

Joint Informational Hearing
Assembly Banking and Finance Committee
Assembly Local Government Committee

Public Banks: An Examination of Public Banking at the Local Level

Monday, February 4, 2014
3:30 pm, Room 444

1. **Hearing Goal.** The goal of this hearing is to provide information to members of the Legislature about public banking at the local level. Multiple studies have been conducted in recent years to determine the feasibility of forming public banks and address the following questions:
 - What is the history of public banking?
 - What are the associated benefits and risks?
 - Is it appropriate to utilize public taxpayer dollars in such a manner?
 - What restrictions should be placed on local public banks?
 - What services and products should local banks provide?

To answer these questions, and to help inform any future legislative efforts, the Committees will hear from experts, practitioners, and other stakeholders.

2. **What is public banking?** A “public bank” is a national or state-chartered depository institution owned by a government entity.¹ Except for public ownership, other features and purposes of public banks are not universally agreed upon. When voicing support for public banks, proponents have cited the following potential benefits:
 - Providing capital at a lower cost than the private sector to preferred uses (e.g., public infrastructure projects, affordable housing, small businesses, unbanked/underbanked).
 - Reducing costs to the government for banking services.
 - The opportunity to invest public funds in a way that reflects the values of the electorate.
 - The ability to divest public funds from commercial banks that provide financing to industries that advocates do not like (e.g., fossil fuel producers, prison operators, gun manufacturers).

Note: Although some proponents of public banking have stated that a public bank could serve the cannabis industry, the Committees decided that the cannabis banking problem is not within the scope of this hearing. Federal law related to cannabis adds layers of complexity that could obscure and overwhelm the underlying merits and challenges of public banking. The focus of the hearing will be on the intersection of public banking and local governments. For a thorough analysis of a public bank to serve California’s cannabis industry, please see the report commissioned by the California Treasurer in 2018.²

¹ Theoretically, a public bank can be established at the federal, state, or municipal level, assuming a legal framework has been adopted by the appropriate governing bodies.

² <https://www.treasurer.ca.gov/comm-external-urls/cannabis-feasibility-full-report.pdf>

3. **Public Banks in Operation.** There is only one public bank operating at scale in the United States – the Bank of North Dakota (BND). BND was founded in 1919 by the state legislature to support the state’s farmers. BND is the state’s exclusive depository institution and also serves local governments, which can voluntarily elect to deposit funds in the bank. Importantly, BND does not compete with private financial institutions. Rather, it partners with local banks and credit unions. These private financial institutions originate the loans, apply to participate in one of BND’s programs, and then BND provides capital to participate in the loan with the private financial institution.

There are several examples of public banks operating outside of the United States. Germany’s Sparkassen and Landesbanken networks serve consumers, businesses, and governments. The Japan Finance Organization for Municipalities provides funds to local governments in Japan. While international examples show that public banks are possible, the differences in regulatory and legal frameworks between countries may inhibit these examples from providing much information for how public banking could work in California.

4. **Recent Efforts on Public Banking.** On the heels of the 2007-08 financial crisis, renewed interest in public banking has sparked legislation or feasibility studies in state and local governments around the United States. To date, no state or local government has established a public bank. Feasibility studies often find significant start-up costs and high levels of financial and operational risk associated with public banks.

California

Two bills were introduced in the 2011-12 Legislative Session. AB 750 (Hueso) would have created a task force to study a public bank at the state level. The bill was approved by the California Legislature but vetoed by Governor Brown who said the matter was “well within the jurisdiction and competence of the Assembly and Senate Banking Committees.” AB 2500 (Hueso) would have established a public bank at the state level. The bill was never heard in policy committee by request of the author.

Los Angeles

In 2017, the City Council of Los Angeles requested a report on the feasibility of a Municipal Bank of Los Angeles. The report was written by the Chief Legislative Analyst and submitted to the Council in February 2018. The report identified a number of risks associated with establishing and operating a municipal bank and necessary legislative changes prior to establishing a bank. Following this report, Council placed an initiative on the November 2018 ballot to amend the city charter as a first step to establishing a public bank. The initiative was rejected by voters with 44% voting “yes” and 56% voting “no”.

San Francisco

The City and County of San Francisco established a task force in 2017, facilitated by the County Treasurer’s Office, to investigate the feasibility of a municipal bank owned by the City. The task force has convened stakeholder meetings and solicited opinions from banking experts to inform its analysis and recommendations. The final report of the task force is expected to be published in February 2019.

Seattle

The City of Seattle commissioned a feasibility study that was published in October 2018. The report concluded that “creating a public bank in Seattle would be at best a long-term process, requiring numerous layers of regulatory review and eventual compliance with a restrictive slate of limitations on its capacity to lend and raise capital.”

Washington

The state legislature provided \$480,000 in 2018 to fund a feasibility study, which is ongoing. Separate from the feasibility study, the State Treasurer conducted a “study of studies” which analyzed twelve studies that had been produced by cities and states around the country. Based on that study, the Treasurer concluded that he does “not support public banking because of the higher risk and lower return on investment compared to the current private banking system.” He stated that using taxpayer funds or state pension assets to capitalize a public bank “would be reckless.”

5. **Local Government Finances.** Local elected and appointed officials are charged with a fiduciary duty to the public. They are responsible for guiding multi-million dollar county and municipal agencies that depend on numerous sources of revenues and have multiple layers of policy and management responsibilities. Understanding their financial fiduciary responsibilities is one of their most important duties.

Many factors dictate how a local agency manages its funds, including: the amount of revenue the agency receives annually; the source of the revenue, whether it be property taxes, sales taxes, fee-based revenue, utility taxes, grants, loans, bond funding, etc.; restrictions on how these funds can be used; and, many other dynamics in which each local agency is accountable. No two local agencies manage their finances in the same way. In order to balance the individual agency needs, the State, both constitutionally and statutorily, has provided local agencies with decision making flexibility in how finances can be managed.

Traditionally, large, commercial banks provide most of the banking services for local agencies. Agencies with larger budgets often require the services of these national banks due to the size and complexity of their banking needs. These banks are for-profit entities, and services are not free. Some local governments also receive banking services from credit unions and community banks. However, the amount that can be deposited in these entities is strictly limited, often making it more difficult and less efficient for local agencies to utilize the services provided by credit unions and community banks.

Banks are subject to a number of requirements when they receive funds from local agencies. Requirements, such as federal insurance and collateralization, decrease the amount of risk local agencies assume when making investments. Local agencies are authorized to invest surplus revenues in many different types of financial mechanisms. However, due to the financial fiduciary duty that local officials carry, they are obligated to make reliable investments.

Investing public dollars carries risk. For example, Orange County filed for federal bankruptcy protection in 1994 because of a \$1.7 billion loss to its Investment Pool, a depository for County surplus and borrowed funds and funds of 196 other cities, school districts and special districts. Subsequent hearings of the Senate Special Committee on Local Government Investments

brought to light questionable and sloppy investment practices and lack of prudent oversight on the part of some local officials.

As a result of the hearings, the Legislature enacted a number of bills to increase protections and address these problems, including SB 866 [(Craven), Chapter 784, Statutes of 1995] and SB 109 [(Kopp), Chapter 749, Statutes of 1996], which, among other requirements:

- Provided that a county treasurer is a trustee and fiduciary subject to the prudent investment rule.
- Established a local investment oversight committee.
- Called for treasurers to render annual investment policy statements to their governing boards required to be considered at a public meeting.
- Defined permitted investment instruments that local agencies can invest in.

6. **Relevant Existing Law.** Creating a public bank at the state or local level in California would require changes to state law. Additionally, approval from federal regulators may also be necessary, depending on how the public bank is structured.

California Banking Law

State law provides for the formation of a corporation for the purpose of conducting a commercial banking business (Financial Code Section 1000 et seq.). In order to become a bank, a corporation must apply for a charter with the Commissioner of Business Oversight. State law does not specify if a government entity can receive a bank charter. New legislation could make such a specification. Alternatively, the Commissioner of Business Oversight could issue a legal opinion that clarifies existing law, but such an opinion could be challenged in the courts.

Local Agency Security

The Commissioner of Business Oversight administers the Local Agency Security Program (Government Code Section 53661). This law specifies that banks secure specified collateral to protect deposits received from local agencies (i.e., county, city, city and county, including a chartered city or county, a community college district, or other public agency or corporation in California). In order to make loans, a public bank holding deposits primarily from local agencies would need an exemption from the collateral requirements. Such an exemption would expose the local agency deposits to a greater risk of loss.

Financial Institutions Law

State law requires banks to insure deposits with the Federal Deposit Insurance Corporation (FDIC). The FDIC may not approve a public bank for acceptance into the deposit insurance program. If accepted, the public bank would be subject to supervision and regulation by the FDIC. State law could be amended to exempt a public bank from the FDIC insurance requirement. Such an exemption would expose local agency deposits (up to the FDIC insurance amount of \$250,000) to a greater risk of loss.

Bergeson-Peace Infrastructure and Economic Development Bank Act

State law created the California Infrastructure and Economic Development Bank (the IBank) in 1994 (Government Code Section 63000 et seq.). The Legislature wanted a financing entity structured with broad authority to issue bonds, provide guarantees, and leverage state and federal funds using techniques that target public investment to facilitate economic development. The

IBank is not a depository institution and not a “bank” according to state law. Some proponents of public banking have proposed the conversion of the IBank to a depository institution. Such a conversion might allow the IBank to expand its existing programs and offer more low-cost loans to local agencies for infrastructure and economic development projects. The conversion of the IBank to a depository institution poses operational risks and implementation challenges that could negatively impact the effectiveness of existing IBank programs.

Federal Reserve Act

Federal law provides for the establishment of the Federal Reserve System. The law allows for state-chartered banks to join the Federal Reserve System. A public bank would need to be a member of the Federal Reserve System if it wants to access critical systems and networks that connect the commercial banking system. The law grants discretion to the Board of Governors of the Federal Reserve System to accept or reject an application based on the financial condition of the applying bank, the general character of its management, and whether or not the corporate powers exercised are consistent with the Federal Reserve Act. Even if state and local laws permit the establishment of a public bank, the public bank would still need approval from the Federal Reserve to connect with the rest of the banking system. Failure to receive approval from the Federal Reserve would severely impact a public bank’s ability to operate.

7. **Additional Resources.**

Beitel, Karl, Roosevelt Institute, *Municipal Banking: An Overview*. April 2016. <http://rooseveltinstitute.org/municipal-banking-overview/>

Beitel, Karl, Roosevelt Institute, *The Municipal Bank: Compliance, Capitalization, Liquidity, and Risk*. July 2016. <http://rooseveltinstitute.org/municipal-bank-regulatory-compliance-capitalization-liquidity-and-risk/>

Brousseau, Fred, Budget and Legislative Analyst, City and County of San Francisco, *Community Supportive Banking Options 2017 Update*. November 2017. http://s79f01z693v3eco3yyjsg1.wpengine.netdna-cdn.com/wp-content/uploads/2017/12/BLA.CommunitySupportiveBanking_112717.pdf

Davidson, Duane A., Washington State Treasurer, *Study of the Studies: A comprehensive review of state, municipal, city and public banking*. October 2018. <https://tre.wa.gov/wp-content/uploads/Public-Banking-Report-Study-of-the-Studies.pdf>

HR&A Advisors, on behalf of City of Seattle, *Public Bank Feasibility Study for the City of Seattle*. October 2018. <http://councilconn.wpengine.netdna-cdn.com/wp-content/uploads/2018/10/HR-A-Advisors-Public-Bank-Feasibility-Study.pdf>

Tso, Sharon, Chief Legislative Analyst of Los Angeles, *Public Bank Framework and Existing Housing and Economic Development Funding Programs*. February 2018. http://clkrep.lacity.org/onlinedocs/2017/17-0831_rpt_CLA_02-26-2018.pdf