MUNICIPAL BANK FEASIBILITY TASK FORCE
PREP MATERIALS FOR MEETING 2
MARCH 20, 2018 3:30-5:30 PM
CITY HALL ROOM 305
PUBLIC BANK REQUIREMENTS

1. WHAT IS A PUBLIC BANK?

☐ A bank is a financial institution licensed to receive deposits and offer loans.

☐ Banks may perform retail banking, serving individuals and small businesses, or wholesale banking, serving large institutions like governments and other banks.

☐ A public bank is a banking institution affiliated with a locality, state or nation. The actual functions of a public bank could vary widely, depending on the jurisdiction’s needs. In California, so long as a public bank accepts deposits, it will be regulated as a bank. Cal. Fin. Code §§ 1004-1005

☐ Below is a non-exhaustive list of administrative and operational requirements for a public bank in San Francisco.

2. ADMINISTRATIVE REQUIREMENTS TO START A BANK

☐ Bank Charter – To operate, a financial institution needs a charter, granted either by the state or federal government. In California, financial institutions can be chartered as credit unions or commercial banks. Neither structure may be fully appropriate for a public bank.

☐ Insurance – Under California state law, all commercial banks must have FDIC insurance, which insures deposits up to $250,000. However, the FDIC may be reluctant to insure a public bank. California Credit unions must be insured through the National Credit Union Association or a private provider.

☐ Access to the Federal Reserve – The Federal Reserve operates an electronic payment system for transferring money across banks. To access the Fed’s payment system, a bank needs a master account with the Fed or a correspondent banking relationship.

☐ Capitalization – A bank must hold between 8 and 10+ percent of its assets in bank capital (fully-paid stock). This capital must cover start-up costs as well as anticipated growth. For a public bank, this capitalization could come from a legislatively appropriation, a bond issuance or philanthropy.

3. OPERATIONAL REQUIREMENTS TO START A BANK

☐ Governance Structure – A bank must have a governance structure (Board of Directors, President, bylaws etc.). A public bank should be structured to insulate its operations and decision-making from political pressure.

☐ Board of Directors – A bank must have independent, knowledgeable individuals willing to serve on its Board. Bank directors can be held personally liable for the bank’s activities, but directors and officers liability insurance can mitigate this risk.

☐ Human Capital – Banking is a highly technical and specialized field and requires a workforce with specific expertise and experience.

☐ Infrastructure – A bank requires significant, costly infrastructure, including information technology systems.

☐ Deposits – To sustain operations, a bank needs an initial funding commitment and a deposit-base. Any City money currently held in bank accounts and the Pooled Investment Fund has already been allocated via the budgetary process. It cannot be used or invested, except in accordance with State Law and the City’s investment policy (see Section 5 below).
4. RESTRICTIONS ON BANK OPERATIONS

☐ No Illegal Activity – Federal law prohibits banks from handling money stemming from illegal activities, including violations of federal drug law. Cannabis is considered a Schedule I drug under the Controlled Substances Act, and therefore federal law prohibits banks from serving the cannabis industry. In 2014, the U.S. Department of Treasury Financial Crimes Enforcement Network published guidance on how banks can handle relationships with cannabis businesses, but this guidance does not immunize banks from prosecution or liability under federal law, and it mandates extensive compliance monitoring.

☐ Conflicts of Interest – Federal law prevents a bank from conducting business with itself and related parties. It is not clear whether government entities are included in this prohibition, but conflict of interest issues may arise for a public bank. 12 U.S.C. § 371c

5. RESTRICTIONS ON PUBLIC FUNDS

☐ Safety, Liquidity, Yield – California law mandates that trustees of public money, including the San Francisco Office of Treasurer & Tax Collector, follow a three-tiered hierarchy in managing public money. First, they must preserve the safety of the principal; next they must ensure liquidity needs are met, and lastly, they must achieve a reasonable rate of return. They must also act as a prudent investor would. Cal Gov’t Code §§ 53600.3-53600.5

☐ Collateralization of Deposits – California law requires that financial institutions holding government deposits collateralize these deposits above the FDIC insurance limit either via securities (110% of value), first deed mortgages (150% of value) or a letter of credit from the Federal Home Loan Bank of San Francisco (105% of value). Cal Gov’t Code § 53652

☐ Community Reinvestment Act (CRA) Rating – To be eligible to hold government deposits, a financial institution must receive an overall CRA rating of “satisfactory” or better. Cal Gov’t Code § 53635.2

☐ Investment Restrictions – California law and San Francisco’s investment policy specify how the City may invest the surplus money it holds. Cal Gov’t Code § 53600-53610

☐ Limit on Deposits – California law limits the total amount of money that a government may deposit in one institution to the capital of that institution. Cal Gov’t Code § 53635.2

☐ Depository Institution – California law requires that governments deposit their funds into a “state or national bank, savings association or federal association, federal or state credit union, or federally insured industrial loan company.” Cal Gov’t Code § 53648

6. OPPORTUNITIES FOR STATE LAW REFORM

☐ Create a Public Bank Charter – There are drawbacks to chartering a public bank as a commercial bank or a credit union. State law change could create a public bank charter that specifically contemplates a public bank’s business model and governance structure.

☐ Change Insurance Requirement – Currently, a commercial bank in California must have FDIC insurance, which may not be available to a public bank. State law reform could allow a public bank to access private insurance or it could eliminate the insurance requirement entirely.

☐ Eliminate Collateralization Requirement – State law reform could eliminate the requirement that a public bank collateralize government deposits. Cal Gov’t Code § 53652

☐ Eliminate Limit on Deposits – State law reform could eliminate the requirement that a public bank have capital equal to or greater than government deposits. Cal Gov’t Code § 53635.2
Memorandum

To: Members of the Municipal Bank Feasibility Task Force
From: Molly Cohen, Senior Policy Analyst, Banking & Investments
Date: March 14, 2018
Subject: Public Banking in the United States – A Literature Review

I. Introduction

In February 2018, City and County of San Francisco (the “City”) Treasurer José Cisneros convened a Municipal Bank Feasibility Task Force (the “Task Force”) to investigate the potential costs and benefits of a municipal bank as well as other opportunities to leverage the City’s banking and investment practices to support community objectives. This effort was initiated by the City’s Board of Supervisors, including Supervisor Malia Cohen, who introduced Resolution 152-17, requesting the Office of Treasurer & Tax Collector (TTX) convene the Task Force, and Supervisor Sandra Fewer, who sought a Budget and Legislative Analyst report on the topic.

A public or municipal bank is a banking institution affiliated with a locality or a state, though it is a legally separate entity. Aside from state ownership, there is no widely-agreed upon definition of a public bank, and the actual functions vested in a public bank could vary widely, depending on the jurisdiction’s needs. There is currently only one fully-operational public bank in the United States, the Bank of North Dakota (“BND”). However, Puerto Rico previously had a public bank—the Puerto Rico Development Bank—which was liquidated in summer 2017, and American Samoa is currently founding a public bank.

1 City and County of San Francisco Board of Supervisors, Resolution 152-17, retrieved from: [http://sfbos.org/sites/default/files/r0152-17.pdf](http://sfbos.org/sites/default/files/r0152-17.pdf). The resolution asks “the Office of the Treasurer & Tax Collector to convene a task force, and the City Attorney to advise the Treasurer in this effort, for the purpose of advising the Mayor, the Board of Supervisors, and relevant City Departments regarding the creation of a Municipal Public Bank, either as a new City Department or a separate Enterprise Department.”

2 A public bank is a bank affiliated with any government entity, no matter the level of government. A municipal bank is a bank associated with a municipality. In the memo, these terms will be used interchangeably.

3 To limit the scope, this literature review will only discuss reports regarding public banking in the United States, though numerous international models exist.

The Territorial Bank of American Samoa—which formally opened in 2016, though it has not yet received access to the Federal Reserve’s payment system.\(^5\)

To assist the work of the Task Force and the staff of TTX, this memo compiles existing resources on public banks, including background reports on benefits and risks of public banking, other jurisdictions’ feasibility studies, and relevant California-related reports.\(^6\)

II. Summary of Findings

While currently any public bank initiative comes with more questions than answers, there are some foundational lessons we can take away from prior work on public banking. For example, the majority of the documents presented below find that:

- Capitalizing a public bank requires a significant outlay of funds and can act as an impediment to public banking
- Serving the cannabis industry will greatly increase the complexity and legal risk of public banking
- Alternative vehicles, like development authorities, may solve similar issues as public banks with less costs though also less flexibility

The documents included in this literature review raise and answer many questions about public banking. Similarly, the Task Force will need to address many of these questions to determine the feasibility and advisability of a municipal bank. These questions cover the goals of the bank, the regulatory structure of the bank as well the bank’s potential products and services. Questions include:

- What are the main aims in creating a municipal bank? Can the bank fully achieve those aims? Can other strategies achieve those aims?
- How should the bank be structured? Should it have a federal or state charter? Should it be a commercial bank or a credit union?
- How much funding is needed to capitalize the bank? Where should this capital come from?
- Would the bank need insurance? Could it get it from the Federal Deposit Insurance Corporation (“FDIC”)? Or a private source? Would it need a change in state law to exempt it from insurance?
- Would the bank need access to the Federal Reserve’s payment systems?
- What services and products should the bank offer? Should it perform treasury functions for the City? Should it act as a banker’s bank and serve local community banks? Should it offer depository services and bank accounts to members of the public? Should it partner with existing banks for lending? Or should it offer and originate loans to members of the public directly?
- Should the bank serve cannabis businesses? How will this impact its access to FDIC insurance and the Federal Reserve’s payment system?
- How much would start-up activities cost? How much would ongoing operational activities cost?
- How and when would the bank make a profit? How much profit? What should it do with these profits?


\(^6\) Within a section, all reports are listed in chronological order.
III. Background Documents

A. Demos, Main Street Partnership Banks

In April 2011, Demos, a public policy research organization, published a report on “partnership banks,” which are public banks that act as banker’s banks to in-state community banks and provide banking services to state governments. Demos’s partnership bank is modeled after BND. Using BND as an example, the report finds that partnership banks could offer many benefits to the local economy, local banking industry and local governments. For example, by partnering with community banks and increasing lending, a partnership bank could create jobs, spur economic growth and strengthen local banks. The report notes that partnership banks could also generate revenue for states via bank dividend payments and could lower debt costs for local governments by providing access to low-cost funds from the regional FHLB and passing these savings on to local governments when they buy debt for infrastructure investments.

B. David Swayze and Christine Schiltz, State-Owned Banks: A Relic of the Past or the Wave of the Future?

This 2013 summary article in Delaware Banker provides background on BND, describes advantages and disadvantages of public banking, and ultimately concludes that alternative loan and hybrid funding vehicles are preferable to public banks. The authors begin by describing BND, which was founded in 1919 on a wave of economic populism, capitalized with a $2 million bond offering and charged with “promoting agriculture, commerce and industry” in North Dakota. Under North Dakota state law, all state funds must be deposited into BND, and the bank is governed by the Industrial Commission of North Dakota, composed of the Governor, the Attorney General and the Agriculture Commissioner. BND is not a member of the FDIC, but, pursuant to state law, its deposits are insured by the “full faith and credit” of the State of North Dakota. Though BND does offer retail banking to members of the public, it does not market these services and does not provide ATMs, debit cards, online bill pay or branch offices to avoid competing with local banks. While BND does originate some student loans, it primarily partners with local banks and credit unions to lend, providing guarantees, capital contributions for the initial loan, and interest rate buy-downs. BND currently turns a profit and has for every year since 1971. From 2003-2013, it returned $300 million to the state fund. Perhaps most importantly, the authors believe that BND can serve as a bulwark in times of natural disaster and economic distress, in one instance providing $70 million in a line of credit to residents and businesses after a natural disaster. In

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9 Id. at 13.
10 Swayze and Schiltz, at 13.
12 Swayze and Schiltz, at 13.
13 Id. Similarly, during the economic crisis from 2007-2009, when most banks faced a credit crunch, BND actually increased its lending: its participation loans with local banks grew by 35 percent. Demos. Putting Massachusetts
In general, the authors agree that BND is a successful public bank, able to offer low-interest loans, support the local banking industry and provide revenue to the state.

Despite noting these advantages, the authors argue that there are many disadvantages to public banks as well as ready alternatives. They believe that the major disadvantages include high cost of start-up capital, concerns about political pressure impairing bank governance, and potential competition with the private sector. To illustrate these issues, the authors outline the failure of the partially state-owned Farmers’ Bank of Delaware, where state pressure to increase profits led to illegal activity, solvency concerns, an attempted bail-out, and ultimately a distress sale. The authors conclude that rather than pursuing a public bank, states should create and expand “special loan, grant and hybrid funding authorities,” such as economic development agencies to target specific needs.

C. Karl Beitel, Municipal Banking: An Overview

This April 2016 report offers a broad, theoretical framework for how municipalities can establish, fund and operate municipal banks. Beitel believes that local governments have two main options for establishing a municipal financial institution. First, the municipality could create a full state-chartered depository institution, either via legislation or voter-approved Charter Amendment. Or second, the municipality could take an incremental approach, creating a non-depository Municipal Financial Corporation for long-term housing and infrastructure investments as well as a small-scale, limited-purpose depository to support these investments. In time, the city could expand the role of the limited-purpose depository to take over the banking and cash management work currently done by outside banks. In both instances, the bank would need start-up capital. Beitel stresses that a municipal bank should be independent from the political process and have strict underwriting criteria as well as independent review and auditing. Profits from the bank may either be capitalized and leveraged to increase lending capacity or invested in dedicated funds to create a source of subsidy for interest-rate payments on various financial instruments (such as affordable housing bonds, loans to small businesses etc.). Aside from generating profits, Beitel believes that a bank could also save the municipality money by purchasing short-term municipal debt obligations from the municipality: according to his calculations, this could amount to savings of $68 million per year in San Francisco. Beitel concludes by outlining ways in which a municipal bank could support affordable housing by financing acquisition programs, new production and linkages to existing city programs.

14 Swayze and Schiltz, at 14.
15 Id. at 14.
17 Id. at 7-8.
18 Id. at 8.
D. Karl Beitel, The Municipal Bank: Regulatory Compliance, Capitalization, Liquidity and Risk

Building on the overview paper, in this report, Beitel further details his vision for the capitalization, funding, lending, liquidity and risks associated with municipal banking. Beitel believes that municipalities have two options for capitalization: a one-time appropriation from the General Fund or a time-limited dedication of annual investment earnings from the investment pool to a capitalization fund. The city would determine the initial capitalization needed based on start-up costs, operating losses and FDIC requirements. Beitel believes a municipal bank could collateralize city deposits as required by California state law by securing a Federal Home Loan Bank ("FHLB") line of credit. Once this FHLB line of credit is secured, the municipal bank could take over city depository and cash management functions, including accepting deposits, conducting payments using the Federal Reserve payment system and investing temporary surpluses in the money market. The bank could fund its lending operations through the issuance of medium-term notes sold to the City Treasurer, and it could also accept deposits and sell CDs and medium-term notes to other entities. To support community development, Beitel argues that the bank could make loans in affordable housing and infrastructure and partner with local credit unions and community banks. Beitel suggests that the bank enter into asset swap agreements with the treasurer to provide additional liquidity. Beitel concludes with strategies to manage risk, including outside monitoring of lending practices and securitization and sale of long-term loans.

IV. Past Feasibility Studies

In recent years, there has been significant interest in public banks across the country. Many states and municipalities including, Oakland, Seattle, Los Angeles and New Jersey are currently considering public banks. While no city or state has created a public bank aside from North Dakota, Puerto Rico and American Samoa, in the past few years, several jurisdictions have performed feasibility studies. This section summarizes feasibility studies done in Massachusetts, Vermont and Santa Fe. All three studies note the benefits of a public bank but also disadvantages, particularly the high costs of capitalization. Because of these costs, the three studies ultimately recommended against creating and capitalizing a full public bank initially, though two reports suggest a phased approach to public banking. The following section summarizes these reports with an emphasis on the goals for the public bank, findings and the outcome of the report.

A. Massachusetts Feasibility Study

In August 2010, the Massachusetts State Legislature passed Chapter 240 of the acts of 2010, creating “a commission to study the feasibility of establishing a bank owned by the commonwealth or by a public

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20 Cal Gov’t Code § 53652.

21 This FHLB line of credit requires FDIC insurance and designated collateral, such as U.S. Treasury notes or securities of housing agencies, and is limited to 15 percent of the bank’s total assets. Beitel, The Municipal Bank, at 6.

22 Per California Government Code, municipalities are limited to investing only 30% of their portfolio in medium-term notes of an “A” rating or better. Cal Gov’t Code § 53601(k).

authority constituted by the commonwealth.”24 As part of the Commission, the Federal Reserve Bank of Boston, published a study evaluating whether BND could serve as a public bank model for Massachusetts and other states.25

**Goals:** In contemplating a public bank, Massachusetts had four main goals: (1) stabilizing the state economy, (2) providing local businesses with greater access to credit, (3) augmenting the lending capacity of private banks, and (4) contributing revenue to help fund the state government.26

**Findings:** Overall, the Federal Reserve Bank of Boston study finds that BND is a well-respected and well-run institution, but a similar institution would not meet Massachusetts’s goals and would require high start-up costs. The authors agree that BND is a conservative institution with a strong and stable balance sheet, and it serves as a lending partner for North Dakota’s numerous small banks.27 However, by comparing North Dakota with South Dakota, the authors find little evidence that BND acts as a fiscal stabilization tool. Though BND did assist with liquidity during the financial crisis, the authors note that this capacity was limited and was backed by federal assistance, suggesting a public bank may not always be able to assist in a credit crunch. Lastly, while BND does serve as a revenue source (and at times has been used to balance North Dakota’s budget), this funding is not guaranteed. Using BND as a model, the authors calculate that the start-up costs for a Massachusetts public bank could be upwards of $3.6 billion.28 The authors conclude by suggesting that there are other avenues to achieve Massachusetts’s aims, such as development and financing agencies and state-level countercyclical policies to offset credit constraints in the private sector. It recommends that Massachusetts more concretely identify the specific market failures it wants to address via a public bank and investigate other ways to fulfill these objectives.29

**Outcome:** Relying on the Federal Reserve Bank of Boston’s study as well as comprehensive review of the management of the Commonwealth’s money and various state development agencies, the Commission recommended that the Legislature not pursue a public bank.30 Their decision rested on a number of rationales, including the significant initial capital investment required, the potential risk to public funds and reduced rate of return, and the lack of successful models (aside from BND) as well as existing programs to achieve infrastructure investment and small business lending.31

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26 Id. at 3.
27 Id. at 10-11.
28 Id. at 19. The report estimates the costs to capitalize a Massachusetts public bank by starting at the $2 million used to capitalize BND in 1919 and adjusting for inflation, the increase in the national economy and the larger size of Massachusetts.
29 Id. at 20.
31 Id.
B. Vermont Feasibility Study

Though the Vermont state legislature has considered bills regarding public banking on several occasions, none of these bills have passed.\footnote{Vermonters for a New Economy. (2013). *Exploring a Public Bank for Vermont: Economic Impacts, Capital Needs, and Implementation*, retrieved from: https://publicbanking.files.wordpress.com/2014/01/public-banking-1-13-2014.pdf.} Taking matters into their own hands, in December 2013, an advocacy coalition called “Vermonters for a New Economy” commissioned a public bank feasibility report.\footnote{Of the three feasibility studies highlighted in this literature review, only the Vermont study was conducted by advocates without the backing of a state or local legislative body.} To ensure the document was well-reasoned, municipal bank skeptics reviewed the report, and their comments were included in the document.

**Goals:** This coalition seeks a public bank to meet the state’s unmet capital needs more cheaply and to dissociate Vermont from traditional Wall Street banks.

**Findings:** Given the high start-up capital costs, the report does not recommend that Vermont create a wholly new public bank, but instead recommends that the Vermont Economic Development Authority (“VEDA”), a state financing agency, operate a bank pilot program.\footnote{Id. at 4.} The primary goal of a Vermont public bank is to meet unmet capital needs. While the report notes that the state could simply invest its money in capital projects (as the Vermont State Treasurer has already done), it finds that a public bank has many benefits over state investment. Compared to state investment, a public bank offers lower costs and more options for liquidity as well as the opportunity to leverage assets to increase local investment.\footnote{Id. at 10-11.} For example, the report finds that if Vermont used 66 percent of its deposits (over $230 million) for VEDA loans, it would result in over 2,500 new jobs, or if it used the money to finance state capital expenditures instead, it would result in $100 million saved on interest costs. Despite these optimistic results, the report acknowledges several major risks of public banking, including the high cost of capitalizing a bank, concerns about lost tax revenue and downgrading of Vermont’s bond rating and liquidity demands. For example, based on projected deposits of over $300 million, Vermont would need to capitalize the bank with $30-60 million, which could come either from a state appropriation or general obligation bond sales.\footnote{Id. at 16-17.}

Critics of the report, however, believe the report has a fatal flaw: it assumes that the bank could both lend a significant chunk of its money and also meet Vermont’s considerable liquidity needs. A bank expert and municipal bank skeptic critiques, “the report makes the assumption that a state bank could simply borrow on a short-term basis the funds necessary to promote liquidity to the state treasury.”\footnote{Id. at 17.} However, if the public bank loaned 66 percent of its assets, it would not have the liquidity necessary to serve the state, and its cash reserves would not meet the leverage and collateral requirements to borrow additional money from the Fed.\footnote{Id. at 17.}
Despite this critique, the authors remain optimistic about public banking. However, due to high costs of capitalization, the report recommends against creating a new public bank, and instead suggests that VEDA create a pilot bank, because VEDA has the collateral and capital, as well as the expertise and capacity, to function as a state depository.

**Outcome:** No government action on public banking has occurred in Vermont.

**C. Santa Fe, New Mexico Feasibility Study**

Spurred by grassroots activists, Santa Fe, New Mexico began exploring the feasibility of creating a municipal bank, and in January 2016, contractor, Building Solutions LLC, published a feasibility analysis.\(^{39}\)

**Goals:** Though the report authors are not explicit about the goals of the municipal bank, they do note concerns with the “banking sector,” including fear that banks may stop accepting Santa Fe’s deposits, businesses’ inability to get loans over $500,000, consolidation in the banking industry, and low loan-to-deposit ratios in Santa Fe. Likely a public bank would seek to address these concerns.

**Findings:** The study finds that a municipal bank is feasible and could “provide enhanced fiscal management, improved net interest rate margins, and a more robust local lending climate.”\(^{40}\) The report, however, advocates for a deliberate and phased approach to municipal banking. In Phase I, Santa Fe would create a separate city entity to assume “basic cash management functions of the City, including lending on approved City capital expenditures.”\(^{41}\) This phase would not require a banking charter and would result in significant benefits to Santa Fe via better cash and liquidity management. During Phase I, Santa Fe could also investigate whether the city could change its depository collateral policy to allow local banks to accept Santa Fe’s deposits.\(^{42}\) During Phase II, the bank would apply for a state banking charter and seek permission to accept deposits from other public entities and non-profits. At this point, the bank could pursue a conventional equity model or a mutual bank model.\(^{43}\) In Phase III, the bank would broaden its lending function to include “public interest loans underwritten by community banks in the region.”\(^{44}\)

The feasibility study includes a discussion of legal risks, administrative costs and economic impacts. The study reports that no explicit legal obstacles exist but notes that further analysis is needed. It also acknowledges there are significant costs associated with a municipal bank, including 10% capitalization via a Santa Fe appropriation and costs of conforming to regulatory requirements.\(^{45}\) On the other hand, an economic impact analysis performed by the Arrowhead Center at New Mexico State University found that a Santa Fe municipal bank could save the city $2.4 to 3 million by its seventh year of operation from

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41 Id. at 19.

42 Id.

43 Id. at 20.

44 Id.

45 Id. at 35.
“increased interest income on deposits, reduced interest costs by better timing issuance of bonds with the expenditures financed by the bond and on profit earned on capital contributed to the bank.”

**Outcome:** Based in part on this feasibility study, in April 2017 the City Council created a nine-member task force to determine “procedures, timelines and requirements that would be necessary to establish a chartered public bank and to make recommendations to the city council in order for the city council to make an informed decision about whether to establish a Public Bank for the City of Santa Fe.” The task force’s report should be published shortly.

**V. California-Related Reports**

Aside from feasibility studies from other jurisdictions, there have been a number of reports related to public banking in California published recently, including memos on legal aspects of public banking, an analysis of access to banking services for the cannabis industry, and preliminary assessments of public banking in San Francisco and Los Angeles. This section summarizes these reports, highlighting points particularly salient to the Task Force’s work.

**A. San Francisco City Attorney’s Office: Municipal Bank Formation**

After receiving a Budget and Legislative Analyst’s report in 2012 (updated in 2017, see Section V(B)), Supervisor John Avalos requested a legal opinion from the City Attorney’s Office regarding two specific questions:

1. Does state law, including Government Code Section 23007, which prohibits a county from “giv[ing] or loan[ing] its credit to or in aid of any persons or corporation,” bar the City from establishing a municipal bank?
2. May the City own stock in a municipal bank?

With regards to the first question, the legal memo explains that “a court would likely conclude” that Government Code Section 23007 does not apply to San Francisco because it is a chartered city and county. Article XVI, Section 6 of the State Constitution—which prohibits the State Legislature from lending the credit of a state, county or city—similarly does not apply to the City. Lastly, though a chartered city may spend its funds “only to promote municipal, rather than private purposes,” the City Attorney’s Office finds this limitation does not bar the City from lending credit to third parties. In fact, the memo notes that the City currently operates several programs that offer loans to private individuals and businesses without facing any legal challenges.

Next, the legal memo takes the position that the City may own stock in a municipal bank and spend City money to support the bank’s operation so long as the Mayor and Board of Supervisors specifically appropriate funding for that purpose, and the bank serves a municipal purpose. A legitimate municipal purpose can be broadly defined and can include goals such as affordable housing and lending to small

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46 Id. at 33.
47 Conversations with David Buchholtz, chair of Task Force, March, 9, 2018.
48 City Attorney’s Office (2013), Memorandum re: Municipal Bank Formation (p. 1).
49 Id.
50 Id. at 2-3.
51 Id. at 7-11.
business. However, the City may not invest funds held in the Treasurer’s Pooled Investment Fund in corporate stock, including stock of a municipal bank (though the legal memo does not take a position regarding whether money in the Pooled Investment Fund could be deposited into the municipal bank).52

B. State Treasurer John Chiang, Banking Access Strategies for Cannabis-Related Businesses

On November 7, 2017, California State Treasurer John Chiang and his Cannabis Banking Work Group released a report on access to banking for the cannabis industry. The report explains that cannabis businesses need banking services because cash-only businesses are targets for violent crime, collecting taxes in cash is risky and expensive, and relationships with banks can help drive out the illicit market.53

The report makes four major recommendations to improve access to financial services for cannabis businesses. To help with the collection of state and local taxes, the report recommends the state contract with an armored courier service to collect state tax and licensing payments. To help traditional banks serve cannabis entrepreneurs, the report suggests that state and local governments cooperate to create an online portal to aggregate data on cannabis businesses which will help financial institutions comply with burdensome know-your-customer and anti-money laundering (“AML”) requirements required under federal guidance. The report also recommends that the state study the feasibility of creating a public financial institution, such as a banker’s bank or a corporate credit union, to serve cannabis businesses. Lastly, to remove all banking barriers, California should lobby Congress to legalize cannabis or create a legal safe harbor for financial institutions serving the adult-use and medical cannabis industry.54

C. Davis Polk & Wardwell: Bank Regulatory Considerations Related to Establishing a Public Bank in the State of California

On November 18, 2017, law firm Davis Polk & Wardwell LLP wrote a legal memo to the Lawyers Committee for Civil Rights of the San Francisco Bay Area regarding federal and state banking laws and public banking. This memo outlines and discusses provisions of California and federal banking law and regulation that would apply to a public bank owned by either California or the City. Noting the unique challenges of serving the cannabis industry, the memo analyzes regulatory requirements and obstacles for a public bank serving cannabis businesses separately.55 The memo took the position that a significant change in federal law is necessary to allow a public bank to serve cannabis businesses. Major issues covered include restrictions on cannabis banking, capitalization requirements, banking charter options and application requirements, access to FDIC insurance and the Federal Reserve, for example:

- Cannabis Restrictions – Under federal law, cannabis is a schedule I controlled substance, and AML laws including the Bank Secrecy Act and USA Patriot Act make it illegal for banks to handle money from illegal activities including violations of federal drug law.

52 Id at 11-12.
54 Id.
• Capitalization Requirements – For new banks, the Federal Reserve Bank of San Francisco requires a leverage capital ratio of 9% for the first three years of operation,\textsuperscript{56} and some banks have been “required to maintain capital at levels well above 10% for an extended period of time due to perceived risks associated with the business model.”\textsuperscript{57}

• FDIC Insurance – Under California law, all state-chartered commercial banks must obtain federal deposit insurance.\textsuperscript{58}

• Municipal Deposits Collateralization – California State law requires that any government entity that deposits money into a bank or credit union seek collateral from that bank over the FDIC-insured amount. This collateral may be securities with a fair value market of at least 110% of the deposits, first deed mortgage notes having a value of 150% of the deposits or Letters of Credit issued by the FHLB of San Francisco at 105% the value of the deposits.\textsuperscript{59}

D. San Francisco Budget and Legislative Analyst’s Office: Community Supportive Banking Options

In 2011, then-Supervisor John Avalos requested the Budget and Legislative Analyst’s Office (“BLA”) research options for how the City could “invest its funds in community-supportive banking institutions, including those that invest more in local small businesses, single family homeowners, and community development.”\textsuperscript{60} The report examined a variety of banking options such as private banks, credit unions and public banks. Supervisor Sandra Fewer requested an update to the memo and in November 2017 BLA published its report.

The report provides background on the City’s current operations in both banking and community development and then outlines policy options moving forward, including the potential for the City to create a municipal bank.\textsuperscript{61} The report begins by describing the major types of financial institutions—commercial banks, credit unions and community development banks—describing their missions, operations, regulatory structure and oversight. It details the banking industry in California, noting its consolidation, which is particularly stark for national commercial banks. Next, the report examines California Government Code and the City’s investment policy—which both mandate the Treasurer first safeguard principal, then meet liquidity needs, and lastly achieve return on funds—as well as the City’s current banking practices. The report then details existing community development and affordable housing programs, such as the Downpayment Assistance Loan Program and the San Francisco Small Business Development Center.\textsuperscript{62}

\textsuperscript{56} Federal Reserve Bank of San Francisco, Membership, retrieved from: https://www.frbsf.org/banking/regulation/applications-membership/information/.
\textsuperscript{57} Davis Polk & Wardwell, Bank Regulatory Considerations Related to Establishing a Public Bank in the State of California.
\textsuperscript{58} Cal. Code Regs. Tit. 10 § 10.3520 (2017).
\textsuperscript{59} Cal Gov’t Code § 53652.
\textsuperscript{62} Id. at 26-33.
The updated BLA report then shifts away from describing current work around banking and community development to lay out options the City could pursue going forward. The report provides background on the Bank of North Dakota, noting its success as a public bank and describes efforts in California and other jurisdictions around the country to establish a public bank. It outlines the steps required to create a municipal bank, including agreeing on goals, conducting a detailed financial feasibility study, appointing an independent board of directors, developing business plans, and determining oversight structure. Lastly, the report concludes by providing four major policy recommendations to the City. The City should:

- Invest more City funds in local credit unions or community development banks to align investment with the City’s community and economic development objectives;
- Support more funding to expand existing community development programs;
- Take steps to establish a municipal bank; and
- Assess legal risk associated with a public bank serving cannabis businesses.

E. Los Angeles’ Chief Legislative Analyst: Public Banking Memo

In July 2017, Los Angeles City Council President Wesson and City Council Member Krekorian introduced a motion asking Council staff to study the “feasibility, requirements, legislative barriers and any other relevant aspects of creating a state-chartered public bank” for Los Angeles. The City Council identified a range of services the public bank could provide, including performing city banking functions, investing in infrastructure and housing projects, offering small business and student loans as well as banking products and services for the cannabis industry and unbanked communities. On February 26, 2018, the Los Angeles Chief Legislative Analyst published its report on public banking and existing housing and economic development programs. The report provides background on public banking, LA’s current banking practices and economic development efforts.

The report begins by defining the term “public bank,” noting that a public bank refers to a financial institution owned by a public entity, but there is no “consistent definition of such a financial institution beyond the core concept of public ownership.” The report then offers international, national, and state models of public banking, describing Germany’s Savings Bank Finance Group and BND as well as public banking efforts in other jurisdictions, such as Hawaii and Massachusetts. Next the report provides background on banking barriers for cannabis businesses, surveying the federal landscape and various state proposals to address the issue, including Treasurer Chiang’s workgroup. The report then describes the most common financial institutions in the U.S., finding that no existing model is optimal for a public bank, and “ideally, a legislative solution would be approved in State or federal law that delineates the structure for a public bank.” The report next details LA’s banking and investment practices, explaining

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63 Id. at 36-38.
64 Id. at 51-52.
67 Id. at 8.
68 Id. at 23.
that LA requires banking services similar to a multi-national corporation. The report then looks at implementation issues around public bank formation and operation, including concerns about procurement, the Prudent Investor Rule, collateralizing government deposits, start-up capital, and deposit insurance. Lastly, the report details current LA programs that perform quasi-banking functions and promote community development, such as affordable housing development programs, micro-loan programs and a linked-banking program.

The report concludes by explaining that the formation of a municipal bank in LA “under existing law and regulation would be a very difficult process, would be very costly, and would result in an institution that would not likely qualify to receive City business” and explains that there may be other opportunities for LA to address issues in the short-term via existing authority. For next steps, the report suggests that the Council hire a consultant with specialized expertise in bank formation and operation to perform a detailed study and cost-benefit analysis. In the meantime, the report notes that the City can “review and enhance” existing housing and economic development programs and implement new investment practices.

VI. Conclusion

This memo summarizes existing resources on public banking to provide a foundation for members of the Task Force and other interested parties. Possible avenues for future research include:

- In-depth analysis of City’s current community development and affordable housing programs to determine effectiveness as well as areas for expansion;
- More research on different structures and models for municipal banks; and
- A policy briefing on issues surrounding cannabis banking

---END---
REPORT OF THE
CHIEF LEGISLATIVE ANALYST

DATE: February 26, 2018

TO: Honorable Members of the City Council

FROM: Sharon M. Tso
Chief Legislative Analyst

Assignment No: 18-02-0178

PUBLIC BANK FRAMEWORK AND
EXISTING HOUSING AND ECONOMIC DEVELOPMENT
FUNDING PROGRAMS

SUMMARY
Motion (Wesson-Krekorian, CF 17-0831), introduced July 26, 2017, and subsequent actions of
the Ad Hoc Committee on Comprehensive Job Creation Plan (Jobs Committee) requested a
number of reports on the feasibility, requirements, legislative barriers and potential models for
establishment of a Municipal Bank of Los Angeles (MBLA), as well as an overview of existing
City programs that may already accomplish the goals of a public bank.

Findings
The report finds that Council will need to consider a number of factors before proceeding:
• Risk associated with forming MBLA
• How MBLA would be financed
• Definitive goals and objectives for MBLA
• Legal requirements and legislative changes required to form MBLA

As discussed in the report, a number of concepts have been identified for the formation of
MBLA, but a thorough review and definitive statement of the goals and objectives for such an
organization is needed.

To advance consideration of the issues associated with forming MBLA, experts who specialize in
bank formation and regulation, including legal counsel experts, should be retained to recommend
how the bank would be funded, identification of specific financial services to be offered by
MBLA, risk to the City’s financial position, and impacts on the City’s financial services, bond
rating, and general City services.

Once a clear statement of the purpose of MBLA has been structured, a review of alternatives to
meet those goals and objectives should be conducted to determine whether they can be met
without the risk, cost, and legislative and regulatory changes needed to form MBLA.
Background
The terms “public bank” and “municipal bank” have been used, in the most basic sense, to describe a bank owned by a public entity, with a public bank serving as a generic term for any publicly owned bank and a municipal bank specifically referring to a public bank owned by a city. A review of the literature concerning public banks has not led to the identification of a consistent definition of such a financial institution beyond the core concept of public ownership. Definitions incorporate additional ideals, such as adherence to social, ethical, and environmental standards; providing services to a jurisdiction’s residents and businesses exclusively; extending credit to identified groups in need, such as small businesses; focusing on housing and economic development lending; and generating new revenues for the jurisdiction.

During Committee deliberations, the following general concepts were identified as the purpose of MBLA:
- Decrease City dependence on commercial banking services
- Reduce costs associated with commercial banking services
- Ensure equitable access to banking services for all City residents and businesses
- Generate new revenues for the City General Fund
- Provide small business loans, job training loans, and student loans
- Reduce costs associated with City banking and bond issuances
- Ensure that City funds support the development of economic and housing opportunity in the City

As requested, international, national, state, and local models for public banks were reviewed. While these models provide examples of how a public bank could be operated, they differ from the concepts under consideration for a MBLA. With regard to legislation and regulation, the federal government has taken various actions related to banking services for cannabis businesses, but no known actions related to public banking. At the State level, North Dakota is notably the only public bank in the nation. In addition, several states and cities in the United States have initiated public bank reports, but we are not aware of any public bank formation process that is underway.

Similarly, State and federal law provide the legal framework to form chartered banks and chartered credit unions as financial institutions that can accept deposits and provide a wide range of financial services for investors and depositors. There is no legal framework for the formation of a chartered public bank that accommodates the structural issues identified for such an institution, and existing laws and regulation do not support effective formation of MBLA. Several quasi-bank financial institutions provide loans and other financial support, but are not authorized to accept deposits.

According to the Office of Finance (Finance), the City Treasurer maintains and manages the City’s financial resources consistent with the Prudent Investor Rule (see page 27). There are approximately $11 billion in assets under management by Finance in the City’s Investment Pool. Finance also oversees cash management services with a $40 billion transactional cash flow. Finance also supports City departments in the collection of approximately $360 million in cash.
vault deposits, processing 18 million debit and credit card transactions worth over one billion in revenue, and over one million payroll transactions.

Formation of MBLA would require compliance with a number of State and federal regulatory requirements, principal among those being the Prudent Investor Rule. A number of criteria must be satisfied for any bank to be formed, such as adequate capital, collateral, reserves, and insurance, and the City would find it difficult to satisfy those criteria in a manner that provides security for City resources, adequate liquidity, and a sufficient rate of return. On review, the following limitations have been identified:

- No source of funds to capitalize the bank is available;
- City funds could not be deposited in MBLA for at least three years;
- MBLA would have difficulty providing adequate collateral to support City banking requirements;
- MBLA would have difficulty qualifying for insurance to protect depositors;
- Changes to federal and State law are required to form MBLA;
- The City Charter would need to be amended to form MBLA; and
- Start-up costs for MBLA are exorbitant with no available source of funds to cover those costs.

In short, existing laws for charter financial institutions are not structured to facilitate formation of public banks. To form a public bank, changes to State law and the City Charter would be required to allow the City to create MBLA.

If the Council would like to continue to explore formation of MBLA, our Office recommends that a consultant be retained with experience in the complexities of State and federal banking laws. The City Attorney recommends that legal counsel with this specialized experience be retained as well. Studies should be prepared that fully evaluate the regulatory structure, the sources of capital and collateral to support the bank, development of a start-up plan, preparation of a market study, and other related factors.

Due to the significant risks and timeframe associated with forming an MBLA, our Office recommends that existing housing, economic development, and infrastructure programs be further evaluated to determine how the City can improve its delivery of these programs, as well as improve social, ethical, and environmental standards for the implementation of these programs. Further, staff should be directed to identify any gaps in financial services, credit availability, financial institution responsibility, or other financial capacity or accountability measures and recommend solutions to address any identified gaps.
RECOMMENDATIONS
Should the City Council choose to continue to explore the formation of a Municipal Bank of Los Angeles (MBLA), recommendations 1 and 2 should be adopted:

1. Instruct the Chief Legislative Analyst (CLA), with the assistance of the City Administrative Officer (CAO), Office of Finance (Finance), and City Attorney, to prepare and release a Request for Qualifications to retain a consultant for the purpose of assisting in analysis of and possible development of MBLA, including a study of potential risk factors and benefits that could be delivered from bank formation;

2. Instruct the CLA and CAO to report on costs associated with implementation of a study and initial formation of MBLA, and also identify and report on any staffing or other costs associated with actions related to the analysis and possible development of MBLA;

That the City Council approve the following recommendation to enhance and improve the City’s current programs and services:

3. Instruct the CLA, with the CAO, Finance, Economic and Workforce Development Department (EWDD), Housing and Community Investment Department (HCID), and City Attorney, to develop a coordinated strategy to expand and enhance financial services to City residents and businesses through current programs, including enhancement of existing housing and economic development financial resources; financial information and education programs; research and monitoring of private banking practices, including analysis of Community Reinvestment Act data; and identification of alternative banking, financing, and investment programs and practices; and

4. Instruct the CLA, with the CAO, Finance, EWDD, and HCID, to identify gaps in financial services, credit availability, financial institution responsibility, or other financial capacity or accountability measures and recommend solutions to address any identified gaps.

FISCAL IMPACT
There is no impact to the General Fund associated with this report.

DISCUSSION
On July 26, 2017, Motion (Wesson-Krekorian, CF 17-0831, Attachment A) was introduced instructing the City Administrative Officer (CAO) and the Chief Legislative Analyst (CLA), with the assistance of the Office of Finance/City Treasurer (Finance), and the City Attorney, to report on the feasibility, requirements, legislative barriers, and any other relevant aspects of creating a State-chartered public bank, or other similar such financial institution, named the “Bank of Los Angeles” that would provide banking services to reinvest in the communities neighborhoods, and residents of the City of Los Angeles primarily through the acquisition, construction, and
rehabilitation of affordable and workforce housing, utilizing deposits and providing financial services and products to local businesses, including the cannabis industry.

At the October 4, 2017 meeting, the Jobs Committee discussed the Motion and identified a range of services that could be offered by the bank, such as:

- Perform City banking functions without the use of a third-party bank,
- Invest in local infrastructure and housing projects,
- Provide local small businesses loans and student loans,
- Provide retail banking services for underserved businesses like the cannabis industry, and
- Provide banking services to “unbanked communities.”

Each of those services would have regulatory and legal framework impacts, which may or may not need to be amended to allow a public bank to operate. Inasmuch as legislative and regulatory barriers that could affect a public bank depend upon the mission of the bank and the type of services that would be offered, the Jobs Committee requested the CLA to identify State and federal legislative and regulatory changes to support development of MBLA, and also requested the CLA report on national and international models for a public bank. Since the Council has not identified a specific structure under which MBLA would operate, it is not possible to recommend legislative proposals at this time. Once a framework, mission, and services have been identified, the Council and the Mayor would adopt Resolutions to seek required legislative and regulatory reform.

At the December 13, 2017 meeting, the Jobs Committee requested:

- CLA to report on legislative efforts in the State Legislature relating to establishing public banks in California, including existing efforts, the State Treasurer’s task force project, and recent efforts to enact legislation to eliminate barriers to public bank formation;
- City Attorney to review and report on the Davis, Polk and Wardwell Memo, as well as the Santa Fe Legal Memo;
- CLA to report on existing economic development programs that are available to provide loans to small business development and start-ups that fulfill the goals potentially achieved by MBLA;
- CLA and CAO to report on the City’s current process for financing infrastructure projects, and how the City might function more efficiently and cost-effectively by reducing reliance on Private Banks through public vehicles; and
- CLA, in consultation with the Housing and Community Investment Department (HCID) and the Economic and Workforce Development Department (EWDD), to report on current City programs that provide loans or guarantees for community development and affordable housing.
### Report Structure
This report begins with a review of broad concepts concerning public banks, reviews models for public banking, identifies key issue areas for consideration, considers the potential for MBLA, and provides recommendations for next steps. The sections are as follows:

| I. | What is a Public Bank? | Consideration of broad concepts to guide the formulation of the purpose of a public bank to serve the City | p. 8 |
| II. | International, National, State, and Local Public Banks | Review of public bank efforts internationally and within the United States, as well as an update on banking services for cannabis businesses | p. 10 |
| III. | Bank Models | Discussion of existing banking and quasi-banking models, and the prospect that a public bank could be formed within the legal guidelines established for these models | p. 19 |
| IV. | Profile of Current City Banking Services | Summary of banking services the City currently uses | p. 25 |
| V. | Implementation Issues | Review of a wide range of issues that must be considered when forming a bank, including changes in federal, State, or local law necessary to allow for bank formation | p. 28 |
| VI. | City Financial Assistance Programs and Services | Review of existing City loan and finance assistance programs related to housing, economic development, and infrastructure | p. 36 |
| VII. | Additional Considerations | Discussion of other issues related to formation of a public bank | p. 49 |
| VIII. | Municipal Bank of Los Angeles | Review of the potential objectives of MBLA | p. 51 |
| IX. | Next Steps | Recommended short-term and long-term actions necessary to address the objectives and implementation of MBLA | p. 53 |

Attachment A provides a bibliography of references consulted in preparing this report, with links where those reports can be found on the web. Attachment B is a copy of the Polk Memo, “Bank Regulatory Considerations Related to Establishing a Public Bank in the State of California,” prepared for the Lawyers Committee for Civil Rights of the San Francisco Bay area which was provided to the City by Public Bank LA, an advocacy group for public banking, and also used as a reference in preparing this report.
Banking Services for Cannabis Businesses

At its meeting of December 13, 2017, the Committee instructed staff to set aside consideration of banking services for cannabis businesses until researching into the broader question of public banking had progressed further. As a result, this report does not consider the formation of MBLA within the context of providing financial services to cannabis businesses.

This report, however, does provide information concerning recent federal and State actions related to banking services for cannabis businesses. The Department of Justice, the Governor, and the State Treasurer each have announced decisions or proposals that are directly relevant to this subject. Since our Office has reported on this subject previously, this report includes a review of these emerging and on-going developments.
I. WHAT IS A PUBLIC BANK?

Public banking has historically emerged as a response to extreme economic uncertainty. The Bank of North Dakota (BND), the only active public bank in the United States, formed in 1919 following a crisis in the agricultural sector and a constriction on credit available to local businesses. Public banking emerged again periodically from the 1930s through the 1970s in response to economic uncertainty, but successful public banks did not result from these efforts as an alternative banking solution. The issue has again experienced a resurgence in response to the fiscal crisis that began in 2008. The most recent interest in public banking can also be attributed to the consolidation of local community banks with larger national and international institutions.

The terms “public bank” and “municipal bank” have been used to describe a bank owned by a public entity, with a public bank serving as a generic term for any publicly owned bank and a municipal bank specifically referring to a public bank owned by a city. This report will use the term “public bank” in any general discussion as the policy concepts presented here have been drawn from a number of reports concerning the formation of banks that would be owned by states, counties, or cities. In some instances, “MBLA” will be used to refer only to a prospective Municipal Bank of Los Angeles, that being a public bank owned by the City of Los Angeles.

In a study entitled “The Bank of North Dakota: A model for Massachusetts and other states?,” the Federal Reserve Bank of Boston advises that “a logical starting point for discussions regarding establishing a public bank...is to identify the specific purposes of such an institution.” A review of the literature concerning public banks has not led to the identification of a consistent definition of such a financial institution beyond the core concept of public ownership. Definitions incorporate additional ideals, such as adherence to social, ethical, and environmental standards; providing services to a jurisdiction’s residents and businesses exclusively; extending credit to identified groups in need, such as small businesses; focusing on housing and economic development lending; and generating new revenues for the jurisdiction.

In addition to this literature review, the following goals and objectives have been identified from comments provided during previous hearings of the Jobs Committee:

- Decrease City dependence on commercial banking services
- Reduce costs associated with commercial banking services
- Ensure equitable access to banking services for all City residents and businesses
- Generate new revenues for the City General Fund
- Provide small business loans, job training loans, and student loans
- Reduce costs associated with City banking and bond issuances
- Ensure that City funds support the development of economic and housing opportunity in the City

Formation of MBLA will require that the Council and Mayor develop a clear, definitive statement of the goals and objectives of the bank. Such a statement is needed to determine whether formation of MBLA is possible under the existing legal and regulatory framework, or
changes that may be required in law and regulation in order to facilitate formation and operation of MBLA. A definitive statement of MBLA’s purpose would also facilitate analysis of alternatives to MBLA should it not be possible to form MBLA.

To assist with consideration and formulation of the specific purposes of a public bank, this report presents a review of banking models and issues associated with bank formation. It concludes with a suggestion of key components of a mission for MBLA and alternatives to formation of MBLA.
II. INTERNATIONAL, NATIONAL, STATE, AND LOCAL PUBLIC BANKS

At the request of the Committee, our Office researched international, national, state, and local public banks as potential models for MBLA. The following provides a review of recent developments concerning public banking.

Of international models, the German Savings Bank Finance Group and the Japan Finance Organization for Municipalities were identified as international public banks that most closely matched the intent of MBLA. While these models provide examples of how a public bank could be operated, they differ from the concepts under consideration for MBLA. Within the United States, the federal government has taken various actions related to banking services for cannabis businesses, but no known actions related to public banking. At the State level, North Dakota is notably the only public bank in the nation. In addition, several states and cities in the United States have initiated public bank studies. This review provides a discussion of these efforts.

International Public Banks
International public bank models are instructive in showing the potential service models for such an institution, but their value is limited in that each nation has its own legal framework for banking. Internationally, as in the United States, public banking is a rare source of banking services.

Germany -- Savings Bank Finance Group
Founded in the 18th century, the Savings Bank Finance Group (SBFG) of Germany, also known as the Sparkassen-Finanzgruppe, is a network of 580 separate Financial Institutions across the country. They form a close network of specialized service providers, rather than a consolidated group, with the individual member institutions managed in a decentralized and self-reliant manner.

The SBFG operates under a public mandate by the people of Germany, and was established to provide all citizens with the opportunity to deposit their savings safely, ensure non-discriminatory provision of financial services, particularly to small and medium-sized enterprises in the region, and sponsor a broad range of social commitments. Each savings bank operates solely in its own region, to encourage local financial investment into their local jurisdiction.

These savings banks were incorporated under public law in the 1930s. They are legally and economically independent institutions, without centralized ownership. To ensure independence from third-party interests, the SBFG is operated as a Municipal Trusteeship, and supervised by a group formed of one-third SBFG employees, one-third citizens, and one-third local Parliament representatives.

Germany’s SBFG model is an example of a locally run and managed financial institution, with checks and balances from citizens, bank employees and governmental entities. The SBFG banks provide access to banking for underserved communities, provide loans to small businesses, and facilitate investment in their local municipalities.
The SBFG model benefits from the support of all 580 separate Financial Institutions, which stabilize individual members facing solvency and liquidity issues. In contrast, an individual public bank would operate independently from other banking entities and be at risk of insolvency with rapid market changes. Further, the SBFG system is authorized under German national law, and a corollary authorization does not exist under U.S. law.

**Japan – Finance Organization for Municipalities**
Founded in 2008, the Japan Finance Organization for Municipalities (JFM) is a joint funding organization for all 1,789 Japanese local governments. The JFM has an objective to provide long-term and low-interest rate loans exclusively to Japanese local governments. The Japanese national government has established a legal framework to monitor fiscal indices for each local government and implement early correction measures for local governments exceeding early warning limits. Therefore no local government has defaulted under the JFM.

Due to its organizational structure, the JFM does not serve as a model for MBLA under the criteria requested by the Committee. Since the JFM is a system exclusively for and by the governmental entities of Japan, individual citizens would not personally be able to use the program. In addition, as the JFM relies on a multitude of municipalities to support the overall organization, the basic framework for this bank would not be self-reliant without buy-in from a larger number of local governments. Finally, authorization for this banking system is provided by the Japanese national government, and a similar authority is not currently provided under U.S. law.

**China – Industrial and Commercial Bank of China**
Founded in 1984, the Industrial and Commercial Bank of China (ICBC) was originally a local state-run bank in Beijing. As an asset of the Chinese government, the ICBC was able to generate and manage programs to directly support the goals of the government. For example, in 1999, the ICBC introduced a new loan program to enable consumers to buy consumption goods, pioneering consumer credit in China. In addition, the Chinese government also adopted a bank loan policy with the ICBC in order to stimulate consumption and reverse a decline in economic growth. However, in 2006 the ICBC instituted an initial public offering, essentially transforming the ICBC into a private bank.

**Indonesia – Bank DKI**
Founded in 1961, Bank DKI was established in Jakarta, Indonesia as a public bank, with the city administration as the sole shareholder. The bank maintained and invested city funds, and was expected to advance community city projects. However, in 2002 the city-owned bank was converted into a private enterprise, and the bank’s policies are now in the hands of shareholders.

**United States – State Governments**
The federal government has not taken any actions on public banking that have yet been identified. There is activity in several states and cities across the nation, however. Formation of public banks has been under consideration by States from time to time over many decades. Most recently, a number of legislative and administrative efforts to create state-run public banks across
the U.S., including California, were initiated in the wake of the 2008 economic crisis. None of these measures have yet to pass any legislature.

Arizona
In 2016, the Arizona Legislature considered SB 1301 which would have established a state-owned bank task force. While the bill passed a vote in the Senate Financial Institutions Committee, the bill was never heard in the Assembly.

California
Two bills were introduced in the California Assembly, one to initiate a study of public banking and the other to establish a charter process for the creation of public banks. In addition, both the State Treasurer and the Governor have been considering solutions to provide safe banking services for the cannabis industry.

AB 750
In 2011, Assembly Bill 750 (Hueso) called for the creation of an Investment Trust Blue Ribbon Task Force that would study the establishment of a California Investment Trust, which would be a state bank receiving deposits of State funds. The task force would have been required to consider how the investment trust could strengthen economic and community development, provide financial stability to businesses, reduce the cost paid by state government for banking services, and provide for excess earnings of the trust to be used to supplement General Fund purposes. While AB 750 was approved by the California Legislature, Governor Brown vetoed the bill on grounds that the matter was “well within the jurisdiction and competence of the Assembly and Senate Banking Committees.” The Legislature has not yet commissioned a study on this topic.

AB 2500
In 2012, Assembly Bill 2500 (Hueso) was introduced, calling for the establishment of the California Investment Trust, and authorization of a trust to exercise various powers and duties relating to banking. The bill would have required all State money to be deposited into the Trust, which would continuously appropriate those funds for expenditure.

Assembly Committee on Banking and Finance analysis noted that “should this measure move forward as currently drafted, the author will need to make several technical and substantive amendments to clarify and clean up the language.” The Assembly Committee further recommended that “the contents of AB 2500 be deleted and language creating a study be implemented to further look into whether a state bank should be established in California. Evidence from the Massachusetts study shows that it is very important to study the feasibility before investing energy into building a state bank, which is not a small task for any state to take on.” The bill was met with opposition by the California banking sector, including the California Bankers Association and the California Independent Bankers. Hearings on AB 2500 were cancelled by request of the author.
Hawaii
Legislation was introduced in the Hawaii State Legislature in 2012 for a state-wide public bank and initially included plans to issue $500 million worth of bonds to capitalize its proposed public bank. The proposal was not approved.

Illinois
The Community Bank of Illinois Act of 2015 was introduced in an attempt to form a public bank in Illinois. The bank would have accepted all State funds and would have been authorized to loan from the General Revenue Fund. Analysis noted that the minimum capital required to operate the bank would have been $9.8 billion, assuming a minimum of 10 percent capital to asset ratio. The bank would not have been FDIC insured. The state proposal was not approved.

Maine
In 2015, the Maine Legislature introduced “An Act to Create a Public State Bank.” The bank would have accepted State funds to make, purchase, guarantee, modify, or hold certain loans and to serve as a custodian bank. Excess income from the bank would have been deposited in the Maine Budget Stabilization Fund. The state proposal was not approved.

Massachusetts
Massachusetts examined the possibility of opening state-wide public bank in 2010. A report by the Federal Reserve Bank of Boston in 2011 examined opening a public bank similar to the Bank of North Dakota in Massachusetts. After adjusting for the size of the State economy, it was determined that the equivalent capitalization funding in Massachusetts would amount to about $3.6 billion. The state proposal was not approved.

North Dakota
Founded in 1919, the Bank of North Dakota (BND) was formed in the wake of economic hardship that led to heightened anti-big-bank and anti-big-business sentiment. The BND was established to provide banking support for agricultural interests, commerce and industry without the alleged fraudulent and discriminatory practices of private, out-of-state banks.

In May of 2011, the New England Public Policy Center released the report titled “The Bank of North Dakota: A model for Massachusetts and other states?,” which examined BND as a model for a potential public bank in Massachusetts. The report considered the following objectives for a public bank: stabilizing the state economy, providing local businesses with greater access to credit, augmenting the lending capacity of private banks, and contributing revenues to help fund state government.

One of BND’s most significant purposes has been participatory lending with community banks in order to stabilize the state economy. Loan participations are arrangements where a lead bank originates and services a loan, and another bank (in this case, BND) is involved in some capacity. This can include guarantees, capital contributions for the
initial loan, and interest rate buy-downs. In this way, BND plays the role of sharing risk
with smaller banks, ensuring that larger-scale projects can get funding. Smaller banks and
the state government also tend to turn to BND for funding during crises. For example,
BND used its access to the federal funds market to purchase loans from smaller banks in
North Dakota, providing liquidity to the market.

In addition, the BND has a long history of making competitive student loans, and issued
the nation’s first federally insured student loan in 1967. However, as a result of the
passage of the Health Care and Education Reconciliation Act of 2010, future student
loans will originate with the federal government, effectively severing this portion of
BND’s loan portfolio.

The report notes a number of impediments toward using the BND model for a larger state
such as Massachusetts, namely in financing. For example, “experiences during the
founding of BND suggest that the costs of starting up a state-owned bank would be
considerable... [and] would likely involve a very sizable bond issue and/or the possibility
of disrupting the operation of existing banks.” In fact, the BND did not make transfers to
the state general fund until 1945, which suggest a public bank would take decades to
become profitable. Since 1971, however, the BND has shown a profit each year.

**United States – Local Governments**

In addition to state efforts to address public banking, several local jurisdictions have taken a very
active role in pursuing information regarding how such banks could be created to serve local
residents. None has yet succeeded in forming a public bank, but research remains ongoing.
Below is a review of cities investigating the feasibility of establishing a public bank.

**Oakland, California**

At its September 19, 2017 meeting, the Oakland City Council approved an action to
conduct a study on the feasibility of opening a public bank, banking requirements, costs,
governance structures, and the bank’s ability to provide community benefit lending and
handle cannabis business deposits. The cities of Berkeley and Richmond and Alameda
County have contributed funding to this study, which has yet to be completed.

**San Francisco, California (City and County)**

On September 8, 2011, the Budget and Legislative Analyst of San Francisco released a
report titled “Community Supportive Banking Options,” which summarized options for
ways the City/County could invest its funds in community-supportive banking
institutions, including private and public banking options. Options addressed in the 2011
report included joint efforts with other neighboring municipalities to establish a Bay Area
network of public banks, or to establish a San Francisco public bank.

According to the report, the primary impediment towards creating a public bank was
California Government Code Section 27003, which states that “a county shall not, in any
manner, give or loan its credit to or in aid of any person or corporation.” However, the
Budget and Legislative Analyst’s Office of San Francisco subsequently released on
November 27, 2017 the report titled “Community Supportive Banking Options 2017 Update,” which clarified that the City Attorney reviewed pertinent State codes in detail and concluded that State law does not preclude the City from creating a bank as a separate entity.

According to the 2017 report, other steps toward forming a public bank include: creation of agreed upon goals and a founding policy statement; retention of staff and/or consultants to conduct detailed financial feasibility studies for the bank and create the administrative infrastructure of the bank; appointment of an independent board of directors and creation of articles of incorporation; development of a multi-year business plan; and determination of whether to be chartered by the State of California or the federal government and whether or not to become a Federal Reserve Bank member. Potential sources of funds include a General Fund appropriation, monies legally available from other City funds, a City bond issue, or a one-time funding from philanthropic organizations.

The potential for providing banking services for the cannabis industry was also addressed by the 2017 report, which was released prior to the Federal government’s rescinding of federal guidance concerning banking services for cannabis businesses (this relates to the Cole Memo, which is further discussed below and in a CLA report to the Jobs Committee dated 12/8/2017).

Santa Fe, New Mexico

In January 2016, the City of Santa Fe’s Public Bank Task Force released a report titled “Public Banking Feasibility Study Final Report” that evaluated the potential for opening a public bank in the City. Potential impacts of a public bank in Santa Fe included:

1. Funding more of the City’s capital improvement projects with internal funds;

2. Reviewing and implementing alterations to the collateral policy of the City, including increasing local lending;

3. Chartering the City’s banking operation and broadening the interdepartmental funding strategy to other public entities in Santa Fe;

4. Encouraging the use of crowdfunding techniques to help with sourcing and funding of smaller loans; and

5. Participation in up to 50 percent of loans underwritten by the banks that qualify under a Local Economic Development plan.

The projected fiscal and economic impact to the City of Santa Fe exceeds $24 million in the first seven years, or 3.6 percent of its $94 million annual General Fund operating...
budget over the same period. The Task Force is still considering the proposal in committee; the initiative has yet to move forward.

**Banking Services for Cannabis Businesses**

At the request of the Jobs Committee, this report provides information on local and State initiatives since 2007 related to public banking, including efforts across California and the nation. Although this report is not focused on banking issues associated with cannabis, recent developments at the federal level have created implications on this subject matter that the Jobs Committee should consider as discussed below.

**Federal – Legislation and Regulation Concerning Cannabis**

No legislation or regulatory actions have been identified at the federal level concerning public banking, although there has been some legislative action related to banking services for cannabis businesses. As noted in our previous report to the Jobs Committee, the report produced by the California Treasurer’s Cannabis Business Working Group (the Chiang Report) advises that the only true solution to the issues of cannabis banking is the removal of federal legal and regulatory roadblocks on cannabis. This would allow cannabis to be treated like other cash-intensive regulated industries, and grant financial institutions freedom to bank State-legal cannabis businesses that are compliant with anti-money laundering and anti-terrorism requirements.

The Chiang Report advises that the removal of federal restrictions demands a large number of legislative fixes, including policy changes by Congress, the executive branch, and regulatory agencies. There was movement toward this form of legislation with the Obama administration, particularly with the issuance of the Cole Memo in 2013 by the Department of Justice, which advised states on how to navigate the tension between federal and state laws on cannabis. The Memo limited the scope of federal cannabis enforcement to areas of particular concern, which largely excluded state-legalized adult usage. However, the Cole Memo did not change the Controlled Substance Act and did not decriminalize cannabis for purposes of federal law.

Similarly, after the Cole Memo, the Financial Crimes Enforcement Network (FinCEN) also issued guidance on compliance with applicable laws, regulations, and regulatory practice in an attempt to clarify how banks and other financial institutions could provide banking services to cannabis businesses. However, like the Cole Memo, this guidance did not change the underlying illegality of cannabis and related businesses under federal law.

Attorney General Jeff Sessions has criticized State cannabis laws and called for stricter enforcement of federal drug laws. The Department of Justice recently rescinded the Cole Memo, leaving states with recreational and medical cannabis laws unsure of their status with federal law.

A number of bills have been introduced in Congress in order to address these complications. The SAFE Act, introduced in 2017, would prohibit federal banking regulators from penalizing depository institutions that serve state legal cannabis businesses and immunize banks and their employees from prosecution solely for providing financial services to state legal cannabis businesses. The Respect State Marijuana Laws Act of 2017 would amend the Criminal Substances Act to provide that provisions of the Act related to cannabis do not apply to any
person acting in compliance with state laws relating to the cannabis industry, thus barring federal officials from prosecuting cannabis consumers and businesses where recreational or medical cannabis use is legal. Both bills are still under consideration in Congress.

The Rohrabacher-Blumenauer amendment (formerly Rohrabacher-Farr), first introduced in 2003 and passed in 2014 as a budget amendment, prohibits the Department of Justice from spending money on cannabis prosecutions in states where medical cannabis is legal at the state level. As a budget amendment, it must be approved every year. The amendment was temporarily extended through a stopgap spending bill through March 23, 2018. Congressional leadership must reauthorize the language of the amendment as part of forthcoming appropriations in order for the provisions to stay in effect.

California – Legislation and Regulation Concerning Cannabis

Cannabis – CBWG Report on Cannabis Banking Options
On November 7, 2017, the California State Treasurer John Chiang released a report entitled “Banking Access Strategies for Cannabis-Related Businesses” (Chiang Report), which outlines the difficulties arising in the banking industry due to the conflict of cannabis legality between federal and State laws. The Treasurer’s report outlines key issues and potential strategies in four areas, including the feasibility of creating a public or private financial institution to serve cannabis businesses. This report was reviewed in detail by the Committee on December 13, 2017, in a report by the Chief Legislative Analyst dated December 8, 2017 (C.F. 17-0831).

Governor’s Cannabis Banking Solution
According to a Los Angeles Times article released on December 17, 2017, titled “California considers ‘green banking’ as it transitions to fully legal pot,” officials in Governor Jerry Brown’s administration have met with representatives of 65 banks and credit unions about creating a network of financial institutions that would accept funds from cannabis businesses in a way that would guarantee federal banking regulators that the cannabis industry money is subjected to special tracking, oversight, and transparency in compliance with federal guidelines. Governor Brown’s proposal would reportedly designate one private bank as a central correspondent bank that would hold accounts from other banks that are doing business with marijuana firms. No official announcement on the matter has yet to come forward. Further, this initiative may be in jeopardy due to recent actions by the federal Department of Justice, as noted above.

The Attorney General is opposed to the Rohrabacher-Farr amendment, and reaffirmed the Department of Justice’s opposition to the inclusion of the amendment in appropriations legislation. Whether the amendment will be passed again in 2018 remains unclear. Without the Attorney General’s support, legislation to remove federal and regulatory roadblocks on cannabis may have a more difficult road through Congress and the White House.

SB 930
SB 930 (Hertzberg), introduced January 25, 2018, offers another potential avenue for banking cannabis businesses. The bill states the intent of the Legislature to enact subsequent legislation that would establish a State-chartered bank. This would allow State-chartered financial institutions to work with licensed cannabis businesses to operate within the banking system. The
Legislature has referred SB 930 to the State Assembly Committee on Rules. The City Council has adopted Resolution (Wesson-Krekorian) in support of this bill.

Analysis/Conclusions
Few public banks currently operate anywhere in the world, and two that had been formed (China and Indonesia) have recently converted fully into independent commercial banks. In all cases, authority for a public bank was provided under national and State law. Models that have been identified were formed with authority provided by the national government or, in the case of BND, by a state government.
III. BANK MODELS

Below are models used by the most common financial institutions in the United States. Our Office has provided a description of how each financial institution collects and receives deposits, interacts with regulatory agencies, and what laws must change in order for the model discussed to perform the functions necessary to operate as MBLA.

Chartered Commercial Bank
A chartered commercial bank is a type of for-profit financial institution that accepts deposits, provides access to lines of credit to businesses and individuals, and offers checking account services. Commercial banks earn profits by selling and earning interest on loans ranging from mortgages, auto loans, and personal loans. Commercial banks offer a wide range of services and can focus on specific types of business, such as only participating in specific types of lending or serving customers in a specific industry.

How it receives deposits and who provides oversight
In California, a commercial bank is required to receive approval from both the California Department of Business Oversight (DBO) and the Federal Deposit Insurance Corporation (FDIC). The FDIC insures deposits at all chartered banks up to $250,000 per depositor. All banks in California must obtain federal deposit insurance. Applications for a Commercial Bank Charter are usually submitted jointly with applications for federal deposit insurance. The decision by the DBO to grant or deny the Commercial Bank Charter application is made independently from the FDIC, although it is unusual for one to be granted without the other. The FDIC and DBO have wide discretion in either granting or denying Commercial Bank Charters.

The Commercial Bank Charter application must include detailed information regarding the proposed business plan and management of the bank. The DBO typically makes its decision to either grant or deny a commercial bank charter 90 days after acceptance of the business proposal. Because any chartered commercial bank in California is required to have FDIC insurance, the DBO encourages the business proposal submission to include the FDIC proposal.

Deposit insurance is separate from a commercial bank charter, although both must be obtained in order to operate as a commercial bank in California, which is why the DBO and FDIC conduct their investigations jointly to minimize the burden to the applicant. The DBO oversees financial service providers and products and supervises the operations of state-licensed financial institutions such as banks.

The DBO can also certify two other types of banks, Industrial Banks and Trust Businesses. Industrial banks may be a relevant banking structure for this report. Industrial banks differ from commercial banks because they cannot accept demand deposits and their parent companies are exempt from the Bank Holding Act for this reason. Industrial banks are subject to the same laws, regulations, and examinations as commercial banks. According to state law, an “industrial banking business” includes the making of loans and acceptance of deposits, including deposits evidenced by investment or thrift certificates, but excluding demand deposits (a deposit that can
be withdrawn without prior notice). There are currently three state chartered industrial banks in California, all of which are in the San Diego region.

What must change for model to work?
In order for a Chartered Commercial Bank to operate as a public bank owned, but not controlled, by a City, a special exemption from the DBO to operate as a financial institution is required. The DBO is currently the sole authority for chartering a private sector banking business in California and has never issued a commercial bank charter for a municipality or other public bank. Given the novelty of using a Commercial Bank Charter for a public bank and the tension between State and federal law regarding financial institutions, the City may want to first submit a request with the DBO for an opinion on the feasibility of using a Commercial Bank Charter for a public bank, should this be pursued.

Chartered Credit Union
A chartered credit union is a not-for-profit financial organization that exists to service its members, which may be broadly defined. Credit unions receive deposits, provide a variety of loans ranging from mortgages to auto and personal loans, and offer checking account services. Unlike banks, credit unions are owned and controlled by the members who use their services and are often controlled by a volunteer board of directors who are elected by its members. Profits earned by the credit union may be returned to members in the form of reduced fees, higher savings rates, and lower loan rates. Members of a credit union often share a common relationship known as a “field of membership,” which may be as broad as being a Los Angeles resident or as narrow as being a member of the United States Congress.

How it receives deposits and who provides oversight
There are two possible alternatives for a Credit Union Charter in California. The first model would require the City of Los Angeles to be the sponsoring organization responsible for contributing the funds necessary for organization and operation of the credit union, while the second involves the City of Los Angeles along with other municipalities to satisfy the “common bond” requirement. The common bond requirement could be met by soliciting other municipalities, as the three basic forms of groups eligible for membership in a credit union are: (1) groups based upon a common bond of occupation; (2) groups based upon a common bond of association; and (3) groups within a well-defined neighborhood, community, or rural district.

California law requires credit unions to apply and obtain federal deposit insurance or other insurance that is satisfactory to the DBO. The vast majority of credit unions in California are insured by the National Credit Union Administration (NCUA), which insures deposits up to $250,000 per depositor, the same amount as the FDIC. It is unknown whether a private deposit insurance company would be willing to insure a public bank with billions of dollars in assets or whether the DBO would accept such insurance. California law also requires that there must be at least 500 members in order to charter a credit union, although this figure is not rigidly enforced by the DBO.
What must change for model to work?
Similar to Chartered Commercial Banks, the DBO possesses wide discretion in the oversight and management of credit unions. As noted above, if the deposit insurance is not satisfactory to the DBO, the credit union will not be permitted to operate. In order for a credit union to operate as a public credit union owned, but not controlled by the City, a special exemption is required.

OTHER MODELS AND QUASI BANKS
Unlike the conventional banking models of commercial banks and credit unions, the financial institutions detailed below do not currently accept deposits but may serve some of the other purposes of MBLA such as affordable housing loans and access to lines of credit. Major changes to State and federal law would be required for the described models to serve as a public bank.

Tribal Banking and Community Development Financial Institutions (CDFIs)
If a Native American reservation wants to enter into the national banking system, they are required to obey the laws and regulations outlined by the Office of the Comptroller of the Currency (OCC). The requirements for a Native American reservation are often similar to that of commercial and credit union charters. CDFIs are financing entities that promote training and financial assistance.

Tribal Banking
The United States Treasury Department’s OCC licenses federally recognized Native American tribes that want to explore entry into the national banking system. If a national bank seeks to establish or acquire one or more branches to receive deposits, pay withdrawals, or make loans to customers, it must obtain approval from the OCC, which applies standards established in federal law. Indian country banks are not required to obtain federal deposit insurance, but most receive either FDIC or NCUA insurance. The FDIC insures Native American accounts held by the Bureau of Indian Affairs (BIA) up to $250,000.

According to the OCC, the Community Development Financial Institution (CDFI) Fund established a fund to provide technical assistance and training for Native American communities. The fund is intended to: (1) increase access to capital in urban and rural Native American communities; (2) create new CDFIs that serve these communities; and (3) increase the capacity of existing CDFIs that currently serve Indian country.

The OCC notes that prospective bank organizers may choose to charter a national bank with a community development focus (CD bank). A CD bank is a depository institution with a stated mission of promoting the public welfare, including the welfare of low- and moderate-income (LMI) communities or families, in which it is chartered to conduct business. CD bank applications must meet the same statutory, regulatory, and procedural requirements as other nationally chartered banks.

Community Development Financial Institutions (CDFIs)
CDFIs are FDIC-insured banks that have a primary mission of promoting community development. CDFIs may be banks, credit unions, loan funds, microloan funds, or venture capitalist providers. These financial institutions are different from traditional banks because they
target low and moderate income markets and work in urban and rural communities without access to credit that are often underserved by the traditional banking industry.

The stated mission of the CDFI Fund is to expand economic opportunity for underserved people and communities by supporting the growth and capacity of a national network of community development lenders, investors, and financial service providers. Many CDFIs assist families finance their first home, support community residents starting businesses, and invest in local health centers, schools, or community centers. There are currently over 1,000 CDFIs operating nationwide that work to invest capital in low-income communities that have awarded over $2 billion to community development organizations and financial institutions since 1994. Examples of CDFIs in Los Angeles are the Local Initiatives Support Corporation (LISC), the Low Income Investment Fund (LIIF), and the Enterprise Community Loan Fund.

**Bankers' Banks**

Bankers' banks are owned by their member institutions and provide both traditional and nontraditional banking services for their members. They do not take deposits from or make loans to the general public, unaffiliated corporations, or government, and they are FDIC-insured. Furthermore, they are often for-profit organizations independent of control by any group or affiliation. Their shareholders, many of whom are their clients, accrue the benefit of any profits. Ownership interests are optional. Some Bankers' banks specialize in providing correspondent banking products such as secondary mortgage products, competitive federal funds rate, cash letter processing with automated cash management, municipal bond underwriting, investment trading, and other related services. Bankers' banks currently exist in roughly 25 states.

**Infrastructure Bank**

The California Infrastructure and Economic Development Bank (IBank) was created in 1994 as an authority within the Governor's Office of Business and Economic Development to finance public infrastructure and private development that promote economic opportunity. The IBank has broad authority to issue tax-exempt and taxable revenue bonds, provide financing to public agencies, provide credit enhancements, acquire or lease facilities, and leverage State and Federal funds. The stated mission of the IBank is to provide financial assistance to support infrastructure and economic development in California. The IBank is not actually a bank, but rather a pass-through finance agency. It is not chartered or insured.

**Public Benefit Corporation**

Established in 2012, a public benefit corporation is a corporation organized under General Corporation Law section 14600 that has a strong social and environmental mission, and must operate consistent with that mission. This material positive impact must be demonstrated against a third-party standard, but does not need to be audited or certified by a third party. The Articles of Incorporation of a public benefit corporation may also identify its purpose to include one or more specific public benefits and commit funds, practices, and resources to these causes. In order for the City to establish a public bank as a public benefit corporation that is eligible to receive deposits, the City would need to request a special exemption from the DBO because benefit corporations are not explicitly allowed to receive deposits. Only chartered banks and credit unions are permitted to receive deposits under California law.
Export-Import Bank
The Export-Import Bank (EXIM) is the official export credit agency of the United States. It is an independent Executive Branch agency with a stated mission of supporting American jobs by facilitating the export of U.S. goods and services. When private sector lenders are unable or unwilling to provide financing, EXIM fills the gap for American businesses by equipping them with the financing tools necessary to compete in the global marketplace. Because it is backed by the full faith and credit of the federal government, EXIM assumes credit and related risk associated with transactions in other countries that the private sector is unable or unwilling to accept. The Bank’s charter requires that all transactions it authorizes demonstrate a reasonable assurance of repayment; the EXIM consistently maintains a low default rate, and closely monitors credit and other risks in its portfolio. As with the IBANK, EXIM is not an actual bank, but rather a finance agency.

Los Angeles Community Development Bank (Not A Bank)
In 1995, the City created the Los Angeles Community Development Bank (LACDB), a non-profit, independent entity charged with making loans to businesses located within the federally designated Empowerment Zone and a one-mile buffer around the Empowerment Zone. LACDB was not a bank, but a finance agency that provided loans in conjunction with commercial banks and CDFIs. A variety of funding sources, including Section 108 and Economic Development Infrastructure grants, were used to provide capital for loans. The structure of the organization, however, hindered the LACDB’s ability to make loans. Although LACDB was structured to work in partnership with commercial banks, those banks were able to pursue these loans independent of LACDB. Due to a range of difficulties associated with its programs, the LACDB dissolved in 2004 and filed for bankruptcy.

Analysis/Conclusions
The commercial bank and credit union models require compliance with State and federal regulations that would constrain formation and operation of a public bank. Public Bank LA, an advocacy group for public banks, notes that these models are a “poor fit” for a public bank due to the current regulatory framework that precludes municipalities from obtaining commercial bank or credit union charters. The memo opines that an ideal solution would be a public bank charter, which does not exist.

The Public Benefit Corporation may provide controls necessary to ensure that a public bank conducts business in compliance with its social benefit mandate, but such an entity is not allowed to accept deposits. The EXIM is an export agency and does not accept deposits, which is an essential component of a public bank. Ideally, a legislative solution would be approved in State or federal law that delineates the structure for a public bank, providing clear requirements concerning capital, collateral, insurance, reserves, and the other business requirements necessary for successfully operating a bank. CDFIs may be an option to perform the functions of a public bank because of their ability to accept deposits and stated function of promoting economic development in underserved communities, but they may have difficulty meeting requirements
related to banking services, such as access to adequate capital, collateral, insurance, and other resources that provide customers with protection from risk. A CDFI would not be able to provide banking services to the City under existing circumstances.
IV. PROFILE OF CURRENT CITY BANKING SERVICES

The City employs numerous banking institutions to perform a wide range of financial services. Bank services include the day-to-day financial transactions; investment services concern long-term management of City funds; and bonds are issued to provide long-term debt to fund a range of City projects and programs. Over 40 financial institutions are involved in the various financial services required by the City.

Role of the City Treasurer
Los Angeles City Charter Section 301 establishes the City Treasury as the official depository of all monies received by the City. According to Finance, all money paid into the City Treasury is credited and kept in separate funds for the City’s various departments, including proprietary departments, pursuant to the City’s ordinances and California State law. The Director of the Office of Finance/City Treasurer manages and controls the City Treasury and needs a wide range of services offered by financial institutions to conduct its operations responsibily.

Finance is responsible for managing the revenue and cash flow for the City, determines the appropriate daily cash needs of the City, and ensures that sufficient liquid assets are available for the City to pay its obligations. State law permits the Treasurer to invest all surplus funds not required to meet the daily cash needs and prescribes the manner in which funds may be invested while considering the safety of principal, liquidity, and yield.

There are currently $11 billion in assets under management by the Treasurer in the City’s Investment Pool. Authorized investments must conform to California Government Code Sections 53600 et seq. On a daily basis, Finance manages the daily investment of surplus City funds through the purchase and sale of fixed income securities (U.S. Treasury issuances, U.S. Agency issuances, corporate notes, certificates of deposit, asset-backed securities, commercial paper) which are facilitated through the use of various banking institutions’ broker/dealer units. The Treasury’s Investment Division utilizes a trading platform and contracts with a bank to serve as the custodian of securities held in the City’s name. The custodial bank also provides securities lending services. Finance also uses analytic models to manage risk in the investment portfolio. Additionally, the City utilizes the services of an investment advisor to monitor the City’s daily investment activities and ensure the investment practices comply with State law.

Finance also oversees cash management services with a $40 billion transactional cash flow. Finance contracts with Wells Fargo Bank to provide commercial bank services and supports the City’s departments by facilitating investment transaction payments, debt payments for a $15 billion debt portfolio, processing disbursement vendor payment obligations, maintaining over 1,000 bank accounts, and conducting daily reconciliations of all receipts and balances. Finance also supports City departments in the collection of approximately $360 million in cash vault deposits, processing 18 million debit and credit card transactions worth over $1 billion in revenue, and over one million payroll transactions.
Finance currently partners with the following agencies to provide treasury business solutions and support the City department’s financial operations:

- **Wells Fargo Bank, Commercial Bank Services:** the bank provides various depository bank services for all City departments, including demand deposit accounts, online system reporting, daylight overdraft services, positive pay, account reconciliation services, payroll disbursement services, controlled disbursement, lockbox services, cash vault, Electronic Funds Transfer (Wire and Automated Clearinghouse), and remote deposit services.

- **Wells Fargo Bank, Credit Facility Services:** provides support to the City’s Contractor Development and Bonding Program. The program qualifies local, small, and emerging contractors in obtaining the required bid, performance, and payment bonds necessary to compete for various City construction jobs. This program is managed by the Office of the City Administrative Officer.

- **U.S. Bank, Purchase Card Services:** provides a credit card-based purchase system to pay for low-value, non-inventory, non-capital, and non-contracted items less than $1,000. The Office of the Controller administers the City’s Purchase Card program for all participating City departments.

- **U.S. Bank, Fleet Fuel Services:** provides fleet card services for City departments to allow for remote fuel purchases when outside the City limits. The program is administered by the Department of General Services in conjunction with the Los Angeles Police and Fire Departments.

- **U.S. Bank, Commercial Card Services:** this service provides an electronic payment acceptance platform for large volume commodities, contracted services, and inventory items. This program is managed by the Office of the Controller.

- **U.S. Bank, Trustee and Paying Agent Services:** supports the City Treasury in the distribution of payments for various Bond issuances and for the City’s Street Improvement Bond holders.

- **MUFG Union Bank, Checking and Commercial Card Services:** provides support to the Office of the City Clerk and the City’s 96 Neighborhood Councils (NC) to facilitate NC payment and purchase transactions. The account established by MUFG Union Bank is managed by the City Clerk.

- **Elavon, Inc. and Wells Fargo Bank, Merchant Card Processing Services:** provides support to all City departments that accept credit and debit card payment by facilitating the payment transactions between customers and the City.
- **GardaWorld and Brinks, *Armored Courier Services***: provides armored courier services to transport currency, coin, and check collections made at City facilities for deposit with the City's bank.

- **Trustwave, *Payment Card Industry Compliance Validation Services***; ensures the City's credit card transactions platforms are compliant with the requisite credit card industry regulations and requirements.

Finance recently released a Request for Proposals for bank services to identify a service provider(s) for the following services: Disbursement services (account reconciliation, positive pay, controlled disbursement, payroll services, commercial and e-payables card services), Neighborhood Council Banking, Check Printing Services, Lockbox services, Depository Services (cash vault, check processing, remote deposit services, armored courier, Contractor Development and Bonding Program letter of Credit Facility), and Electronic Funds Transfer services.

Finally, Finance's treasury operations provide appropriate financial controls to ensure the reliability of financial reporting, the security and efficiency of transactions, and compliance with applicable laws and regulations.

**Analysis/Conclusions**
The City requires banking services similar to those of a multi-national corporation. With an approximately $11 billion portfolio, millions of transaction, hundreds of accounts, and contracts for services with dozens of banks, the City has developed a system that ensures a careful management of its financial resources and spreads risk among its banking partnerships. Consolidation and transfer of these banking services into MBLA, or any single financial institution, could increase risk to the City's financial health.
V. IMPLEMENTATION ISSUES

Bank formation and operation requires consideration of a wide range of issues that would determine the type of financial institution created, how it would be regulated, and how it would manage funds received. Several of the issue areas are central criteria when forming a chartered bank or credit union, essential to any application to the State, FDIC, and NCUA. The manner in which these issues are addressed would inform bank regulators as to the strength and stability of a proposed bank and assures depositors, investors, and borrowers that the institution is well managed and solvent.

The following provides a brief review of these issues and notes any changes in federal, State, or local law required to address existing constraints in law that may hinder or prevent formation of MBLA.

City Charter
City Charter Section 104(g) prohibits the City from entering into a purely commercial venture, unless the venture is approved by the voters, was in operation before the Charter was approved, or is otherwise authorized by the Charter. Inasmuch as MBLA would be a commercial venture, the Charter is a relevant regulatory factor. Since MBLA was not previously in operation in the City before the Charter was approved and is not otherwise authorized by the Charter, voters would be required to approve formation of such an institution.

Charter Amendment: A Charter Amendment would need to be presented to the voters to allow for the formation of MBLA owned by the City that would earn a profit.

Role of the City Treasurer
The City Charter designates the City Treasurer as the custodian of all money deposited into the City treasury. Further, State law provides that the Treasurer is responsible for safekeeping these moneys and selects the depositories that “in his or her judgment is to the public advantage.” Neither of these provisions provide the Mayor or Council with authority to instruct the Treasurer where those deposits shall be made; as such, the Treasurer would not be obligated to deposit any funds into MBLA.

Charter Amendment: Any change to the Treasurer’s fiduciary authority would require a Charter amendment. Additionally, designating MBLA as the City’s depository for its moneys would also require a Charter amendment. Any Charter change that could affect the Treasurer’s independence and fiduciary responsibility when it comes to the management of public funds must be weighed very carefully.

State Law: Any change to the Treasurer’s fiduciary authority would require a change to State law. Any change in State law that could affect the Treasurer’s independence and fiduciary responsibility when it comes to the management of public funds must be weighed very carefully.
Proprietary Departments
The Department of Airports (LAWA), Harbor Department (Harbor), and Department of Water and Power (DWP) each have independence over their financial services under the Charter. In addition, LAWA is regulated by federal law and uses federal funds regulated by the Federal Aviation Administration, which may include how its finances are managed. The Harbor is regulated under the State Tidelands Trust, which may affect how it may manage its finances.

Charter Amendment: Any change to the fiduciary authority of the proprietary departments would require a Charter amendment. Additionally, designating MBLA as the depository for moneys controlled by the proprietary departments would also require a Charter amendment. Any Charter change that could affect the proprietary departments’ independence and fiduciary responsibility when it comes to the management of public funds must be weighed very carefully.

State/Federal Authority: Additional research is required to determine whether changes in federal and State law or regulatory controls are needed to allow LAWA and the Harbor to deposit funds in MBLA.

Competitive Bidding
The City Charter requires that the City select a contractor for services through a competitive process. This requirement includes banking services. Unless the Charter is changed, the City would not likely be able to select MBLA to provide its banking services without having completed a competitive bidding process. There are exceptions to the competitive bidding requirements of the Charter, including a process whereby a sole source contract may be made with appropriate findings to justify the designation of a single service provider. But the provision of banking services is not currently one of those exceptions. Further, it may be difficult to make sole source findings considering the breadth and depth of financial services available to the City.

Charter Amendment: A Charter Amendment may be needed to exempt selection of banking services from the competitive bidding requirements of the Charter.

Prudent Investor Rule
The Prudent Investor Rule is a national standard adopted into law by nearly all of the states, including California (Government Code Section 53600.3 et seq). The Prudent Investment Rule requires that fiduciaries, those decision-makers responsible for managing financial resources, ensure that their decisions and actions take into account the following:

- Preserve capital
- Ensure adequate liquidity
- Obtain a sufficient rate of return

With regard to the City’s funds, State law requires that the City must deposit and invest its funds in consideration of the Prudent Investor Rule. As detailed below, this presents significant constraints on the City’s actions related to how it selects and manages banking and investment.
services, including requirements that the selected bank provide substantial collateral; hold a rating by an appropriate federal agency; and have experience as a designated financial institution.

The City is also obligated to obtain the highest return possible on its portfolio. If MBLA does not perform at or above market with respect to interest earnings, the City would be obligated to obtain financial services that can provide a higher return.

Likewise, the Board and administrators of MBLA would also be required to comply with the Prudent Investor Rule. In this case, it means that decisions concerning loans and investments must ensure that deposits made with the bank are secure and provide a rate of return that is competitive in the market and responsible to depositors.

The Prudent Investor Rule has implications for loan management. If a borrower fails to make payments, a bank must take action to ensure payment, up to and including foreclosure on property. Failure to actively manage a loan portfolio and to take actions necessary to ensure payment or to secure the asset would be deemed a failure to perform under the Prudent Investor Rule. MBLA would face such decisions from time-to-time, as do any other financial institutions.

It should be noted that the Prudent Investor Rule applies to all fiduciaries, that is, all individuals responsible for making decisions regarding an organization's financial resources and those individuals are personally liable for the decisions they make. In the City today, the Mayor and Council are fiduciaries responsible for City financial resources. Should the City form and own MBLA, fiduciary responsibilities of the Mayor and Council may extend to all business decisions of the bank, even if they are not on the bank's Board of Directors.

**State Law:** Since the Prudent Investor Rule is a national standard to protect depositors, investors, and borrowers, revisions to this standard to facilitate formation of public banks is not likely. With regard to local government, the Prudent Investor Rule protects taxpayer funds and any revisions should be considered with great caution.

**Mission Compliance**
The mission of MBLA would likely require that services be focused on helping City residents and businesses in compliance with social, ethical, and environmental standards. The Board of Directors of MBLA would be obligated by this mission to ensure that the bank's actions are consistent with these provisions, but they would also be obligated to comply with the Prudent Investor Rule which takes precedence over any other policy objectives. This could create a tension between competing policy objectives that the Board would be required to balance. It would also create potential conflict between the Board and the community with regard to the bank's compliance with these objectives. Such tensions could significantly limit the bank's ability to manage its funds in a manner that produces a return for its investors and customers.

A significant area of uncertainty concerns the ability of the Mayor and Council to enforce compliance with policy objectives for MBLA. If the bank is entirely independent from the City, there would be no direct ability of the City's elected officials to ensure that the bank adheres to the objectives under which the bank was created. On the other hand, City control over the bank could...
creates a wide range of complications that may limit or prevent the City from forming such a bank in the first place.

Any formation documents for MBLA should include provisions to ensure that the bank would comply with its mission and that monitoring and enforcement provisions are in place to ensure compliance. But beyond these formation documents, it is not certain which mechanism would allow for enforcement to ensure compliance.

**State/Federal Law:** Changes to either State or federal law may be needed to provide an enforcement mechanism to ensure that a public bank complies with the goals of its mission. Until the framework for MBLA is identified, no recommendations for legislative solutions can be recommended.

**Collateral for City Funds**
State law requires that private banks receiving municipal funds on deposit provide collateral to protect the amount of those funds exceeding coverage by FDIC. The City, for example, maintains an average balance of approximately $100 million in the bank on any given day. The City’s bank is required to provide $100 million (less the FDIC protection of $250,000) in liquid assets as collateral to ensure the protection of the City’s funds. MBLA would be required to maintain similar collateral levels to protect City funds on deposit under current law. There are a variety of financial instruments that may satisfy the collateral requirement, established under State law, such as municipal bonds. The City would encounter challenges, especially in the start-up period, securing this level of collateral. A change in State law would be required to set a different standard for collateral where MBLA receives deposits from its ownership authority.

**State Law:** State law would need to be revised to clarify the amount of collateral required by MBLA accepting funds from its ownership, possibly including a reduction in the collateral requirement and clarification on the types of City funds that would require collateral support. It should be noted that collateral requirements are in place for the protection of financial deposits and changes should be carefully weighed.

**Capital – Start-up**
A substantial amount of capital is needed to start a bank. The Federal Reserve Bank of Boston estimated that a public bank for the State of Massachusetts would need $3.6 billion in start-up capital, for example. An analysis is needed to determine the amount of start-up capital needed for a public bank serving the City, the calculation of which would be dependent on the types of services to be offered by the bank.

Sources of cash to initially fund the bank that have been identified in the literature include City General Fund revenues; philanthropic organizations; and City-issued bonds. As the bank would have no customers at start-up, depositor funds are not an available source of start-up capital. General Obligation Bonds would not be available either due to regulations regarding their use, such as time limits on when they can be used, prohibition on use to benefit a private party, and recordation of a covenant for public benefit on properties that receive bond funds. The City would remain responsible and liable for how bond funds would be used.
Complications exist for the remaining sources of funds:

- City General Fund  State law requires that the City deposit its funds into a chartered and federally rated financial institution that meets certain criteria, including a requirement that the institution has been in operation for at least three years. The City might be able to make an investment of General Fund revenues as it would any payment for services, investment, or economic development loan or payment. Collateral requirements, as previously discussed, would likely apply. In addition, investment could not be made in a manner that benefits a private party, which could be considered a gift of public funds, without an associated public benefit.

- Philanthropic  Research would be required to identify philanthropic organizations that would provide a grant to support formation of a public bank.

**Capital Reserve Requirements**

The Federal Reserve Bank requires banks to maintain a reserve against deposit liabilities in very safe, secure assets. If a bank’s reserve liabilities exceed $122.3 million, the bank must maintain a reserve of 10 percent of those liabilities. It is not currently known how MBLA would be structured and how it would meet the Capital Reserve requirements and deposit liabilities it would be obligated to maintain.

**Federal Regulation/Law:** Further research is needed to determine whether federal regulations or laws would need to be revised to allow MBLA to meet capital reserve requirements.

**Depository Institution**

State law requires that a local agency, including the City, shall “choose a nationally or State-chartered commercial bank, savings bank, savings and loan association, or credit union” for its deposits and investments. This requirement would either require that MBLA be established under existing laws as a chartered financial institution, or State law would need to be amended to recognize the organizational structure under which MBLA is formed.

**State Law:** State law would need to be revised to allow the City to deposit General Fund revenue into MBLA if it is not a State-chartered financial institution.

**Financial Risk**

In 2016, nearly 40 financial institutions doing business or seeking to do business with the City provided statements in compliance with the City’s Responsible Banking ordinance. These financial institutions provide to the City, including LAWA, the Harbor, and DWP, services related to general banking, investments, and bonds.

The MBLA proposal seeks to consolidate a significant amount of the City’s financial resources into this newly formed bank. This could increase the City’s risk exposure; failure of MBLA
could be catastrophic. Provisions in State law, such as the Prudent Investor Rule, require that local governments manage such risks. If the City were to consolidate a significant portion of its fiscal resources in MBLA, additional measures would be required to mitigate any risk of bank failure. Additional analysis is required to fully understand the consequences of such risk exposure, options to mitigate this risk, and any legislative solutions necessary to resolve this issue.

**State Law:** This is not directly a legal or regulatory matter, but would be a significant factor in evaluating the City’s compliance with the Prudent Investor Rule. Again, with regard to local government, the Prudent Investor Rule protects taxpayer funds and any revisions should be considered with great caution.

**Insurance**
Most banks offer deposit protection to their customers through FDIC coverage. The FDIC, an independent government agency, provides insurance coverage for deposits up to $250,000. MBLA would either need to meet all of the regulatory requirements associated with participation in the FDIC program, which is required as a chartered bank, or provide alternative insurance coverage for depositors.

Alternately, credit unions offer deposit insurance to their customers through NCUA. Similar to the FDIC, the NCUA provides coverage for deposits up to $250,000. A municipal credit union would need to meet all of the regulatory requirements associated with participation in the NCUA insurance program.

Advocates for public banks have suggested that a public entity, such as the City, provide deposit insurance. It is not recommended that the City use its self-insurance capacity to accept the liability associated with insuring MBLA. The City’s General Fund incurs costs associated with self-insurance. Using such authority to insure MBLA could expose the City to financial claims that could not be paid and would put all City services at risk. Therefore, MBLA should be structured to qualify for participation in the FDIC or NCUA program or another source of deposit insurance should be identified.

**Federal Regulation/Law:** Further research is needed to determine whether federal regulations or laws would need to be revised to allow MBLA to meet insurance requirements.

**Bank Operations**
A depository bank requires a complex administrative infrastructure to provide the full scope of services to be offered. Store-front locations and business offices would be needed for a retail operation, as would skilled staff to provide services both to bank customers and to fulfill the full range of regulatory and administrative requirements associated with bank operations.

One of the most critical needs of any bank is a software system that would record all bank transactions. A depository bank, for example, would maintain records on a significant number of transactions occurring daily. Such software is custom-built to implement the business plan of the
bank and includes significant program elements associated with security, auditing, regulatory compliance, and reporting, among other functions. It is anticipated that development of such a software system would take several years to program at significant cost with on-going programming and maintenance needs.

**Federal/State Law:** No legal or regulatory changes have been identified that would impede formation of MBLA on this matter.

**Additional Laws and Regulations**
The issues above are a preliminary review of the issues related to bank formation that should be considered. There is an extensive body of law and regulation related to banking that will be relevant for MBLA-formation that should be reviewed by specialists in the field. If Council decides to move forward with formation of MBLA, a consultant should be retained with experience in this area. The following is a partial list of additional laws and regulations that should be considered in any further analysis:

**Federal Laws and Regulations**
- Truth in Lending Act
- Fair Credit and Reporting Act and Regulation Z
- Interest Rate regulations
- Fair Credit Billing Act
- Electronic Funds Transfer Act
- Right to Financial Privacy Act
- Credit Opportunity Act and Regulation B of the Federal Reserve Board
- Community Reinvestment Act
- Dodd-Frank Act
- Foreign Account Tax Compliance Act
- Regulations issued by the Consumer Financial Protection Bureau
- US Securities and Exchange Commission rules, or laws of any other federal agencies that regulate non-banking financial services
- Other regulations of the Federal Reserve, including banking regulations and reporting requirements

**State Laws and Regulations**
- Open Meetings Laws
- Public Records Act Laws
- Procurement Laws
- Audit Laws
- Laws Concerning Property Disposition

Review of these laws and regulations is necessary to understand additional constraints that may affect the ability of the City to own a public bank. For example, banking laws regulate how bank investors and board members may conduct business with the bank. If the City were to own a bank, it is unclear how these laws would affect the ability of the City to conduct business with its own bank.
Analysis/Conclusions
The two models for providing financial services in the United States, chartered commercial banks and chartered credit unions, operate under a wide range of federal and state laws and regulations that are not aligned with the formation and operation of a public bank. Changes in federal and State law are needed to facilitate formation of public banks.

In addition, the City Charter would need to be amended to allow for the formation of MBLA. The Charter controls the ability of the City to establish a business under City ownership, as well as defining how the City Treasury functions. These provisions would need to be amended to accommodate the formation and operation of MBLA.
VI. CITY FINANCIAL ASSISTANCE PROGRAMS AND SERVICES

A number of current City programs carry out quasi-banking functions and promote community investment and development objectives raised by proponents of public banking. Programs that further the development of affordable housing, assist small businesses, finance public infrastructure and provide services to underserved communities are described below. The City has the opportunity to tailor most programs to meet the needs of its unique communities and regularly revisit program regulations to ensure that they are achieving the City’s objectives.

City quasi-banking functions carried out through these programs offer financing that is often more favorable than commercial products. City financing includes residual receipts loans with very low interest rates for affordable housing development, loans subject to service repayment provisions, and grants to improve living conditions for the City’s residents, among others. The City maintains control over programs funded with its General Fund, with the exception of others subject to certain State or federal regulations, depending on the funding source.

Two tables are provided at the end of this section that identify 39 housing and economic development programs currently operated by the City that directly or indirectly relate to financing and financial capacity.

Affordable Housing Programs
The City currently operates a range of programs to assist in the development of affordable housing, including programs to fund the acquisition of land for housing development, as well as construction and rehabilitation of housing. City incentives, including funding and real property development, facilitate the construction of affordable housing and restrict occupancy to ensure long-term affordability. Programs are also available to provide funds for limited repairs for single-family homes and lead-hazard abatement. Through the City’s funding and land disposition agreements to build housing, the City is able to negotiate terms relative to affordability, sustainable building methods, property management standards, supportive services, and other requirements to ensure the City’s community-serving goals are met.

In addition to City-controlled programs, the Council and Mayor take an active role in supporting and shaping funding programs with non-City sources. The City has taken unprecedented steps in co-applying with developers to secure additional resources for the City. Further, it has supported legislation and participated in the development of programs managed by the State to ensure that the City receives its fair share of State and federal funding. Below is an abbreviated list and description of the City’s recent participation in externally funded programs.

Quasi-Banking and Economic Development
The City of Los Angeles currently funds quasi-banking functions that allows it to provide loans, technical assistance, and banking services to small business, low-income residents, and others. The following section of the report will detail these existing City programs and provide a snapshot of the current activity levels. These programs are led by multiple City departments and provide loans and services on a wide ranging scales. The list of programs have been divided into
two groups: programs that have quasi-baking and economic development functions and programs that provide technical assistance.

In addition to the programs listed in the table, the City offers additional financial services assistance to families. The FamilySource Centers (FSC), managed by HCID, serve as the City’s delivery system for anti-poverty and asset-building services. These “Asset Building Hubs” offer coordinated, outcome-driven programs and financial empowerment services to the most vulnerable residents. During tax season, each of the 16 FSCs are designated Volunteer Income Tax Assistance (VITA) Program sites. The VITA Program offers free tax help to persons with disabilities, elderly, limited English-language speakers, and those whose income does not exceed $54,000. The program also connects the unbanked or underbanked with the financial mainstream.

In 2017, HCID launched “Free Tax Prep LA,” a public awareness campaign to promote the utilization of the Earned Income Tax Credit, Child Tax Credit, and new California Earned Income Tax Credit, and promote financial literacy resources. FSCs have certified financial coaches that assist families reduce their debt, establish financial goals, improve FICO scores, and access safe and affordable banking products and services.

**Infrastructure Funding**
The CAO has prepared a report that reviews the City’s procedures for infrastructure funding, which is available under separate cover.

**Analysis/Conclusions**
The City offers a wide range of financial assistance to build affordable housing, assist homeowners, and support local businesses. The City has great flexibility in establishing program guidelines and targeting resources to high-need populations and regions of the City. Because these programs operate under different federal and State legal and regulatory requirements, the social, ethical, and environmental needs of local communities can be a primary factor in allocating funds. These programs operate on providing the greatest community benefit rather than the Prudent Investor Rule.

With regard to program need, recent actions by the City, the County of Los Angeles, and the State, will result in the allocation and leveraging of approximately $10 billion for affordable housing over the next decade. In addition, the Council has recently created new programs, such as the Small Business Commission, and allocated new funds, such as the newly reconstituted EDA Revolving Loan Fund and the Economic Development Trust Fund, to expand support for economic development opportunities.

Should the City create MBLA, it would not be advantageous to consolidate any of these programs into MBLA. The current program flexibility offered by these programs would not be enhanced by incorporation into MBLA, but rather limit the operations of these programs. The City may choose to expand existing program or develop new programs to address unmet needs.
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<tr>
<th>Program</th>
<th>Description</th>
<th>Form of Financial Incentive</th>
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<tr>
<td>1. Affordable Housing Managed Pipeline (AHMP)</td>
<td>The AHMP funds the construction and rehabilitation of affordable housing. This fund, mostly capitalized with HOME Investment Partnership (HOME) and Community Development Block Grant (CDBG) funds, is distributed through the Housing and Community Investment Department (HCID) Managed Pipeline process. Through a competitive Call for Projects, HCID creates a list of eligible projects that receive funding based on readiness.</td>
<td>Residual Receipts Loan</td>
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<td>2. HCID Managed Pipeline</td>
<td>In 2013, the City secured its own allocation of nine percent (9%) Low Income Housing Tax Credits from the State to ensure that the City could efficiently align resources for affordable housing projects. According to HCID, Los Angeles was designated as the 11th region to have its own geographic allocation of tax credits to distribute within its region. The State Treasurer’s Tax Credit Allocation Committee (TCAC) oversees the competitive process throughout the State. HCID distributes AHMP monies and tax credits through the Managed Pipeline.</td>
<td>Low Income Housing Tax Credit Allocation</td>
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<td>Program</td>
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<tr>
<td>3. <strong>Proposition HHH - Permanent Supportive Housing Loan Program (PSHLP) and Facilities Program</strong></td>
<td>In 2016, the voters passed a $1.2 billion bond to fund permanent supportive housing (PSH) for the homeless population and those at risk of becoming homeless, affordable housing, and facilities that facilitate services to the homeless population. Under the 2017 PSHLP guidelines, eligible developers may qualify for a loan not to exceed $12 million per project, with a maximum of $220,000 per eligible unit. Under the Facilities Program guidelines, a project may apply for a loan under a service repayment agreement ranging from $100,000 to $3.5 million per project.</td>
<td>Residual receipts loan or loan under service repayment agreement</td>
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<tr>
<td>4. <strong>CRA/LA Low/Moderate Income Housing Fund</strong></td>
<td>In 2013, the HCID, as the housing successor entity, accepted housing assets from the former Community Redevelopment Agency of the City of Los Angeles (CRA/LA), including funds to build or acquire low- to moderate-income housing. Pursuant to AB 1484, any funds generated from housing assets shall be maintained in a separate Low and Moderate Income Housing Asset Fund (LMIHAF). Funds shall be used in accordance with applicable housing-related provisions of the Community Redevelopment Law.</td>
<td>Residual receipts loan</td>
</tr>
<tr>
<td>5. <strong>CRA/LA Unencumbered Housing Bond Proceeds</strong></td>
<td>In June 2015, HCID received $12.8 million in Housing Excess Bond Proceeds from the former CRA/LA. The Housing Bond Expenditure Agreement (C-125743) between the CRA/LA and the City (by and through the HCID) outlines how HCID can use these funds for City housing projects that meet the conditions and requirements contained in the Indenture Bond documents (e.g. Housing projects contemplated prior to dissolution).</td>
<td>Residual receipts loan</td>
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<td>6.</td>
<td><strong>HUD Consolidated Plan - Housing and Related Programs</strong></td>
<td>A number of other housing and related programs provide housing related services such as rental subsidies, coordinated referrals, security deposits, urgent repairs, and development of affordable housing, with funding from CDBG, Housing Opportunities for Persons Living with AIDS (HOPWA), and Emergency Solutions Grant (ESG).</td>
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<tr>
<td>7.</td>
<td><strong>Public Land Development Program</strong></td>
<td>Through this program, the City conveys City-owned properties to developers seeking to build affordable housing (the Affordable Housing Opportunity Sites program, AHOS). The City has identified a number of City-owned sites as potential affordable housing sites and entered into several Exclusive Negotiating Agreements with developers to create new affordable housing, including affordable single-family homes and Permanent Supportive Housing for homeless.</td>
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<td>8.</td>
<td><strong>Homeownership Program</strong></td>
<td>Provides purchase assistance loans, and/or mortgage credit certificates, combined with first-lien mortgages from participating lenders, to low- and moderate-income homebuyers to assist in the purchase of a home in the City.</td>
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<td>9.</td>
<td><strong>Single Family Rehabilitation Handyworker</strong></td>
<td>Provides minor home repairs to low-income elderly and disabled homeowners. Grants of up to $5,725 per client can be used for the repairs to address safety and accessibility. Installation of safety and security devices are provided to low-income elderly and disabled homeowners and renters. Grants of up to $400 per client can be used for the installation of safety and security devices that help to prevent accidents and crime in the home.</td>
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<td>Program</td>
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<tr>
<td><strong>10. Lead Hazard Remediation and Healthy Homes Program</strong></td>
<td>Provides grants to multi-family units and single family homes, where low-income families reside, to remediate lead-based paint (LBP) hazards. Education and relocation assistance is also provided.</td>
<td>Deferred loan or grant</td>
</tr>
<tr>
<td><strong>11. Loan Portfolio and Occupancy Monitoring</strong></td>
<td>HCID monitors department- and CRA/LA-issued affordable housing outstanding loans and affordability covenants. HCID's Occupancy Unit is responsible for monitoring the covenants that restrict the units' long term affordability, typically up to 55 years for rental housing and 45 years for homeownership.</td>
<td>Monitoring of outstanding loans and occupancy requirements</td>
</tr>
<tr>
<td><strong>12. Municipal Bond Finance</strong></td>
<td>The City serves as the primary issuer of tax-exempt and taxable multi-family housing bonds for the development of affordable housing. Bonds can be combined with 4% tax credits to fund the development of affordable housing.</td>
<td>Bond issuance</td>
</tr>
<tr>
<td><strong>13. Affordable Housing Preservation</strong></td>
<td>HCID facilitates recapitalization of loans for affordable housing developments seeking a bond allocation with 4% tax credits. This program seeks to extend the affordability of housing units and rehabilitate units.</td>
<td>Loan recapitalization</td>
</tr>
<tr>
<td><strong>14. Supportive Housing Loan Fund (SHLF) and New Generation Fund (NGF)</strong></td>
<td>The City provides support funding to support the SHLF and NGF programs which offer predevelopment and acquisition loans to fund permanent supportive and affordable housing developments.</td>
<td>Predevelopment and acquisition loan</td>
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<td>Program</td>
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<tr>
<td>Linkage Fee Program (Council-approved Fee; Program Under Development).</td>
<td>The recently approved Linkage Fee, a fee applied to specific market rate development, could potentially generate between $90 and $130 million per year to fund affordable housing. Funds will be directed to the City’s Affordable Housing Trust Fund for the construction, rehabilitation and preservation of Affordable Housing, as well as payment assistance for affordable ownership housing.</td>
<td>Program to be defined, but anticipated to offer residual receipts and/or deferred loans</td>
</tr>
<tr>
<td>Naturally Occurring Affordable Housing (NOAH) Program (Under Development)</td>
<td>The NOAH Program loan product will utilize the City-supported NGF to help mission-driven organizations acquire, and hold market-rate multi-family properties in order to preserve and stabilize housing stock. HCID has partnered with the California Housing Finance Agency to maximize leverage of City resources.</td>
<td>Funding and program pending Council approval</td>
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<tr>
<td>University of Southern California Loan Program (Under Development)</td>
<td>The USC Loan Program is made possible by a 2013 community benefits contribution required under the City’s Development Agreement with USC relative to the university’s development activities within the USC Specific Plan. Under the Development Agreement, USC agreed to provide up to $20 million to support affordable housing in the area surrounding the university. The proposed program is expected to fund the preservation of affordable housing, acquisition of land for new affordable housing, and the NOAH Loan program, among other housing solutions.</td>
<td>Council approved funding through the Development Agreement; Program pending Council approval</td>
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<tr>
<td>Affordable Housing and Sustainable Communities (AHSC) Program</td>
<td>The California Strategic Growth Council’s AHSC Program funded with what are commonly known as cap-and-trade monies, invests in projects that support infill and compact development. Funding is available for Transit Oriented Developments, Integrated Connectivity Projects, under which incorporating affordable housing is an option, and Rural Innovation Project Areas. In 2016, City co-applied with developers securing $64.6 million for eight projects. In January 2018, the City co-applied for an additional $113 million for eight projects, which would create approximately 643 units.</td>
<td>Participated in program development; and co-applied with developers for residual receipts loans and grants.</td>
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<td>No Place Like Home (NPLH)</td>
<td>Created in July 2016, the State’s NPLH Program will allocate $2 billion in bond proceeds for the development of permanent supportive housing for persons who are experiencing homelessness, chronic homelessness or who are at risk of chronic homelessness, and who are in need of mental health services. The State is expected to release its Notice of Funding Availability (NOFA) in Fall 2018.</td>
<td>Supported legislation and participated in program development</td>
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<td>Program</td>
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<td><strong>20.</strong> Real Estate Transactions Fee - Senate Bill 2, Building Homes and Jobs Act (Atkins)</td>
<td>Enacted into law in September 2017, a new fee for the recordation of real estate documents in a transaction, excluding home sales, is expected to generate up to $250 million for affordable housing. The revenue generated as of January 1, 2018 will be available to the State and local governments based on specified percentages. Fee revenue will be distributed as follows: 20 percent for affordable owner-occupied workforce housing; 10 percent for agricultural housing; and 70 percent for affordable rental and homeownership opportunities. The fee is expected to generate $250 million statewide per year.</td>
<td>Supported legislation and will monitor program development</td>
</tr>
<tr>
<td><strong>21.</strong> $4 Billion Housing Bond - Senate Bill 3, Veterans and Affordable Housing Bond Act (Beall)</td>
<td>As approved by the Governor in September 2017, a $4 billion bond will be placed on the November 2018 Statewide ballot to provide $3 billion for various existing affordable housing programs, infill infrastructure financing and affordable housing matching grant programs. A total of $1 billion would be set aside for a military veterans homeownership assistance.</td>
<td>Supported legislation and will monitor program development</td>
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**Quasi-banking and Economic Development**

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<tr>
<th>Program</th>
<th>Description</th>
<th>Implementing Department</th>
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<tbody>
<tr>
<td><strong>22.</strong> Sewer Connection Loan Program</td>
<td>Provides low interest rate loans to rehabilitate sewer laterals or abandoned on-site wastewater treatment systems and connect to the City sewer.</td>
<td>Bureau of Sanitation</td>
</tr>
<tr>
<td>Program</td>
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<td>Implementing Department</td>
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<tr>
<td>23. Sewerage Facilities Charge Installment Payment Program</td>
<td>Provides an installment payment program as an alternative to lump sum payment for sewer customers that require new/additional sewer capacity for their properties.</td>
<td>Bureau of Sanitation</td>
</tr>
<tr>
<td>24. Section 108 Secured Loan Program</td>
<td>Offers larger capital loans for real estate development, business expansion or new business development. It is a federally funded loan program, typically focused on projects that need more than $2 million or more in public subsidy. Below market interest rates and variable terms.</td>
<td>Economic and Workforce Development Department</td>
</tr>
<tr>
<td>25. Industrial Development Bonds</td>
<td>Provides a low cost financing option to manufacturing concerns to acquire and develop real properties and equipment. The Industrial Development Authority serves as a conduit issuer for the City of Los Angeles’ tax-exempt bond program. The bond sizes range from $2 to $10 million.</td>
<td>Economic and Workforce Development Department</td>
</tr>
<tr>
<td>26. Small Business Loan Program</td>
<td>Provides financing to viable small businesses that private lenders cannot accommodate. The goal of the program is job creation in the City of Los Angeles. To be eligible, businesses must have annual revenue less than $10 million, create one full time job for every $35,000 in assistance, and have 51% of the jobs created be made available to low and moderate-income people.</td>
<td>Economic and Workforce Development Department</td>
</tr>
<tr>
<td>27. Healthy Neighborhood Market Network Program</td>
<td>Builds the capacity of corner stores and neighborhood market owners to operate as successful healthy food retailers in under-served communities.</td>
<td>Economic and Workforce Development Department</td>
</tr>
<tr>
<td>28. Micro-Loan Program</td>
<td>Provides businesses with loans ranging from $10,000 to $50,000 to support a microenterprise.</td>
<td>Economic and Workforce Development Department</td>
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<td>No.</td>
<td>Program</td>
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<tr>
<td>29.</td>
<td>Capital Projects Business Retention Program</td>
<td>Provides financial assistance and continuity services for small businesses who are inconvenienced by nearby DWP infrastructure replacement projects.</td>
</tr>
<tr>
<td>30.</td>
<td>Utility Infrastructure Loan Program</td>
<td>Provides loans to new and existing commercial/industrial DWP customers. Loans will only be extended to qualifying prospective projects. Funds can be used for the following: purchase and installation of equipment required by the DWP to provide electric energy or water service to the customer, purchase and installation of energy efficiency equipment that exceeds Title 24 requirements and/or water conservation equipment, purchase and installation of power factor correction/power reliability equipment, and purchase and installation of solar photovoltaic systems except for the Feed-in Tariff Program.</td>
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<tr>
<td>31.</td>
<td>New Market Tax Credits</td>
<td>Attracts investment capital to low-income communities by permitting individual and corporate investors to receive a tax credit against their Federal income tax return in exchange for making equity investments in specialized financial institutions called Community Development Entities. The credit totals 39 percent of the original investment amount and is claimed over a period of seven years (five percent for each of the first three years, and six percent for each of the remaining four years).</td>
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<tr>
<td>32.</td>
<td>Los Angeles Community Reinvestment Program</td>
<td>A linked-banking program that allows the City to provide funding to community banks who then provide short-term loans to local businesses. The City currently provides $5 million annually for this program.</td>
</tr>
<tr>
<td>Program</td>
<td>Description</td>
<td>Implementing Department</td>
</tr>
<tr>
<td>----------------------------------------------</td>
<td>-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
<td>------------------------------------------</td>
</tr>
<tr>
<td>33. Inspection Case Management</td>
<td>Establishes an interaction between the project team and the inspection team throughout the construction process to create a strong communication network at all levels; also expeditiously resolves any construction issues; and eliminate any miscommunication or code interpretation conflicts.</td>
<td>Department of Building and Safety</td>
</tr>
<tr>
<td>34. Concierge Program</td>
<td>Helps guide customers through the development permitting process; this includes providing a road map to the process, answering questions, and making sure that customers are prepared for their planning appointments with the correct forms, plans, etc.</td>
<td>Department of Building and Safety</td>
</tr>
<tr>
<td>35. Restaurant &amp; Hospitality Express Program</td>
<td>Allows for qualified business in this industry to receive expedited permitting and approvals, reducing the time and money it usually takes to open a business.</td>
<td>Department of Building and Safety</td>
</tr>
<tr>
<td>36. BuildLA</td>
<td>A Citywide development services system that provides 24/7 online access from home or office. It includes a single internet portal for all City agencies, project tracking across agencies, auto project status notifications, and universal payment.</td>
<td>Department of Building and Safety</td>
</tr>
<tr>
<td>37. BusinessSource Centers</td>
<td>Provide startup ventures and current small business owners various cost effective tools to make their business a success. Through these tools, small businesses can grow and remain competitive within the City of Los Angeles.</td>
<td>Economic and Workforce Development</td>
</tr>
<tr>
<td>38. Los Angeles Clean Tech Incubator</td>
<td>Provides assistance to promising, early-stage clean technology companies by bringing their products and services to market. Services include business assessment, coaching and mentoring, training, access to capital, etc.</td>
<td>Economic and Workforce Development</td>
</tr>
<tr>
<td>Program</td>
<td>Description</td>
<td>Implementing Department</td>
</tr>
<tr>
<td>---------</td>
<td>-----------------------------------------------------------------------------</td>
<td>-----------------------------------------------</td>
</tr>
<tr>
<td>39. GRID 110</td>
<td>Provides services to micro enterprises including office space, mentors, community programs, investor boot camps, hackathons to develop fashion-technology wearable prototypes and opportunities for community partnerships.</td>
<td>Economic and Workforce Development Department</td>
</tr>
</tbody>
</table>
VII. ADDITIONAL CONSIDERATIONS

During the review of materials conducted for this report, several additional issues that require consideration related to banking services were identified. These are not related directly to the formation of a public bank, but rather inform the broader discussion of the roles, impacts, and opportunities for banks, government, and community that provide and use financial services. These topics further inform any actions related to financial services.

**Service Gap Analysis**
As indicated in the previous section, the City provides a wide range of loan, financial assistance, technical assistance, investment, and education programs. These programs, however, may not cover the full spectrum of needs in the City’s diverse communities. An analysis of gaps in financial services, credit availability, financial institution responsibility, or other financial capacity or accountability may identify needs that are not currently being met by existing governmental, non-profit, or private sector programs or services.

**Reporting and Enforcement**
The Community Reinvestment Act (CRA) is a federal law that encourages depository institutions to help meet the credit needs of the communities in which they operate, including low- and moderate-income neighborhoods, consistent with safe and sound banking operations. Federal agencies evaluate data to ensure that these institutions meet their obligations under the CRA. The data are publicly available for review. The City understands the needs of its communities and is better positioned to evaluate CRA data and determine whether there are financial service needs that local depository institutions should be meeting. A regular review and reporting process could be established to identify issues and develop strategies annually, working with local depository institutions, to ensure more effective compliance with the CRA.

**Public Information and Education**
As noted above, the City currently provides educational programs through its Family Source Centers, helping households develop capacity in managing family finances or assisting small businesses with start-up assistance. There may be other educational and informational resources that could be developed to ensure that all residents and businesses in the City have access to banking services and the financial resources they offer. For example, the City recently created a Small Business Commission to help develop services to support this significant sector of the economy. The Commission could be directed to focus on evaluating the financial resources needed by small businesses and recommend programs the City would develop to deliver these resources.

**New Financial Resources Programs**
The EWDD is currently developing the Citywide Economic Development Strategy (Strategy), which seeks to promote economic growth in the City, with a focus on greater economic inclusion and lowering barriers to economic opportunity. The Strategy will include a review of programs offered in other cities that may be helpful to Los Angeles residents and businesses. The Strategy may produce an opportunity to improve financial services to City residents and businesses.
In addition, the California Policy Lab at UCLA has indicated that they would be available to help the City identify programs that increase the availability of credit, insurance, and other financial resources for low income households.

**Partnerships with Existing Banks and Quasi-Bank Institutions**

The City does not currently maintain any organized cooperative program with banks operating in the region. Expanded public education and outreach and new research efforts could result in the development of new programs and projects that banks currently operating in the region could support. New efforts to communicate the City’s priorities and programs to the banking community could lead to the availability of new resources or alter the direction of existing resources in ways to address City priorities.

Similarly, there are several organizations with quasi-banking authority that operate in the City or could provide additional resources in the City. There are also several CDFIs that operate in the City and there could be opportunities to access resources through the I-Bank or ExIm Bank. It may be appropriate to develop the City’s partnerships with the organizations to expand opportunities and increase finance resources in the City.

**Market Analysis**

A public bank that provides financial services beyond a single client, the City of Los Angeles and open to the public, would need to understand the market potential for its services. Success of the bank would be dependent on its ability to make loans and attract investors and depositors, depending on the type of bank that is formed. An analysis should be conducted to determine whether a market exists for the type of products that would be offered by MBLA.

Part of that analysis should determine, though, whether formation of a new bank would create unanticipated impacts in the local economy. For example, would the bank provide services to customers who are not currently using banking services, or would the bank take business from other financial institutions? Also, would the bank provide credit to a sector of the market that is not able to access credit, or would the new surplus of credit create some unintended consequence in the marketplace?

A market analysis would help determine whether MBLA would create new opportunity in the marketplace or greater difficulties.
This report began with the question “What is a Municipal Bank?” The following concepts, drawn from public hearings on this matter were presented:

- Decrease City dependence on commercial banking services
- Reduce costs associated with commercial banking services
- Ensure equitable access to banking services for all City residents and businesses
- Generate new revenues for the City General Fund
- Provide small business loans, job training loans, and student loans
- Reduce costs associated with City banking and bond issuances
- Ensure that City funds support the development of economic and housing opportunity in the City

The information provided then reviewed materials regarding existing public banks; efforts by other jurisdictions to form public banks; existing legal frameworks for banks; and issues that must be addressed when forming a new bank.

Based on concepts for the purpose of MBLA and legal requirements for charter commercial bank formation, the following have been identified as elements in the formation of MBLA that do not require changes in local, State or federal law or regulation:

- It would be governed by an independent Board of Directors
- The Board would include community representation
- Bank services would be available to residents and businesses of the City only

The following criteria have been identified as important parts of the MBLA, but information suggests that these may be difficult to implement:

- A financial institution that is owned by the City
- City funds would be deposited into the bank
- Bank services and operations would be guided by standards that ensure and enhance social and economic equity to residents and businesses in the City
- Bank would invest in affordable housing, infrastructure, and economic development in the City exclusively

As noted previously, voters would need to approve a Charter amendment to authorize formation of MBLA. Further, State law provides clear criteria as to where the City can deposit its funds and any newly formed bank will not meet those criteria. It would be at least three years after formation before the City could consider depositing its funds into its own bank. Following this initial period, MBLA may then be required to compete for the City’s banking services, unless the City Charter provides otherwise. Further, there is no clear mechanism to ensure that a bank complies with a mission to adhere to enhanced social and economic equity. Finally, the bank would be obligated to conduct its business, such as making loans, consistent with the Prudent
Investor Rule. Limiting its activities to the City alone could prevent the bank from meeting these obligations.

Analysis/Conclusions
Review of the information provided above suggests that formation of MBLA under existing law and regulation would be a very difficult process, would be very costly, and would result in an institution that would not likely qualify to receive City business. If the intent of MBLA is, in part, to establish a financial institution that meets certain social, ethical, and environmental standards, there is no mechanism that allows such an institution to be formed as a regulated, chartered bank that is also responsible and accountable to the community.

Further, the inclusion of City funds in the formation of MBLA in the form of collateral, investment, or deposits, presents risk to the City. The City is obligated to ensure that taxpayer funds are carefully managed. Should Council and the Mayor choose to conduct additional analysis into the formation of MBLA, risk assessment should be a high priority in that analysis to ensure that protection of the City’s funds is not compromised. Further, formation of MBLA should be predicated on maintaining the highest standards for protecting City funds.

This analysis is based, however, on a wide range of concepts introduced for consideration, not any direct instructions related to the specific mission and structure of MBLA. At this point, a formalized definition of MBLA’s mission, purpose, and services is needed in order to advance evaluation of the proposal. A clear statement of the solutions that MBLA seek to resolve and needs that MBLA would meet is needed to advance deliberation on this matter and a more detailed description of MBLA’s program may result in a path toward formation that is viable.

Finally, the challenges associated with forming MBLA will not be resolved quickly and, if solutions to the formation of MBLA are identified, the bank would not be open for business soon. There may be additional work within the City’s existing authority to address some of the problems that MBLA is intended to solve, and do so in the short-term. Existing programs for housing, economic development, and infrastructure development could be expanded or revised and new partnerships could be developed. Finally, an analysis of gaps in the financial needs of Los Angeles communities should be conducted, with the potential to develop new programs to meet those needs.
IX. NEXT STEPS

Specialized expertise is needed to further pursue analysis of options for the formation of a City-owned public bank should the Council wish to further consider this approach. Expertise in State and federal regulations is needed to fully explore the details associated with the requirements to fund and operate a bank, including the formation process and long-term operations. In addition, the City Attorney has indicated that outside legal counsel with expertise in banking regulation would be needed, as well.

Based on information gathered in this review, formation of MBLA would ideally commence under the authority of a State law that describes the regulatory framework for a chartered public bank, a framework that does not currently exist. A more challenging path would be to pursue formation under the existing State Charter Commercial Bank law. Should Council choose to move forward, staff should be instructed to prepare and release a Request for Proposals to select a qualified consultant or consultants.

Once selected, the consultant(s) would perform the following tasks:

- develop detailed statement of purpose for MBLA, including a description of its purpose, the services it would offer, and its mission with regard to social, ethical, and environmental standards;

- evaluate formation options for MBLA, including a detailed analysis of issues such as determination of the capital needed for up-front and ongoing costs to operate a bank; requirements for collateral, reserves, and insurance; regulatory frameworks that would apply to such a bank; identification of the types of services that a public bank would provide; impacts on the City's finances and investments; analysis of the City's banking and investment needs; and identification of risks associated with formation of MBLA.

- identify a management and oversight structure for MBLA that includes City ownership, oversight by an independent board, interaction between the City and the bank, monitoring and enforcement of social, ethical, and environmental priorities established in the bank's founding mission, independent regulatory oversight, and other related governance matters.

- evaluate the current private banking market in Los Angeles, including the types of banks and credit unions serving the region; determination of any gaps in the credit market that the City would be able to fill; the availability of credit to serve the region; compliance with CRA requirements; the effect of adding another lending institution to the market; and the market for services that would be provided by a public bank.
-- develop a detailed strategy for the formation of a public bank to serve the City, including costs associated with formation and operations of the bank, staffing requirements, determination of facility, equipment, and systems needs, and operational plans for long-term operations.

-- prepare a cost-benefit analysis to determine whether MBLA would create new financial capacity that would benefit the economy; and comparison of current financial impact of the City compared to the costs associated with starting and operating a bank.

-- an optional task would be to prepare a regulatory framework for chartered public banks that could be used to sponsor State legislation.

The formation process will require dedicated staffing among several City departments to manage the contractor's work for this initial study; ensure that all issues related to City finances, risks, and governmental obligations are identified; and, if a decision is made to move forward with formation of a public bank, implement the formation process and transition and integrate the City's finances with the newly formed bank. It is anticipated that the Office of Finance, CAO, City Attorney, and Controller may require additional staff to support this effort. Other City departments would be consulted in the process, but may not require additional staff. For example, existing loan programs at HCID and EWDD would likely continue under their current practice, as previously discussed, but HCID would be consulted during the formation process concerning the relevance of proposed bank programs on their programs.

While a consultant is being identified to conduct this work, the Council would continue its effort to define the objectives of a public bank. Part of that process would be to identify which objectives could be achieved through the City's other resources and authorities. It is anticipated that formation of a public bank will take several years. While that effort moves forward, the City could review and enhance its housing and economic development programs, expand public information and education programs, and implement financial management and investment practices that align with the objectives of MBLA.

The formation of MBLA is challenging under the existing State and federal legal framework. The most effective solution for the formation of public banks would be legislation under State law that would establish a charter process for the formation and operation of public banks. Such a law would ensure that local governments have a clear understanding of how they could use their own resources, manage their risks and liabilities, and provide the ability to ensure compliance with the mission, such as local service provisions, on which a public bank would be founded. The current models for the formation of depository lending institutions include safeguards to ensure that taxpayer revenues are not at risk. Laws ensure that any official with fiduciary responsibilities conducts themselves with the highest degree of caution with regard to other people's money. Any new legal framework would need to identify solutions that satisfy these concerns while at the same time meeting the mission objectives of a public bank.
Attachment A

Motion
Wesson-Krekorian
CF 17-0831
The nation's only public bank, the Bank of North Dakota, was created in 1919 in a populist wave when farmers there were unhappy with decisions being made by major banks heavily influenced by railroads and out-of-state agricultural interests. Its mission is to promote agriculture, commerce and industry in that state. Furthermore, over time the Bank of North Dakota has provided a variety of financial products to the residents and governments of North Dakota, including low interest student loans, home loans, college savings accounts, scholarships, school construction loans, affordable housing construction and rehabilitation loans, and public construction financing. This financial institution not only provides a model of how cities and states can better utilize their banking needs, services, and deposits to give back to the community, it may also provide the best financial solution to reducing the cost of the creation and rehabilitation of affordable and workforce housing in the City of Los Angeles, while at the same time providing low cost financial services for city residents and local governments within the Los Angeles region and much needed financial services for the cannabis industry.

With the current conflict between federal and state law on the issue of cannabis, financial institutions face significant risk for violating federal law if they offer banking services to cannabis-related businesses. Based on the current guidelines, the required level of transparency, a time intensive customer-financial institution relationship, and risk with being out of compliance with federal guidelines, most large banks and financial institutions have not taken on, or provide financial products to, cannabis-related businesses. Without a solid banking solution, including account services and access to financial products such as loans, the current situation makes it difficult for cannabis entrepreneurs to raise capital and forces most businesses to deal exclusively in cash, creating administrative, logistical, and security challenges. Another result is the current marketplace renders credit card and debit card transactions impossible without a merchant account, and a business must have a relationship with a financial institution or bank to secure a merchant account number. Even under these difficult circumstances, some local banks and credit unions are currently banking the cannabis industry, while others strive to create new institutions and solutions.

According to the Department of Treasury's Financial Crimes Enforcement Network (FinCEN) data released on March 31, 2017, there are 368 banks, credit unions, and depository institutions in the United States offering services to cannabis-related businesses on a very limited basis, with a few exceptions. The Partner Colorado Credit Union with its Safe Harbor Private Banking Program, is one of the few financial institutions that has taken on the cannabis industry's needs, and now reports approximately 80 percent of their monthly business, averaging $20 million dollars in monthly deposits, is with the cannabis industry or ancillary services related to the cannabis industry. Community banks and credit unions, unlike larger financial institutions, are willing to put in the extra time and effort to comply with the U.S Department of Justice and FinCEN guidelines, requiring onsite visits by bankers that include in depth investigation and documentation, and these smaller institutions with a community focus are more likely to be willing to take on the extra work.

One solution to similar issues being researched by the City of Oakland and the City and County of San Francisco is the creation of a publicly controlled, state-chartered bank to provide financial services to their respective cities, reinvestment in their respective cities, and banking solutions for other local businesses including the cannabis industry.
WE THEREFORE MOVE that the City Council INSTRUCT the City Administrative Officer and the Chief Legislative Analyst (CLA), with the assistance of the Office of Finance/City Treasurer, and the City Attorney, to report back quickly to the Ad Hoc Committee on Comprehensive Job Creation Plan on the feasibility, requirements, legislative barriers, and any other relevant aspects of creating a state-chartered public bank, or other similar such financial institution, named the “Bank of Los Angeles” that would provide banking services to reinvest in the communities, neighborhoods, and residents of the City of Los Angeles primarily through the acquisition, construction, and rehabilitation of affordable and workforce housing, utilizing deposits and providing financial services and products to local businesses, including the cannabis industry.

WE FURTHER MOVE that the City Council INSTRUCT the CLA, to report back with a RESOLUTION for the City of Los Angeles to include in its 2017-2018 Federal Legislative Program SUPPORT for HR 2215 (Perlmutter) – The Secure and Fair Enforcement Banking Act of 2017.

WE FURTHER MOVE that the City Council INSTRUCT the CLA, to report back with a RESOLUTION for the City of Los Angeles to include in its 2017-18 State Legislative Program and 2017-2018 Federal Legislative Program SUPPORT and/or SPONSORSHIP of legislation and/or administrative action that would allow for the creation of a state-chartered public bank for the City of Los Angeles.

PRESENTED BY:

HERB J. WESSON, JR.  
Councilmember, 10th District

Paul Krekorian  
Councilmember, 2nd District

SECONDED BY:
Attachment B

Bibliography
BIBLIOGRAPHY

The following is a bibliography of materials related to public banking that were consulted to inform this report.

  <http://sfbos.org/sites/default/files/FileCenter/Documents/39680-BLA_Community_Supportive_Banking_Options_090811.pdf>

  <http://sfbos.org/sites/default/files/BLA_CommunitySupportiveBanking_112717.pdf>

  <http://www.treasurer.ca.gov/cbwg/resources/reports/110717-cannabis-report.pdf>


  <https://www.congress.gov/amendment/114th-congress/house-amendment/332>


  <https://www.bostonfed.org/-/media/Documents/Workingpapers/PDF/neppcrr1102.pdf>

  <http://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201120120AB750>


- Uniform Prudent Investor Act [16045 - 16054], Article 2.5 added by Stats. 1995, Ch. 63, Sec. 6.
  <https://leginfo.legislature.ca.gov/faces/codes_displayText.xhtml?lawCode=PROB&division=9.&title=&part=4.&chapter=1.&article=2.5>
Attachment C

"Bank Regulatory Considerations Related to Establishing a Public Bank in the State of California"
November 29, 2017

Councilmember Paul Krekorian
Councilmember Herb Wesson
Councilmember Mitchell Englander
Councilmember Bob Blumenfield
Councilmember Marqueece Harris-Dawson

cc: Chief Legislative Office
City Attorney’s Office

Dear Councilmembers:

We have attached a legal memorandum prepared by [Davis Polk] on behalf of the [civil rights lawyers] on the ability of the City of San Francisco to start a public bank. We concur with nearly all the analysis and recommendations made in the memo, and we submit it for your review as a very relevant examination of the legal and regulatory questions surround the formation of a Los Angeles public bank. Because San Francisco is also a charter city in the state of California with a comparable government, economy and public finance needs, we feel this memo provides the best answers to those questions thus far contemplated by suitably experienced legal experts.

The primary findings of the memo that we feel are key to the feasibility of a Bank of Los Angeles are:

- San Francisco (and Los Angeles) has the power under the state constitution to found a public bank as part of its home rule power determine its “municipal affairs,” based on the findings of the Owen Memo.
- A bank whose deposits are guaranteed by a public entity, rather than traditional FDIC deposit insurance, is not subject to the oversight of the FDIC. This allows it to forgo certain compliance issues that would prove contrary to the banks’ purpose, most importantly restrictions on transactions with affiliates and shareholders, which would defeat the purpose of a public bank.
- The question of whether cannabis businesses can be serviced by a public bank adds a layer of complexity and potential legal issues which make a public bank unfeasible until cannabis is reclassified.
- A commercial banking charter or credit union charter are poor fits for a public bank, for a number of reasons, and that a statutory exception may be necessary to create a “Public Bank Charter (License)” allowing the Department of Business Oversight to approve municipal charter applications for a special type of bank.
- Such a charter or license would allow and require a public bank to:
  - Operate, lend, and take deposits from qualified depositors within the borders of a given region;
- Raise capital by donation, public bond or appropriation;
- Establish an independent governance committee, comprised of bank employees, elected or appointed officials, and members of the local community;
- Maintain a business plan to operate a commercially viable bank and policies as required to achieve it;
- Require public input, in the form of a social impact and mission statement, annual review, participatory budgeting, or city statute on the allocation of the bank’s loan portfolio;
- Use the founding charter city and its partners as guarantors of deposits, qualifying them as a ‘source of strength’ for federal and state regulatory purposes;
- Hold deposit insurance or equivalent security (including public guarantee or general obligation bond) for deposits as approved by the Department of Business Oversight;
- Relax or remove collateral requirements and affiliate transaction restrictions for public funds that would prove antithetical to the bank’s purpose;
- Adhere to strict social and environmental responsibility standards in its lending and business practices;
- Seek to return a profit to its shareholders by making commercially viable, economically sustainable loans and providing a high level of service to its depositors, customers, and partners;

This special status available to charter cities seeking to found a public bank addresses the central regulatory obstacles and peculiarities facing those efforts. We hope that the Committee and city staff will closely read this memo and make their own analysis of how it applies to Los Angeles. We believe this, and other work on the subject by the Treasurer, the City of Santa Fe, and others, show the path forward for a municipal bank. This includes rigorous planning, budgeting, and stakeholder onboarding at the city level in preparation for state-level action, and the creation of a special Public Bank Charter under existing California banking regulations, carving out the exceptions and requirements as listed above.

We encourage the city to lend its influence to the effort in Sacramento to create a public bank license for cities like Los Angeles, and we believe this goal can be achieved in a relatively short time, concurrent with city efforts to prepare a business plan, exploratory committee, and a plan to capitalize a Bank of Los Angeles.

David Jette, Legislative Director
djette@gmail.com
617-953-8544

\footnote{Thomas J. Owen, Deputy City Att’y, to John Avalos, Member, Board of Supervisors, Municipal Bank Formation}
Date: November 18, 2017

To: Lawyers Committee for Civil Rights of the San Francisco Bay Area

From: Davis Polk & Wardwell LLP

Re: Bank Regulatory Considerations Related to Establishing a Public Bank in the State of California

You have asked us about the City of San Francisco's ability to establish a public bank. This memorandum directly addresses that question by discussing select provisions of California and U.S. federal bank regulatory law that would apply to a public bank, the shares of which would be wholly owned by a municipality. It also considers the California and U.S. federal bank regulatory law that would apply to a public bank owned by the State of California.¹

We understand that there is a desire to establish a public bank in California that could provide greater access to banking services to underbanked populations such as those with lower income and local small businesses. We also understand that there is a concern about the lack of banking services and related access to the payment systems for businesses directly engaged in activities involving cannabis that are legal under state law.²

As provided in the recent report by the Cannabis Banking Working Group established by

¹ This memorandum addresses only California and federal bank regulatory law and does not consider any other federal or state laws. For example, we are providing no tax advice in this memorandum. This memorandum also does not address the question of whether a public bank could be established by a regional joint powers authority under California law. We note this question as a topic for further exploration.

² Under California law, medical cannabis is currently legal and the sale and taxation of cannabis for recreational purposes will go into effect on January 1, 2018. References in this memorandum to cannabis businesses assume a state legal business that is otherwise compliant with applicable laws and regulations, including tax regulations, except for the federal laws under the Controlled Substances Act and other similar laws that criminalize cannabis at the federal level.
California State Treasurer John Chiang, Banking Access Strategies for Cannabis-Related Businesses (the "Chiang Report"), the combined impact of the lack of banking services for the cannabis sector and the increase in sales of cannabis for recreational purposes anticipated upon the effective date of the new law presents public safety concerns. In the Chiang Report, the Cannabis Banking Working Group makes four recommendations to address what it refers to as the "cannabis banking problem": (1) the implementation of safer, more effective, and scalable ways to handle the payment of taxes and fees in cash that minimize the risks to stakeholders; (2) the development of a data portal of compliance and regulatory data to be made available to financial institutions that bank cannabis businesses; (3) a feasibility study of a public bank or other state-backed financial institution that provides banking services to the cannabis industry; and (4) a multistate consortium of state government representatives and other stakeholders should be established to pursue changes to federal law to remove the barriers to cannabis banking.3

With respect to the recommendation for a feasibility study of a public bank, the report suggests that the study consider "costs, benefits, risks, and regulatory issues, including capitalization, deposit insurance, and access to interbank funds and transfer systems," as well as "various ownership structures, including appropriate mixes of public and private capital" and "a legal analysis addressing the legality and associated legal risks of creating a public cannabis financial institution, including, but not limited to, whether such an institution can be created without violating federal law, the extent to which it would remain subject to federal oversight and regulation, and whether tax revenues deposited in it could be at risk of seizure by the federal government."4 Much of the analysis in this memorandum is a deeper dive on some of these technical legal issues foreshadowed in the Chiang Report.

In this memorandum, we first provide a general background of public banking in the United States and then review some of the issues affecting the ability of state legal cannabis businesses to obtain banking services. We analyze the questions listed below with respect to each of two distinct business models: the "Traditional Public Bank Business Model," which refers to a public bank that does not offer banking services to cannabis businesses, and the "Traditional Plus Cannabis Business Model," under which a public bank would provide banking services to state legal cannabis businesses as part of its initial business plan.5

Subject to the facts and assumptions set out in this memorandum, we examine a series of questions related to the establishment of a public bank and provide a brief summary answer for each. We expand upon these answers in the sections which follow.

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4 Id. at 4.
5 It is not anticipated that the public bank would be a monoline bank providing services only to the cannabis sector. As the Chiang Report notes, regulators tend to disapprove of financial institutions that are overly concentrated in one industry, because the fortunes of these institutions are too closely tied to the industries they serve, and so would be in danger of failing if the industries they serve experienced a downturn. See State Treasurer's Cannabis Banking Working Group, Banking Access Strategies for Cannabis-Related Businesses, 4 (2017).
1. What bank or bank-like charters are available under California law for a public bank?

We have examined three potential charters for a public bank. The first is a “Public Bank Charter,” a charter established by special statutory authority for or on behalf of a public entity. The second is a “Commercial Bank Charter,” a charter for one of the traditional depository institutions such as a commercial bank, savings and loan or industrial bank that exist under California state law and that is designed for private sector investors. The third, a “Credit Union Charter,” is a charter for either a federally-insured or privately-insured credit union.

There is currently no option under California law for a Public Bank Charter, although a properly crafted statute would be ideal for a public bank. As a threshold matter, based upon instructions from you, we have assumed the conclusions in the 2013 memorandum from the San Francisco city attorney to Supervisor Avalos (the “Owen Memo”): (1) that neither the provision of the Government Code prohibiting a county from giving or loaning its credit to any person or corporation nor the provision of the California Constitution limiting the power of the state legislature to give or lend the credit of cities or counties would bar the City of San Francisco from establishing a public bank; and (2) that the City of San Francisco would have the power to own the shares of a public bank under California law, despite the state constitutional restrictions on owning corporate stock, if the City appropriated funds for that purpose and the operation of the bank served a legitimate municipal purpose. Based on the analysis in the Owen Memo, we further assume that ownership of a public bank providing greater access to banking services to underbanked populations in the City of San Francisco would be considered a legitimate municipal purpose.6

There are substantial drawbacks to both the Commercial Bank Charter and the Credit Union Charter that would be challenging in the public bank context. Both the Commercial Bank Charter and the Credit Union Charter would require the approval of the California Department of Business Oversight, a sound business plan, experienced management and appropriate capitalization.7

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6 See Mem. from Thomas J. Owen, Deputy City Att’y, to John Avalos, Member, Board of Supervisors, Municipal Bank Formation (May 15, 2013). We take note of the memorandum prepared by the legal counsel of the Financial Institutions Division of the New Mexico and Licensing Department (the "New Mexico FID Memo"), which argues that the establishment of a public bank in New Mexico would be a direct violation of the terms of the "anti-donation clause" of the New Mexico constitution. As we understand it, as applied to a public bank, the so-called anti-donation clause generally prohibits a state, county or municipality from lending credit to any private person or corporation. Based on the Owen Memo, however, we assume that a public bank in San Francisco would not be subject to the constitutional limitations that have been raised as an issue by the New Mexico FID Memo. See Mem. from the New Mexico Regulation and Licensing Department, Financial Institutions Division, Legal Issues and Matters for Further Research and Examination Regarding Proposed Public Bank of Santa Fe (Aug. 24, 2017), https://www.santafenm.gov/media/archive_center/Item_3.pdf?page=128, at 8.

7 Credit unions do not issue stock as would a commercial bank; their start-up capital generally comes from donations and grants. Their capital is generally generated through retained earnings. Part of the evaluation of a charter would involve consideration of the ability to generate sufficient capital through earnings and other sources.
use of the Commercial Bank Charter and the Credit Union Charter under California law would in many ways be like putting a square peg in a round hole—forcing the public shareholders of the proposed public bank to retrofit the public bank business model into a regulatory system that was designed for private sector investors.

The use of a Credit Union Charter is a bit more of a possibility, although challenges exist. As credit unions do not have shares, it is somewhat inconsistent to think of a credit union being a public bank, at least in the way defined above. However, it is conceivable that the City of San Francisco could sponsor a credit union and provide the seed funding for its organization and operation or that the City of San Francisco could be the member of a state-chartered credit union.8 Under California law, a credit union may have either federal or private insurance. The feasibility of retrofitting the Credit Union Charter requires that private insurance acceptable to the commissioner of the California Department of Business Oversight be available and that the California Department of Business Oversight would not, as is typically the case, insist upon at least 500 members.

The obstacles with respect to each of a Commercial Bank Charter and a Credit Union Charter have driven most advocates of public banks to assume the need for special statutory authority.

2. What federal banking laws would affect the ability of such a public bank to operate?

A public bank owned by the state or a political subdivision and using the Commercial Bank Charter would need to apply for federal deposit insurance, maintain the high capital levels that the FDIC requires for a de novo bank9 and keep to a preset business plan for at least three years. It would generally be subject to the full panoply of federal laws and regulations governing operations, safety and soundness, permissible activities and similar requirements. It is highly likely that the public sector investors would be required to serve as a source of strength to the bank. Laws that severely limit the ability of the bank to lend money to its controlling investors and to affiliates (i.e., to other political subdivisions of the state of California) would most likely apply, although that is not certain. We believe that it would be a difficult challenge to get federal deposit insurance for a commercial bank using the Traditional Public Bank Business Model and, until federal law changes with respect to cannabis, impossible for a bank using the Traditional Plus Cannabis Business Model.

8 The City of San Francisco would not be permitted to be a member of a federally-chartered credit union; thus, were it to be deemed necessary for the City to be a member, a state-chartered credit union with private insurance would be the only realistic option.

9 The term “de novo bank” refers to a newly chartered bank. It is typically the case that a de novo bank is subject to stricter regulatory scrutiny in its start-up years, including higher than minimum capital and a requirement that there be a preset business plan.
A privately insured credit union would not be subject to the prudential oversight of any federal banking regulator.

3. **Would such a public bank be able to access the Federal Reserve's payments system, either directly or indirectly?**

A public bank that operates under a Commercial Bank Charter or Credit Union Charter and uses the Traditional Public Bank Business Model should, over time, be able to open a master account at the Federal Reserve Bank of San Francisco, although we believe that the Federal Reserve Board and the regional Federal Reserve Banks will continue to take the view that granting such a master account is discretionary.

Most *de novo* banks originally access the Federal Reserve payments system through a correspondent banking relationship. Despite the recent Tenth Circuit opinion in *Fourth Corner Credit Union v. Federal Reserve Bank of Kansas*, 10 we do not think that the Federal Reserve Board or the Federal Reserve Bank of San Francisco would likely open an account for a public bank with the Traditional Plus Cannabis Business Model without either a change in federal law or a direct court order. A public bank operating under the Traditional Plus Cannabis Business Model might, over time, have access, via correspondent banking, to the Federal Reserve payments system, depending upon the policies of the Trump Administration with respect to prosecutorial discretion and the willingness of the correspondent bank to provide such services, although we expect that such access will remain challenging without changes to federal law.

4. **Is there a viable argument under the Tenth Amendment to the U.S. Constitution that the provision of banking services by a public bank to state legal cannabis businesses is protected and that federal law would not apply?**

No.

5. **What legislation at the state or federal level would provide clearer solutions?**

The most definitive action that could alleviate many of the concerns addressed above would be to decriminalize cannabis at the federal level and to bring the entire cannabis business sector into a fully legal and tightly regulated framework. A tailored California statute, loosely based on the Bank of North Dakota model, would provide a clear path to a public bank charter. Such a bank would likely need private or state funded insurance, and its access to the Federal Reserve payments system would be problematic.11 Some of these concerns

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11 Even aside from banking services, it is clear that a legal cannabis business would need to be subject to significant regulation in other aspects as well. For a discussion of what a regulatory situation might look like, see
could be alleviated were cannabis to be decriminalized at the federal level. It is possible that if the Trump Administration were to continue the policy of prosecutorial discretion initiated by the Obama Administration, other banks and credit unions would be willing to offer correspondent banking arrangements to such a public bank. As noted in the Chiang Report, the policies of prosecutorial discretion provide a "narrow and fragile" path for banking services. Passage of federal legislation, such as the Secure and Fair Enforcement Banking Act (the "SAFE Act") or the Respect State Marijuana Laws Act of 2017, by Congress would be a major step forward. More detail on our proposed next steps, which primarily involve changes in legislation, is included at the end of this memorandum.

I. Background

We begin with a background section that examines the history of public banking in the United States, a review of recent advocacy around the public banking concept and a discussion about how we believe, based upon our review of media and other public sources, that private sector banks are engaging, or not engaging, with state legal cannabis businesses today.

a. The Bank of North Dakota

Advocates of public banking often assert that there is only one public bank in the United States, the Bank of North Dakota. That assertion would be more accurately stated as there is, at this time, only one successful public bank in the United States. The recently insolvent Government Development Bank for Puerto Rico is a cautionary tale of an unsuccessful public bank in the United States.13

The Bank of North Dakota, a bank with approximately $7 billion assets,14 is the only state chartered public bank currently functioning in the United States. The size of the Bank

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13 Another example of a public sector bank in the United States was the U.S. Postal Bank, which began operations in 1911 and closed in 1967. The U.S. Postal Bank was a narrow bank which took deposits from the public and invested only in U.S. Treasuries. There are, and have been, in many other countries around the world, state-owned public banks. It is safe to say that in most of Western Europe and Japan, state-owned banking has generally been in retreat in recent years. An important exception is Germany, which has an extensive system of municipal banks, known as Sparkassen, and regional banks controlled by state governments, known as Landesbanken, that make up an integral component of the German banking system. In our view, state-owned banks in China and most emerging nations are not a close model to the public banks under discussion in the United States.

of North Dakota makes it a relatively small bank in the structure of the U.S. banking sector. For instance, if it were a private sector bank, it would be classified as a community bank.15

The Bank of North Dakota was chartered in 1919 pursuant to an explicit and special chartering authority contained in the North Dakota constitution that is implemented via a specific North Dakota state statutory authority. The Bank of North Dakota's mission is to "deliver quality, sound financial services that promote agriculture, commerce and industry in North Dakota."16 Like a private sector bank under California law, the Bank of North Dakota takes deposits and makes loans. In addition to taking deposits from state and government agencies, the Bank of North Dakota also offers basic checking and savings accounts to North Dakota residents. Because of its policy of not competing with the private sector for retail deposits, however, it does not provide various services such as ATM cards, debit cards, credit cards or online bill pay to the public.17 It has only one office.18

It does not operate like most banks and in many respects is similar to a bankers' bank.19 The Bank of North Dakota does not deal directly with borrowers for the business and agricultural loans that comprise about half of its loan portfolio but instead participates in loans that are originated by North Dakota community banks.20 As a result, these loans are made under private sector credit underwriting standards. Moreover, as a result of its cooperation, rather than competition, with North Dakota community banks, the Bank of North Dakota enjoys the support of the private banking sector in North Dakota. The Bank of North Dakota does however interface directly with borrowers for student loans, which as of the end of 2016 accounted for approximately 29% of its total loan portfolio.21 These loans, which are a relatively recent addition to the loan portfolio, are guaranteed by the State of North Dakota.22 The Bank of North Dakota also works directly with borrowers to originate mortgages for primary residences in certain areas where private sector mortgage services are not readily available.23


19 A "bankers' bank" generally refers to a financial institution that provides financial services to community or regional banks in the United States. The goal of a bankers' bank is to provide community or regional banks (as well as their customers) with access to services that, due to pricing or other reasons, would generally only be available to larger banks, thereby enabling the community or regional banks to more effectively compete with larger banks.


22 Id.


#89817964v107
Thus, although in many ways the Bank of North Dakota is similar to a bankers' bank, the analogy is imperfect. Unlike private sector banks, the Bank of North Dakota enjoys a dominant position with respect to the deposits of all North Dakota state funds because, under the North Dakota state constitution, "[all] state funds and funds of all state penal, educational and industrial institutions may be deposited in [the Bank of North Dakota]." This authority gives the Bank of North Dakota a stable core deposit base from which to fund its loans. Another important differentiating factor enjoyed by the Bank of North Dakota is that all of its deposits are guaranteed by the state of North Dakota itself and not by the Federal Deposit Insurance Corporation (the "FDIC").

A critical element of the Bank of North Dakota business model is that it is run to make a profit. The bank evaluates loan opportunities according to how likely they are to be repaid and provide a return; indeed, the model of participating in loans that have met the credit underwriting standards of local private sector banks is one means to ensure that loans will be made only if there is an expectation of repayment. The bank's president and chief executive, Eric Hardmeyer, has commented:

If you are going to have a state-owned bank, you have to staff it with bankers. If you staff it with economic developers you are going to have a very short-lived, very expensive experiment. Economic developers have never seen a deal they didn't like. We deal with that every day.

b. The Government Development Bank of Puerto Rico

The counterexample to the Bank of North Dakota is the now insolvent Government Development Bank for Puerto Rico. The Government Development Bank was created in 1942 to finance Puerto Rico's infrastructure and was highly successful in its early years. Unlike the Bank of North Dakota, over time, it was given tremendous powers and became the fiscal agent and financial advisor to the island and was intertwined with the daily functioning of the Puerto Rican government. Like the Bank of North Dakota, the Government Development Bank for Puerto Rico benefited from the deposits of other Puerto Rican governmental entities, was created by a special statute and did not have federal deposit insurance. Unlike the Bank of North Dakota, the Government Development Bank for Puerto Rico was not run like a commercial bank. According to its then president and Chairwomen, Melba Acosta Febo, "The problems started when the Government Development Bank started lending for deficit financing instead of capital improvements . . .

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25 Id.
27 Id.
30 Id.
and when it started lending to entities that didn’t have a source of repayment.”\textsuperscript{31} The Government Development Bank for Puerto Rico announced in 2017 that it would liquidate and wind down after becoming insolvent.\textsuperscript{32}

\section*{c. Public Bank Business Models under Discussion in the Public Bank Movement}

In the aftermath of the financial crisis, there has been increasing interest in state- or municipal-level banks. Public banking advocacy groups in over 20 states, typically linked to progressive movements, are collaborating with city and state officials to promote public banking.\textsuperscript{33} Our review of the literature reveals that many in the public bank movement, like citizens in general, do not have a solid understanding of how a bank operates. As a result, in this section, we set forth some basics about a bank balance sheet as well as discuss some of the business models that are discussed in the literature.

For any bank, public or private, to operate profitably and take advantage of the power of leverage, it needs a steady source of stable core deposits or other debt funding. It uses those deposits to fund projects which it can underwrite as loans (the asset side of its balance sheet). To provide a cushion for losses and to absorb other expenses, banks have some form of shareholder equity capital.\textsuperscript{34} Banks operate under a fractional reserve model, which means that they need to maintain, in the form of cash or other highly liquid investments, only a small portion of the deposits they have received, even though most deposits legally can be withdrawn at any time. This permits banks to use the deposits and other borrowings to fund loans, the vast majority of which will have maturities longer than the deposits. This difference is known as maturity mismatch.

Prior to the adoption of federal deposit insurance, banks were often subject to runs and panics. Federal deposit insurance creates a stability in core deposits, even though they generally may be withdrawn on demand by the depositor, because they tend to act in predictable ways that can be modeled permitting the bank to treat such deposits as if they were long-term debt. State or municipal deposits, including tax receipts and the proceeds from state bond issuances awaiting reinvestment, could be a source of stable deposit funding for a public bank. Since stable core deposits are generally a cheaper source of funding than long-term debt, they are an attractive source of funding. The use of deposits from state entities has proven beneficial to the Bank of North Dakota. As its financial condition deteriorated, the Government Development Bank for Puerto Rico, like any bank in trouble, began to lose its deposit base.

We understand that one model of a public bank under discussion in California is to include both retail deposits and deposits from a municipal owner, although retail deposits

\textsuperscript{31} Id.

\textsuperscript{32} Eric Platt, \textit{Puerto Rico’s Government Development Bank strikes deal on debt burden}, The Financial Times (May 15, 2017), https://www.ft.com/content/6012e78f-0e24-3ec3-b89a-6e1533cd0505.

would raise the likelihood that some form of deposit insurance would be required by the California Department of Business Oversight. We note the concerns expressed in the New Mexico FID Memo that because of its heavy dependence upon deposits from one source, the City of Santa Fe, a sudden reduction in funding by the City of Santa Fe "could result in immediate jeopardy to the financial security of the bank." We understand that certain public bank models under discussion in California, including the proposal for a public bank owned by the State of California described in the Chiang Report, include the concept of both deposits from the municipal or state owner and from others, including the retail public, and so would differ from the model under discussion in Santa Fe.

For the asset side of the balance sheet, advocates propose that a public bank would fund projects that support economic development in its region, provide credit to underbanked low income citizens, make up the gap in lending to small- and medium-size enterprises and, in some instances, make loans to its public entity shareholders or other state governmental entities to replace, at least in part, the municipal bond issuances currently used by such entities. In California, the concept of the public bank has, for many, begun to be melded with the need for local cannabis businesses operating permissibly under state law to have more access to banking services. The contrasting fortunes of the Bank of North Dakota and the Government Development Bank for Puerto Rico reveal the challenges that exist in loan underwriting decisions by any public bank. The risk that a public bank might be incentivized or forced to make loans based on political preferences, rather than on the basis of prudent financial and economic considerations inherent in typical loan underwriting, should be mitigated through appropriate governance mechanisms and other safeguards. The fact that the public bank model has worked well in North Dakota and not in Puerto Rico illustrates the critical importance of such governance mechanisms and safeguards.

Capitalization is a difficult issue for the public bank model. The public shareholders would be required to raise funds to capitalize the public bank at an acceptable level. The capital will be needed to fund operating expenses until the bank obtains profitability and to

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35 Mem. from the New Mexico Regulation and Licensing Department, Financial Institutions Division, Legal Issues and Matters for Further Research and Examination Regarding Proposed Public Bank of Santa Fe (Aug. 24, 2017), https://www.santafenm.gov/media/archive_center/item_3.pdf#page=128. The concern that a bank might be overly dependent upon deposits from one or a weighted group of depositors has a historical precedent. Histories of the Banking Crisis of 1933, which started in the state of Michigan, recount how the banks controlled by Ford Motor Company were dependent on deposits from Henry Ford. Ford's actions around his deposits were an exacerbating factor in that crisis. See Susan E. Kennedy, The Banking Crisis of 1933 (1973); see also Darwyn H. Lumley, Breaking the Banks in Motor City: The Auto Industry, the 1933 Detroit Banking Crisis and the Start of the New Deal (2009).

36 See Public Banking Feasibility Study: Final Report for the City of Santa Fe, 7(Jan. 2016).

37 Similar issues have been faced by state-owned banks in other countries.

38 The concern about politically driven credit decisions has also been raised by the legal counsel for the Financial Institutions Division of the New Mexico Regulation and Licensing Department. The New Mexico FID Memo states that "[w]hen the government owns the banks, lending decisions could become increasingly driven by politics, rather than economics. Resources flow to those with influence. Government-owned banks may also tend to under-price risk in order to gain votes. If there is one lesson we should take away from the recent crisis, it is that when you under-price risk, bad things happen." Mem. from the New Mexico Regulation and Licensing Department, Financial Institutions Division, Legal Issues and Matters for Further Research and Examination Regarding Proposed Public Bank of Santa Fe (Aug. 24, 2017), https://www.santafenm.gov/media/archive_center/item_3.pdf#page=128, at 8.
absorb losses from loans that are not repaid. \(^{39}\) The amount of capital necessary would depend on the anticipated size of the balance sheet and business plan of the public bank. A report by the Federal Reserve Bank of Boston that examined whether the Bank of North Dakota model could be implemented in Massachusetts noted that the Bank of North Dakota was capitalized initially through a $2 million bond issue in 1919 which, adjusted for inflation and for the growth of the economy, would be the equivalent of an initial capitalization of approximately $325 million. \(^{40}\) As of the end of 2016, the Bank of North Dakota had an actual equity capital of $875 million. \(^{41}\) The Massachusetts report examined a state-wide public bank and determined that, adjusting for the size of the Massachusetts economy, the equivalent capital for Bank of North Dakota in Massachusetts would amount to about $3.6 billion. \(^{42}\) Proposed legislation from 2012 for a state-wide public bank in Hawaii initially included plans to issue $500 million worth of bonds to capitalize its proposed public bank. \(^{43}\)

As noted above, the capital requirements of a public bank will depend upon the anticipated asset size, the projected operating expense, the source and stability of deposit funding, the nature of the loan portfolio and a myriad of other factors. In 2012, Assembly Bill 2500, proposing the establishment of a California investment trust, was introduced to the California legislature. An investment trust is a form of public bank designed to exercise certain powers relating to banking, including, among others, receiving and managing deposits from public funds, loaning money, engaging in financial transactions, and buying and selling federal funds. \(^{44}\) The bill was met with opposition by the California banking sector, including the California Bankers Association and the California Independent Bankers. \(^{45}\) A statement by the then-California State Treasurer noted that the capitalization requirements for a public bank in California would "further complicate the state's ability to meet its obligations, especially while the state continues to suffer from structural imbalances of revenues and expenditures, resulting in chronic shortages of cash and scarce reserves." \(^{46}\) The Chiang Report notes that some of the obstacles likely to stand in the way of creating a public banking in California include unknown start-up costs, investments that are likely to

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\(^{39}\) At least one advocate for public banking has argued that equity capital is not needed, but that is a minority position. See generally Ellen Hodgson Brown, The Public Bank Solution: From Austerity to Posterity (2013).


\(^{44}\) Cal. Assembly Comm. on Banking and Fin., AB 2500 (Hueso), Apr. 23, 2012.

\(^{45}\) Id.

measure up in the billions of dollars, and the probability of losses for several years or more that taxpayers would have to recover.47

**d. Public Banking Movement in California**

Various groups in California are considering the viability of the public banking model and conducting feasibility studies. For instance, the Oakland City Council Finance and Management Committee approved funding for a feasibility study for a public bank that might serve the City of Oakland.48 Additionally, the concept of a public bank in California has begun to be meshed with the pressing need for state legal cannabis businesses to have access to the banking sector. The Cannabis Working Group established by John Chiang and which recently issued the Chiang Report has received testimony on whether a public bank model might work in California. Unlike the earlier attempt to introduce a bill on public banking in California, which was opposed by the California banking sector, the Cannabis Working Group has members of the banking sector and the California Banking Association as part of its membership.

One of the key recommendations of the Chiang Report is that the Attorney General of the State of California would conduct a feasibility study to assess whether it is advisable to create a public bank that, as part of its business model, would provide financial services to state legal cannabis businesses.49 While municipalities generally are considering a public bank that would be owned by and serve a city, the Chiang Report contemplates a public bank that would be state-wide. In addition to examining the costs, benefits risks and regulatory issues and providing a legal analysis addressing the legality and associated legal risks of creating a public cannabis financial institution, the feasibility study would also examine various ownership structures, including one that would be a combination of public and private ownership and another that, like the federal Fannie Mae and Freddie Mac models, would receive a special charter from the state.50 Regardless of which structure is decided upon, the Chiang Report takes the view that a state-wide retail branch network would be required in order to cut the flow of cannabis cash.51

The Chiang Report also recommends a feasibility study on a bankers’ bank and a corporate credit union. The classic way that a bankers’ bank or a corporate credit union operates is as a bank owned by other banks or a credit union whose members are other credit unions and which operates solely to provide banking services (deposits, loans or payment services) to other banks or credit unions.52 As described in the Chiang Report,

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50 Id. at 18.
51 Id.
52 As discussed above, the Bank of North Dakota shares some features of a bankers’ bank but is not a true bankers’ bank. An example of a classic bankers’ bank would be CLS Bank (real time gross settlement of foreign exchange) or DTCC (securities clearance and settlement). During the financial crisis, many corporate credit
however, the bankers' bank or corporate credit union seem more akin to a shared industry compliance portal. In this respect, the concept shares some characteristics with the shared anti-money laundering and BSA industry utility that The Clearing House has been proposing for some time.53

**e. Background on Banking the Cannabis Sector**

This section describes the growing tension around banking the cannabis sector due to the direct conflict between the legalization of cannabis for medical and recreational use under state law even as cannabis remains criminalized under the Controlled Substances Act.54 The Controlled Substances Act, by virtue of the Supremacy Clause of the U.S. Constitution, makes it illegal under the anti-money laundering laws for banks to aid and abet a cannabis business.55 Notwithstanding this direct conflict, sympathetic attitudes at the federal administrative level toward state level legalization of cannabis during the Obama Administration, prompted the piecemeal and patchwork issuance of regulatory guidance and proposed legislation in recent years and perhaps created some practical "breathing room" for smaller banks to provide some services to state-legal cannabis businesses.

Despite the growth of the state legal cannabis sector, most state legal cannabis businesses have what the Chiang Report describes as only "sporadic" access to banking services.56 In light of the federal statutes against money laundering and the criminal liability that attaches to aiding and abetting activities that are crimes under federal law, as well as the history of enforcement and fines in the anti-money laundering arena, most payments providers are effectively prevented from providing banking services to cannabis businesses, and the Federal Reserve itself has refused to do so. The relevant statute subjects banks and payment systems providers to the risk of criminal liability and provides that "whoever aids, abets, counsels, commands, induces or procures" a federal crime, or "causes" a federal criminal act to be done, "is punishable as a principal."57 The Bank Secrecy Act (the


54 At least 26 states and the District of Columbia have laws legalizing some form of cannabis use. See Governing the States and Localities, *State Marijuana Laws in 2017 Map*, http://www.governing.com/gov-data/state-marijuana-laws-map-medical-recreational.html. Recreational cannabis has also become legal in Canada with mid to late 2018 set as the date for transition to a fully legal framework in banking and otherwise.

55 See 21 U.S.C. §§ 841(a)(1) ("[i]t shall be unlawful for any person knowingly or intentionally . . . to manufacture, distribute, or dispense, or possess with intent to manufacture, distribute, or dispense, a controlled substance.") Cannabis is a controlled substance. 21 U.S.C. §§ 802(6), 812 (Schedule I)(c)(10).

56 U.S. Const. art. VI, § 2.


"BSA") and anti-money laundering statutes and regulations are strictly enforced, and banking institutions have received large fines for violations of these laws. Banks that might otherwise wish to provide banking services to cannabis businesses face high regulatory risk, and as a result, the vast majority of banks have so far avoided the cannabis sector. According to one source, in 2016, only 301 banks and credit unions (which represent less than 3% of the United States banks and credit unions) worked directly with the cannabis business, and, as a result, "cannabis businesses are generally unable to write checks, make and receive electronic payments, or accept credit and debit cards." These laws would also apply to a public bank in California and would require the public bank to weigh the risks and consequences of acting in violation of the federal statutes.

States have a strong public interest in making certain that state legal cannabis businesses operate in a legal manner and fully pay their taxes. State legal cannabis businesses desire to operate openly within the legal system in light of all of the benefits that accrue to a legal operating model for a business. State law enforcement officials have raised concerns about the risk of robbery to cannabis businesses that must operate in a cash-dominant environment. The Chiang Report notes that the lack of access to banking services "forces cannabis businesses to deal in large amounts of cash, which makes targets for assaults and puts the general public in danger" and that "security and procedural concerns about handling massive amounts of cash also create a nightmare for state and local government revenue-collecting agencies." These factors provide an impetus to bringing cannabis businesses into the banking system.

At least one commentator has expressed the view that the lack of stable access to the banking system is "inadequate for a swiftly-growing, multi-billion dollar industry." Initial efforts are focused on permitting cannabis businesses to obtain access to basic deposit accounts and indirect access to the payments system. Even those banks that are willing to


61 Id.


63 State tax departments have experienced difficulty in taking tax payments delivered in bundles of cash. See Clay Dillow, Paying taxes in cash, marijuana companies have a lot to hash out with the IRS, CNBC (April 18, 2017, 9:59 AM), http://www.cnbc.com/2017/04/18/marijuana-companies-sending-a-huge-cash-roll-to-irs-on-tax-day.html.


provide deposit accounts and indirect access to the payments system remain reluctant to make loans. Among other risks, enforcing such a loan in the court system is fraught with risk. Further, the fact that cannabis businesses do not benefit from the federal Bankruptcy Code increases the risk to bank lenders.

i. Federal Regulatory Guidance

Because removing cannabis from its current classification as a Schedule I drug would require action by Congress or the U.S. Attorney General, in 2013, the Obama Administration’s Department of Justice issued the “Cole Memo.” Acknowledging the tension inherent as a result of the trend towards state legalization of cannabis, the Cole Memo, as a matter of prosecutorial discretion, limits the scope of federal cannabis enforcement to areas of particular concern, which largely excludes state-legalized adult usage. The Cole Memo conditions its guidance by requiring states and local governments that have enacted laws authorizing cannabis-related conduct to implement “strong and effective regulatory and enforcement systems that will address the threat those state laws could pose to public safety, public health and other enforcement interests.”

Importantly, the Cole Memo did not change the Controlled Substance Act, and it did not decriminalize cannabis for purposes of federal law. The Cole Memo is not a regulation and does not have the force of law. Instead, it elucidates a principle of prosecutorial discretion that federal prosecutors would not enforce an otherwise valid federal criminal law in certain circumstances. The practical result of the Cole Memo was a détente between law enforcement at the federal level and state level where state law contradicted federal law. The continued status of the Cole Memo is an open question under the Trump


68 Moses Fali-Velasquez, Changes Needed to Protect Banking and Financial Services When Dealing with the Marijuana Industry, Lexis Practice Advisor J., August 3, 2016 (citing to In re Medpoint Mgmt., 528 B.R. 178 (Bankr. D. Ariz. 2015); see also In re Arenas, 514 B.R. 887, 895 (Bankr. D. Colo. 2014) (The court dismissed a Chapter 7 case and denied conversion to a Chapter 13 case. The court stated that it “cannot force the Debtors’ Trustee to administer assets under circumstances where the mere act of estate administration would require him to commit federal crimes under the Controlled Substances Act. Nor can the Court confirm a reorganization plan that is funded from the fruits of federal crimes.”).


71 The Cole Memo listed the Obama Administration’s priorities related to the enforcement of laws involving cannabis: preventing the distribution of cannabis to minors; preventing revenue from the sale of cannabis from going to criminal enterprises, gangs and cartels; preventing the diversion of cannabis from states where it is legal under state law in some form to other states where it is illegal; preventing state-authorized cannabis activity from being used as a cover or pretext for the trafficking of other illegal drugs or other illegal activity; preventing violence and the use of firearms in the cultivation and distribution of cannabis; preventing drugged driving and the exacerbation of other adverse public health consequences associated with cannabis use; preventing the growing of cannabis on public lands; and preventing cannabis possession or use on federal property. Id.

72 Id. at 2.
Attorney General Sessions has indicated that the Cole Memo is “valid,” though his ultimate enforcement decisions are still unclear as he has made other statements critical of cannabis and lax drug enforcement generally. In a letter to the Governor and Attorney General of Washington from July 2017, Attorney General Sessions suggested that the State of Washington falls short of meeting the condition under the Cole Memo that requires states that have legalized cannabis to implement adequate regulatory structures. The memo may signal that the Trump Administration will more strictly enforce the Cole Memo requirements going forward.

After the Cole Memo, and as part of the Obama Administration’s sympathetic attitude towards the state level legalization of cannabis, FinCEN also issued guidance (the “FinCEN Guidance”) on compliance with applicable laws, regulations and regulatory practice, including the BSA. The FinCEN Guidance attempted to clarify how banks and other financial institutions could provide banking services to cannabis businesses and still remain consistent with their obligations under the BSA. Much like the Cole Memo, the FinCEN Guidance does not change the underlying illegality of cannabis and cannabis businesses under federal law, nor does it change the fact that these businesses are determined to be high-risk. Furthermore, these federal guidelines do not have the force of law, can be withdrawn at any time and do not guarantee that the U.S. government will not take action against financial institutions that follow their rules. As a result, notwithstanding the FinCEN Guidance, banks and other money services businesses dealing with the cannabis industry


77 Specifically, the FinCEN Guidance provides that in assessing the risk of providing services to cannabis businesses, a financial institution should conduct due diligence that includes: (1) verifying with the appropriate state authorities whether the business is duly licensed and registered; (2) reviewing the license application (and related documentation) submitted by the business for obtaining a state license to operate as a cannabis business; (3) requesting from state licensing and enforcement authorities available information about the business and related parties; (4) developing an understanding of the normal and expected activity for the business, including the types of products to be sold and the type of customers to be served (e.g., medical versus recreational customers); (5) ongoing monitoring of publicly available sources for adverse information about the business and related parties; (6) ongoing monitoring for suspicious activity, including for any of the red flags described in this guidance; and (7) refreshing information obtained as part of customer due diligence on a periodic basis and commensurate with the risk. Id.

will still be required to file suspicious activity reports for transactions involving these businesses which may be passed on to federal agencies and law enforcement authorities. Some bankers have stated that the FinCEN Guidance is impracticable and that compliance with it is so difficult that even those banks that might be willing to take the risk will not do so. As the Chiang Report noted, the Cole Memo and FinCEN Guidance may have opened a "narrow and fragile" path for cannabis banking, but because they do not offer a safe harbor from federal law and most financial institutions view the requirements as too burdensome to make cannabis banking worthwhile, they provide only an impartial solution.

ii. Bills Introduced into Congress

In an attempt to solve the issues associated with state legal cannabis businesses and their inability to obtain banking services and access payment systems, the SAFE Act was introduced in the U.S. House of Representatives on April 27, 2017. The SAFE Act would prohibit the federal banking regulators from penalizing depository institutions that serve state legal cannabis businesses through either: (1) terminating or limiting their deposit insurance or (2) prohibiting, penalizing, or otherwise discouraging depository institutions from providing financial services to state legal cannabis businesses. The SAFE Act would also immunize banks and their officers, directors and employees from prosecution under federal law solely for providing financial services to state legal cannabis businesses pursuant to the law or for investing any income derived from providing such financial services. The SAFE Act would amend the BSA to require that financial institutions and their directors, officers, employees and agents comply with any guidance issued by FinCEN related to suspicious activity reports regarding state legal cannabis businesses. The SAFE Act provides that any such guidance must be consistent with the purpose and intent of the SAFE Act and must not inhibit the provision of financial services to state legal cannabis businesses.


82 The term "federal banking regulators" for purposes of the SAFE Act includes the Federal Reserve Board, FDIC, Office of the Comptroller of the Currency (the "OCC"), National Credit Union Administration (the "NCUA"), Consumer Financial Protection Bureau, and any other regulator as determined by the Secretary of the Treasury. Even though they are part of the Federal Reserve System, because the Federal Reserve Banks are separately chartered and technically separate from the Federal Reserve Board, it remains unclear based on the text of the SAFE Act whether the Federal Reserve Banks would be subject to that law.


84 Id.
Another proposed bill, the Respect State Marijuana Laws Act of 2017, introduced in February 2017 by Representative Rohrabacher, along with six Republicans and six Democrats, would amend the Criminal Substances Act to provide that the provisions of the Act related to cannabis do not apply to any person acting in compliance with state laws relating to the production, possession, distribution, dispensation, administration or delivery of cannabis. Passage of the Act would thus bar federal officials from prosecuting cannabis consumers and businesses under the Criminal Substances Act in states where recreational or medical cannabis use is legal. The Act does not directly address or provide a safe harbor for banking.

In addition, the Rohrabacher-Farr amendment, first introduced in 2003 and passed on December 16, 2014, prohibits the Department of Justice from spending money on cannabis prosecutions in states where medical cannabis is legal at the state level. As a budget amendment, it must be approved every year. Thus far, the amendment has been approved every year, but continued passage is in doubt. Some commentators hope that The Rohrabacher-Farr protections could possibly be expanded to cover recreational cannabis usage even in those states where medical cannabis has not been legalized. Attorney General Sessions is opposed to the Rohrabacher-Farr amendment and sent a letter to congressional leadership reaffirming the Department of Justice’s opposition to the inclusion of the amendment in appropriations legislation. On September 6, 2017 the House Rules Committee blocked a floor vote on the amendment. On September 8, President Trump signed a $15 billion emergency aid package for victims of Hurricane Harvey which extended the current federal budget, including the Rohrabacher-Farr amendment, until December 8, at which point it will be voted upon by Congress to determine whether it will be renewed for the upcoming fiscal year.

II. Discussion

This section analyzes the feasibility of establishing a public bank in California under either the Traditional Public Bank Business Model or Traditional Plus Cannabis Business Model against the background of the public banking movement and the growing state legal

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87 Id.
cannabis sector. It is a deeper technical legal analysis of many of the legal issues mentioned in the Chiang Report.90

1. What bank or bank-like charters are available under California law for a public bank?

   a. Commercial Bank Charter

   Under California law, a charter is required to take deposits.91 As there is no California law equivalent to the North Dakota statute authorizing the establishment of a public bank pursuant to a Public Bank Charter, one path under California law would be for the public sector investors to attempt to use a Commercial Bank Charter. This would require convincing the California Department of Business Oversight, the sole current authority for chartering a state private sector banking business in California,92 to issue such a charter. Fitting the public bank business model into a Commercial Bank Charter would be challenging. It would require the approval of the California Department of Business Oversight, a sound business plan, experienced management and appropriate capitalization. As discussed below, a commercial bank would also require approval from the FDIC, something that has proven difficult. Using a Commercial Bank Charter would in many ways be like putting a square peg in a round hole by forcing the public shareholders of the proposed public bank to retrofit the Public Bank Business Model into a regulatory system that was designed for private sector investors.

   To obtain a Commercial Bank Charter, the proposed organizers of the bank must file an application with the California Department of Business Oversight, and the proposed bank may not begin its operations until its charter has been approved by that Department.93 It is common for bank charter applications to take a year or more to be approved. Given the complexity and rigor of the application for a Commercial Bank Charter, the novelty of using a Commercial Bank Charter for a public bank and the tension between federal and state law with respect to providing financial services for cannabis businesses, it would be prudent to submit to the commissioner of the California Department of Business Oversight a request for a written opinion on the feasibility of using a Commercial Bank Charter for a public bank before beginning the application process.

90 The treatment of tax laws and any federal criminal asset forfeiture laws are outside the scope of this memorandum.

91 A California state bank is defined as a corporation incorporated under the Corporations Code that is, with the approval of the commissioner, incorporated for the purpose of engaging in, or that is authorized by the commissioner to engage in, the banking business. Cal. Fin. Code § 1004; Cal. Fin. Code § 1043. It is unlawful to engage in or transact banking business within California except by means of a corporation duly organized for that purpose. Cal. Fin. Code § 1005.

92 Cal. Fin. Code § 1043 ("It shall be unlawful to accept payment of subscriptions for shares of any corporation proposing to engage in the banking or trust business unless authority to organize such corporation has been granted by the commissioner [of the California Department of Business Oversight].")

Each application for a Commercial Bank Charter in California must provide detailed information about the proposed bank’s business plan, management and organizing group.\footnote{Any de novo bank would also need to meet business plan requirements in connection with the application for deposit insurance from the FDIC. The FDIC requires that a bank operate within the parameters of the business plan submitted to the FDIC in connection with its application for deposit insurance during the first three years of operations. The de novo bank must seek the prior approval of the appropriate Regional Director, if not the FDIC, for any proposed major deviation or material change from the submitted business plan. FDIC, Applying for Deposit Insurance: A Handbook for Organizers of De Novo Institutions (Apr. 2017), at App. 2.} California law requires that the business plan include:

- a description of the market that the bank proposes to serve;
- a description of the services and products proposed to be offered by the bank;
- an analysis of the need for the services and products proposed to be offered by the bank;
- a description of competition in the proposed market of the bank, including the name of each other business which provides to the proposed market of the bank, including the name of each other business which provides to the proposed market services and products that are similar to any of the principal services and products offered by the bank;
- a description of how services and products of the bank will be marketed in consideration of the existing and anticipated competition;
- an analysis of the capital, financial, physical and human resources required by the bank to successfully implement the proposed business plan; and
- in case any material element of the business plan is based on an assumption, a statement of the assumption and justification for the assumption.\footnote{Cal. Code Regs. tit. 10, § 10.3155.}

The application must also include information regarding proposed directors and executive officers. Each director, executive officer and 10% shareholder must submit detailed biographical and financial reports, and fingerprinting may be required. Individuals proposed to be executive officers must have appropriate character, demonstrated banking experience and business qualifications. Proposed directors must have reputations of honesty and integrity within the community where the bank will be located and must have demonstrated experience in financial affairs, supported by descriptions of relevant banking experience. For each proposed director, the application must include descriptions of how
the proposed director intends to serve the proposed bank and relevant qualifications to implement such intentions.96

Upon receiving an application for a Commercial Bank Charter, the commissioner of the California Department of Business Oversight has wide discretion in granting or denying the charter. The commissioner is responsible for making the decision whether to approve each application and will not approve an application until he or she has ascertained that:

- the public convenience and advantage will be promoted by the establishment of the proposed bank;
- the proposed bank will have a reasonable promise of successful operation;
- the bank is being formed for no other purpose than the legitimate objects contemplated;
- the proposed capital structure is adequate;
- the proposed officers and directors have sufficient banking experience, ability and standing to afford reasonable promise of successful operation;
- the name of the proposed bank does not resemble, so closely as to be likely to cause confusion, the name of any other bank or trust company transacting business in California or which had previously enacted business in California; and
- the applicant has complied with all of the applicable provisions.97

In addition to a commercial bank, we have also considered other legal entity types under California law that may be available for a public bank. We have excluded a trust company from consideration as it could only take trust deposits and would be very limited in its activities.98 We have excluded a California Benefit Corporation, since it cannot take deposits.99 While we have examined the industrial bank and loan company, it appears to provide no significant benefits over that of a commercial bank and presents the same sorts of challenges.100

98 Under California law, the term “trust company” means a corporation, industrial bank, or a commercial bank that is authorized to engage in the trust business. Cal. Fin. Code § 117. An application to establish a trust company must meet the same requirements regarding commercial and industrial bank applications.
99 California Benefit Corporations are another corporate form specifically designed for benefitting a public purpose, but it would not be feasible since, because it is not established pursuant to a bank charter, it would not be able to take deposits. Cal. Corp. Code § 14600-14604 (2012).
100 Industrial loan companies are institutions that are authorized to make loans and take deposits much like banks and may be controlled by companies. Cal. Fin. Code § 1541. An application for an industrial bank must
b. Credit Union Charter

We have also considered whether the Credit Union Charter might be a suitable charter for a public bank under either the Traditional Public Bank Business Model or the Traditional Plus Cannabis Business Model. There are two possible alternatives for a Credit Union Charter. Under the first model, the City of San Francisco could be the sponsoring organization, contributing the funds necessary for organization and operation of the credit union. The credit union would have to obtain sufficient members satisfying the common bond requirement as discussed below. Alternatively, the City of San Francisco could be a member, and potentially solicit other municipalities to satisfy the common bond requirement. California law contemplates that there must be 500 members in order to charter a credit union, but it appears that the commissioner of the California Department of Business Oversight may approve a charter with fewer than that number. We are aware that the California Department of Business Oversight previously has not interpreted the 500 members to be discretionary.

The statute also provides that California credit unions must apply for and obtain federal deposit insurance or other insurance that is not unsatisfactory to the commissioner of the California Department of Business Oversight. If a California credit union could obtain private deposit insurance, neither the NCUA nor any federal banking regulator would have jurisdiction over the credit union or its operations. It is not known whether either a private deposit insurance company such as American Share Insurance would be open to the possibility of insuring such an institution, or whether the California Department of Business Oversight would accept such insurance. A California credit union with private deposit insurance would avoid some of the federal banking law issues faced by a public bank using a Commercial Bank Charter. In addition, a California state-chartered credit union with private insurance would not be subject to the 12.25% limit on business loans applicable to

meet the requirements described above regarding commercial bank applications, and, therefore, a public bank organized under an industrial loan company charter would have the same hurdles as one organized under a Commercial Bank Charter.

A number of institutions that have publicly expressed a desire to provide banking services to the cannabis industry are credit unions. Examples of such credit unions include the Salal Credit Union in Washington and Fourth Corner in Colorado.

Under California law, a credit union must be based on, among other things, a group of persons with a common bond beyond obtaining financial services from the credit union. There are three basic forms of groups eligible for membership in a credit union: groups based upon a common bond of occupation; groups based upon a common bond of association; and groups within a well-defined neighborhood, community, or rural district. Cal. Code, Regs. tit. 10, § 30.51.

Cal. Fin. Code § 14155 (stating that the commissioner "may" deny the application for a credit union if the number of persons eligible for membership is less than 500).


Cal. Fin. Code § 14858 ("Every credit union shall apply for and obtain insurance as provided for by [the NCUA], or other insurance or guaranty of shares that is not unsatisfactory to the commission [of the Department of Business Oversight].").

federally insured credit unions. A credit union with a Traditional Plus Cannabis Business Model would have the same difficulty in opening a Federal Reserve Bank master account. As with a Commercial Banking Charter, it would be prudent to submit to the commissioner of the California Department of Business Oversight a request for a written opinion on the feasibility of using a Credit Union Charter with private share insurance.

c. Observations

We expect that the California Department of Business Oversight will examine any application for a Commercial Bank Charter or Credit Union Charter with great care and will want to have a high level of comfort on the California constitutional, home rule and other California public law authority of the public shareholders to own a bank. We also expect that the Department might be influenced by the litigation position of the Federal Reserve Board that a Federal Reserve Bank may deny a master account to a depository institution that has a Traditional Plus Cannabis Business Model as a result of the prohibitions associated with its activities under applicable federal law.

It is also useful to note the argument put forth by the Federal Reserve Bank of Kansas City that the Fourth Corner Credit Union charter is preempted by the federal statutes dealing with controlled substances. In our view, federal law may affect the permissible activities of a chartered depository institution, but would not preempt the authority of the state to grant a charter. The preemption argument may, nevertheless, reappear in other contexts. Finally, as noted in the Chiang Report, all other federal criminal laws would continue to apply to any such bank.

2. What federal banking laws would affect the ability of such a public bank to operate?

Were the public bank required to obtain federal deposit insurance, it would be subject to the full panoply of the federal laws and regulations governing operations, safety and soundness, permissible activities and similar requirements. In this section, we touch on only a few of the federal laws and regulations we believe would be the most difficult to meet: deposit insurance, bank holding company, source of strength, capital and restrictions on affiliate transactions.

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107 See 12 U.S.C. § 1757a (describing federal limits on "member business loan[s]"); 12 C.F.R. § 723.1(b)(1) (applying federal member-business-loan limitation to state-chartered credit unions that are federally insured); Cal. Code Regs. tit. 10 § 30.903 (same).

108 Considerations of these California public law topics are outside of the scope of this memorandum. As topics for further exploration, we note the following: state constitutional law, charter cities, municipal affairs, home rule authority, open meetings, public records and fiduciary duties.

109 It is the Federal Reserve Banks, not the Board of Governors, that determine whether to provide financial institutions with a master account and access to the payment systems.

110 Answer Brief of Appellee at 31, The Fourth Corner Credit Union v. Federal Reserve Bank of Kansas City, No. 16-1016, (10th Cir. filed June 27, 2017).

a. **FDIC Insurance Requirements**

Under California law, all state-chartered banks must obtain federal deposit insurance.\(^{112}\) Thus, it is not possible for a Commercial Bank Charter to be granted without federal deposit insurance from the FDIC. Applications for a Commercial Bank Charter are therefore generally submitted jointly with applications for federal deposit insurance. The final decision by the California Department of Business Oversight to grant or deny the Commercial Bank Charter application is made independently of the decision to grant or deny federal deposit insurance. However, it is unusual for one to be granted without the other.

In considering applications for federal deposit insurance, the FDIC takes into account:

- the financial condition of the proposed depository institution;
- the adequacy of its capital structure;
- its future earnings prospects;
- the general character and fitness of its management;
- the risk presented by such depository institution to the deposit insurance fund;
- the convenience and needs of the community to be served by the depository institution; and
- whether its corporate powers are consistent with the purposes of the Federal Deposit Insurance Act.\(^ {113}\)

The FDIC Statement of Policy on Applications for Deposit Insurance states that if each of these factors is met, the proposed applicant will generally receive deposit

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\(^{112}\) Cal. Code Regs. tit. 10 § 10.3520 (2017). Under California law, every industrial loan company, trust company and credit union must obtain deposit insurance. Cal. Code Regs. tit. 10 § 10.3520 covers any "subject institution," which means "any California state bank which is or is proposed to be a commercial bank or an independent trust company." Cal. Code Regs. tit. 10 § 10.3100. In 2000, deposit-taking industrial loan companies in California were re-categorized as industrial banks within the meaning of the California Financial Code, which requires that they have insurance. SB 2148 (2000); Cal. Fin. Code § 1401 ("[e]ach industrial bank shall be an insured bank at all times while it is engaged in the industrial banking business", "any reference in a provision of any statute or regulation of this state to banks or commercial banks includes industrial banks"). Congress has imposed a moratorium on the granting of any new FDIC insurance for industrial loan companies in 2010 and, since 2013, the FDIC has not lifted its informal moratorium policy. It is widely understood that, as a policy matter, no new industrial loan companies will be granted FDIC insurance. Michael S. Barr, Howell E. Jackson & Margaret E. Tahyar, Financial Regulation: Law and Policy 175 (Robert C. Clark et al. eds., 1st ed., 2016). Credit unions must obtain deposit insurance provided for by Title II of the Federal Credit Union Act, or other insurance that is satisfactory to the commissioner. Cal. Fin. Code § 14858. Federal credit unions must be insured by the National Credit Union Administration. 12 U.S.C. § 1781(a) (2012).

It is widely understood that there is a strong discretionary element in the granting of deposit insurance. The FDIC may also conduct examinations of the proposed bank in connection with reviewing the deposit insurance application. There is no explicit requirement that the FDIC act within any certain time frame. It should be expected that such an application might take a year or more, and there are no assurances that an application would be granted.

Of specific importance for any public bank, the FDIC Statement of Policy on Applications for Deposit Insurance expressly states that an application for deposit insurance for such a public bank will be reviewed “very closely,” because such institutions present “unique supervisory concerns that do not exist with privately owned depository institutions.”

The policy statement states:

For example, because of their 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 (particularly in the form of true equity rather than governmental transfers). On the other hand, 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. In view of such considerations and the policy issues they embody, the FDIC will closely evaluate such applications to ensure the required statutory factors are met.

The FDIC would carefully scrutinize the proposed bank’s application for deposit insurance. Although the FDIC has stated that it is willing to consider providing deposit

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115 A recent FDIC proposal, open for comment through September 8, 2017, regarding its deposit insurance application procedures manual suggests that the FDIC aims to act within 120-180 days after a substantially complete application is received. Deposit Insurance Applications Procedures Manual, FDIC, (2017), https://www.fdic.gov/regulations/applications/procmanual.pdf. The lived experience is that a year’s timing would be an appropriate assumption. Keith Noreika, the acting comptroller of the currency, recently criticized the FDIC for its inaction with respect to the assessment of de novo charter applications. Noreika stated that “since 2001, we’ve had 14 organizers of national banks that [the OCC has] approved for a charter that have not gotten an answer, yes or no, from the FDIC” and called it “unconscionable that they spend all this money to organize a bank to go through two regulatory processes [through the OCC and the FDIC]—and they can’t even get a no out of them that they could go to court and challenge.” See Lalita Clozel, OCC to Take First Step Toward Rolling Back Volcker Rule, American Banker (July 19, 2017).


117 Id. The New Mexico FID Memo notes that while the Statement of Policy on Applications for Deposit Insurance is “not a definitive rejection of granting deposit insurance,” it makes clear the FDIC’s concerns. Mem. from the New Mexico Regulation and Licensing Department, Financial Institutions Division, Legal Issues and Matters for Further Research and Examination Regarding Proposed Public Bank of Santa Fe (Aug. 24, 2017), https://www.santafenm.gov/media/archive_center/item_3.pdf#page=128, at 7–8.
insurance for public banks, the text of the FDIC Statement of Policy on Applications for Deposit Insurance suggests the bar for receiving approval of such an application is high.

Based upon our experience, we believe that the FDIC would have concerns over public ownership, accountability, and the ability of the institution to obtain needed capital funds in the future. The FDIC has privately expressed concerns about its ability to exercise its enforcement authorities where a public entity is involved. In an earlier experience we had with a bank that would have been owned by a housing finance agency, these concerns eventually led to the withdrawal of the application.

However difficult it would be to obtain federal deposit insurance for a public bank operating pursuant to the Traditional Public Bank Business Model, it would be far more difficult under the Traditional Plus Cannabis Business Model. The illegality of the cannabis business under federal law makes it extremely unlikely that the FDIC would grant deposit insurance. In Colorado, the Fourth Corner Credit Union, a state-chartered credit union for the cannabis sector, was denied insurance by the NCUA, and subsequently sued the NCUA. The lawsuit, while unresolved, underscores the difficulties in obtaining federal deposit insurance particularly for institutions operated pursuant to the Traditional Plus Cannabis Business Model.\textsuperscript{118}

Given the difficulty in obtaining a Commercial Bank Charter and FDIC insurance, the most stable legal foundation for a public bank under the Public Bank Business Model would be for the California legislature to pass a specific statute that either creates a public bank or creates the possibility of a public bank authorized pursuant to a Public Bank Charter that did not require federal deposit insurance. The Bank of North Dakota is not required under state law to have federal deposit insurance. If a similar law passed in California providing that a bank with a Public Bank Charter does not need federal deposit insurance, it would remove a key obstacle to establishing a public bank pursuant to either the Traditional Public Bank Business Model or the Traditional Plus Cannabis Business Model.

Obviously, a state guaranty similar to the one provided to the Bank of North Dakota represents a substantial contingent financial exposure. It would require willingness on the part of the California government to assume the financial risk associated with guaranteeing deposits of a public bank. Additionally, the state would need to evaluate whether any state deposit insurance scheme or guarantee of a public bank’s deposits conflicts with other provisions of California state law.\textsuperscript{119}

As discussed above, it might be possible for a state chartered credit union to obtain private deposit insurance that would be acceptable to the California Department of Business Oversight.

b. Bank Holding Company Requirements

\textsuperscript{118} The Fourth Corner Credit Union v. National Credit Union Administration, No: 1:15-cv-01634-REB. Comp. (D. Colo. 2016).

\textsuperscript{119} See, e.g., Cal. Const. art. XVI, § 6 (generally prohibiting the state or any political corporation or subdivision thereof to give or to lend its credit in aid of or to any person, including for the payment of the liabilities of any individual, association, municipal or other corporation).
Certain persons or entities that own or control a bank are deemed "bank holding companies" under federal law and, as a result, are subject to supervision by the Federal Reserve Board and various regulatory requirements. The Bank Holding Company Act of 1956 generally excludes from the definition of "company," and thus from the definition of "bank holding company," however, a direct government investor or any corporation that is majority owned by any state.\footnote{120} Therefore, a public bank owned by the State of California, as described in the Chiang Report, would not be a federal bank holding company. The language in the statute does not refer to a city, and it would be an issue of first impression with the Federal Reserve Board, but we believe that the Federal Reserve Board should also not consider a bank owned by the City of San Francisco to be a federal bank holding company.\footnote{121} It would be important that this view be taken as the consequences of a municipal public bank becoming a federal bank holding company would be dire. The Bank Holding Company of 1956, for example, limits the activities of a bank holding company to those that are "closely related to banking" or "financial in nature," requirements that a municipality could not meet. The policy purposes of these restrictions however, did not contemplate municipal ownership, hence the exception for state ownership.\footnote{122}

California law also includes a separate definition of "bank holding company" and associated regulatory requirements.\footnote{123} Unlike under the federal Bank Holding Company Act of 1956, however, the definition of "bank holding company" under California law includes any "person" that controls a bank, through stock ownership or otherwise.\footnote{124} An investment by either the City of San Francisco or by the State of California in a bank with a Commercial Bank Charter may therefore trigger regulations as a bank holding company under California law. In sharp contrast to federal law, however, it appears that the consequences of being deemed a bank holding company under California law are not as onerous and involve largely reporting and examination requirements, the contours of which may be able to be worked out with the California Department of Business Oversight. It may be helpful to make a written request to the commissioner for an opinion on whether the City of San Francisco would be considered a bank holding company under California law in this context and, if so, how the relevant regulatory exam and reporting requirements would apply.

For an investment by State of California or the City of San Francisco in a bank with a Public Bank Charter, we recommend that the statute establishing the public bank specify

\footnote{120 }12 U.S.C. § 1841(b), 12 C.F.R. § 225.2(d)(2); see also Letter from the Board of Governors of the Federal Reserve System to Patricia S. Skigen and John B. Cairns (Aug. 19, 1988).

\footnote{121 }We assume, based on the Owen Memo, that to establish a public bank, the City of San Francisco would have to form a separate corporation for that purpose. See Mem. from Thomas J. Owen, Deputy City Att'y, to John Avalos, Member, Board of Supervisors, Municipal Bank Formation, 5 (May 15, 2013).

\footnote{122 }For a discussion of policy purposes, see Saule T. Omarova and Margaret E. Tahyser, *That Which We Call a Bank: Revisiting the History of Bank Holding Company Regulation in the United States*, 31 Rev. Banking & Fin. L. 113 (2011).

\footnote{123 }A bank holding company under California law also must submit reports to and be subject to examination by the California Department of Business Oversight. See Cal. Fin Code §§ 1283, 1284.

\footnote{124 }Cal. Fin Code § 1280. The relevant definition of "person" under California Law includes "an individual, sole proprietorship, partnership, joint venture, association, trust, estate, business trust, corporation, joint stock company, limited liability company, unincorporated association, sovereign government or agency, instrumentality, or political subdivision thereof, or any similar entity or organization." (emphasis added) Cal. Fin. Code § 127.
whether the public bank would be subject to the federal and state statutory provisions regarding bank holding companies and, if so, how practically the regulatory requirements would apply.

The bank holding company provisions under federal and state law would not apply to the City of San Francisco’s ownership interest in a credit union.

c. Source of Strength Requirements

The federal banking laws also contain a statutory obligation that any “company” that controls an insured depository institution act as a “source of strength” to the insured depository institution.125 Regardless of whether the State of California or City of San Francisco technically are considered companies under the language of the statute, since the source of strength doctrine is a core principle of federal banking law, we suspect that the FDIC would be reluctant to grant deposit insurance to a public bank unless it had some assurances, likely from a capital maintenance or other contractual arrangement, that the policy goals of the source of strength doctrine would be satisfied. We read the references to equity capital in the FDIC Statement of Policy on Applications for Deposit Insurance to be implicit references to the source of strength doctrine.

d. Capital Requirements

A newly-established public bank would also be required to maintain a capital level higher than the regulatory minimum for at least three years under the FDIC’s rules for de novo banks. The FDIC’s manual on the deposit insurance application process states that obtaining FDIC insurance may be conditioned on the applicant’s satisfaction of minimum initial capital and ongoing capital maintenance for the three-year de novo period.126 Since each de novo bank is unique in terms of its business plan, management team, market competition and local economy, the FDIC does not prescribe a minimum dollar level of capital but instead considers the unique factors of each proposal and sets a minimum capital requirement based on an evaluation of the proposed institution’s market dynamics, anticipated size, complexity, activities, concentrations and business model.127 The FDIC will require higher capital if the proposal presents more than routine risk or novel characteristics.128 The FDIC states that the tier 1 capital-to-assets leverage ratio should be maintained at not less than 8% during the first three years of operation, and the de novo bank must also maintain an adequate allowance for loan and lease losses.129 The de novo bank’s business plan should not assume any new or additional capital raises during the first three years beyond the initial capital contributions made during the institution’s organization

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127 Id. at 18
128 For example, proposals involving monoline operations or high levels of non-core funding may need higher capital to mitigate the risks of engaging in a single line of business or operating with potentially volatile funding. Id. at 18.
129 Id.
We are aware of numerous instances where a de novo bank was required to maintain capital at levels well above 10% for an extended period of time due to perceived risks associated with the business model.

e. Restrictions on Covered Transactions

Section 23A of the Federal Reserve Act and its implementing regulation, Regulation W, apply to transactions between an insured bank and its affiliates. The term “affiliate” includes companies that control the bank, as well as companies controlled by such companies. Strict limitations on and collateral requirements for transactions with affiliates have been referred to as the “Magna Carta” of banking law. While government entities are generally not considered to be companies for the purposes of the banking laws, there is a risk that the FDIC, as a condition of granting deposit insurance, may seek to regulate transactions between the bank and its affiliates. In this context, the FDIC might define the public shareholders and potentially any other California governmental entities as affiliates of the public bank.

Transactions covered by 23A and Regulation W include loans and extensions of credit by a bank to its non-bank affiliate. Therefore, if the controlling shareholder municipality attempts to borrow from the bank, the transaction could be subject to the restrictions of Section 23A and Regulation W. As a technical matter, Section 23A, like the source of strength doctrine, should not apply to public shareholders and their affiliated governmental entities. Based upon the centrality of the affiliate limitations to banking law, however, we express concern that the FDIC might condition the grant of deposit insurance on some type of affiliate transaction limit.

The Bank of North Dakota, as a public bank without federal deposit insurance and created under a special statute, is not subject to this limitation. It makes loans to North Dakota governmental entities with some frequency. By avoiding federal deposit insurance, any limitations on transactions with affiliated entities would likely be governed by the California Department of Business Oversight.

f. Requirement that Municipal Deposits above the Insurance Limit be Collateralized

California state law, like that of many other states, requires that any California state governmental entity that deposits funds into a private commercial bank or credit union must seek collateral from that bank over the FDIC-insured amount. If a Commercial Bank

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130 Id.
133 The reason is that the term “company” as used in the statute has traditionally been read to exclude direct governmental entities.
Charter or Credit Union Charter were used, this requirement would apply. The Bank of North Dakota is exempt from this requirement. Amending this requirement would require a modification of a California statute.

3. Would such a public bank be able to access the Federal Reserve’s payments system, either directly or indirectly?

Illegal businesses tend to be cash businesses and the anti-money laundering statutes are designed to prevent cash derived from illegal activities from entering the banking sector. In today’s economy, legal businesses use cash less and less and rely instead on electronic payments systems to receive or transmit funds. We are not aware of a recent example in which an entire business sector, in transitioning from an illegal business model to a legal business model, found itself partly in and partly out of the banking and payments system. The state legal cannabis sector remains either solely cash or cash dominant. The current situation is neither ideal nor stable. As the Chiang Report notes, large amounts of cash make cannabis businesses, their employees and their customers targets of violent crime. In addition, state and local government agencies that collect tax and fee payments in cash from the cannabis industry incur added expenses, demands on staff time and risks to employee safety.

In the first stage of state-level legalization, cannabis businesses concentrated on access to bank deposit accounts. The essential purpose of a bank deposit account was to lessen the risks associated with a cash-dominant business model and to have access to the banking and payments system through the ability to write checks and make direct payments to employees, vendors and tax authorities. Before the Cole Memo and the FinCEN guidance, according to media reports, many state legal cannabis businesses relied, at least in part, upon subterfuge to obtain deposit accounts. The Cole Memo and the FinCEN guidance opened up the possibility for some state legal cannabis businesses to openly obtain bank accounts. Nonetheless, only a few banks and credit unions have been willing to do so, and these are generally small banks and credit unions that already had their own direct (via a master account with the local Federal Reserve Bank) or indirect (via a correspondent banking account with a larger bank) access to the payments system.

Attempts by de novo depository institutions to have both a cannabis-dominant business model and to get direct access to the Federal Reserve’s payment system have not been successful to date, although there are some lessons from these attempts that are of interest with respect to a proposed public bank in California. Colorado began by changing its law to permit the creation of a state-chartered cooperative for state legal cannabis businesses.

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137 Id.
138 Some have added cannabis banking as a new business line. One example is Salal Credit Union, a credit union in Seattle, Washington that has been operating for 65 years and announced that in addition to its prior business lines of providing retail banking, small business services, mortgages and dealer direct lending, it would add a new business line supporting cannabis businesses. See Cannabis Industry, Salal Credit Union, https://www.salalcu.org/business/cannabis-industry/.
businesses that could take deposits but which would not be required to have FDIC insurance. The Colorado cooperative statute required that the cooperative have direct access to a master account at a Federal Reserve Bank. No cooperatives have been chartered in Colorado.

In November 2014, the Colorado Division of Financial Services granted a credit union charter to Fourth Corner, whose members envisioned a business plan that would serve Colorado state legal cannabis businesses by providing banking services to licensed cannabis businesses and cannabis legalization supporters. Immediately after its state charter became final, Fourth Corner applied to the Federal Reserve Bank of Kansas City for a master account. Fourth Corner, which operated under the Traditional Plus Cannabis Business Model, was unable to open such a correspondent account. For most banks and credit unions, opening a master account at a Federal Reserve Bank is a routine matter that happens quickly.

After almost nine months, the Federal Reserve Bank of Kansas City denied Fourth Corner's application for a master account. It cited eight reasons for the denial: (1) as a de novo bank, there was no historical record for the Federal Reserve Bank to review; (2) insufficient information to assess Fourth Corner's ability to safely and soundly operate; (3) insufficient information to assess Fourth Corner's ability to comply with applicable laws and regulations, including the BSA and anti-money laundering responsibilities; (4) Fourth Corner's focus on serving cannabis businesses; (5) the illegality under the Controlled Substances Act to manufacture, distribute and dispense cannabis; (6) Fourth Corner had not demonstrated its ability to conduct appropriate enhanced monitoring requirements and manage its risk appropriately with respect to its customers with cannabis businesses; (7) Fourth Corner's business model focused on a newly licensed industry with relatively immature businesses operating in an environment of evolving laws and regulations; and (8)...
Fourth Corner’s lack of capital at inception would make it unable to absorb losses it may initially incur.144

Fourth Corner, citing the Cole Memo and FinCEN Guidance, sued the Federal Reserve Bank of Kansas City. Noting the continued nature of cannabis as a Schedule 1 drug under the Controlled Substances Act, the district court dismissed Fourth Corner’s lawsuit on the grounds that “courts cannot use equitable powers to issue an order that would facilitate criminal activity.”145 The district court also characterized Fourth Corner’s arguments that the Cole Memo and FinCEN Guidance provide tacit approval for providing banking services to cannabis businesses as “something of a sleight of hand,”146 stating that these statements suggest that “prosecutors and bank regulators might ‘look the other way’”147 and that the memo and guidance “does not change the law.”148

Fourth Corner appealed the district court’s decision to the U.S. Court of Appeals for the Tenth Circuit, which, in a per curiam opinion issued on June 27, 2017, ruled that the district court’s order was vacated and Fourth Corner’s claim was dismissed without prejudice.149 One judge would have largely agreed with the district court and dismissed with prejudice. A second judge was influenced by Fourth Corner’s mid-litigation change of strategy in which the credit union changed its business plan so that it would now only provide banking services to cannabis businesses when and if it became legal to do so under federal law. That judge was of the view that the case was no longer ripe, as Fourth Corner would need to reapply for a master account in light of its new business plan. The third judge opined that granting the master account to Fourth Corner, or any other chartered depository institution, was not discretionary, but his opinion assumed that Fourth Corner would operate pursuant to its new business plan and would not engage in illegal activity (i.e., it would not provide banking services to the cannabis industry while it was illegal to do so under federal law). The net result of the fractured views of the panel was a compromise position under which two of the three opinions from the judges on the Tenth Circuit panel affirmed the view that cannabis businesses remain illegal under federal law, but the dismissal was without prejudice.

Our view is that a well-capitalized public bank using the Commercial Bank Charter and following with the Traditional Public Bank Business Model (i.e., without any cannabis activities), should, over time, be able to open a master account at its local Federal Reserve Bank. We believe that a public bank with a Public Bank Charter should qualify as a “depository institution,” and to the extent it follows the Traditional Public Bank Business

144 Letter from the Federal Reserve Bank of Kansas City to Fourth Corner Credit Union, (July 16, 2015).
146 Id. at 1189.
147 Id.
148 Id.
149 The Fourth Corner Credit Union v. Federal Reserve Bank of Kansas City, No. 16-1016 (10th Cir. filed. June 27, 2017).
Model, the same conclusion should hold. The same analysis would apply to a credit union. The Bank of North Dakota has such an account. We expect that a solid business plan and the backing of the state or municipal government will overcome the non-cannabis related reasons given for the rejection of the Fourth Corner’s master account.

We believe, however, that it will be extraordinarily difficult for a public bank operating under the Traditional Plus Cannabis Business Model to open a master account with its local Federal Reserve Bank for all of the reasons that resulted in the Fourth Corner denial. Based on long experience working with the Federal Reserve System, we are of the view that neither the Federal Reserve Board nor any of the other Federal Reserve Banks will find the views of the one judge that viewed granting a master account as a nondiscretionary activity dispositive. Any such public bank would need to either await a change in federal law or be willing to sue its local Federal Reserve Bank after a denial in the hopes of a more positive outcome than that under Fourth Corner. It may be possible for a public bank operating under the Traditional Plus Cannabis Business Model to find a bank or credit union that is willing to engage in correspondent banking to give the public bank indirect access to the Federal Reserve’s payment system. Although Fourth Corner was unable to find such a bank or credit union, a well-capitalized public bank with a solid business plan may be in a different scenario. Of course, much will depend upon whether the Trump Administration continues the Cole Memo and the FinCEN Guidance.

It is unclear whether the SAFE Act would completely solve the problem of a master account for a de novo public bank. We believe that the policy behind the SAFE Act is intended to do so, but its actual language could be improved. The text of the bill speaks solely to preventing any “terminations” or actions against banks that provide services to cannabis businesses. It does not explicitly speak to providing charters, federal deposit insurance or master accounts to de novo banks. In light of Fourth Corner, it would make sense to clarify the intent, either through a language change or through legislative history.

Visa, MasterCard and American Express do not permit debit or credit card transactions by state legal cannabis businesses. As a result, retail cannabis businesses cannot

150 The Federal Reserve’s Operating Circular 1 governs account relationships and sets forth the terms under which a financial institution may open, maintain, and terminate a master account. Federal Reserve, Operating Circular 1 (effective Feb. 1, 2013). A “financial institution” is defined to include, among other entities, a “depository institution” as defined under section 19(b)(1)(A) of the Federal Reserve Act. That definition of “depository institution” includes any bank that is eligible to make an application to become an insured bank under section 5 of the Federal Deposit Insurance Act. 12 U.S.C. § 461(b)(1)(A). This would include any bank, banking association, trust company, or other depository institution that is both (i) engaged in the business of receiving deposits (other than trust funds), and (ii) incorporated under the laws of any state. See 12 U.S.C. § 1813(a)(2), 1815(a). A public bank that takes deposits and is organized as a corporation under California law, regardless of whether or not its deposits were insured by the FDIC or otherwise, should be able to qualify as a Financial Institution for purposes of Operating Circular 1.

151 The Federal Reserve Board filed an amicus brief in support of the Federal Reserve Bank of Kansas City’s position that the Reserve Bank had discretion to deny the master account.

152 For those who would like a deeper dive into the technical argument, it may be found here, Fourth Corner Credit Union v. Fed. Reserve Bank of Kansas City, No. 16-1016, at *19 (10th Cir. June 27, 2017).

153 Elain Pofeldt, Marijuana businesses find card processing still elusive, CreditCards.com, (January 19, 2016), http://www.creditcards.com/credit-card-news/marijuana-business-card-processing-elusive-1264.php. The FDIC has also become increasingly concerned in recent years about reputational risk posed by and to banks,
directly accept debit and credit cards at the point of sale and no sponsoring bank will knowingly process a credit card transaction for a cannabis business. These restrictions have led to a practice of placing a stand-alone third-party vendor ATM in the retail outlet with a security guard to allow cash purchases and avoid the use of credit cards. Despite these restrictions, based on assertions on websites, some cannabis businesses apparently manage to take credit cards.

4. Is there a viable argument under the Tenth Amendment to the U.S. Constitution that the provision of banking services by a public bank to state legal cannabis businesses is protected and that federal law would not apply?

Some cannabis sector advocates have suggested that the Tenth Amendment to the U.S. Constitution may provide a constitutional shield against certain types of federal regulation of a public bank that would operate under the Traditional Plus Cannabis Business Model. The Tenth Amendment provides in relevant part that “the powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.” Historically, the Supreme Court has interpreted the Tenth Amendment as evidence of a limiting principle in our constitutional system that prevents the federal government from encroaching on the rightful domain of state government. In the context of public banking for cannabis businesses, a Tenth Amendment issue may arise as a result of the particular method of regulation the federal government seeks to use to implement federal law—the Supreme Court has held that certain methods for implementing regulation violate principles of federalism protected by the Tenth Amendment. Some have also suggested that a Tenth Amendment issue might arise as a result of the application of laws that are generally applicable to private parties to a public bank.

Under applicable Supreme Court precedents, we do not believe that the Tenth Amendment would shield state-run businesses or institutions from the dictates of otherwise constitutional federal legislation, even if those organizations engage in activities that are integral or necessary to traditional state government functions. The Supreme Court firmly established in Garcia v. San Antonio Metropolitan Transit Authority that Congress has the specifically in connection with third-party payment processors, and has explained that in conducting due diligence of third-party payment processors, financial institutions must “assure themselves that they are not facilitating fraudulent or other illegal activity.” FDIC, Financial Institution Letter No. 43-2013, FDIC Supervisory Approach to Payment Processing Relationships With Merchant Customers That Engage in Higher-Risk Activities (Sept. 27, 2013), http://c.ymcdn.com/sites/www.onlinelendersalliance.org/resource/resmgr/fdic_letter_-_banks_can_proc.pdf.

154 There are concerns about the unregulated nature of many of these third-party ATM networks leading some in the cannabis sector to decline the ATM in the store model.


authority under the Commerce Clause to subject a state-run business to the same legislation applicable to private parties.\textsuperscript{159} The holding and reasoning in \textit{Garcia} would apply to otherwise constitutional legislation regulating the activities of a public bank with equal force. Framing the bank as a “public financial utility” would not change the analysis, as the Supreme Court was firm in \textit{Garcia} that the Court would not distinguish between different types of state activities based on whether or not the activities were “integral” or “necessary” to state governmental functions or whether or not the state government functions were “traditional” in determining whether federal law would apply.\textsuperscript{160} The Court strongly suggested that the only constitutional remedy for otherwise constitutional federal regulation of state-run businesses is through the “internal safeguards” of “state participation in federal government action. The political process ensures that laws that unduly burden the States will not be promulgated.”\textsuperscript{161}

Arguments that a public bank will animate policy considerations raised in \textit{Printz v. U.S.} or \textit{New York v. U.S.} are similarly unavailing. These cases establish the Supreme Court’s “anti-commandeering” doctrine, which prohibits Congress from compelling the executive officers or legislative representatives of a state to implement a federal regulatory program.\textsuperscript{162} A public bank would not invoke the anti-commandeering doctrine, as a public bank would not be asked to implement a federal regulatory program, and the Controlled Substances Act does not involve directives emanating from Congress to state officials. Instead, a public bank would be subject to the federal laws generally applicable to private parties. For example, action by a Federal Reserve Bank that denies a master account to a public bank with the Traditional Plus Cannabis Business Model would not constitute implementation of the Controlled Substances Act but application of the statute.

Based on the foregoing, we are of the view that the Tenth Amendment would not provide any special protections against the enforcement of otherwise constitutional federal laws regulating the cannabis-related activities of a public bank pursuant to the Traditional Public Bank Business Model. With respect to a public bank established pursuant to the Traditional Plus Cannabis Business Model, because the Tenth Amendment of the U.S. Constitution does not shield state-run businesses or institutions from federal regulation, even if those organizations perform activities that are “integral” or “necessary” to the “traditional” functions of state government, there is no viable constitutional argument that otherwise constitutional federal laws criminalizing cannabis would be overridden by the Tenth Amendment. Framing the bank as a “public financial utility,” as some policy advocates have done,\textsuperscript{163} would not change the analysis.

5. What legislation at the state or federal level would provide clearer solutions?

\textsuperscript{160} Id. at 546–47.
\textsuperscript{161} Id. at 556–57.
\textsuperscript{162} See \textit{Printz v. U.S.}, 521 U.S. 898, 925 (1997); \textit{New York v. U.S.}, 505 U.S. 144, 177 (1992); see also Stannard (claiming that an action against the Federal Reserve “could be buttressed by a Tenth amendment-oriented argument” raising the same points motivating the court in \textit{New York v. U.S.}).
\textsuperscript{163} Matt Stannard, \textit{Public Banking, Including the Banking of State Cannabis Revenue: Federal, California, and Local Legal Considerations}, Commonomics USA (Jan. 10, 2017).
The most definitive action that could alleviate many of the concerns addressed above would be to decriminalize cannabis at the federal level and to bring the entire cannabis business sector into a fully legal and tightly regulated framework. These sentiments are shared by California State Treasurer Chiang, who stated that it has "became apparent that a definitive solution to the cannabis banking quandary will remain elusive until the federal government removes cannabis from its official list of dangerous drugs or Congress approves safe harbor legislation protecting financial institutions that serve cannabis businesses from federal penalties," and that "there is no durable, failsafe solution to the banking problem until federal law is changed . . . ."

Although certain federal agencies have developed guidance to address the need for banking services in the state legal cannabis sector, the guidance did not nullify the Controlled Substances Act or federal money-laundering statutes and so does not change the fact that cannabis activities and businesses remain criminal under federal law. The success of any endeavor to provide financial services for the state legal cannabis sector will be impacted by any drug policy and enforcement decisions by the Trump Administration. If the decriminalization of cannabis is not feasible in the short term, the SAFE Act provides the next best alternative for cannabis businesses to obtain access to banking services. While not a perfect solution, the SAFE Act would provide a more feasible alternative than the Cole Memo and the FinCEN Guidance.

III. Possible Next Steps

Given the difficulties in establishing and operating a public bank with a possible Commercial Bank Charter or Credit Union Charter under California law, whether pursuant to either the Traditional Public Bank Business Model or the Traditional Plus Cannabis Business Model, possible next steps would be:

1. Support efforts to decriminalize recreational and medical cannabis use by removing it from the list of Schedule 1 drugs under the Controlled Substances Act. Assist in the implementation of the recommendation from the Chiang Report to establish a multistate consortium of cannabis legal states, local governments, cannabis and financial services industries and law enforcement to pursue other potential changes to federal law that would remove the

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164 Even aside from banking services, it is clear that a legal cannabis business would need to be subject to significant regulation in other aspects as well. For a discussion of what a regulatory situation might look like, see NACB Guiding Document, National Association of Cannabis Businesses, https://nacb.com/ (NACB is the cannabis sector’s first self-regulatory organization).


166 Alternative legislative solutions may also be under discussion. One alternative solution that has been termed “cooperative federalism” by some would be to amend the Controlled Substances Act to provide that states that meet specified criteria, such as those set forth in the Cole Memo, could opt out of the provisions of the Controlled Substances Act relating to cannabis. See, Erwin Chemerinsky, Jolene Forman, Allen Hopper and Sam Kamin, Cooperative Federalism and Marijuana Regulation, 65 UCLA L. Rev. 74 (2015). Because this solution is not specific to banking and financial services, it could in many aspects potentially provide broader relief than the SAFE Act, but it may also be less likely to receive the political support necessary to be approved by Congress and signed into law.
barriers to cannabis banking. In our view, only a significant change in federal law will provide a stable platform for the Traditional Plus Cannabis Business Model. We are aware that changes and pressure brought at the state level, such as the possible passage of a public bank statute or the use of a state credit union charter with private insurance, might focus Congress on the need to provide a more stable solution for banking state legal cannabis businesses, but we view federal action as being essential.

2. As a next best alternative to removing cannabis from the list of Schedule 1 drugs, support the passage of the SAFE Act. It would also make sense to advocate for amending the text of the SAFE Act to address directly providing charters, federal deposit insurance or master accounts to de novo banks and credit unions in order to remove any ambiguity. The Respect State Marijuana Laws Act of 2017 is another potential solution, but providing an explicit safe harbor in the Act for financial institutions should be considered.

3. Assist in the development of the feasibility study of a public bank owned by the state, as recommended by the Chiang Report, and work with the California Department of Business Oversight, the John Chiang Cannabis Banking Working Group and certain other parties referenced in the Chiang Report, such as the California Department of Justice and Office of the Attorney General, to encourage the California legislature to pass a special statute that would establish a Public Bank Charter that would not need federal deposit insurance and could tailor its business plan, governance models, source of strength obligations and standards for affiliate transactions to its public sector shareholders and the policy goals of the model. We believe it would be useful to enlist the support of private banks in California.

4. Consult with the California Department of Business Oversight to pre-vet the possible use of a Commercial Bank Charter or Credit Union Charter and discuss whether the use of private deposit insurance is a viable option. It may be advisable to seek a written opinion from the California Department of Business Oversight on some points.

5. Consult with the FDIC about the circumstances under which it would provide federal deposit insurance to a public bank with the Traditional Public Bank Business Model.

6. Assist in the other recommendations from the Chiang Report to develop a data portal of compliance and regulatory data for financial institutions that provide services to state legal cannabis businesses and to consider safer, more effective ways to handle the payment of taxes and fees in cash.

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