

Date of Hearing: April 23, 2012

ASSEMBLY COMMITTEE ON BANKING AND FINANCE  
Mike Eng, Chair  
AB 2500 (Hueso) – As Introduced: February 24, 2012

SUBJECT: State government: California Investment Trust: state bank.

SUMMARY: Creates a State Bank in California. Specifically, this bill:

- 1) Establishes the California Investment Trust (Trust) within state government as an independent entity
- 2) Defines "advisory board" as the advisory board of the trust.
- 3) Defines "board" as the board of directors of the trust.
- 4) Defines "California Investment Trust Fund" as a fund established for the deposit and appropriation of state money.
- 5) Defines "financial institutions" as a bank or savings organization, including, but not limited to, banks, savings and loan associations, and credit unions authorized to conduct business in California, and state-chartered commercial banks, trust companies, and savings and loan associations.
- 6) Defines "public funds" as any public funds of any local entity or financial bank.
- 7) Defines "state-chartered bank" as a corporation incorporated, with the approval of the commissioner, incorporated for the purpose of engaging in, or that is authorized by the commissioner to engage in, the commercial or industrial banking business, and, in that capacity, may carry out various powers and duties, including, among others, the receipt of private deposits, and the loaning and investment of money.
- 8) Defines "state money" as all general fund money in the possession of, or collected by, any state agency or department that is not otherwise restricted for expenditure by the California Constitution.
- 9) Provides the purpose of the trust is to:
  - a) Support the economic development of the state by increasing access to capital for businesses and farms within the state in partnership with local financial intuitions.
  - b) Provides stability to the local financial sector without entering into competition with community banks, credit unions, or other financial institutions.
  - c) Reduce the cost paid by the state government for banking services.
  - d) To return profits, beyond those necessary to accomplish the mission and sound operations of the trust to the General Fund.

- 10) Creates a board of directors with the following members: the Governor, or his or her designee, the Treasurer, The Controller, or his or her designee, one member appointed by Senate Rules and one member appointed by the Speaker of the Assembly.
  - a) The Treasurer shall act as the chairperson of the Board.
  - b) Provides that three members constitute a quorum.
  - c) Allows the board to appoint a president of a trust who will be allowed to hire others.
- 11) Creates an advisory board to the board with the following members: a representative from the state's financial industry sector, a representative from the state's small business sector, a representative from the state's agricultural sector, a representative from the state's labor groups, and at least two members shall be officers of state-chartered banks who do not maintain offices outside the boundaries of this state.
  - a) Specifies that the board will appoint positions that shall not exceed 4 year terms.
  - b) Requires the advisory board to do the following: meet regularly to review the trust's operations and finances, make recommendations, and meet with the board.
- 12) Allows the trust to accept deposits of public funds but does not allow the trust to accept deposits of private funds.
  - a) Requires all state moneys to be deposited in the Trust.
  - b) Requires all income earned to become part of the revenues and income of Trust.
  - c) Requires the Trust to pay interest on public deposits at a rate comparable to average statewide rates paid by private depositories of public funds.
  - d) Allows the Trust to offer other financial products to state entities on a competitive basis.
- 13) Allows the Trust to do the following:
  - a) Make loans in the form of participation loans.
  - b) Purchase participation interests in loans made or held by financial institutions doing business in this state.
  - c) Purchase, guarantee, or hold loans originated by financial institutions
  - d) Purchase or hold loans that are insured or guaranteed in whole or in part by the United States.
  - e) Make, purchase, guarantee, or hold loans of instrumentalities of this state.

- f) Purchase or hold loans that are obtained as security pledged for or originated in the restructuring, of, any other loan properly originated or participated in by the trust.
  - g) Invest its funds in conformity with policies of the board.
  - h) Buy and sell federal funds.
  - i) Act as a custodian bank for financial institutions organized under the law of this state.
  - j) Issue bank stock loans to financial institutions organized under the laws of this state and doing the majority of their business in this state.
  - k) For financial institutions that make the trust a reserve depository, perform the functions and render the services of a clearinghouse, including all facilities for providing domestic and foreign exchange.
  - l) Perform all acts and do all things necessary, convenient, advisable, or desirable to carry out the powers expressly granted.
  - m) The bank may not make a loan to any board member, the president, or any officer of the bank.
- 14) Establishes the trust fund in the State Treasury for use by the trust.
- 15) Provides that the board will determine how much of the excess money earned by the trust shall be transferred to the General Fund.
- 16) Requires the board to adopt rules and regulations.
- 17) Requires the State Auditor to contract with an independent auditor for an annual audit of the trust and report to the legislature and the board.
- 18) Requires the Department of Finance and the Controller to examine the bank at least once every 24 months.
- 19) Requires the Treasurer to prepare a report of each calendar month on the General Fund, the trust and every other fund under his or her control, as specified.
- 20) Requires all business of the California Investment Trust to be conducted under the name of the California Investment Trust.
- 21) Specifies that records, as specified, of the trust are confidential and shall not be disclosed to the public.
- 22) Makes various findings and declarations.

EXISTING LAW

- 1) Authorizes the establishment and operation of state-chartered banks, state-chartered credit unions, state-chartered industrial loan companies, and state-chartered savings associations, all of which are overseen by the California Department of Financial Institutions (DFI), and allows for the operation of federally-chartered depository institutions and foreign (out-of-state) depository institutions in California.
- 2) Creates the California Infrastructure and Economic Development Bank (I-Bank), within Business Transportation and Housing (BTH). I-Bank is located within the BTH Agency and is governed by a five-member Board of Directors. The I-Bank was created in 1994 to promote economic revitalization, enable future development, and encourage a healthy climate for jobs in California. The I-Bank operates pursuant to the Bergeson-Peace Infrastructure and Economic Development Bank Act. The I-Bank has broad authority to issue tax-exempt and taxable revenue bonds, provide financing to public agencies, provide credit enhancements, acquire or lease facilities, and leverage State and Federal funds. The I-Bank's current programs include the Infrastructure State Revolving Fund (ISRF) Program, 501(c)(3) Revenue Bond Program, Industrial Development Revenue Bond Program, Exempt Facility Revenue Bond Program and Governmental Bond Program. [Government Code Section 63000 et seq.].
- 3) Requires the Treasurer to receive and keep in the vaults of the Treasury or to deposit in banks or credit unions all moneys belonging to the state.
- 4) Requires the Controller to account for all expenditures as scheduled in the Budget Act including providing a monthly comparison between actual and estimated revenues.
- 5) Establishes various financing programs relating to housing, small business, infrastructure and schools. These programs are administered through multiple agencies under differing goals, processes and reporting requirements.

FISCAL EFFECT: Unknown.

COMMENTS:

AB 2500, if enacted, would create a State Bank in California. The measure creates a board of directors, an advisory board to the board of directors, and specifies that all state moneys shall be deposited into the Investment Trust Fund. The measure also requires the state bank to be audited, adopt rules and regulations, and submit and prepare reports. According to the measure, the purpose of the State Bank is to support economic development, provide stability, and reduce the cost paid by state government for banking and return profits.

Banks are entities that accept deposits and make loans. State governments in 49 states except North Dakota 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.

As of December 31, 2011, California has 178 state-chartered banks and 158 state-chartered credit unions. These numbers do not include federally chartered institutions but poses the question of what can a state bank provide that these institutions cannot?

### BANK OF NORTH DAKOTA (BND)

The only example of a state bank is the BND. In 1919, the state legislature established BND with \$2 million of capital.

BND was charged with the mission of "promoting agriculture, commerce and industry" in North Dakota. It was never intended for BND to compete with or replace existing banks. Instead, Bank of North Dakota was created to partner with other financial institutions and assist them in meeting the needs of the citizens of North Dakota. The State of North Dakota began using bank profits in 1945 when money was first transferred into the General Fund. Since that time, capital transfers have become the norm to augment state revenues. To this point, BND is perceived to be a success.

Today, BND has total assets of \$4 billion and total deposits of \$3.1 billion. It is comparable in size to the 180<sup>th</sup> largest private bank in the nation. Roughly 50% of the bank's loan portfolio consists of loan participations and loan purchases from community banks.

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). BND is examined annually by an independent auditor and every 24 months by the North Dakota Department of Financial Institutions. BND's budget including decisions on salaries, employee headcount and major capital projects are controlled by the legislature.

In May of 2011, the Federal Reserve Bank of Boston released a report titled, "The Bank of North Dakota: A model for Massachusetts and other states?" This report makes several findings which include:

- Financial difficulties of a state bank can exacerbate state fiscal problems.
- North Dakota views the BND as a revenue source rather than a fiscal stabilization tool.
- 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.
- State 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.
- North Dakota's recent economic resilience can be attributable 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.

- Creating a state bank would entail significant startup costs. Massachusetts estimated for their state that an amount of \$3.6 billion would be necessary. California's economy is much larger.
- Beyond the initial capitalization, the state would need to determine a schedule for depositing funds in the newly created public bank.
- The recently enacted Dodd-Frank Act gives federal agencies new authority over large and systematically important institutions (Too BIG To Fail). Due to its potential size, a fully capitalized state-owned bank in Massachusetts likely poses supervisory and regulatory challenges.
- BND's most important role in 2011 was serving as a lending partner for North Dakota's numerous small banks.
- The willingness and capacity of a state-owned bank to offset a serious credit crunch has not been shown.
- With the possible exception of the Great Depression, BND's contributions to stabilizing the state's economy and finances appear to have been relatively minor.

#### NEED FOR THE BILL:

*According to the Author, "AB 2500 is modeled after the Bank of North Dakota and seeks to run a similar program in California to build a strong resilient economy and use the people's collective resources for their own benefit. The mission of the investment trust is to foster growth in agriculture, education, community development, economic development, housing, and industry in the state.*

*Specifically, AB 2500:*

- *Provides stability to the local financial sector without competing against community banks, credit unions or other financial institutions.*
- *Augments the state's general fund with profits earned.*
- *Makes participation loans in conjunction with financial institutions doing business in the state.*
- *Accepts deposits of public funds, not private funds."*

#### OTHER STATES

According to the U.S. Census Bureau, the population size of North Dakota as of 2011 is 683,932. To compare, California has a population size as of 2011, of 37,691,912. This is a drastic difference. California also has the 8<sup>th</sup> largest economy in the world.

In 2011, at least 11 states looked into creating state banks. These states included Illinois, Virginia, Hawaii, Oregon, Washington, Massachusetts, Maryland, Arizona, Vermont, California and Maine. Most of these states introduced measures to study the concept of a state bank. Not one State has been successful in creating a State Bank except for the BND in 1919.

In the 1970's at least six states explored starting a state-owned bank; these states were Colorado, Maine, New York, New Jersey, Oregon and Washington. At that time, as well, not one state was successful in creating a state-owned bank.

### MASSACHUSETTS

In 2010, Massachusetts introduced SB 2331 which created a study on whether to implement a state owned bank. Massachusetts was successful in creating a study of a State Bank. Following the study in 2011, Massachusetts decided not to pursue a state-owned bank following the study because the study found:

- It would require significant initial capital investment without a proven need to justify the investment.
- Given the vast differences in the banking industries and economies of North Dakota and Massachusetts, the only existing model is inadequate to provide guidance.
- The bank's public funds would be exposed to an unacceptably high risk, would be used to provide risky gap financing, and would need to match the current rate of return earned under the management of the treasurer.
- Infrastructure investment in Massachusetts is much more established than in North Dakota.
- Massachusetts already has a large network of public and quasi-public agencies and nonprofits that offer various lending programs and services, including lending to support infrastructure.

### CALIFORNIA

In 2011, Assemblymember Hueso introduced AB 750 which would have created a task force to look into the feasibility of a State Bank. AB 750 passed out of the Assembly Banking and Finance Committee with a 10-1 vote. The Governor stated in his veto messages that "This bill would mandate yet another "blue ribbon" task force: in this case to examine whether California should establish a state bank. This is a matter well within the jurisdiction and competence of the Assembly and Senate Banking Committees."

Although AB 750 was vetoed, it is the opinion of the Committee that a study still needs to take place prior to the creation of a State Bank. The Legislature does not have enough information and data relevant to California as to the benefits and/or consequences to creating a State Bank.

### POOLED MONEY INVESTMENT ACCOUNT (PMIA)

The PMIA, created in 1955, governed by the Pooled Money Investment Board (PMIB) has the responsibility for administering an effective cash management and investment program. The PMIA manages all monies flowing through the accounts in the State Treasury and keeps all available funds invested consistent with and subject to the goals of safety, liquidity and yield. The PMIA has three primary sources of funds: State general fund, special funds held by state agencies, and moneys deposited by local jurisdictions in the Local Agency Investment Fund (LAIF). Moneys in the PMIA can only be invested in U.S. government securities, securities of

federally-sponsored agencies, domestic corporate bonds, interest bearing time deposits in California banks, savings and loan associations and credit unions, prime-rated commercial paper, repurchase and reverse repurchase agreements, security loans, banker's acceptances, negotiable certificates of deposit and loans to various bond funds.

#### ARGUMENTS IN SUPPORT

*According to the Public Banking Institute, "The California Investment Trust will strengthen economic and community development. By providing loans in partnership with community banks to individuals and businesses, the California Investment Trust will eliminate fees currently paid by state government for banking services, and will combine these savings with additional revenue generated through various operating activities.*

*AB 2500 will create the California Investment Trust and model it after the highly successful Bank of North Dakota. In response to current economic challenges, several states, including Maine, Oregon, Washington and Rhode Island, have considered the creation of a state bank"*

#### ARGUMENTS IN OPPOSITION

*According to the California Treasurer, Bill Lockyer, "AB 2500 would detrimentally overlay the current centralized treasury system as well as requiring capitalization and long-term investments which would further complicate the state's ability to meet its obligations, especially while the state continues to suffer from structural imbalance of revenues and expenditures, resulting in chronic shortages of cash and scarce reserves. In addition, the types of investing proposed as permissible for the Investment Trust would significantly increase the risk of losses to earnings and principal, losses that would be shouldered by the General Fund."*

#### QUESTIONS:

- 1) What information exists that establishes that California needs a state bank? AB 750 (Hueso) of 2011 was on the right track with trying to gather the necessary information to support or not support a State Bank in California.
- 2) What problem exists that a state bank will cure? Considering California's budget shortfall and the state's credit rating, should California take on the responsibilities of having its own State Bank? According to the S&P, California has an A- rating, S&P's fourth-lowest investment grade and the lowest of any state.
- 3) Where would California get the money to capitalize a State Bank?
- 4) How would AB 2500 save California money? The measure creates a new entity, with new positions and responsibilities.
- 5) Considering a state bank may not be FDIC insured, what happens if the bank fails?
- 6) Should California be encouraging private financial institutions to establish branches that provide tax revenue to the state rather than establish a tax-exempt state bank that will compete with local, established financial institutions?



AMENDMENTS:

Should this measure move forward as currently drafted, the author will need to make several technical and substantive amendments to clarify and clean up the language.

The Committee is recommending that the contents of AB 2500 be deleted and language creating a study be implemented to further look into whether a state bank should be established in California. Evidence from the Massachusetts study shows that it is very important to study the feasibility before investing energy into building a state bank which is not a small task for any state to take on.

REGISTERED SUPPORT / OPPOSITION:

Support

Contra Costa Interfaith Supporting Community Organization  
Hollywood Adventist Church  
PICO California  
Public Banking Institute  
Most Holy Trinity Church – PACT  
Town of Fairfax  
6 Individuals

Opposition

California Bankers Association (CBA)  
California Independent Bankers (CIB)  
California State Treasurer

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