



---

---

# 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 legislative 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