

# **PUBLIC BANK FEASIBILITY STUDY**

*for the City of Seattle*

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City of Seattle  
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To the people and City of Seattle:

HR&A Advisors is proud to present this feasibility study concerning the City's development of a public bank. For over 30 years, HR&A has worked at the forefront of urban change, building capacity in cities around the world, from developing innovative economic development entities, to leading publicly-accountable procurements, to reviewing public incentives and guiding hurricane recovery and resilience strategies.

Given our history of helping cities think about new ways to respond to unique challenges, we were thrilled to be selected for this project, viewing it as a way to help the City of Seattle take a bold new step in creating a much-needed alternative to our current financial system that would maximize the City's independence and free up capital for public priorities such as housing and infrastructure.

Equally, therefore, we were dismayed when we discovered the sheer complexity of the proposal: current laws and regulatory structures meant 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.

Despite these barriers, however, we are still optimistic about the idea of a public bank. In concept, a public bank be a new kind of financial institution directly accountable to local values. It would retain of investment and profits in local markets and could provide new financial services to constituencies that need them. These benefits are real, and though the current legal and regulatory environment makes the implementation of a fully-fledged public bank difficult, it does not preclude gradual changes that work to make these goals a reality or, since laws are made by the people, legal change to guide implementation.

The current legal and regulatory environment for banks in the United States came about during a time when banking services were universally provided by unaccountable, and often unstable, private-sector entities. Then as now, these institutions put short-term profits ahead of duty to depositors and communities. Forged over a hundred years of perennial crises, current banking laws and regulatory norms, naturally resist change, which is why new ideas, such as public banks, are difficult to implement.

The idea of a public bank, however, as a financial institution explicitly oriented towards the public good and directly accountable to publicly-elected bodies, flips this model on its head. Indeed, many of the "barriers" to public bank implementation under the current system—the need for FDIC insurance, protections governing public depositories, and intensive charter review, for instance—were created to safeguard the public against private institutions oriented towards profit. Though a public bank is forced to contend with these regulations as its opposition, it is motivated by the same goal—protecting the public from an unaccountable, irresponsible financial system. It does so by providing an alternative to the system itself.

As the nation's incubators of policy change, cities have a vital role to play in developing this alternative model and a regulatory framework that accommodates it. After all, cities were the first entities to create so many innovative government structures now vital to American life: public housing, direct assistance to the poor and infirm, public-private partnerships for infrastructure and service delivery, and public utilities. Cities play this role because they have the most direct connection of any government entity to their citizens and,

therefore, an acute obligation to step in when market activity works against the public good. Given this history, it is unsurprising that the idea of a public bank has arisen from the grassroots.

Creating a public bank is sure to be long-term, whether Seattle decides to work within the current system or seeks to change it. However, as the City moves forward, we are grateful to have played a small part in its pursuit of a more equitable financial system and look forward to being a resource in the time to come.

We are incredibly grateful to the City Council and to the members of our stakeholder group, both of which helped us greatly during the study. We look forward to continuing to work in this field in the future and to seeing how Seattle advances towards its goal of a more equitable financial system.

All the best,

A handwritten signature in black ink, appearing to read 'Andrea', with a long horizontal line extending to the right.

Andrea Batista Schlesinger  
Partner, HR&A Advisors, Inc.

**EXECUTIVE SUMMARY**..... 1

**INTRODUCTION**.....6

    What is a Public Bank?..... 6

    Efforts in Seattle to Date..... 7

    Research Purpose..... 8

    Summary of Seattle’s Current Banking Relationship..... 9

**FEASIBILITY OF THE BASELINE MODEL**..... 11

    Introduction to the Baseline Model..... 11

    Authority to Charter a Bank..... 11

    Administrative Factors Impacting the Award of a Charter..... 12

    Composition and Performance: Private Sector Examples..... 12

    Availability of Funding and Start-Up Capital..... 15

    Public Depository Requirements..... 16

    Return Expectations under the Lending Constraints ..... 16

**FEASIBILITY OF SECONDARY ACTIVITIES**..... 18

    Secondary Activities..... 18

    Providing Loans to the Public..... 18

    Accepting Retail Deposits..... 18

    Serving Cannabis-Related Businesses..... 20

**CONCLUSIONS AND NEXT STEPS**..... 21

**APPENDICES**

- Appendix A: ComplYmentary Strategies and Alignment with City Goals
- Appendix B: Legal Memorandum (Pacifica Law Group)
- Appendix C: Stakeholder Group Feedback Workshop Presentation (October 1, 2018)

The past quarter-century has been a period of rapid change for American cities and of rapid innovation for their governments. As cities re-assert their role as centers-of-gravity of regional commerce and population, they must accommodate ever-growing demand for services and infrastructure with a scarcity of funds, all while renewing their commitment to equity. In large part, cities have answered this call by becoming leaders in innovation—developing policies and institutions that rethink the public sector’s relationship to various segments of the economy including education, housing, infrastructure, and transportation.

In this context, supporters of publicly-owned banks have imagined financial institutions “operated in the public interest ... owned by the people through their representative government”<sup>1</sup> as an innovative way to ensure civic independence from the banking industry, provide fiscal savings to governments, and offer banking services not supplied by the market. Although public banking in the United States lacks precedents at the municipal level, successful implementations such as the Bank of North Dakota, Territorial Bank of American Samoa, and Tribally-owned banks, as well as international examples such as Germany’s *Sparkasse Finanzgruppe* and Japan’s Finance Organization for Municipalities, demonstrate that, given a compatible regulatory and legal framework, public banking can thrive alongside private institutions.

Now, having resolved to discontinue its use of Wells Fargo, Seattle is exploring the idea of creating its own public bank in pursuit of the public interest. The enormity of this task cannot be overstated: Seattle would be among the largest cities to ever consider forming a public bank and, if successful, the only one to implement such an institution. This study addresses the legal, regulatory, financial, and administrative feasibility of a Seattle-owned public bank based on City Council resolutions 117845,<sup>2</sup> which required the City consider socially responsible banking practices when selecting vendors for depository services, and 118905, which called for the City to discontinue its use of Wells Fargo as a banking services provider.<sup>3</sup> Additionally, we draw on study questions issued in a public RFP for this study on February 2018.<sup>4</sup>

Our analysis considers both the City’s primary goal to discontinue its use of Wells Fargo and secondary goal to provide banking services to the public. We therefore organized our analysis into a baseline model that would accomplish the City’s first goal, and an analysis of secondary activities that would fulfill its second. In the **baseline model**, the City is the sole depositor of the bank, which attempts to replicate the banking services that the City currently receives from Wells Fargo. The **supplementary activities** that we assess are those in which the City does not currently engage, whether by itself or through a banking partner, including accepting retail deposits, extending loans to private citizens, and providing services to the cannabis industry. Applying this framework, we find that:

- (1) **Establishing a public bank along the lines of the baseline model is not forbidden by state or federal law but would be highly challenging in the current regulatory environment.** It would require approval by state and federal agencies, which may be reluctant to act without a clear precedent. Establishing the bank would also require a commitment of capital. Thus, the City will need to make trade offs between its desire for banking services that are consistent with its values and the financial feasibility of the public bank.
- (2) **Taking on supplementary activities would increase the complexity of the bank, adding time and cost to the establishment process.** Some activities, such as accepting retail deposits and issuing loans

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<sup>1</sup> Public Banking Institute. [Intro to Public Banks](#).

<sup>2</sup> [CB 117845](#).

<sup>3</sup> [CB 118905](#).

<sup>4</sup> Public Bank Feasibility Study; RFP #LEG2018-0004. City of Seattle.

using public funds, would require additional regulatory approvals. Others, such as issuing loans to the general public or serving cannabis-related businesses, would require changes in state or federal law.

- (3) **The necessity of these approvals, many of which are contingent upon cooperation from regulators and public-buy in, as well as enough commitment of capital, render the public bank as a replacement for Wells Fargo’s services technically feasible, though likely a long-term process.** If the City should decide to move forward, it could take on complementary strategies—such as seeking a new banking service provider, expanding its use of quasi-bank loan funds and other tools, and partnering with local financial institutions to pave the way to a public bank.

Additional discussion of findings within each section as well as potential next steps follows.

### **BASELINE MODEL: REPLACING WELLS FARGO**

- The baseline model represents the most feasible option from a legal and regulatory perspective in that it requires the fewest changes to existing law. By operating without retail deposits, it avoids the need for Federal Deposit Insurance Corporation (FDIC) insurance. By refraining from making loans and investing nearly all public deposits in low-risk collateral, it meets the collateralization requirements issued by the Washington Public Deposit Protection Commission (PDPC).
- To establish the bank, the City must first amend its charter to grant itself the authority to engage in banking activities. Amendment of the charter is a political process, requiring Council authorization and a public referendum. A business plan that defines the parameters of the bank would help it make the case for passage to these bodies.
- In addition, the bank must seek approval from State agencies. This includes obtaining a commercial charter from the Washington Department of Financial Institutions (DFI), which has never approved a public bank but has participated in the state-level public banking discussions and obtaining licensure as a public depository from the PDPC. Regulators care deeply about the level of risk to which the bank is exposed and would scrutinize its ten-year financial plan as well as its insulation from conflicts of interest. They would also look to their peer agencies for guidance on approval.
- Additionally, the bank must seek approval from the Federal Reserve Bank to access its national payment system, to which other public banks have gained access only after lengthy scrutiny: the Territorial Bank of American Samoa, for instance, waited two years for Federal Reserve access, while the median processing time for a *de novo* financial institution applying for Federal Reserve membership in 2017 was 14 days.<sup>5</sup>
- As a precondition for approval by regulators, the City must establish the corporate independence of bank management from political interference and must commit to funding the bank in the long term, even in the event of a change in City administration. In other words, to receive a charter, the City must define the bank’s mission in its application and explain how it will balance its financial feasibility with social purpose and how bank management will prioritize these motivations amid a potential conflict of interest. Regulators would have to be assured that the City would not seek to alter the mission of the bank or exert influence over its funding following its charter.
- Current state law will constrain the public bank’s scope of activities, which will limit asset yields<sup>6</sup> and balance sheet size.<sup>7</sup> Thus, the baseline model bank may struggle to achieve financial feasibility in

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<sup>5</sup> Federal Reserve. [Semiannual Report on Banking Applications](#). 2017.

<sup>6</sup> Low-risk collateral investments, mandated by the PDPC, typically have lower returns than loans.

<sup>7</sup> Since the City is the sole depositor in the bank, its balance sheet would be limited to the City’s commitment of funds.

early years. Furthermore, its limited income stream may necessitate ongoing financial support to cover start-up costs and the ongoing expense of managing the City's high volume of transactions.

- Compared to the existing relationship with Wells Fargo, the baseline model will not provide cost savings. The bank will have higher overhead costs and therefore have a likely need for ongoing subsidy in the form of capital contributions and the opportunity cost of forgone income from the City's investment account, which currently contains the bulk of the City's liquid assets available for investment in the bank. Thus, the City will not be able to redirect any savings toward pursuing public interest goals, such as additional investments in affordable housing.

### **SUPPLEMENTARY ACTIVITIES**

- Engaging in supplementary activities such as lending and accepting deposits from the general public is possible with additional regulatory signoff, though certain activities, such as lending to the general public or serving cannabis-related businesses would require changes in state and federal law.
- Under current public depository requirements, any bank that accepts public deposits must provide collateral equal to between 50% and 100% of these funds. In the case of an institution where the City is the sole depositor, this effectively prevents the City from lending using its own funds, since these deposits must largely remain collateralized. For the bank to lend using City deposits, it will require either a discretionary exception from the Public Depository Protection Commission (PDPC), allowing it to use these deposits for higher-risk, non-collateral investments, or a change to state law allowing these uses. Additionally, public agencies other than the City such as retirement funds and public utilities are also subject to these restrictions. "Collateral" is narrowly-defined by the PDPC to only include assets that can be rapidly liquidated and therefore excludes assets such as real estate and core infrastructure.
- Furthermore, the state constitution forbids lending to private individuals and corporations beyond the "poor and infirm." If the bank were to extend loans, it would be limited to doing so only with borrowers classified as "poor or infirm" unless it sought to amend the state constitution.<sup>8</sup>
- For the bank to accept retail deposits from the general public, it likely needs to obtain FDIC insurance as a condition of approval for a state banking charter. Given lack of precedent, FDIC approval represents a distinct and unproven challenge.
- Based on federal precedent, providing services to the cannabis industry likely precludes access to the Federal Reserve payment system. Without such access, the bank could not transact with other financial institutions and so would be functionally unable to issue or accept payments.

### **POTENTIAL NEXT STEPS**

Above all, the City Council must determine whether a public bank represents the most appropriate strategy to support these goals and whether alternative models may be better suited to reach these objectives. For a brief discussion of alternative models that complement these objectives, refer to Appendix A: Alternative Models and Alignment with City Goals.

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<sup>8</sup> According to the Washington State constitution, local governments are precluded from extending credit to the general public except for the "poor and infirm."

If the City elects to move forward with pursuit of the baseline model discussed above as a means of severing its ties with Wells Fargo, HR&A proposes the following next steps. These steps are intended to illustrate the complexity of the process of creating a municipal bank since the actual implementation will necessarily vary depending on political context and the willingness of regulators to cooperate with the City.

Though these steps present a path for moving forward in the current legal and regulatory environment, success will require successful engagement of a wide variety of stakeholders including the Council, state and federal regulators, the general public, and the City's Department of Financial Institutions. This engagement includes at least two legislative commitments by the City Council—amending the City's charter and appropriating start-up funds—as well as a public referendum, and no less than three applications to federal and state regulators, each of which would be subject to a period of evaluation and review. Therefore, we feel the City should carefully weigh the difficulty of establishing its bank against perceived benefits.

First, the City would have to engage in the following activities to **define the parameters of the bank** as well as **organize internal resources** necessary to its creation:

- To start, the City should **authorize and conduct a business planning study** and draft **articles of incorporation** for the bank, specifying sources of start-up and long-term capital, a governance structure, and assessment of market opportunity and risk. Such a business plan would be required to define the scope of the City's charter amendment and seek approval from state and federal regulatory bodies.
- Second, the City should **amend its charter** to expressly allow for it to engage in banking activities, which requires a vote of the City Council and public referendum.
- Finally, the City should **dedicate start-up capital and long-term funding for the bank** contingent on regulatory approval. Presumably, start-up capital would be allocated through an appropriation from the general fund and long-term funding would be secured through a reallocation of capital from the City's investment pool, though sources such as philanthropy or a bond issue could provide alternative sources.

With a board of directors in place, capital committed, and start-up funds secured, the bank would seek **regulatory approval** from the following state and federal bodies:

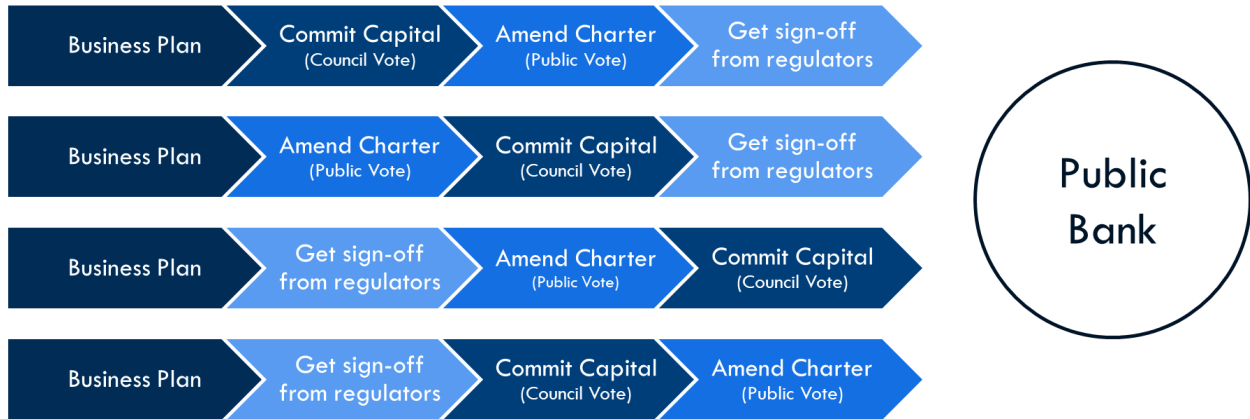
- First, the bank would apply for a **state banking charter** with DFI. A banking charter would allow the bank to begin receiving capital and commence applications to the Federal Reserve, PDPC, and optionally, the FDIC.
- Second, upon receipt of a banking charter, the bank would apply for **public depository status** with PDPC. Public depository status would certify the amount of public deposits the bank would be allowed to accept.
- Concurrently, the bank would apply for access to the **Federal Reserve payment system**. The Federal Reserve system is a requirement for making and receiving payments and so, though a bank may, for a brief time, be chartered without Federal Reserve approval, it would not be able to engage in any transactions without it.

Upon receiving these approvals, the bank would be cleared to accept the City's deposits and begin normal operations. Notably, regulatory approvals and capitalization could take place in any order, as shown by the chart below, though order is dependent on the risk-tolerance of each subsequent body. For instance, the public may be willing to approve a charter amendment without regulatory approval, but regulators may want to see a charter amendment and/or commitment of funding before approving the bank.



**Figure 1: Potential Order of Next Steps**

Source: HR&A Advisors, Inc.



Since, as in most *de novo* public institutions, the bank’s operational competence and efficiency will improve over time, we recommend that the City gradually phase out its operations with Wells Fargo, allowing the bank to take on an increasing share of operations over time. Furthermore, to engage in secondary activities beyond the baseline model, including the extension of loans using public funds and accepting deposits from the general public, the following actions are required:

- To extend loans from public deposits, obtain a collateral requirements waiver from PDPC. Even if the PDPC did ease these requirements, however, the bank would still be limited by the State constitution in the loans it could extend.
- To accept deposits from the general public, obtain FDIC insurance and amend the state banking charter. No financial institution in Washington that accepts public deposits has ever been chartered without FDIC insurance. Additionally, the FDIC has never provided insurance to a public institution. As such, this represents an area of great uncertainty with regard to regulatory feasibility.

As discussed above, the success of these steps relies on the cooperation of several political constituencies and regulators and will likely require many years of sustained effort. We find the creation of a public bank for the City of Seattle feasible, but challenging, given these constraints. Therefore, the City should carefully weigh the benefits of its proposed bank against the capital and effort required to create it without a change in the regulatory and legal framework.

## WHAT IS A PUBLIC BANK?

The terms “public bank” and “municipal bank” have been used to describe a bank owned by a public entity. The latter term applies specifically to institutions owned by city governments. Beyond the core concept of public ownership, however, there is little consistent definition of the term.<sup>9</sup> Policymakers have used the word “bank” to encompass many types of organizations, such as depository institutions, loan funds (including infrastructure banks), and Community Development Financial Institutions (CDFIs) (which may or may not be banks). In this study, we use “bank” to mean a national or state-chartered depository institution,<sup>10</sup> i.e. an institution with the authority to accept deposits, whether from the general public or other entities. Other typical banking activities such as making loans can be performed by non-bank institutions, including CDFIs or loan funds. Although no municipality has ever established a public bank in the US, precedents do exist, enabled by state, territorial, or sovereign Tribal law.

- The Bank of North Dakota (BND), founded in 1919, is the country’s largest public bank with \$7B in assets.<sup>11</sup> Granted a charter by the North Dakota legislature, the BND serves as the State government’s exclusive depository and also accepts deposits from local governments, which voluntarily choose whether to deposit funds in the bank. The BND also partners with community banks in the state to issue loans to farmers, school districts, and students. Nevertheless, it does not accept deposits from the general public or provide retail banking services.
- The Territorial Bank of American Samoa (TBAS) provides retail banking services including depository accounts and loans to the Island’s 55,000 residents, who had previously been served by just three retail banking branches. It does not currently provide depository services to the Government of American Samoa, though local law allows it to accept public deposits.<sup>12</sup> Although the bank was first chartered in 2016 by the territory, it required two years to receive approval from the Federal Reserve to access the national payment system.<sup>13</sup> As of May 2018, TBAS held \$8.7M in deposits and \$2.9M in loans, making it among the smallest depository institutions in the United States.<sup>14</sup>
- American Indian tribes currently own and operate 19 banks with a total \$2.5B in assets<sup>15</sup>. The Federal Office of the Comptroller of the Currency (OCC) regulates these institutions, which tribal governments may establish themselves or purchase by becoming a controlling shareholder in an existing bank. Because tribal governments enjoy legal sovereignty in their jurisdictions, these banks are exempt from many state and federal regulations. By avoiding state restrictions on public deposits, for instance, they can leverage tribal funds for loans and investments. Nevertheless, tribal banks must still meet federal regulatory requirements to participate in interstate banking services, such as the Federal Reserve’s payment system and FDIC insurance.

Internationally, a variety of public and quasi-public institutions provide banking services for both private citizens and municipalities, such as Germany’s *Sparkasse Finanzgruppe* and Japan’s Finance Organization for Municipalities. While these models demonstrate the general viability of public banking, they do not directly apply to municipalities in the US due to distinct regulatory and legal frameworks.

<sup>9</sup> Beitel, Karl. *Municipal Banking: An Overview*. Roosevelt Institute. 2016.

<sup>10</sup> FDI Act Section 3.

<sup>11</sup> *Annual Report*. Bank of North Dakota. 2017.

<sup>12</sup> “Territorial Bank of American Samoa Details Its Origins.” Samoa News. May 2018.

<sup>13</sup> Blackwell, Rob. “American Samoa finally gets a public bank.” *American Banker*. April 30, 2018.

<sup>14</sup> “TBAS Opens Master Account at Federal Reserve bank” Samoa News. June 2018.

<sup>15</sup> *Indian Banks Small in Assets, Small in Number*. *Indian Country Today*. September 2015.

## EFFORTS IN SEATTLE TO DATE

In the years following the financial crisis, advocates have brought renewed interest to the idea that American states and cities should establish public banks to assert independence from the banking industry and support financial services not currently provided by the market, such as subsidized lending programs and deposit accounts for underserved populations. Growing interest in public banking is reflected by studies currently proposed, underway, or completed in Los Angeles, San Francisco, Santa Fe, New York City, Philadelphia, New Jersey, Massachusetts, Maine, Vermont, and Washington State at the time of this report.<sup>16</sup>

In Washington State, local advocates have explored the idea of a public bank since at least 2010, when the Center for State Innovation released an impact analysis of a proposed bank to be owned and operated by Washington State.<sup>17</sup> After years of legislative and regulatory discussions, the State is currently developing a business plan for the proposed bank. For Seattle, the issue came to head in February 2017 when the City Council voted 9-0 on CB 118905, which instructed the City’s Department of Finance and Administrative Services (FAS) to notify Wells Fargo of its intent not to renew its contract in 2018 and conduct a procurement process to select an alternative provider. The resolution cited a difference in values over the company’s investments in the Dakota Access Pipeline and its high-profile scandal involving the creation of fraudulent customer accounts.<sup>18</sup>

In December 2017, the FAS issued a Request for Proposals (RFP) in search of an alternative provider, segmenting the City’s banking services into multiple modules to encourage participation from local banks; however, the RFP received no responses. Conversations with local bankers suggest that the lack of responses resulted from the demands of the City’s banking activity, the challenge of responding to each module separately, and stringent requirements such as an “Outstanding” Community Reinvestment Act (CRA) rating.<sup>19</sup> Faced with a lack of options, FAS approved a one-year contract extension with Wells Fargo in January 2018, and additional renewals are expected without a second RFP.

In response to the lack of industry interest in the RFP and in pursuit of alternatives for commercial banking, the City Council authorized funding for a study to evaluate the feasibility of a public bank that would replicate the services that Wells Fargo currently provides to the City and, potentially, provide benefits to the public and the City’s bottom line. The City Council’s motivation to create a public bank, defined in the study’s RFP, aligned with the benefits that public banking advocates have cited:<sup>20</sup>

- **Independence**—a public bank could grant the City independence from business practices that do not meet its standards of social responsibility and fair business practices.
- **Fiscal benefits**—a public bank may provide the City with banking services at a lower cost than its current contract with Wells Fargo or, alternatively, produce new revenues for the City through lending and investment activities.
- **Public benefits**— a public bank could offer services not currently provided by the private market, such as subsidized lending for affordable housing or infrastructure and retail banking for underserved communities including the City’s legal cannabis industry.

<sup>16</sup> *Report of the Chief Legislative Analyst: Public Bank Framework and Existing Housing and Economic Development Funding Programs*. City of Los Angeles. February 2018.

<sup>17</sup> *Washington State Bank Analysis*. Center for State Innovation. December 2010.

<sup>18</sup> [CB 118905](#). City of Seattle, Office of the City Clerk.

<sup>19</sup> As of September 1, 2018, only two Washington banks – both headquartered in the rural eastern part of the State – are currently rated “Outstanding,” the highest score in the CRA.

<sup>20</sup> Public Bank Feasibility Study; RFP #LEG2018-0004. City of Seattle.

**RESEARCH PURPOSE**

This study evaluates the legal, financial, regulatory, and administrative feasibility of a public bank for the City of Seattle. Throughout the study, HR&A considered both the City’s primary goal for the bank – ending the dependence on Wells Fargo – and opportunities for other goals, such as fiscal and public benefits. To this effect, we have organized our research question into two tiers:

First, we evaluate a **baseline model**, in which City creates a public bank to serve its own banking needs as currently provided by Wells Fargo, including maintaining deposit accounts and providing transaction services. In this model, the bank does not accept retail deposits or service loans of any kind; the City is its exclusive customer. As shown below, with the exception of servicing loans, this model resembles the Bank of North Dakota—the country’s longest operating public bank.

**Figure 2: Comparison of Baseline Model with Precedent Banking Models**

*Source: HR&A Advisors, Inc.*

	<b>Baseline Model</b>	<b>Bank of North Dakota</b>	<b>Bank of American Samoa</b>	<b>Commercial Bank</b>
<b>Owner</b>	City of Seattle	State of North Dakota	Government of American Samoa	Shareholders
<b>Issuer of Charter (Primary Regulator)</b>	State of Washington	State of North Dakota	Government of American Samoa	Home State or Fed. Government
<b>Activities</b>				
Accepts public deposits	Yes	Yes	Yes	Sometimes
Accepts deposits from general public	No	No	Yes	Yes
Issues loans	No	Yes	Yes	Yes
Serves cannabis-related businesses	No	No	No	No

We investigate the legal and regulatory requirements of the activities within this framework, such as the laws and government bodies that would control approvals and exercise oversight over the bank. In addition, we investigate the financial implications of this business model by comparing it to the typical activities of existing private banks.

Second, we evaluate three **supplementary activities** that the public bank may elect to pursue but do not represent services currently provided to the City by Wells Fargo: **lending money** to the general public, whether residents, businesses, or nonprofits; **accepting deposits** from private citizens and businesses, as well as other municipalities; and providing banking services to the city’s legal **cannabis industry**.

While these supplemental activities may benefit the bank’s financial feasibility and/or achieve public objectives, they also require more strenuous legal and regulatory approvals. For each alternative, we address the legal, financial, and administrative implications of these activities on the public bank’s feasibility relative to the baseline model.

Following this analysis, we present a set of high-level conclusions and immediate next steps should the City decide to move forward with creating a public bank under current State and Federal law.

Additionally, recognizing that the City may pursue alternative approaches to achieving its goals aside from or in addition to creating a public bank, our Appendix A enumerates opportunities to address the City’s goals, such as gaining independence from Wells Fargo and supporting social priorities, that do not require the creation of public bank.

**SUMMARY OF SEATTLE’S CURRENT BANKING RELATIONSHIP**

The City currently maintains an exclusive banking relationship with Wells Fargo, which manages over \$3B in annual deposits to the City’s operating account, ranging from electronic tax receipts to parking meter coin deliveries.<sup>21</sup> To support the volume and complexity the City’s transactions, Wells Fargo offers a variety of services, including ACH originations and wire transfers; cash, check, and ATM deposits; cash vault deposits; account information and reporting; merchant banking services; commercial card services; and cash management through an electronic banking platform. In return for these services, Wells Fargo charges the City between \$150K and \$200K in service fees annually depending on overall transaction volume.<sup>22</sup>

Although millions of dollars flow through the accounts each day, FAS orders an overnight sweep of most of the remaining funds into the City-managed investment account. Through this sweep, the City moves nearly all deposit funds into overnight repurchase agreements held by the City-managed investment account. On a given day, these sweeps average \$170M and are expected to range from \$25M to \$322M through the rest of 2018 as the City’s daily cash needs fluctuate.<sup>23</sup> For comparison, the City leaves just \$3M in its Wells Fargo deposit account overnight.<sup>24</sup> Consequently, Wells Fargo can only leverage a minimal portion of the City’s funds to support its lending and investment activities, limiting its ability to profit from these deposits.

In 2018, the City’s investment account totaled over \$2.6B, which includes a portfolio of securities ranging in term from the repurchase agreements to long-term government bonds. During 2017, the investment account overall generated \$32.9M in revenue for the City with an earnings yield of 1.56%.<sup>25</sup> The following chart breaks down the composition of the City’s investment account in December 2017:

**Figure 3: Pooled Investment Asset Allocation, City of Seattle; December 2017**

*Source: Seattle Department of Finance and Administrative Services*

Investment Type	Value	% of Total
Overnight Repurchase Agreements	\$138M	6%
Local Government Investment Pool	\$121M	5%
Commercial Paper	\$252M	11%
Bank Notes	\$48M	2%
Municipal Bonds	\$367M	16%
US Government Agency Securities	\$702M	30%
US Government Bonds	\$479M	20%
Agency Mortgage-Backed Securities	\$245M	10%
<b>Total</b>	<b>\$2.4B</b>	<b>100%</b>

<sup>21</sup> City of Seattle. Request for Proposals for Comprehensive Banking Services. December 2017.

<sup>22</sup> According to conversations with FAS staff and account statements provided by FAS staff.

<sup>23</sup> FAS internal cash forecasts

<sup>24</sup> City of Seattle. Request for Proposals for Comprehensive Banking Services. December 2017.

<sup>25</sup> City of Seattle Comprehensive Financial Report. 2017.

The repurchase agreements, which represent the most liquid portion of the investment account, earned an annual return of 1.90% as of August 2018, compared to the interest rate at the City's Wells Fargo deposit account, which, over the past five years, has ranged from 0.40% to 0.60%.<sup>26</sup> As a result, the sweep strategy helps fulfill FAS's fiduciary duty to maximize return on the City's investments at a given risk level. In addition, the City participates in the Washington's Local Government Investment Pool (LGIP), which offers a relatively liquid portfolio to municipalities. FAS structures its operating portfolio (the most liquid assets) to target the LGIP's return, which reached an annualized 1.99% in July 2018.<sup>27</sup> Consequently, the City expects an annual return of close to 2% in 2018.<sup>28</sup>

Although Wells Fargo does hold the City's the investment account in safekeeping, it does so only indirectly through a contract with Washington State, which negotiates a master contract for the State's municipalities. In this role, Wells Fargo acts as custodian of the City's investments and executes trades at the FAS's direction; however, the bank does not own or control these assets. The City pays \$6K in annual safekeeping fees to the State, far less than that they would expect to pay if negotiating independently.<sup>29</sup>

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<sup>26</sup> [Treasury Repo Reference Rates](#). March 2018. Federal Reserve Bank of New York.

<sup>27</sup> [Local Government Investment Pool \(LGIP\) Information](#). Washington State Department of the Treasury. August 2018.

<sup>28</sup> According to conversations with FAS.

<sup>29</sup> FAS paid over \$100K per year for the previous safekeeping provider.

## INTRODUCTION TO THE BASELINE MODEL

In the baseline model of a public bank, the institution specifically serves the City's own banking needs, including all of the transaction services that Wells Fargo currently provides. It then invests these funds in debt securities that conform to existing legal and regulatory requirements. In this model, the bank does not accept outside deposits or service loans of any kind. Given the dependence on public deposits and limitations on permitted activities, the baseline model resembles the Bank of North Dakota.

While no provision in Washington State law expressly prevents Seattle from forming a public bank to serve the City alone, the City will need to amend its Charter to authorize banking operations. In addition, the bank must obtain a state banking charter from the State's DFI, which will evaluate the business plan according to the same criteria as commercial banks. In addition, the State's PDPC will have to certify the bank as a public depository, adding an additional layer of regulations and oversight.

## AUTHORITY TO CHARTER A BANK

Neither state nor federal law precludes the City from establishing and operating a public bank to provide banking services solely to itself. To form such a bank, however, the City would need to amend its Charter, apply for a bank charter from DFI, and obtain access to the Federal Reserve's payment system.

Cities enjoy broad Home Rule Authority in the state of Washington. While operating a bank is not specifically enumerated as a municipal power, it is also not disallowed. In general, Washington courts have interpreted that any activity not expressly prohibited for municipalities will be allowed under Home Rule. As a result, the City will not have to obtain a legislative grant of approval to operate a public bank.<sup>30</sup> As with all charter amendments in Seattle, it must first pass the City Council and then achieve a simple majority among the electorate.

Any institution that intends to accept deposits – whether public or retail – must still apply for a state banking charter from DFI.<sup>31</sup> In general, the DFI follows a similar approach to the FDIC in reviewing charter applications; in fact, both regulators require the Interagency Charter and Federal Deposit Insurance Application.<sup>32</sup> Per the application form, the prospective bank must establish its Board and management governance, capital structure, premises and fixed assets, information systems, and ability to meet community needs. In addition, DFI must approve the bank's business plan, backed by financial projections for at least three years. Through this analysis, the bank defines the activities and operations that it will pursue, consistent with the corporate powers for commercial banks enumerated in the Revenue Code of Washington (RCW) Title 30A. If the bank subsequently decides to change these functions, it will likely require additional approval from the DFI. Furthermore, the business plan must demonstrate an ability to achieve financial feasibility and a commitment to maintain capital levels above regulatory minimums.

Once granted a state charter, the bank can seek access to the Federal Reserve payment system, through which all banks in the US clear payments. Consequently, every bank operating in the US, including the existing public banks, maintains access to the Federal Reserve payment system. Specifically, the newly-formed bank must apply for a routing number from the American Banking Association, which allows the bank

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<sup>30</sup> See Appendix B: Legal Memorandum.

<sup>31</sup> While the City could hypothetically apply for a national bank charter from the Office of the Comptroller of the Currency, the federal regulators would likely still seek approval from the State, since it ultimately governs the City.

<sup>32</sup> Washington State Department of Financial Institutions ([DFI](#)).

to transact with other financial institutions. For the bank to be eligible for a routing number, the Federal Reserve must first authorize its eligibility to maintain an account.

### **ADMINISTRATIVE FACTORS IMPACTING AWARD OF CHARTER**

Through the bank's charter and governing documents, the City Council must outline the bank's legal independence, the City's capital commitments, and protections against conflicts of interest. From the onset, regulators will expect a legal division between the City and bank to protect depositors, whether the City itself or the public. A bank, therefore, should be formed as a separate entity such as a public authority. The majority of its Board members should also be independent of the City Council or City government. While the City can maintain accountability by nominating Board members, the DFI would be expected to possess regulatory authority over the institution. In tandem with DFI oversight, the state charter should outline the schedule for independent audits to evaluate compliance with the charter. Similar to the BND relationship with North Dakota, the City could retain access to bank records through audits, but it would be precluded from executing enforcement actions.

Through deposits and capital funding, the City Council must mandate the City's own responsibilities to support the bank's financial health, which will be needed to obtain initial regulatory approval. In particular, a business plan should project both the initial capitalization and ongoing funding needs. In addition, the bank may require a minimum deposit from the City to fund balance sheet activities, a threshold that the City Council should mandate in the founding documents. This ordinance should also define the withdrawal limits and advance notices needed to support the bank's PDPC compliance and liquidity position. If the bank incurs losses over time, the City may need to continue capitalizing the public bank. In response, the City Council must address minimum capital ratios and liquidity thresholds that the bank must maintain. In the event of financial stress, the bank charter must establish the extent of the City's capital commitment to the bank, including any limits. If the City's commitment is limited, the charter must outline a strategy for bank failure that identifies the entity that will control the bank and how it will prioritize outstanding liabilities.

Regulators are particularly concerned with the bank's stability within a 10-year timeframe. As such, if the bank were to require initial subsidy, the City would have to guarantee funding for the bank over ten years, which presents a political challenge as particular elected officials as well as a public opinion environment which supports the bank may change during that time. Though establishing ten-year funding commitments is difficult since it would require raising funds outside a traditional budget process, the City could use tools such as a bond issue or endowed fund to do so. That said, this would increase the initial expense of the bank beyond a 1-year appropriation.

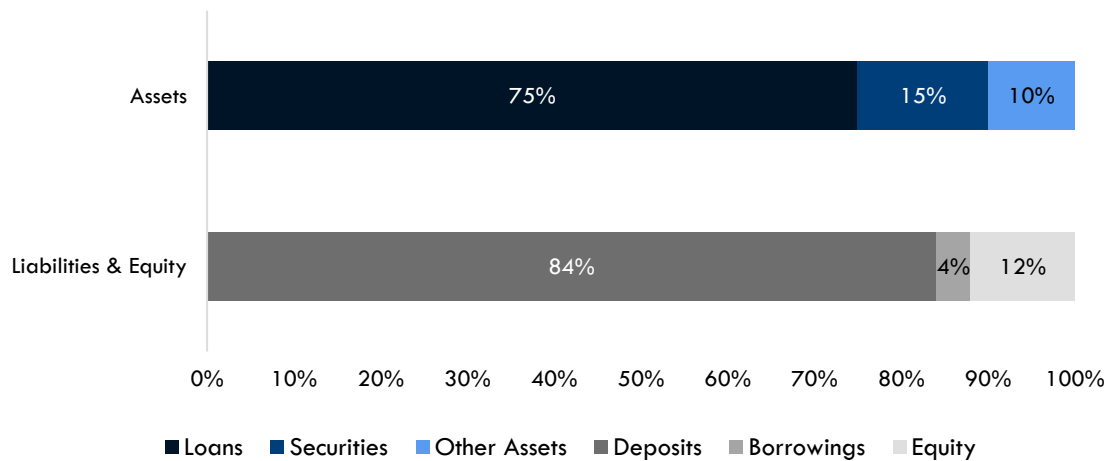
Given the bank's dual mission of serving the City and improving public good it will inevitably face internal conflicts. As a City-owned institution, the bank may feel pressure to invest in assets for social or political priorities that it might not otherwise extend. In response to these concerns, the bank charter must establish clear protocol for how to prioritize business interests. The founding bank documents must address any overlapping relationships with the bank and its affiliates, including City agencies and employees. In particular, the bank charter should establish guidelines and limits for services contracted with the City or other affiliated parties. Similarly, the bank charter should specify the interest on the City deposits, the fees for City services, and guidelines for setting future rates. Finally, the bank's charter must clarify which activities the bank can pursue, what underwriting standards it must maintain, and where it can reduce credit quality to meet social priorities.



**COMPOSITION AND PERFORMANCE: PRIVATE SECTOR EXAMPLES**

Given the lack of a precedent for a city-owned bank, this study uses private industry examples to explain typical bank composition and performance. While a public bank would differ in many key ways from a private institution, it would face the same challenges of attaining sufficient size and scale to meet the City’s needs. Regardless of size or business model, banks operate by accepting short-term funding, concentrated in deposits, and investing it in long-term assets, including loans and securities. The chart below displays the average balance sheet distributions of FDIC-insured banks based in Washington State, according to quarterly Call Report data from the Federal Financial Institutions Examination Council (FFIEC):

**Figure 4: Average Washington Bank Balance Sheet**  
Source: FFIEC Reports of Condition and Income as of June 30, 2018



As shown in the chart, banks in Washington State fund over 80% of their balance sheets with deposits, including demand, savings, and CD accounts. In addition, they borrow a relatively small share of funds to cover short-term needs and match asset maturities. Banks principally leverage these funds to support lending, which represents three-quarters of a typical balance sheet. They also purchase securities to provide liquidity and mitigate interest rate risk. On net, the average Washington bank maintains total equity of 12% of assets, above the 10% regulatory baseline.

Due to differences in timing and risk, banks earn a higher interest rate on assets than they pay on liabilities – a spread known as a Net Interest Margin (NIM). On average, Washington banks earn yields of 4.47% on earning assets<sup>33</sup> and pay funding costs of 0.48%, leading to a NIM of 3.99%. This income is supported by average fee and service revenue totaling 0.75% of earning assets. From the proceeds of interest income and service fees, a bank covers the overhead costs of operations, including salaries, premises, and data processing, among other expenses. On average, these costs represent 3.08% of average total assets. In addition, banks deduct a provision for expected loan losses – an annualized rate of 0.05% of average

<sup>33</sup> Earning assets, which include all-interest bearing assets such as loans and securities, make up 94% of total assets on the average Washington bank balance sheet. All income and expense ratios are calculated with the average daily balance of assets during the 2<sup>nd</sup> quarter of 2018..

loans through June 2018. After incurring these costs, banks generate pre-tax net income averaging 1.31% of average assets and a post-tax return on assets of 1.10%.<sup>34</sup>

To illustrate these metrics in absolute terms, we construct a representative income statement for a fictional bank with \$100M in assets that exhibits the average performance for Washington banks:

**Figure 5: Model Washington Bank Income Statement**

Source: HR&A Advisors, FFEIC.

Average Assets	\$100,000,000
Interest Income	\$4,184,955
Interest Expense	(\$451,184)
Net Interest Income	\$3,733,771
Non-Interest Income	\$702,544
Non-Interest Expense	(\$3,083,693)
Provision for Loan & Lease Losses	(\$38,593)
<b>Pre-Tax Net Income</b>	<b>\$1,314,029</b>
Pre-Tax ROA	1.31%
Estimated Post-Tax Net Income	\$1,097,640

Although these metrics capture typical private bank operations, they do not represent a prediction for the public bank's performance given key functional differences. For instance, the public bank may need to invest in an above-average share of securities to collateralize the City's deposits, which could reduce net interest income. In addition, the infrastructure to support the City's account needs may drive up overhead costs, while the avoidance of retail deposits may reduce these expenses, adding uncertainty to any financial projections. Furthermore, the Washington data reflects established institutions with stabilized operations. By contrast, regulators expect newly-chartered banks to incur losses in the initial years; BND did not earn a profit for nearly 30 years. Even if the model bank does generate the average pre-tax ROA of 1.31%, the City would forego its expected 2.0% return on its investment account to fund both the public bank's deposit and capital. Regardless of bank size, the City faces the same trade-off between funding a sustainable public bank and earning higher returns on investments.

While private banks can succeed with a variety of sizes and operations, any bank that supports the City's needs requires a certain scale to manage the volume and complexity of the City's transactions. Based on conversations with regulators and bankers, a new private bank should expect to hold \$100M in assets at an absolute minimum, with a more realistic target of \$250M to support rising technology and compliance costs. As shown in the table, the representative \$100M bank would expect to incur \$3.1M in annual overhead costs. For context, the estimated salary and benefits expenses could support 16 full-time employees at the

<sup>34</sup> As a public entity that returns all earnings to the City, the public bank would not be expected to pay federal income taxes.

average salary for Seattle Metro banks.<sup>35</sup> By contrast, the \$150K to \$200K in annual fees to Wells Fargo could fund just one full-time employee, and they represent less than 30% of the bank’s estimated fee income. If the bank only serves the City, the City must either pay higher services fees or reduce earnings expectations.

Moreover, only the largest banks with national footprints typically possess the scale to competitively offer the full suite of the City’s treasury services. Capital-intensive operations such as payment processing and software platforms demand high start-up funding and ongoing fixed costs. As a result, small banks – which would include the \$100M model – outsource many of these functions to control overhead and sustain earnings. The chart below compares the City’s banking needs to the types of institutions that offer and operate these services on their own, rather than outsource through a partner:

**Figure 6: Typical Banking Services Provided by Bank Size**  
Source: *Conversations with Washington Bankers, HR&A Advisors, Inc.*

Service offered in-house	Small Bank (<\$1B assets)	Regional Bank (\$1B-\$50B)	National Bank (\$50B+)
ACH & wire transfers	X	X	X
Cash, check, & ATM deposits	X	X	X
Cash vault & coin counting		X	X
Commercial card services		X	X
Investment safekeeping		X	X
Government banking department		X	X
Merchant banking services			X
Proprietary electronic platform			X

Given the critical importance of scale in these operations, the City-owned bank should expect to outsource some of the City’s services to other partners. As a result, FAS would still need to issue additional RFPs to dissociate from Wells Fargo’s services. Ultimately, the City can determine the needed scale and operations by developing a formal business plan that estimates the overhead costs of meeting the City’s needs. Although a limited-purpose public bank could propose a smaller asset size and narrower lending activities than full-service private bank, it is venturing into uncharted regulatory terrain.

**AVAILABILITY OF FUNDING AND START-UP CAPITAL**

To support balance sheet activities in the baseline model, the public bank will need large deposit commitments from the City. Since the City currently leaves minimal balances overnight with Wells Fargo, these funds cannot simply be diverted from the existing deposit account. Rather, they will have to be reallocated from the City’s investment account, appropriated, or raised from an outside source or bond issue. Based on the 84% deposit ratio above, a \$100M bank would expect to hold at least \$84M in deposits and a \$250M bank at least \$210M. As discussed above, the City only maintains an average of around \$3M in overnight deposits at Wells Fargo. For this reason, the bank would need additional deposits to support a feasible business model without an increased fee structure. Possible sources include:

- **City investment account** – as discussed above, the City’s investment account contains over \$200M in liquid securities such as overnight repo and LGIP balances. By mandate, the City Council could require FAS to divert a portion of these funds (which include the City’s General Fund) to maintain a

<sup>35</sup> Based on the FFIEC data, the average Washington bank spends 60% of total overhead expenses on salaries and benefits: \$1.8M in the model \$100M bank. In the Seattle Metro, these expenses average \$111K per FTE employee.

minimum balance in overnight deposits at the public bank. Given the existing liquidity in the account, it represents the most accessible source of deposits for the bank.

- **Other Washington municipalities** – as of May 2018, Washington municipalities maintained \$6.1B in deposit balances at approved public depositories. Given the benefits of scale to cover overhead costs, the public bank would benefit from partnering with other cities to attract additional funding.
- **Other entities within the City** – such as public Utilities and the retirement fund. Like the City itself, these depositors would need to be guaranteed a minimum return above the return threshold of a typical depositor.
- **The general public** – retail deposits could offer a reliable source of local funding, assuming that the bank receives FDIC approval, discussed in the next section. Without FDIC insurance, the bank would struggle to attract funds from the general public or obtain a bank charter from DFI.

In addition to deposits, the City will need to provide the start-up capital to establish the bank. When reviewing bank applications, the FDIC and DFI both expect a business plan that maintains equity capital levels of at least 10% of assets. Among Washington Banks, average total equity totals over 12%. The \$100M model bank would thus require at least \$10M in equity and likely more; regulators will expect a capital cushion above the 10% level to absorb potential losses during the start-up period. Moreover, \$100M represents the minimum expected asset size; a \$250M bank would require at least \$25M in start-up capital. To allocate this capital, the City would have to appropriate a portion of the its budget or issue a bond referendum to raise the funds.

## PUBLIC DEPOSITORY REQUIREMENTS

Even if the bank accepts only public deposits, it faces state-level limitations on the amount that it can lend with the City’s funds, which must be collateralized to certain percentages with government securities. To accept deposits from the City or any other municipality, the bank must obtain approval from the PDPC as a public depository. Per PDPC requirements, a public depository must pledge eligible collateral totaling at least 50% of public deposit balances – and closer to 100% for a bank that exclusively accepts public deposits, depending on the capital share. Although the baseline model could fulfill these requirements without a change in law, they would effectively prevent the bank from lending with the City’s deposit funding.

The following assets are considered eligible collateral by the PDPC<sup>36</sup>

- US government obligations
- US government-sponsored enterprise obligations
- Federal Home Loan Bank and Federal Reserve obligations
- Municipal general obligation bonds
- Municipal revenue bonds within Washington State
- Select other municipal revenue bonds
- Federal Home Loan Bank or Federal Reserve Bank letter of credit

These assets are differentiated by the ability of the depository to rapidly convert them into cash in the event of a crisis. Other items typically considered “collateral” such as real estate or common stock, are not included in this list of actions. As such, the City would not be able to use non-liquid assets, such as its real estate to collateralize its deposits.

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<sup>36</sup> RCW 39.58.130.

During the financial crisis, the PDPC raised the eligible collateral requirements to 100% of all public deposit balances not insured by the FDIC. Since then, the PDPC relaxed the minimum ratio to 50%<sup>37</sup> for banks considered “well-capitalized”<sup>38</sup> – currently every bank in Washington state according to FFIEC data. However, state law also limits uncollateralized public deposit balances to 100% of the bank’s net worth (total equity) from a single municipality or 150% from all municipalities in aggregate. As a result, a bank funded entirely by the City’s public deposits could only acquire non-collateral assets totaling less than the equity funding – 12% of total assets in the model bank. Although the PDPC does have the authority to relax these rules, this decision would be subject to the agency’s discretion, and the bank may need a state law change to guarantee activities beyond eligible collateral. Beyond the PDPC requirements, banks typically maintain an additional liquidity buffer to provide for the volatile account activity in a public deposit. Consequently, the public bank would expect to leverage a minimal portion of the City’s deposits for lending activities.

### RETURN EXPECTATIONS UNDER LENDING CONSTRAINTS

Given the importance of lending to support bank returns, a bank that faces lending constraints would expect below-average performance and, potentially, negative net income. While loan yields average 5.32% at Washington banks, security returns total just 2.43%. To model a reduction in lending, we return to the fictional \$100M private bank with average Washington performance. The table below illustrates the expected change in income if the bank decreases its loan portfolio from 75% of assets to 12% of assets, as constrained by PDPC regulations and/or liquidity needs:

**Figure 7: Comparison of Income Statements by Loan Composition**

Source: HR&A Advisors, Inc.

Model Income Statement	75% Loans	12% Loans	Breakeven Costs
Interest Income	\$4,184,955	\$2,597,747	\$2,597,747
Interest Expense	(\$451,184)	(\$451,184)	(\$451,184)
Net Interest Margin	\$3,733,771	\$2,146,562	\$2,146,562
Non-Interest (Fee) Income	\$702,544	\$702,544	\$702,544
Non-Interest Expense	(\$3,083,693)	(\$3,083,693)	(\$2,844,475)
Provision for Loan Losses	(\$38,593)	(\$4,631)	(\$4,631)
<b>Pre-Tax Net Income</b>	<b>\$1,314,029</b>	<b>(\$239,218)</b>	<b>\$0</b>
Pre-Tax ROA	1.31%	-0.24%	0.00%

As the table shows, typical private banks depend heavily on lending income to support operations; without it, they struggle to generate sustainable earnings. Nevertheless, a limited-purpose bank could reduce overhead costs through smaller loan origination and credit administration functions. To break even financially, the model bank would only need to decrease total overhead costs by 8%, illustrated by the chart’s “Breakeven Costs” scenario. To reach the average ROA, however, those costs would have to decline by 50%. Moreover, the breakeven scenario still assumes \$703K in fee income, which the City would have to bolster through increased service charges. Paired with the uncertain fixed and variable expenses of managing the

<sup>37</sup> PDPC Resolution 2018-1, as authorized by RCW 39.58.010

<sup>38</sup> Per Prompt Corrective Action definition. FDI Act Section 38.

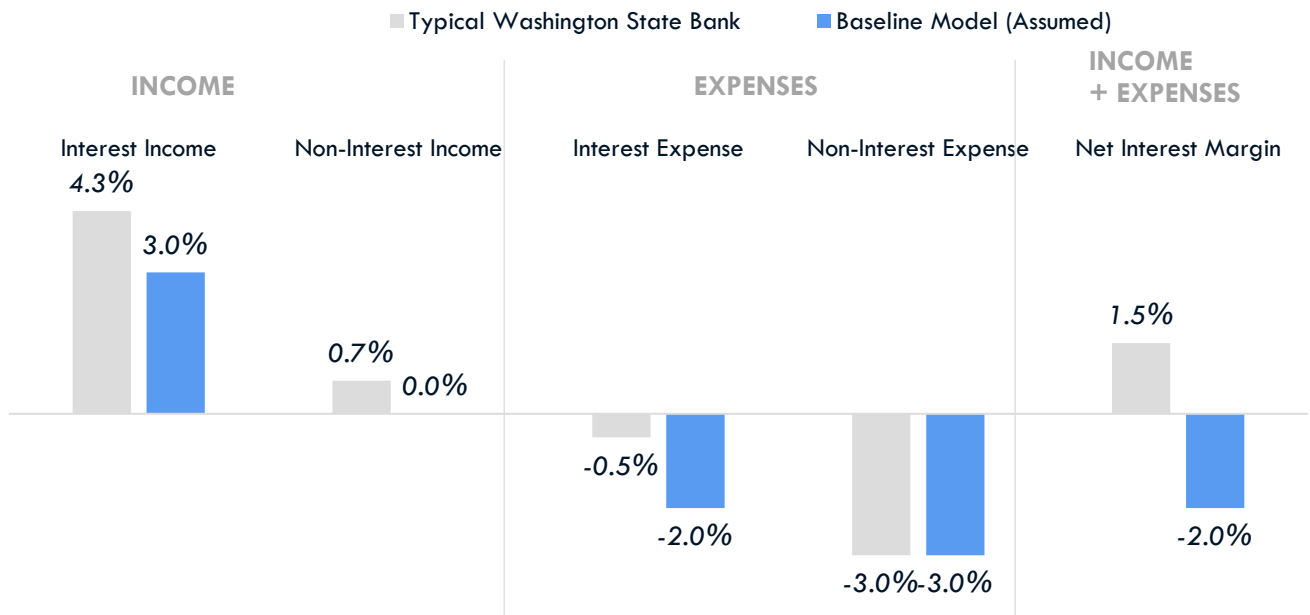
City’s deposits, the PDPC limitations could hinder the public bank’s ability to generate sustainable income, let alone a market-rate return.

**SUMMARY**

In summary, likely capital sources and uses for the bank constrain its bottom line from the top (revenue) and the bottom (cost of capital.). These relationships are summarized in the chart below.

**Figure 8: Comparison of Income and Expenses as a Percentage of Average Assets**

Source: FFEIC, HR&A Advisors, Inc.



Since the bank would be precluded from issuing market-rate loans and since it would not charge fees of the City itself, income would be constrained below the level of typical Washington financial institutions. Because the City and other public entities receive, at minimum, a 2% return on their deposits, its interest expenses would be higher than a typical commercial bank. Therefore, assuming similar non-interest expenses, the baseline model would have a negative net-interest margin in early years, requiring public subsidy in the form of fee income, subsidy for non-interest expenses, or forgone interest on deposits.

## SUPPLEMENTARY ACTIVITIES

From a legal perspective, the baseline model represents the path of least resistance, in which the City establishes a public bank with the fewest changes to state laws or regulations. By pursuing additional activities beyond the current banking services, the City would tread onto untested legal ground with few precedents. These activities include (1) **accepting deposits** from private citizens and businesses; (2) **lending money** to the general public, whether residents, businesses, or nonprofits, outside of existing state-level exceptions; and (3) providing banking services for the City's legal **cannabis industry**.

If the bank seeks to accept retail deposits, it should expect to obtain FDIC insurance as a condition of approval for its DFI charter. This approval poses a distinct hurdle because FDIC guidance suggests that the agency will review applications from public banks with heightened scrutiny, and it has never provided insurance to a public bank. In addition, the City's ability to lend would be limited by the Washington State Constitution's prohibition on extending credit to private citizens or businesses except for the "poor and infirm." While the bank could still lend to these borrower classes without legal changes, it may struggle to achieve the loan portfolio scale necessary to support operations. Finally, serving the cannabis industry directly likely precludes access to the Federal Reserve payment system and any interbank transactions, including checks, credit cards, and correspondent relationships.

## PROVIDING LOANS TO THE PUBLIC

In addition to the PDPC restrictions on eligible collateral, the bank's lending activities may be limited by the Washington State Constitution, which generally prohibits the extension of credit by municipalities. Specifically, Article VII, Section 7 of the Constitution states:

*"No county, city, town or other municipal corporation shall hereafter give any money, or property, or loan its money, or credit to or in aid of any individual, association, company or corporation, except for the necessary support of the poor and infirm, or become directly or indirectly the owner of any stock in or bonds of any association, company or corporation."*

As a City-owned corporation, the bank would likely be subject to this restriction on lending to private individuals and corporations. Nevertheless, the exception for "poor and infirm" would enable the bank to lend to low-income borrowers, at least directly. In support of this potential exception, the Washington Supreme Court upheld a state-level program to provide mortgage loans to low-income residents. Beyond direct lending to exempted parties, the exception becomes more ambiguous, but it may allow loans to affordable housing developments, for instance. While these types of lending may be possible, the bank may struggle to develop a loan portfolio of sufficient scale to fund operations given these constraints. Consequently, it would benefit from an amendment to Section 7 that specifically exempts public banks from this prohibition. Furthermore, the state legislature should consider revising RCW Title 30A to specifically enumerate the powers of a public bank, including eligible types of lending.

## ACCEPTING RETAIL DEPOSITS

While the bank could avoid FDIC insurance by accepting deposits only from the City and other municipalities, accepting retail deposits from private residents would likely necessitate FDIC approval, an uncharted regulatory process for a public bank. Although Washington State law does not require FDIC insurance to obtain a bank charter, the DFI may require it as a condition of approval. In practice, every state-chartered bank in Washington has obtained FDIC insurance. If the bank only accepts public deposits, it may be able

to justify that it does not need FDIC insurance; these accounts far exceed the \$250K insurance limit, rendering the protection inconsequential. By contrast, a bank that accepts retail deposits from the public would be expected to obtain insurance protection to protect citizens' money.

Federal law does not preclude deposit insurance for public banks. However, a public bank would be treading on unknown ground since the two existing public banks in US have not obtained FDIC insurance; instead, their deposits are backed by the *full faith and credit* of the public owner. Additionally, FDIC guidance suggests that a public bank would be subjected to heightened scrutiny:

*“An application for deposit insurance from a depository institution which would be owned or controlled by a domestic governmental entity (such as, for example, a state, county or a municipality) will be reviewed very closely. The FDIC is of the opinion that due to their public ownership, such depository institutions present unique supervisory concerns that do not exist with privately owned depository institutions. For example, because of the ultimate control by the political process, such institutions could raise special concerns relating to management stability, their business purpose, and their ability and willingness to raise capital. On the other hand, such institutions may be particularly likely to meet the convenience and need of their local community, particularly if the local community is currently un- or under- served by depository institutions.”<sup>39</sup>*

This guidance specifically mentions several of 7 statutory factors that the FDIC must assess when reviewing applications for deposit insurance:<sup>40</sup>

- Financial History and Condition,
- Adequacy of Capital Structure,
- Future Earnings Prospects,
- General Character of Management,
- Risk Presented to the Insurance Fund,
- Convenience and Needs of the Community to Be Served, and
- Consistency of Corporate Powers.

While federal law does not rank these factors, the FDIC considers management quality to be “perhaps the single most important element in determining the applicant’s acceptability for deposit insurance.”<sup>41</sup> As discussed in the guidance above, management stability presents a unique concern at public banks because of the political process. In response, the City would have to prove that the bank remains politically independent to retain management that prioritizes the bank’s condition. In addition, the majority of the Board of Directors would have to be independent of the City government or elected officials. Furthermore, the City must prove consistent capital support for the bank after the initial outlay, regardless of who governs City Hall. Beyond justifying the City’s *ability* to raise capital, the application must substantiate the City’s *willingness* to raise capital over time, likely through a legal mandate to support ongoing capital needs.

With regard to establishing whether “the local community is currently un- or under-served by depository institutions,” Seattle may struggle to argue that its population is currently underserved relative to other jurisdictions or the country as a whole. According to FDIC data on bank branch locations, approximately 3,100 Seattle households, less than 0.5% of the city’s total, live more than a half mile from a bank branch and most of these households (1,800 or 70%) are above 200% of the poverty line and therefore unlikely to be unbanked or underbanked. In fact, based on the City’s income profile and national data tying

<sup>39</sup> FDIC Statement of Policy on Applications for Deposit Insurance

<sup>40</sup> FDI Act Section 6

<sup>41</sup> FDIC Risk Management Manual of Examination Policies, Section 12.1.



utilization of traditional banking services to income, HR&A estimates that between 4.5% and 5.5% of Seattle residents, approximately 16,000 households, may be without banking services regardless of their distance to a bank location, below the national average of 7%.<sup>42</sup>

Given the primacy of management and capital in the FDIC's decision, obtaining FDIC insurance poses a unique obstacle without precedent; the FDIC's heightened scrutiny underlines the uncertainty of both the approval and the duration of the application process. For this reason, we assume that the bank does not accept public deposits, at least initially; subsequently, the bank would need to revise the state charter with DFI to pursue these funds.

As alternatives to the FDIC, the bank could pursue three alternative insurance options for retail deposits, but these options lack precedents for DFI approval:

- The bank could **self-insure deposits with the full faith and credit of the City**. TBAS and the BND have both adopted this approach, though the BND does not accept retail deposits. Of particular concern, this strategy may negatively impact the City's bond rating given the funding commitments to the bank. To protect its bond rating, the bank structure would have to insulate the City from unexpected funding obligations and require collateral protection for the City's deposits.
- The City could seek **private insurance** for deposits (or portions thereof), though no known financial institution in the US use private insurance for general deposits.
- In the long term, the City could undertake a strategy of inter-city or inter-entity **mutual insurance**. The *Sparkasse Finanzgruppe* in Germany guarantees municipal deposits through mutual insurance: cities agree to provide emergency capital in the event of a bank failure. In the US, a similar system would require collaboration among cities and state legislatures (if interstate), which could take many years to develop.

## SERVING CANNABIS BUSINESS

Though the sale and recreational use of cannabis is legal under Washington law, serving the cannabis industry would likely preclude use of the Federal Reserve Bank's payment system— and the essential access to transaction services that it provides. For more information on the legality of serving cannabis-related businesses, see Appendix B: Legal Memorandum.

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<sup>42</sup> HR&A Analysis of FDIC survey of Unbanked and Underbanked Households, 2015.

## CONCLUSIONS AND NEXT STEPS

In summary, we find that though no law precludes the City from establishing a public bank, state and federal laws would limit its operations and revenue potential, such that the value of such a bank must be carefully weighed vis-à-vis the City's goals.

A public, city-owned bank capitalized by City deposits and which does not lend money or offer retail banking services—the baseline model—would guarantee independence from Wells Fargo, but would require an ongoing dedication of capital and, potentially, foregone income from the City's investment account. This ongoing funding requirement would likely exceed the \$150-\$200K the City pays for banking services currently.

Additionally, the approval of such a bank would require the sign-off of multiple state and federal regulators and would likely take several years to complete. Cooperation with state lawmakers has the potential to expedite approval through the legislative process. A public bank is feasible under current law, therefore, but should be weighed against alternative paths to addressing the City's primary goal of divestment.

The addition of secondary services such as retail banking, lending, and serving cannabis-related businesses would expand the public goals served by the bank and could help generate revenue to decrease the City's required outlay but would require additional approval by state and federal regulators. Specifically, lending using the City's own deposits would require the PDPC to waive collateral requirements and would be limited by the State constitution to "poor and infirm" borrowers. Expanding the pool of eligible borrowers would require a constitutional amendment. To accept retail deposits from the general public, the City would be required to seek approval from the FDIC, which has expressed that public banks would be subject to heightened scrutiny given the potential for political interference. Finally, providing banking services to cannabis-related businesses would require a change in Federal law, as the Federal Reserve has denied access to its payments system for financial institutions that engage with cannabis-related businesses in the past.

Though the barriers to creating a financially-sustainable public bank are steep, they are not insurmountable. To create the baseline model under current law, we recommend the City undertake the following steps:

- **Authorize and conduct business planning study and draft articles of incorporation for the bank.**

A business plan for the bank would provide concrete estimates of start-up costs such as hardware and physical infrastructure and operating costs such as staffing, outsourced services, and software. Informed by these assumptions, the business plan would estimate the bank's revenue potential and long-term capitalization requirements. As a result, the plan would allow the City Council to weigh the net cost or benefit against its objectives and the political capital required for success. A business plan is also a prerequisite for applying for a banking charter. The bank's articles of incorporation should specify key administrative factors including the bank's mission and investment priorities, who will form the Board of Directors, how it will be capitalized, when City will be expected to support capital, what lending activities it can/cannot pursue, how it will handle City deposits, and how directors/employees will overcome conflicts of interest.

- **Obtain Memoranda of Understanding (MOUs) from DFI, PDPC, and potentially the Federal Reserve signing off on the business plan.**

Given the unprecedented nature of the bank, regulatory approval represents a risk to project success. Legal uncertainty also raises concerns among council members and the public, whose

approval is required to amend the City Charter and fund the bank. By having key regulatory agencies sign off on the business plan, the City could ease these concerns and help preserve support among key constituencies. Though these agencies would likely be reluctant to guarantee approval of the bank, they may be willing to comment on the business plan and suggest alternative paths forward. Alternatively, the City could pursue state legislation that would direct state agencies to negotiate MOUs with the City.

- **Amend City charter to expressly allow banking activities.**

According to Washington State's Home Rule provisions, a City government may undertake any activity specified in its charter as long as it is not precluded by state law. Since Seattle's charter does not currently give the City the authority to conduct banking services, it must be amended. A charter amendment would require a vote by the City Council followed by approval by a simple majority of Seattle's electorate.

- **Dedicate start-up capital and long-term funding for the bank.**

Prior to applying for a banking charter or public depository status, the City Council should appropriate start-up capital to fund bank operations upon approval by regulators. In addition, it should direct FAS to re-allocate short-term funds to the bank upon operationalization. Guaranteeing this funding in advance would assure regulators of the City's intention to support the bank and its long-term financial security.

- **Apply for a banking charter with DFI.**

With capital secured and a business plan drafted, the City would begin the formal charter application process by submitting its business plan and an application to DFI.

- **Apply for access to access the Federal Reserve payment system.**

Following charter approval, the newly-formed bank would apply for access to the Federal Reserve's payment system, which would allow it to make and receive payments. Typically, the Federal Reserve grants this authority by default to state-chartered banks; however, TBAS took two years to receive approval.

- **Apply for public depository status.**

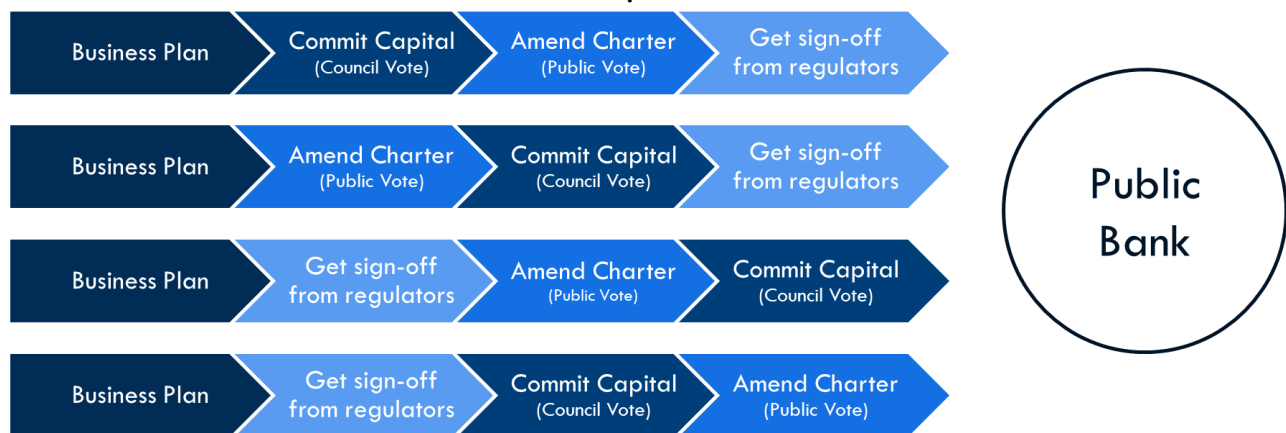
Following charter approval, the newly-formed bank would apply for public depository status with the PDPC. Upon approval, the bank could accept the City's deposits and begin operations, following the PDPC's eligible collateral requirements.

- **Gradually phase out operations with Wells Fargo, allowing the Bank to take on a greater share of City operations.**

Any new bank will experience growing pains and may incur in the initial years as it hires new staff and formalizes its internal processes. Therefore, the City should incrementally transition services from the current provider to the public bank to minimize disruptive effects on City business.

Importantly, these steps could be taken in any order, as shown by the chart below. The order of these steps is dependent on the tolerance of later bodies (regulators, the public, the council) for uncertainty. Once defined by a business plan, the bank would gain credibility as it gains approval from each body.

**Figure 9: Potential Order of Next Steps**  
Source: HR&A Advisors, Inc



These steps, which would likely take several years to carry out, would authorize and establish a bank for the City that could replicate many or all of the services that it currently receives from Wells Fargo. The bank's sole depositor would be the City; it would neither engage in retail activities with the general public nor invest in assets outside of the collateral requirements imposed by the PDPC. For the public bank to participate in activities beyond this narrow scope, it could pursue the following actions:

- **To extend loans using public deposits, obtain a waiver from the PDPC.**

The PDPC's existing regulations limit the public bank's ability to fund loans with public deposits, especially with the City as the sole depositor. However, the PDPC is granted regulatory authority to make exceptions to this rule or adjust requirements. Whether before or after establishing the bank, the City could ask the PDPC to waive this requirement since the City is effectively depositing funds to itself through the City-owned bank. Alternatively, the City could ask the state legislature to waive these requirements for public banks through legislation. The Washington State constitution forbids public institutions from extending credit to persons or businesses except the "poor and infirm." Although this exception would possibly allow Seattle's bank to lend to affordable housing and other projects targeting low-income residents, it would preclude lending to most of the general public or the city's small businesses.

- **To accept deposits from the general public, obtain FDIC insurance and receive DFI approval.**

Though no provision of state law expressly requires deposit insurance for retail deposits, DFI would almost certainly require it as a condition for approving the bank's charter. If the bank decides to pursue retail deposits after opening, it would likely have to apply for FDIC insurance and receive approval from DFI simultaneously.

A constitutional amendment would be needed to change this provision, which would require passage by either house of the state legislature followed by a simple majority of the Washington electorate.

The key barriers to public bank operation and required actions are summarized in the table below.

**Figure 10: Actions and Approvals Required for Banking Activities**

Source: HR&A Advisors, Inc

Activity	Action Required	Approval Required
<b>Baseline Model</b>		
Authorize establishment of a City-owned bank	Amend City Charter to expressly allow banking activities	<ul style="list-style-type: none"> <li>- City Council</li> <li>- Public ballot</li> </ul>
Obtain a state commercial bank charter	Apply for a state banking charter from the DFI	DFI
Access Federal Reserve payment system	Apply for access (requires charter)	Federal Reserve
Authorize acceptance of public deposits	Apply for public depository status	PDPC
Fund and capitalize the bank	<ul style="list-style-type: none"> <li>- Appropriate start-up capital</li> <li>- Reallocate short-term deposits from investment account to bank</li> </ul>	City Council
<b>Secondary Activities</b>		
Accept retail deposits from general public	Obtain FDIC insurance and amend state bank charter	FDIC; DFI
Extend loans using public deposits	Receive eligible collateral waiver from PDPC or change state law	PDPC or State legislature
Extend loans to borrowers beyond the “poor and infirm”	Amend Washington State constitution	<ul style="list-style-type: none"> <li>- State legislature</li> <li>- Statewide ballot</li> </ul>
Provide services to cannabis-related businesses	Await change in federal law; advocate for change	Federal government

Additionally, there are several policy options aside from the creation of a public bank that would help the City accomplish its primary goals of independence from Wells Fargo and provision of banking services to public priorities and communities in need. These options are discussed at a high level in Appendix A: Alternative Models and Alignment with City Goals.

# Appendices

## APPENDIX A: COMPLEMENTARY STRATEGIES AND ALIGNMENT WITH CITY GOALS

Given the political and financial challenges of forming a City-owned bank and the difficulty of achieving large-scale public benefits within the existing legal and regulatory framework, the City may want to consider complementary approaches to achieve its objectives. We call these “complementary approaches” since they do not preclude the creation of a public bank and could potentially be incorporated into its operations.

As discussed in the body of the study, the City’s goals for the bank include discontinuing its use of Wells Fargo, increasing the availability of capital for local priority projects such as affordable housing and infrastructure, and offering improved banking services to Seattle residents. Although a public bank has the potential to affect each of these goals, these strategies provide paths to achieving them with greater certainty, lower public expense, and a more rapid execution timeline, in the current regulatory and political environment:

- 1. Refresh the City’s treasury services RFP content and process** to make it easier for socially responsible banking partners to participate and compete with Wells Fargo. Our conversations with financial institutions that considered participating in the City’s last RFP identified several barriers, including the technical complexity of the required response; the five-week timeframe between RFP issuance and submission; the requirement of an “outstanding” CRA rating; and the capital, infrastructure, and technology demands of serving the City of Seattle. With the exception of infrastructural capacity, each of these factors is under the City’s control and could be revised to ease participation by local financial institutions. A multi-stage Request for Information (RFI) or Request for Qualifications (RFQ) process, whereby prospective partners participate in the development of the City’s scope of services, presents a proven way to design a refreshed RFP with partner input.
- 2. Develop non-bank investment vehicles and partnerships** to support social priorities. Non-bank investment vehicles, such as the affordable home loan program supported by the City’s housing levy, community banking partnerships, and syndicated loan partnerships offer tested models for increasing the availability of credit for public priorities and providing banking services to underserved communities without the need for approval by regulators. Depending on current conditions in the credit market, such a program could be designed to maximize public benefit as well as financial return to the City. Specifically, the City’s housing levy provides a tested avenue for this type of investment since it already operates loan and cash transfer activities through local banking partners funded by the levy. Exploring how to create a revolving loan fund or quasi-bank through the housing levy is a promising avenue that could be later incorporated into a public bank.
- 3. Collaborate with existing public banking efforts**, such as the State’s business planning process, to pursue participation in a public bank not owned and operated by the City. Compared to municipal efforts, State-level efforts benefit from legislative authority that can pre-empt state regulatory requirements upon legislative approval, thereby avoiding regulatory uncertainty. Though such a bank would not be under the direct control of the City, it would be independent from Wells Fargo and could be designed in such a way that it accomplishes other goals such as making additional capital available to the City or offering improved services to Seattle residents. Alternatively, the changes in state law that enable a state bank could be expanded to create a new class of “public bank” under Washington state law, which would mitigate some of the legal and regulatory constraints that limit the financial success of the baseline model. In any case, the City’s participation in the business planning process for the state bank is vital.

In the body of this study, we identified two goals of the City Council for a public bank: discontinuing the use of Wells Fargo and pursuing expanded banking activities. In this Appendix, we further subdivide the second

goal into two parts: increasing capital for local priorities and improving banking services for Seattle residents. In addition to these goals, we evaluate each alternative strategy based on three potential challenges to implementation: cost, timeline, and regulatory uncertainty. The matrix below summarizes this assessment:

**Figure 1: Alternative Strategies and Alignment with Goals and Challenges**

Source: HR&A Advisors, Inc.

STRATEGIES	GOALS			CHALLENGES		
	Discontinue use of Wells Fargo	Increase capital available for local priorities	Offer better banking services to Seattle residents	Cost to City	Execution timeline	Regulatory uncertainty
Refresh treasury services RFP	Yes	No	No	Low	Short-term	Low
Develop non-bank investment vehicles and partnerships	No	Yes	Yes	Medium	Mid-term	Medium
Collaborate with existing public banking efforts	Yes	Maybe	Maybe	Unknown	Long-term	High

**STRATEGY I: REFRESH THE TREASURY SERVICES RFP**

As a first-step toward ending its dependence on Wells Fargo, the City has already solicited an alternative banking services provider: in November 2017, in response to City Council resolutions calling for discontinuation of its contract with Wells Fargo, the City’s Department of Finance and Administrative Services (FAS) issued RFP No.FAS-3792 for Treasury Services.<sup>43</sup> Intended to select a new banking partner, the RFP process established minimum qualifications and social responsibility criteria for potential respondents. Applicants could reply for one or multiple services, divided among five modules:

- Banking services,
- Merchant services,
- Safekeeping services,
- Commercial card services, and
- Coin counting/intelligent safes.

Despite hosting a pre-proposal conference and responding to questions, the City did not receive any responses to the RFP. As a result, the City extended its contract with Wells Fargo through 2018. While the

<sup>43</sup> The Buy Line Seattle. [Treasury Services RFP](#).



unsuccessful RFP underlines the challenges of selecting a new banking partner, it does not preclude a future effort. Conversations with potential respondents held by HR&A indicated that interest in the RFP was high, but respondent requirements and the RFP timeframe prevented their responding. Furthermore, the City can issue a new RFP at relatively low cost without regulatory oversight. Informed by conversations with local bankers, we identified several components of the RFP that the City could consider revising to attract applicants in the future.

**Response timeframe:** after issuing the RFP on November 14, 2017, FAS required responses by December 21, 2017, with questions due by December 7, 2017. Due to a lack of initial responses, the deadline for submission was extended through January 23, 2018. Following this ten-week timeframe, which included several holidays, may not have offered enough time to respond to the multi-module application, especially given the complexity of the services requested.

**Separate module applications:** FAS divided the RFP into multiple modules to attract bidders that could perform certain services but not others. However, this approach may have deterred banks, credit unions, and their partners that would have preferred to apply as a team. If the RFP encouraged team-based applications, a local, regional, or community-based institution could apply as a lead respondent but still propose to outsource several of their services. This approach may be helpful for banks that do not currently have the capacity to handle certain modules, such as coin counting and commercial card services.

**“Outstanding” CRA rating:** driven by social responsibility goals, FAS required an “Outstanding” rating under the Community Reinvestment Act (CRA) for banks applying for the banking services module. However, only two banks based in Washington State maintain this rating, which is the highest issued by regulators: Community First Bank in Kennewick and Farmington State Bank in Farmington. Neither of these banks possesses the capacity to provide the City’s complex services or collateralize its deposits. By contrast, the majority of Washington-based banks maintain a “Satisfactory” rating. Notably, Wells Fargo received a “Needs to Improve” CRA rating in 2017 due to the regulatory consent orders resulting from its high-profile consumer fraud scandal, during which the bank opened thousands of illegal accounts without the permission of its customers.<sup>44</sup> Moving forward, the City could still use CRA ratings to score potential partners on social responsibility, but it should weigh the desire to maintain the highest possible rating against the effect of excluding most prospective respondents, including local community banks, which typically do not maintain ratings above “Satisfactory.” In 2016, 82% of banks maintained a CRA rating of “Satisfactory,” 16% maintained a rating of “Outstanding,” 2% maintained a rating of “Needs to Improve,” and less than 1% maintained a rating of “Substantial Noncompliance.”<sup>45</sup>

CRA ratings primarily measure a bank’s distribution of resources such as branches, loans, services, and investment throughout the communities it serves and was meant as a gauge of geographic and sociodemographic equity in its investments. It is therefore an incomplete measure of social responsibility in banking. Reimagining a broader metric to replace CRA for this purpose may help Seattle and other municipalities make decisions about the social responsibility of banking providers.

**Capital requirements:** while the City only maintains \$3M in overnight deposits, FAS still required banking services applicants to maintain a net worth above \$300M, per the Public Depository Protection Commission (PDPC) definition. Although this threshold eliminates many local banks and credit unions, it does allow several larger Washington-based regional banks, including:

<sup>44</sup> [Federal Reserve Enforcement Action against Wells Fargo.](#)

<sup>45</sup> Federal Financial Institutions Examination Council (FFIEC).

- Columbia State Bank, Tacoma
- Washington Federal, Seattle
- Banner Bank, Walla Walla
- Heritage Bank, Olympia
- Washington Trust Bank, Spokane
- HomeStreet Bank, Seattle

The capital requirements are likely needed due to both PDPC standards and the City's high deposit activity. Nevertheless, the City could pursue multi-bank partnerships that spread portions of the business to smaller banks and credit unions that may not meet the \$300M threshold or pursue a partnership with a large, but local, bank.

**Infrastructure and technology demands:** due to its volume of transactions and the complexity of the City's banking services, banking partners must possess the systems and platforms that can manage the transaction scale, whether online or in-person. Banks with extensive branch networks in Seattle and powerful online platforms would be best suited for the City's business. While small community banks may not reach this standard, regional banks could again provide most infrastructural needs, excluding certain outsourced services. Alternatively, the City could consider partnering with a consortium of local banks that could collectively offer the services at an appropriate scale.

In response to these concerns and other potential challenges, the City could encourage flexibility in responding to the scope of services by first issuing a Request for Qualifications (RFQ) or Request for Information (RFI) that would target local banks, credit unions, or even existing public or tribally-owned institutions. While an RFP asks suppliers to bid on a predetermined scope of services, an RFI requests general information on the suppliers' capabilities and an RFQ asks for prior work qualifications and potential interest in the requested services. Both RFQs and RFIs provide a multi-step, participatory process that informs the subsequent creation of an RFP and ultimately lessens the likelihood of a "no response" outcome.

Prior to issuing the RFP, the City would enter negotiations with selected potential bidders to determine the final scope of services. By engaging with local bankers through these processes, the City can receive feedback on how to structure its service offerings to attract a strong set of qualified partners. In particular, the City should solicit responses from local community and regional banks that share the City's community connections and social values. Informed by these discussions, FAS can then conduct a formal RFP process that identifies qualified, socially responsible banking partners.

## **STRATEGY II: DEVELOP NON-BANK INVESTMENT VEHICLES AND PARTNERSHIPS**

Although there are no precedents for a municipally-owned bank in the United States, there are many examples of municipal governments participating in the banking process, relying on local partners to provide low-interest loans or banking services, which are paid for or supported by City funds. Through its housing levy, Acquisition and Opportunity loan fund, and homeownership support programs, Seattle already engages in these partnerships to some extent, though these could be expanded using additional City funds if the City determines that existing programs do not meet its goals as currently implemented. Additionally, the form of the housing levy, which currently funds temporary homeowner assistance and opportunity loan funds, could be changed to resemble a revolving housing trust fund, which would gain in value over time. In this way, the Levy could be reshaped to accrue value in a way like a bank, but without the need for regulatory approval. Doing so would enable more investment for affordable housing, current a critical issue in the City.

Below, we provide a set of precedent programs that illustrate ways that cities can act to accomplish two objectives: providing additional capital funding for public priorities and providing better services to constituents. Two of these programs—the Acquisition and Opportunity loan fund and homebuyer assistance bridge loans—are currently implemented by the City of Seattle.

### (1) New investment vehicles for public priorities

For many years, cities have engaged in lending to support public priorities such as affordable housing and infrastructure through the use of non-bank investment vehicles. In most cases, these vehicles take the form of loan funds (sometimes called “infrastructure banks”) that accept an initial infusion of seed capital from a public entity, sometimes combined with private and non-profit funding, which they then lend to a targeted set of borrowers. Often, these loans serve as “gap financing,” providing funding for projects above and beyond the level that is available from a commercial bank. They may or may not provide this financing at below-market rates. Though the loan fund is responsible for sourcing these borrowers and managing its funds, the loans themselves are serviced by a third-party bank.

**Acquisition and Opportunity Loan Fund (Seattle, WA):** In Seattle, the Acquisition and Opportunity Loan fund provides short-term financing for the acquisition and preservation of affordable rental and homeownership housing. The Fund is intended as a rapid-response investment vehicle that will step in to assist in the purchase of a property before private financing is approved. Loans made by the Fund are typically repaid when permanent financing is secured. Loans are initiated using City funds but are serviced by third-party banks.<sup>46</sup> The program is funded by Seattle’s housing levy: since 1981, Seattle voters have approved five levies to create affordable housing, which provides funds for development, first-time home buyers, and emergency rental assistance.<sup>47</sup> Notably, the levy is re-issued periodically to replenish funding for these programs, which disburse funds over time, but do not sustain a long-term balance like a trust fund or revolving loan fund.

**Affordable Housing Managed Pipeline (Los Angeles, CA):** In Los Angeles, the Affordable Housing Managed Pipeline program has supported affordable rental housing since 2000. As opposed to Seattle’s program, which provides opportunistic short-term loans for acquisition, LA’s program extends long-term loans to support development through an open competitive process.<sup>48</sup> Capital for the program is provided by LA’s Affordable Housing Trust Fund, which is continually funded by bond issuances and commitments of city funds and which maintains long-term solvency through income generated from its loans.

**Chicago Infrastructure Trust (Chicago, IL):** The Chicago Infrastructure Trust was created in April 2012 by executive order of Mayor Rahm Emanuel and City Council resolution. The Trust, which is funded by the City as well as State, Federal and private grants, provides alternative financing and project delivery options for transformative infrastructure projects through joint ventures and public-private partnerships facilitated by third-party lenders.<sup>49</sup> By partnering with private investors, the Trust limits their risk exposure, allowing them to increase their investment in infrastructure projects. The Trust subsidizes infrastructure through its higher-than-typical tolerance for risk, and is intended to reinvest its profits, increasing in size year-to-year.

<sup>46</sup> <http://nlihc.org/rental-programs/catalog/seattle-acquisition-and-opportunity-loan-fund>

<sup>47</sup> <https://www.seattle.gov/housing/levy>

<sup>48</sup> <https://hcidla.lacity.org/Affordable-Housing-Trust-Fund-pipeline>

<sup>49</sup> <http://chicagoinfrastructure.org/about/operational-principles/>

## (2) Providing banking services to constituents

In addition to providing funding for public priorities, cities have partnered with third-party organizations and financial institutions to provide financial products and services to the general public. Typical programs include first-time home buyer assistance programs, such as those supported by Seattle’s Housing Levy, and low- or no-interest loans. Additionally, in recent years, cities have partnered with financial institutions to deliver financial service to vulnerable constituencies such as undocumented immigrants and participants in payday loans.

**First-Time Home Buyer Assistance Programs (Seattle, WA):** In Seattle, Housing Levy funds support a variety of first-time home buyer assistance programs including down payment assistance and lending administered by third-party programs. Partner organizations include HomeSight, which provides low-interest loans to qualified borrowers; House Key Plus Seattle, which provides second mortgage loans beyond the amount provided by commercial lenders; and Homestead Community Land Trust, which provides discounted homes with a long-term guarantee of affordability.<sup>50</sup> Each of these partner organizations works with a contracted bank to provide these loans.

**0% Interest Home Repair Loans (Detroit, MI):** The Detroit 0% Interest Home Repair Loan Program provides interest-free loans between \$5,000 and \$25,000 to single family home owner-occupants looking to complete home repairs or improvements. Funding for the program comes from U.S. Housing and Urban Development Community Development Block Grant funds pledged by the City of Detroit, as well as funding from a private investor and the Local Initiatives Support Corporation (LISC), a New York-based nonprofit Community Development Financial Institution (CDFI). Bank of America services the loans and collects a fee from the funders in lieu of charging interest.<sup>51</sup>

**WeDevelopment Credit Union (Kansas City, MO):** In May of 2018, the WeDevelopment Credit Union opened in Kansas City, MO with the mission of providing banking services to the unbanked and underbanked and a focus on offering alternatives to predatory lending practices such as payday loans. The credit union, supported by a \$250,000 deposit commitment from the City of Kansas City and a \$1M deposit commitment from Kansas City Power & Light, is privately-controlled but leverages City participation to offer its services.

**IDNYC Banking Partnerships (New York, NY):** Since 2015, New York City has offered IDNYC, a municipal ID card, with the goal of providing New York City residents, regardless of citizenship status, with a stigma-free, accessible, government-issued form of identification and, therefore, access to City services and amenities. As one of the benefits of the program, the IDNYC could be used as a primary form of identification to open an account at 12 partner financial institutions within New York City. By securing the cooperation of these institutions, New York City hoped to provide a banking option for immigrants, who have historically been unbanked or underbanked. The City’s financial empowerment centers as well as IDNYC enrollment centers provided counseling to enrollees in English and Spanish focused on financial services access.<sup>52</sup>

In each case, delivering these services requires the commitment of capital by the City but allows it to deliver increased services or increase the availability of credit without regulatory approval. That said, the need for these services must be clearly established to justify the commitment of additional capital beyond the programs in which Seattle already engages. Therefore, we recommend further study of local capital and banking services needs prior to proceeding with an expansion of local partnerships and investment vehicles.

<sup>50</sup> <http://www2.oaklandnet.com/government/o/hcd/s/HousingResources/OAK047037>

<sup>51</sup> <http://www.detroithomeloans.org/frequently-asked-questions/>

<sup>52</sup> <https://www1.nyc.gov/site/idnyc/benefits/banks-and-credit-unions.page>

### STRATEGY III: COLLABORATE WITH EXISTING PUBLIC BANKING EFFORTS

Forming its own bank presents Seattle with a large number of challenges, particularly in terms of state regulations and the need for capital. Nevertheless, Seattle's participation in third-party public banking effort may help to mitigate these challenges. Specifically, the City could either engage with the State-level public bank effort, which would allow it to leverage a broader pool of capital resources and pre-empt state regulation. Over the long term, it could engage with other municipalities to develop a scalable, sustainable public option across state lines, which would provide with additional sources of capital and greater political heft to lobby the government.

**Collaborate with State-level public banking advocates:** since at least 2010, legislators and advocates have pursued a public banking model at the State level.<sup>53</sup> Spearheaded by State Senator Bob Hasegawa, this effort has progressed to the business planning stage and has included feasibility discussions with the State's Department of Financial Institutions (DFI). Compared to a municipal bank, the State bank would benefit from greater access to startup capital and greater ability to change State laws, including lending restrictions and public depository requirements. As an alternative to the City's own public bank, the City Council could partner with the State bank to capitalize on its existing momentum; business planning for the bank commenced in 2017.<sup>54</sup> As the State bank develops, the City could lobby for allowing municipalities to deposit funds, in line with the Bank of North Dakota. In addition, an early partnership with the state in planning the bank could improve the City's influence in the public bank as a stakeholder, encouraging the bank to align with the City Council's social priorities.

**Engage with other municipalities:** In addition to the State, other municipalities, both within Washington and outside it, provide a potential source of capital for the bank as well as a long-term option for mutual self-insurance as an alternative to FDIC insurance. This model, similar to the *Sparkasse Finanzgruppe* banking system in Germany, would pool deposits from multiple cities into a single pool, allowing Cities to save on banking services by achieving large economies of scale. In addition, the municipal partners would insure each other's deposits by guaranteeing support to any individual city amid a liquidity or capital crisis, alleviating the need for an outside insurer. Given the unprecedented level of inter-city cooperation, however, this model represents at best a long-term strategy for public banking in Seattle. Nevertheless, the City could begin engaging other municipalities, in Washington and elsewhere, that are exploring the idea of a public bank. As of September 2018, these cities include San Francisco, Los Angeles, Santa Fe, Philadelphia, Washington, DC, and New York City. Through this engagement, the cities can share knowledge and develop relationships that could later support a broader banking network once one or more cities successfully founds a public bank.

While both of these strategies could bolster the public banking effort, they will demand financial and time costs, from lobbying for the bank to capitalizing the balance sheet. Each step in this process could take multiple years. In this way, a collaborative approach does not differ significantly from the City-owned bank in this study, though it may offer feasibility benefits from political momentum and/or financial scale. Consequently, the City may be best served by implementing the shorter-term alternatives while pursuing the longer-term vision concurrently.

<sup>53</sup> Center for State Innovation. *Washington State Public Bank Legislative Guide*. 2010.

<sup>54</sup> [Public Depository Task Force](#). Washington State Department of the Treasury.

MEMORANDUM

**TO:** Andrea Batista Schlesinger, Avinoam Baral, and Julian Sagastume, HR&A Advisors, Inc.

**FROM:** Paul Lawrence and Alanna Peterson, Pacifica Law Group LLP

**DATE:** October 5, 2018

**SUBJECT:** City of Seattle Public Bank Feasibility Study  
Legal Analysis

## I. OVERVIEW

The City of Seattle (the “City”) is one of a growing number of state and local government entities exploring the possibility of establishing and operating a public bank. Public banks are perceived as a potential solution to numerous issues, including mistrust of big banks and the insufficiency and unreliability of banking services for cannabis businesses. Yet despite that significant interest, only two public banks—the century-old Bank of North Dakota and the Territorial Bank of American Samoa, which received federal regulatory approval just this year—are currently in operation.

The City previously conducted a limited analysis on the issue, including a brief memorandum by City Attorney Pete Holmes, and now seeks to conduct a comprehensive feasibility study to determine if it is lawful and sensible for the City to create and operate a public bank. To that end, you have asked us to respond to the legal questions identified in the City’s Request for Proposal (“RFP”).<sup>1</sup> Specifically, this memorandum addresses the following questions:

- Is the City precluded by state or federal law from establishing and operating a public bank that is solely focused on providing banking services to the City?

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<sup>1</sup> These questions can be found in Section 5, Scope of Work, in the City’s RFP for this feasibility study.

- Is the City precluded by state or federal law from establishing and operating a public bank that also provides depository and other banking services to the public?
- Are there any particular legal challenges to a City-owned bank providing banking services to the cannabis industry?
- What are the necessary steps for the City to establish a public bank?
- Could a public bank be under the direct control of the City's elected officials or would it need to be fully independent of the City's governance?

In short, state and federal law generally do not preclude the City from operating a public bank, although that conclusion becomes less certain as the scope of services and client base of the bank are broadened. The operation of a public bank likely falls within the City's broad authority under state law. However, the state constitution prohibits the City from making gifts or lending its credit to private individuals and businesses, although there is an exception for aid to the poor or infirm. If the bank's services include the lending of credit (i.e. by loans or guarantees of deposits) to persons other than government entities, the poor, or the infirm, there is a risk that Washington courts would find those services unconstitutional. Offering services to the cannabis industry is similarly uncertain and would likely preclude approval by the Federal Reserve, preventing the City from providing basic banking services to the general public. Regardless of the scope of services provided or clients served, the first step is to amend the city charter to identify the creation and operation of a public bank among the City's powers and functions. Finally, there are no federal or state requirements regarding the control of a public bank, although as a practical matter it may be easier to obtain needed state and federal approvals if elected officials' influence is limited.

## II. DISCUSSION

### **A. Neither state nor federal law precludes the City from establishing and operating a public bank to provide banking services solely to the City.**

Although there are state and federal requirements with which the City (or a public corporation it creates for this purpose) must comply to establish a public bank to serve it, we found no laws precluding the City from doing so.

#### **1. Relevant Federal Laws.**

Federal Reserve Account. To provide basic banking services, such as performing wire or funds transfers, transferring funds out of state, clearing checks, and processing credit and debit

cards, the City would need to obtain the approval of the Federal Reserve. The two existing public banks have Federal Reserve accounts. The process for applying for a Federal Reserve account is described in Section II.D below.

FDIC Insurance. A public bank would likely not qualify for Federal Deposit Insurance Corporation (“FDIC”) insurance, at least not right from inception. So, a Seattle bank would likely need to self-insure its deposits. Neither of the two existing public banks is insured by the FDIC. The FDIC has previously issued guidance expressing that any applications for deposit insurance from state-run banks would be “reviewed very closely.”<sup>2</sup> Specifically, the FDIC stated that “due to their public ownership, such depository institutions present unique supervisory concerns that do not exist with privately owned depository institutions,” such as “special concerns relating to management stability, their business purpose, and their ability and willingness to raise capital . . . due to their ultimate control by the political process.”<sup>3</sup> The FDIC did allow, though, that “such institutions may be particularly likely to meet the convenience and needs of their local community, particularly if the local community is currently un- or under-served by depository institutions.”<sup>4</sup> That particular consideration is unlikely to weigh in the City’s favor here, where residents certainly do not have a shortage of banks to serve them. That guidance was issued twenty years ago, though, so there is the potential that the FDIC’s position has changed.

## 2. Relevant State Laws.

Home Rule Authority. The creation and operation of a public bank, particularly one that serves only the City, is well within the City’s broad authority under state law. Washington law permits residents of large (or “first class”) cities, like the City, to draft their own charters establishing the structure, functions, and powers of their local government.<sup>5</sup> It also permits them to “make and enforce within its limits all such local police, sanitary and other regulations as are not in conflict with general laws.”<sup>6</sup> Washington law also grants cities “all powers possible for a city or town to have under the Constitution of this state, and not specifically denied to [] cities by law,” including the power to provide “local social, cultural, recreational, educational,

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<sup>2</sup> FDIC, FDIC Statement of Policy on Applications for Deposit Insurance, 500 (July 7, 1998), <https://www.fdic.gov/regulations/laws/rules/5000-3000.html>.

<sup>3</sup> *Id.*

<sup>4</sup> *Id.*

<sup>5</sup> Wash. Const. Art. XI, sec. 10; *see also* RCW 35.22.030.

<sup>6</sup> Wash. Const. Art. XI, sec. 11.



governmental, or corporate services[.]”<sup>7</sup> Although the legislature has granted some specific rights to cities, those express grants are “in addition and supplementary to” those broad powers.<sup>8</sup> This “general grant of municipal power . . . is intended to confer the greatest power of local self-government consistent with the Constitution of this state and shall be construed liberally in favor of such cities.”<sup>9</sup>

The creation of a public bank to ensure the security of City funds falls squarely within that broad grant of authority. Although the legislature has not expressly granted cities the authority to operate public banks, it also has not expressly denied cities that right.<sup>10</sup> Further, the legislature has granted cities the authority to “control . . . finances.”<sup>11</sup> Because the operation of a public bank is consistent with the City’s broad constitutional and statutory authority and is not expressly denied by the legislature, no legislative grant of approval is required. Seattle has a City Charter, however, that sets forth the scope of the exercise of its powers. Currently, the Charter is silent with respect to operation of a bank. Thus, the City likely would need to adopt a Charter amendment to specifically include the creation and operation of a public bank among its powers and functions. The charter amendment process is described in more detail in Section II.D.

Public Depository Requirements. State law requires that all public funds be deposited only in certified public depositories.<sup>12</sup> The State Public Deposit Protection Commission (“PDPC”) oversees and regulates the states’ public depositories. The function of these rules is to ensure that public funds are protected if a financial institution becomes insolvent.<sup>13</sup> To become a certified public depository, the public bank must be approved by the PDPC and segregate collateral equal to the amount of uninsured public deposits it will receive.<sup>14</sup> The PDPC also has the discretion to require a public depository to pledge additional collateral or permit it to pledge

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<sup>7</sup> RCW 35A.11.020. This provision applies to charter cities. *See* RCW 35.22.195 (providing that charter cities “have all of the powers which are conferred upon incorporated cities and towns . . . and all such powers as are usually exercised by municipal corporations of like character and degree”). Courts have applied home rule authority broadly to permit cities to establish a municipal cable television system and broadband internet services, for example. *See Rohrbach v. City of Edmonds*, 162 Wn. App. 513, 256 P.3d 1242 (2011); *City of Issaquah v. Teleprompter Corp.*, 93 Wn.2d 567, 611 P.2d 741 (1980).

<sup>8</sup> RCW 35A.11.050.

<sup>9</sup> *Id.*

<sup>10</sup> *See* Chapter 35 RCW; Chapter 35A RCW.

<sup>11</sup> RCW 35.22.280.

<sup>12</sup> RCW 39.58.080(1) (“no public funds shall be deposited in demand or investment deposits except in a public depository located in this state or as otherwise expressly permitted by statute”).

<sup>13</sup> <https://tre.wa.gov/partners/public-deposit-protection-commission-pdpc/>.

<sup>14</sup> WAC 389-12-071.

less collateral.<sup>15</sup> In determining whether to permit a depository to pledge less collateral, the PDC may consider, among other factors, “the overall market conditions for financial institutions, the extent to which public deposit protections might be lessened, and the effects such change may have on other public depositories.”<sup>16</sup> Any public bank the City creates will need to receive PDPC approval to accept the City’s deposits.

**B. State law likely permits the City to establish and operate a public bank to serve the poor or infirm, but the extent to which the City could serve the general public and private businesses is uncertain.**

As noted in Section II.A, federal law does not preclude the City from operating a public bank and the City generally has the authority under state law to do so. However, state constitutional prohibitions on loaning money or credit will likely limit the scope of services the City can provide and to whom.

Article VIII, Section 7 of the Washington Constitution prohibits cities from lending money or credit to private individuals and businesses.<sup>17</sup> It is not necessary that the City incur “actual indebtedness” to implicate this provision. Instead, a city “lends its credit whenever it allows its unique governmental status or authority to be utilized for the purpose of enabling a private corporation or individual to obtain property or money that it could not otherwise acquire for the same price, whether or not actual indebtedness is incurred.”<sup>18</sup> Importantly, “[g]ratuitous state aid to private enterprise or private persons although for a laudable public purpose is prohibited[.]”<sup>19</sup> Although Washington courts have not considered the issue, most banking services, particularly loans and credit card services, would likely implicate this provision, particularly if the City aims to provide banking services at more affordable rates than private banks.

Article VIII, section 7 explicitly excepts the loaning of money or credit for “the necessary support of the poor and infirm,” so banking services that fall within that exception would likely

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<sup>15</sup> WAC 389-17-071; WAC 389-12-045.

<sup>16</sup> WAC 389-12-045.

<sup>17</sup> Wash. Const. Art. VIII, sec. 7 (“No county, city, town or other municipal corporation shall hereafter give any money, or property, or loan its money or credit to or in aid of any individual, association, company or corporation, except for the necessary support of the poor and infirm or become directly or indirectly the owner of any stock in or bonds of any association, company or corporation.”).

<sup>18</sup> *Washington Health Care Facilities v. Ray*, 93 Wn.2d 108, 114, 605 P.2d 1260 (1980).

<sup>19</sup> *Washington State Hous. Fin. Comm'n v. O'Brien*, 100 Wn.2d 491, 498, 671 P.2d 247 (1983).

be permissible.<sup>20</sup> Washington courts read the phrase “poor and infirm” in the “disjunctive,” so gifts or loans can be made to those who are poor **or** infirm.<sup>21</sup> For example, the Washington Supreme Court upheld a state program providing mortgage loans to low-income residents because its “purpose . . . is to benefit a class of citizens reasonably determined to require public aid to meet their housing needs, and not to benefit a specific private enterprise. Because such a purpose is well within the legitimate purview of state government, it does not conflict with the lending of credit prohibition.”<sup>22</sup> Thus, the City bank likely would be able to lend its credit to support non-profits in building low-income housing or lending to low-income residents to help obtain housing. Courts defer to the government entity’s conclusion regarding the population that its actions serve, and determine only whether the government’s conclusion is reasonable.<sup>23</sup> For that reason, it would be advisable for the City to define the public bank’s scope of services to conform to this exception and to base those services on explicit findings regarding the populations they are intended to serve.

### **C. Federal law would likely preclude a public bank from serving the cannabis industry.**

Serving the cannabis industry would also raise significant legal challenges. Serving the cannabis industry would likely preclude Federal Reserve approval, which would then impede the bank’s ability to provide basic banking services to the general public. The Federal Reserve recently denied a master account to a state-chartered credit union for just that reason.<sup>24</sup> A federal court declined to exercise its jurisdiction to require the Federal Reserve to approve the account, because the outcome the credit union desired—to serve marijuana businesses—is illegal under federal law.<sup>25</sup> Although the Federal Reserve ultimately opened a master account for the credit union, it only did so after the credit union limited its services to serve only individuals and companies that indirectly support legalized marijuana, such as accountants and landlords.<sup>26</sup> We are unaware of any state laws or regulations precluding the provision of banking services to the marijuana industry.

### **D. Legal steps to establish a public bank.**

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<sup>20</sup> *Ray*, 93 Wn.2d at 114.

<sup>21</sup> *Id.* at 116.

<sup>22</sup> *O'Brien*, 100 Wn.2d at 498.

<sup>23</sup> *Id.* at 497.

<sup>24</sup> *Fourth Corner Credit Union v. Fed. Reserve Bank of Kansas City*, 861 F.3d 1052, 1054 (10th Cir. 2017).

<sup>25</sup> *Id.*

<sup>26</sup> Lalita Clozel, “Fed Backs Marijuana-Focused Credit Union,” Wall Street Journal (Feb. 5, 2018), available at <https://www.wsj.com/articles/fed-backs-marijuana-focused-credit-union-1517870188>.

Regardless of the scope of services the bank will provide, the City should first amend its charter to identify the creation and operation of a public bank among its powers and functions. To do so, a majority of the City council must approve the amendment and then submit it to the voters in the next general election.<sup>27</sup> The City council must approve the amendment at least 60 days before the election.<sup>28</sup> The amendment must be approved by a simple majority of voters.<sup>29</sup> An amendment can also be proposed by the voters themselves.<sup>30</sup> As described above, the creation of a public bank falls within the City's broad police powers and thus state legislative approval is not required.

After the City amends its charter, it can begin the process to seek a state bank charter. To do so, the City should notify the Department of Financial Institutions (“DFI”) of its intent to create a public bank and schedule a meeting to discuss what DFI may require. Although state law directs incorporators to first file a notice of intent to organize with DFI to start the process,<sup>31</sup> DFI recommends that applicants instead schedule a pre-application meeting to determine whether an applicant’s unique circumstances may require different or additional submissions.<sup>32</sup> DFI’s online materials appear to assume that an applicant will also be applying for FDIC insurance, but we are unaware of any state laws or regulations requiring FDIC insurance to obtain a state bank charter.

The public bank must apply for (but need not yet obtain) a state bank charter before starting the process to obtain a Federal Reserve account.<sup>33</sup> Although the application process generally takes 30 to 60 days, its review of the Territorial Bank of American Samoa, which took two years, suggests that the unique circumstances here likely would prolong its review.<sup>34</sup>

**E. There are no state or federal requirements governing the control of a public bank.**

Finally, the City also asks whether a public bank could be controlled directly by City officials or should be independent from the City. We are not aware of any applicable federal or

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<sup>27</sup> City Charter, Article XX, Section. 1.

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

<sup>30</sup> *See id.*, Section 2. It must be approved by 15% of the registered voters who voted in the last election for Mayor. *Id.*

<sup>31</sup> *See* RCW 30A.020.

<sup>32</sup> <https://dfi.wa.gov/banks/faqs#how-start-bank>.

<sup>33</sup> <https://www.federalreserve.gov/supervisionreg/afi/smfilings.htm>.

<sup>34</sup> *Id.*

state legal requirements that require one particular means of governance. However, it would be advisable to create some separation to appease the concerns of state and federal regulators. For example, both the Bank of North Dakota and the Territorial Bank of American Samoa—the only two public banks in the United States—are governed by a board/commission either comprised of or selected by federal officials, but the day-to-day operations of the banks are run independent of government.

There are a variety of ways that the City could accomplish this, but the most direct approach would be to create a special purpose corporation to operate the bank. Cities often create special purpose public corporations, commissions, or authorities, known as “PDAs,” when undertaking unusual activities that are outside the province of the City’s normal operations (and often expertise). PDAs can be created to perform any “lawful public purpose or public function,” and state law requires that the PDA’s liability be limited to its own “assets and properties” to protect the city that created it.<sup>35</sup> PDAs are often governed by a board of directors appointed by the executive branch (here, the mayor) and confirmed by the city council, but otherwise operate independently of the local government that created it.<sup>36</sup> We understand that recommendations regarding the specific structure of the public bank and the process for establishing it are beyond the scope of this memorandum.

Please let us know if you have any questions. Thank you.

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<sup>35</sup> RCW 35.21.730(5).

<sup>36</sup> For example, the city of Bellevue established the Bellevue Public Development Authority to build and operate the Meydenbauer Center, a convention center and theatre complex intended to boost the local economy. It is operated by a board of directors appointed by the city manager with confirmation by the city council.



**PUBLIC BANK FEASIBILITY STUDY**  
STAKEHOLDER GROUP WORKSHOP

**10.1.18**

# PLAN FOR TODAY

<b>Project Overview</b>	2:00-2:05
<b>Review of Findings</b>	2:05-2:25
<b>Alternative Options</b>	2:25-2:40
<b>Group Discussion</b>	2:40-3:20
<b>Next Steps</b>	3:20-3:30

# PROJECT OVERVIEW

**Question 1** Can the City of Seattle be its own bank?



**Question 2** Can this bank engage in other activities?

- *Take deposits from the general public?*
- *Serve cannabis-related businesses?*
- *Make loans?*



# PROJECT OVERVIEW

	<b>Baseline Model</b>	<b>Bank of North Dakota</b>	<b>Bank of American Samoa</b>	<b>Commercial Bank</b>
<b>Owner</b>	City of Seattle	State of North Dakota	Government of American Samoa	Shareholders
<b>Issuer of Charter</b> (Primary Regulator)	State of Washington	State of North Dakota	Government of American Samoa	Home State or Fed. Government
<b>Activities</b>				
Accepts government deposits	Yes	Yes	Yes	Sometimes
Accepts deposits from general public	No	No	Yes	Yes
Issues loans	No	Yes	Yes	Yes
Serves cannabis-related businesses	No	No	No	No

## SUMMARY OF FINDINGS: REGULATORY

*The baseline model is feasible, but subject to several layers of administrative review.*

Questions	Agency	Answer
Can the bank receive a charter?	<b>DFI</b> Department of Financial Institutions (WA)	<i>Yes, provided it can prove its financial stability.</i>
Can the bank accept deposits from the City?	<b>PDPC</b> Public Deposit Protection Commission (WA)	<i>Yes, provided it meets PDPC requirements.</i>
Can the bank perform transactions?	<b>FRB</b> Federal Reserve Bank	<i>Yes, but be prepared for a review process of up to two years.</i>
Can the bank accept deposits from the general public?	<b>FDIC</b> Federal Deposit Insurance Corporation	<i>Yes, provided it can prove its financial stability.</i>

## SUMMARY OF FINDINGS: LEGAL

*The City has the authority to charter a bank, subject to the restriction of existing law.*

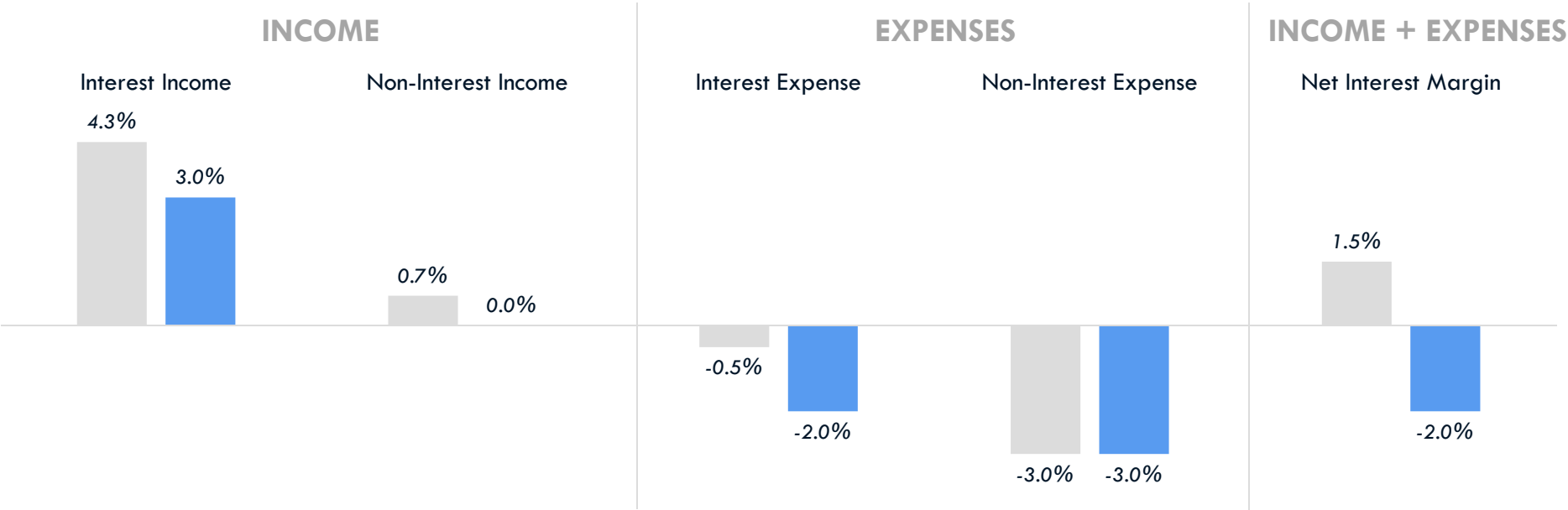
Questions	Relevant Law	Answer
Can the bank receive a charter?	<b>N/A</b>	<i>No law exists preventing a public bank from being chartered. Home rule means the public must vote to give Seattle the ability to operate it.</i>
Can the bank make loans?	<b>Washington Constitution</b>	<i>Yes, but it can only do so to the “poor and infirm.” Public institutions cannot extend credit to the general public.</i>
Can the bank accept government deposits?	<b>Washington Public Depository Law</b>	<i>Yes, but it must maintain collateral equal to 100% of these deposits.</i>
Can the bank serve cannabis businesses?	<b>Federal Law</b>	No.

# SUMMARY OF FINDINGS: FINANCIAL

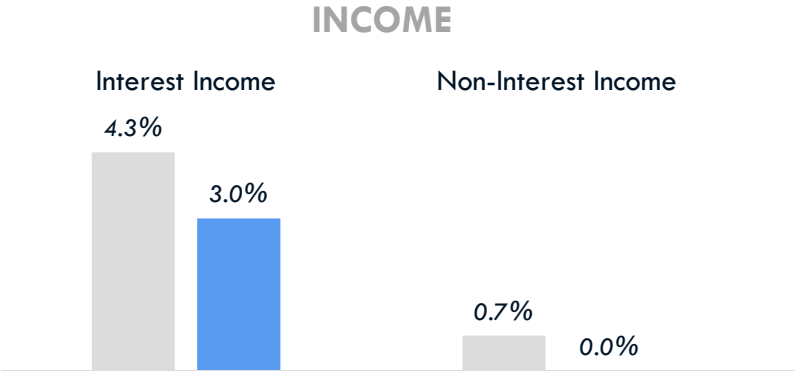
*Within the existing legal framework, bank income would be lower and expenses would be higher.*

## COMPARISON OF INCOME AND EXPENSES AS A PERCENTAGE OF AVERAGE ASSETS

■ Typical Washington State Bank   ■ Baseline Model (Assumed)



# SUMMARY OF FINDINGS: FINANCIAL



Because of the PDPC’s restriction on mainstream loans, interest income would be lower than commercial banks.

Additionally, the bank would not earn substantial income from fees.

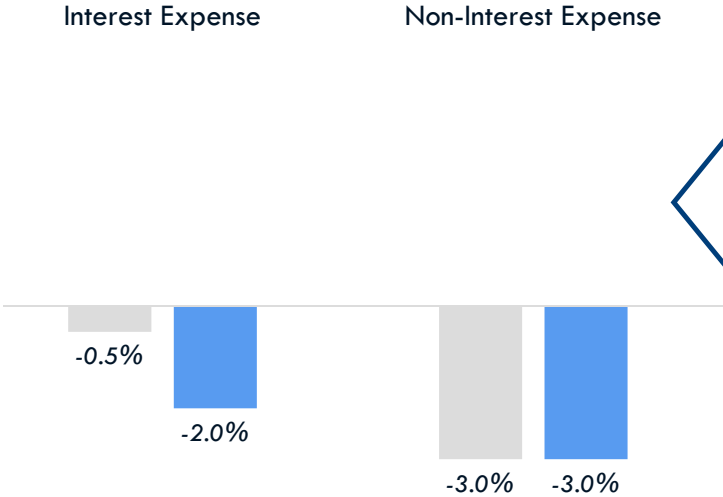
# SUMMARY OF FINDINGS: FINANCIAL

*Commercial banks pay between 0% and 1% for capital in the form of interest.*

*In contrast, Seattle gets at a 2% return on its capital assets. A bank would have to match this amount or the City would functionally absorb a loss.*



## EXPENSES

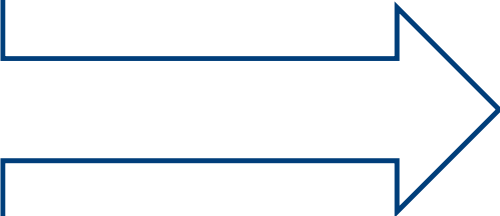


*We assume expenses will be similar, but could be higher as the bank gains expertise or lower since it provides fewer services.*

# SUMMARY OF FINDINGS: FINANCIAL

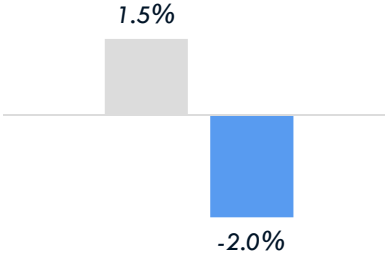
As a result, the margin of the bank will be narrow or may be negative in initial years.

The bank could raise its income or lower its expenses to counter these factors. Both would be uncertain or forms of public subsidy.



## INCOME + EXPENSES

Net Interest Margin

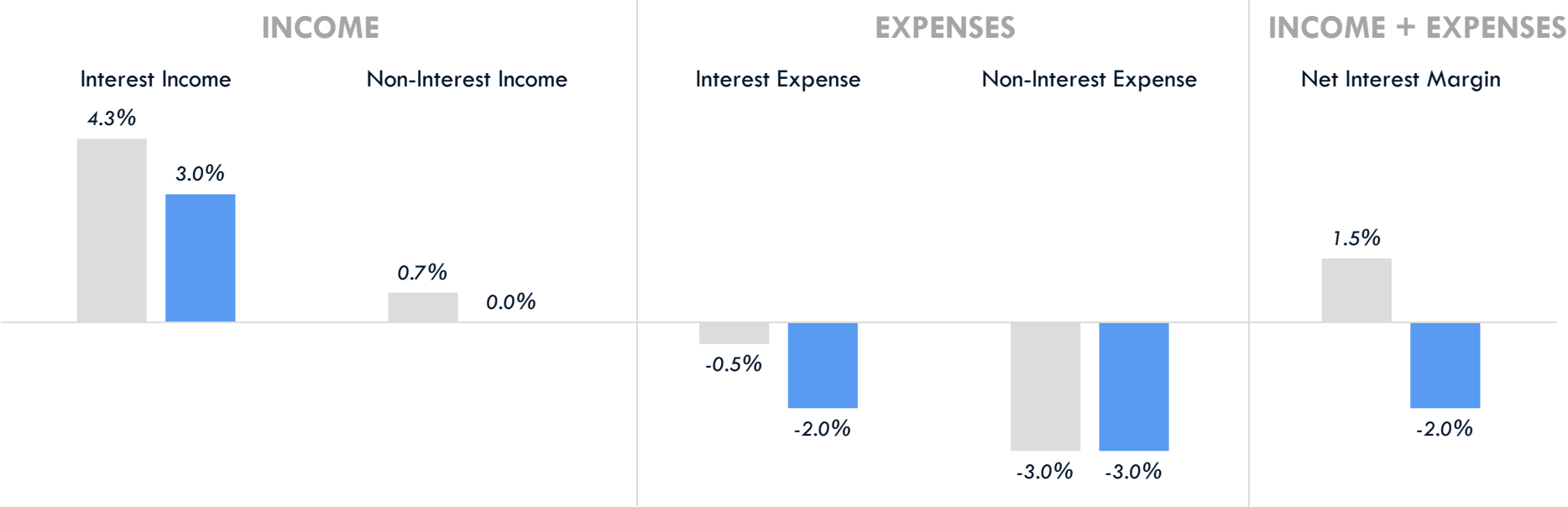


# SUMMARY OF FINDINGS: FINANCIAL

*Within the existing legal framework, bank income would be lower and expenses would be higher.*

## COMPARISON OF INCOME AND EXPENSES AS A PERCENTAGE OF AVERAGE ASSETS

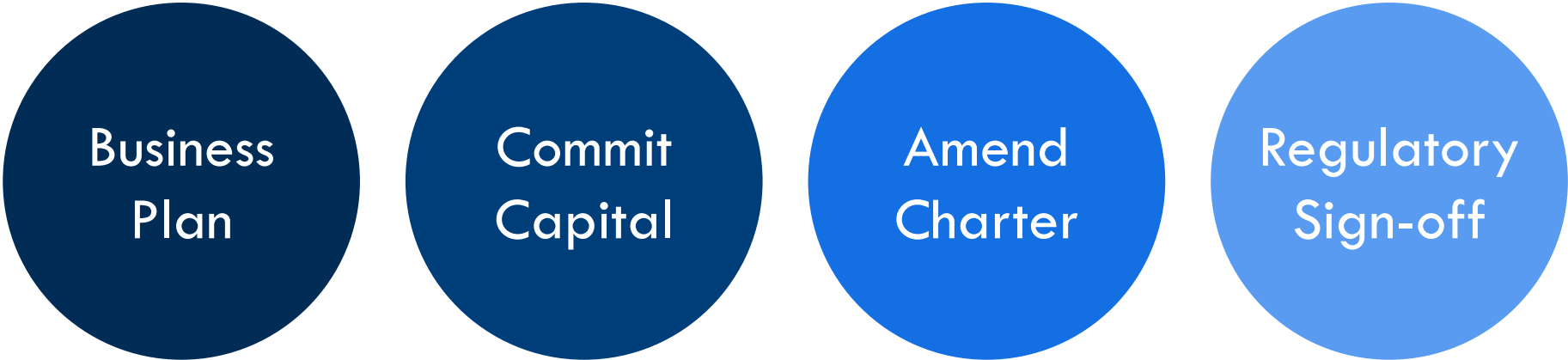
■ Typical Washington State Bank   ■ Baseline Model (Assumed)





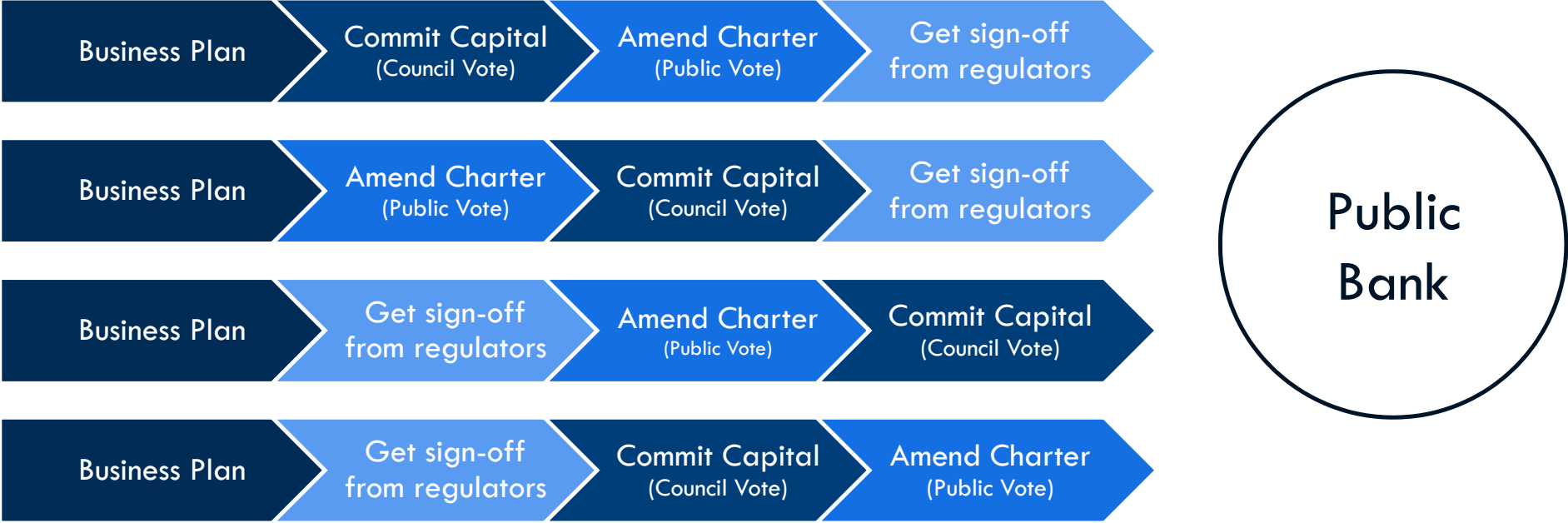
# SUMMARY OF FINDINGS: NEXT-STEPS

*There are four key steps to creating the bank.*



# SUMMARY OF FINDINGS: NEXT-STEPS

*Once a business plan is created, approval from the council, public, and regulators can come in any order.*



## SUMMARY OF FINDINGS

- No law prohibits the City from establishing a public bank, but doing so requires **sign-off from at least three state and federal regulators**.
- In addition, Washington’s public depository law prevents the bank from making **high-interest investments** with public deposits. Washington’s constitution prevents it or **market-rate loans** at all.
- Therefore, the bank is likely to have **lower-than-average returns** and **higher-than average costs** for capital, meaning that the City would likely need to subsidize it in some way.
- If the City wishes to proceed with the bank under current law, it should (1) create a **business plan**, and then—in any order—(2) **amend its charter**, (3) **commit capital** to the bank, and (4) seek **sign-off from regulators**.
- Regulatory requirements, such as public depository restrictions, could be eased with the help of the **state legislature**, as is the case with the Bank of North Dakota and Territorial Bank of American Samoa.

## THREE COMPLEMENTARY STRATEGIES

- **Refresh treasury services RFP** to seek out a more appropriate banking partner
- **Develop non-bank investment vehicles and partnerships** such as infrastructure banks, loan funds, and service partnerships
- **Collaborate with existing public banking efforts**, such as the State's business planning process

# STRATEGIES X GOALS

STRATEGIES	GOALS		
	Discontinue use of Wells Fargo	Increase capital available for local priorities	Offer better banking services to Seattle residents
Refresh treasury services RFP	Yes	No	No
Develop non-bank investment vehicles and partnerships	No	Yes	Yes
Collaborate with existing public banking efforts	Yes	Maybe	Maybe

## **(1) RFP REFRESH**

### **Issues local banks cited in responding to the City's RFP**

- Timeline
- “Outstanding” CRA rating requirement
- Volume of transactions vs. average account balance
- Infrastructure requirements (safes, local branches, custom software)
- Capital requirements

**(1) RFP REFRESH**



**RFP**

Single-stage process

*Respondents demonstrate that they meet set requirements and submit a pricing proposal.*



**RFI/RFQ**

Multi-stage process

*Respondents collaborate with the purchasing entity to set terms, pricing, and qualifications.*

## (2) NEW INVESTMENT VEHICLES AND PARTNERSHIPS



Seattle’s housing levy funds first-time homebuyer assistance programs as well as short-term opportunity site purchase loans syndicated through local CDFIs.



Los Angeles dedicates funding to extend short-term loans to support development of affordable housing through an open competitive process.



In 2012, Chicago creates its infrastructure trust, which provides mezzanine financing to infrastructure projects, limiting the risk exposure of investors and allowing them to expand their investment.



## (2) NEW INVESTMENT VEHICLES AND PARTNERSHIPS



### 0% INTEREST HOME REPAIR LOANS

Detroit dedicated CDBG funds to subsidizing interest for home-repair loans administered by Bank of America.



Kansas City committed \$1.25M in deposits to a credit union with the mission of providing alternatives to predatory lending practices.



NYC provides ID cards for all residents regardless of immigration status and works with local banks to ensure it is accepted as valid for new accounts.

### (3) EXISTING PUBLIC BANKING EFFORTS

#### SENATE BILL REPORT SB 6375

As Reported by Senate Committee On:  
Financial Institutions & Insurance, January 25, 2018

**Title:** An act relating to developing a publicly owned depository business plan.

**Brief Description:** Developing a publicly owned depository business plan.

**Sponsors:** Senators Hasegawa, Kuderer, Chase, Wellman, Saldaña, Palumbo, Ranker, Rolfes, Conway, Keiser and Hunt.

**Brief History:**

**Committee Activity:** Financial Institutions & Insurance: 1/16/18, 1/25/18 [DP-WM, DNP].

**Brief Summary of Bill**

- Directs the Department of Commerce (Commerce) to contract with an entity with expertise in public finance and banking to develop a business plan to establish a publically owned depository.

**Summary of Bill:** Commerce must work with DFI, the Office of Financial Management, the Treasurer, the attorney general, and other appropriate agencies to contract with an entity with expertise in public finance and banking to develop a governance structure and a business plan to establish a publicly owned depository. The business plan must include a start-up business plan for the public bank that includes plans and timelines for new functions and functions transitioning to the bank that were previously performed by another entity. The business plan must also identify sources of capitalization and recommended cash flows. The business plan should consider different scale options for the financial assets of the public bank including an option for financial deposits up to \$500 million over the first five years of operation.

The business plan must also address:

- legal, constitutional, and regulatory issues;
- how to obtain a federal master account and join the federal reserve;
- information technology security;
- opportunities for collaborating with other financial institutions;
- impacts on the state's debt limit;
- recommendations for managing political influence on the public bank;
- impacts on the budget and existing state agencies including the Treasurer; and
- other items necessary to establish a state bank, state cooperative bank, or a state bank modeled after the Federal Home Loan Bank.

The Department must provide a final report to the Legislature by December 1, 2018.

# STRATEGIES X GOALS X CHALLENGES

STRATEGIES	GOALS			CHALLENGES		
	Discontinue use of Wells Fargo	Increase capital available for local priorities	Offer better banking services to Seattle residents	Cost to City	Execution timeline	Regulatory uncertainty
Refresh treasury services RFP	Yes	No	No	Low	Short-term	Low
Develop non-bank investment vehicles and partnerships	No	Yes	Yes	Medium	Mid-term	Medium
Collaborate with existing public banking efforts	Yes	Maybe	Maybe	Unknown	Long-term	High