal deposits, they're our bread and butter. They form a good piece of our deposit base. So I get it. I get why they feel that way. But in the case of North Dakota, they don't know any different. They've never had the ability to go after state funds. And when, quite honestly, all, all deposits, even municipal deposits initially came to the bank. But there was a referendum or initiated measure back in the 30s that stripped that away from BND and took that back out to private. So I understand that issue completely.

Earl: As I understand it, a couple of years ago, I think the Bank of North Dakota was lending or funding governments and that policy was changed somehow. I may not have that right.

Eric: What do you mean, governments?

Earl: Well, governmental units, subdivisions, local communities in North Dakota, maybe. Or maybe it was infrastructure that you used to lend for infrastructure and that was changed over to private banks, maybe? I'm trying to remember exactly what the change was, but it had something to do with something that the bank was lending for before involving local governments and that it ceased to do. Maybe that doesn't come close enough to ring a bell, but sure.

Eric: There's a couple of things. One is there is an infrastructure fund, which the bank manages. It's not on our books, but it's a separate fund that was established that would fund infrastructure projects around the state. Sewer, Water. Lights. There was a little pushback from the local investment firms, Doherty, who said, well, now you're you're getting in our space. Well, first of all, that was never BNDs concept or idea. That came from the legislature. And so they would counter that argument and say, "Well, we can do this at a rate much cheaper than the private sector could. And we need to help build these communities and their infrastructure. So sorry, guys, we're going to keep doing this." So they started off with $150 million. And I don't know where they're at today, but... So that could be one.

Earl: When you say they, you're referring to who?

Ellen: Started with $150 million.

Eric: Well, I'm saying that they being the private sector investment bankers who were used to going out and selling bonds to fund those projects and then taking a spiff. And so when the state came in and said, well, we're going to dabble here because we have all this oil money, and these cities need help right now. And if we can provide it cheaper than what the investment bankers can out in the open market, then we're going to do that up to this amount.

Ellen: And you did it not as bonds, but as loans, regular loans, right?

Eric: Yep. And then we did it for schools as well. So there was a school fund which had been around that was pped up to do the very same thing.

Earl: Just direct lending to schools?

Eric: Yeah. Yeah.

Earl: Wow.

Ellen: Yeah, I saw an article about that. It was some governments were borrowing from banks rather than on the bond market because it's just a lot cheaper. You don't have to ... and you don't even have to get voter approval. You know, you can just take out a loan.

Eric: In the case of school districts, yes, you did have to get voter approval.

Ellen: Oh, yeah.

Eric: Yeah. That was a requirement.

Ellen: But the underwriting I guess is very expensive somehow. I don't know that whole process but...

Eric: Well.

Ellen: ... you avoid all that.

Eric: Yeah well, I mean you still have underwriting costs but what you... The real savings was in fees that were paid to the underwriters, to the …, to the investment bankers. We could just simply do it a lot cheaper.

Earl: Yeah.

Ellen: Plus, if you have a credit line with a bank, you don't have to spend it. I mean, if you do a bond issue, it's like $1 billion all at once and then you're paying interest on it. Whereas if you have a credit line with a bank, you can just pull out a million at a time.

Eric: Exactly. Yes. I mean, that's a huge point. Ellen, right there.

Earl: I think we are pretty close to covering our issues. The questions. Very interesting.

Ellen: Yeah, very interesting.

Earl: I've learned a lot. I'm going to have to listen to it. Make sure I didn't miss anything.

Eric: But anyway. Yeah, so. That's that's kind of where we landed with the infrastructure. You know, the state, quite frankly, has a lot of money. And so because of the oil, the legacy fund they get...

Earl: Yeah.

Eric: ... 30% off the top of the production tax. And so you literally have hundreds of millions coming in every year. The fund now, I think, is $10 billion or so. And they get to spend the interest income off of that.

Earl: That's a lot of money. Yeah.

Eric: Well, I wouldn't say interest income. They get to they get to spend... Now they're looking at it as you would any kind of endowment fund where you say, okay, I can take 4% of the off the total return and dedicate that. Or 4% of the principal, I guess, would be a better way of saying it. And you would hope that it outpaces that with earnings. But yeah, so they can take up to, I think, 4% of the assets and use that to fund government with and programs. So a lot of money coming in. And so instead of just throwing the money out at cities, what they'll say is, "We're going to create a fund. And you can borrow. We're not giving it to you, but you can borrow at 1%." And that's that's what a lot of these programs, the infrastructure, school fund are at 1 or 2%.

Earl: Wow.

Eric: Much, much lower than market rates. And the fees are as we talked about, very low compared. So they're they're trying to be wise in terms of using this money for a public good.

Ellen: That's great.

Eric: In a way, it's a lot like the bank itself.

Earl: Yeah.

Ellen: So, yeah, that's great. Well, this has been really interesting.

Eric: Any other questions?

Earl: I think I think that pretty much covers it. We really appreciate your time. This is very helpful to us.

Ellen: Yeah, it was great talking to you. Thank you so much.