



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,¹ and Supervisor Sandra Fewer, who sought a Budget and Legislative Analyst report on the topic.

A public or municipal bank² 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”).³ However, Puerto Rico previously had a public bank—the Puerto Rico Development Bank—which was liquidated in summer 2017,⁴ and American Samoa is currently founding a public

¹ City and County of San Francisco Board of Supervisors, Resolution 152-17, retrieved from: <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.

⁴ Scurria, A. (2017, April 28). Puerto Rico Government Development Bank Opts to Liquidate. *The Wall Street Journal*, retrieved from: <https://www.wsj.com/articles/puerto-rico-government-development-bank-opts-to-liquidate-1493386141>.

bank—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?

⁵ Blackwell, R. (2017, July 31). How Far Does American Samoa Have to Go to Get a Bank? *American Banker*, retrieved from: <https://www.americanbanker.com/news/how-far-does-american-samoa-have-to-go-to-get-a-bank>; Email correspondence with Makerita T. Polu, Chief Operations Officer, Territorial Bank of American Samoa.

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.⁷ 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.⁸ 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.⁹ 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.¹⁰ 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.¹¹ 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.¹² 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.¹³ In

⁷ Judd, J. and McGhee, H. *Banking on America: How Main Street Partnership Banks Can Improve Local Economies*. New York, NY: Demos, retrieved from: http://www.demos.org/sites/default/files/publications/Demos_NationalBankPaper.pdf.

⁸ Swayze, David S. and Christine Schiltz (Spring 2013), *State-Owned Banks: A Relic of the Past or the Wave of the Future?*, *Delaware Banker*, Delaware, retrieved from: <https://www.pgslegal.com/wp-content/uploads/2017/07/Spring-2013-Delaware-Banker-Article.pdf>

⁹ *Id.* at 13.

¹⁰ Swayze and Schiltz, at 13.

¹¹ Bank of North Dakota. *Public*. Retrieved from: <https://bnd.nd.gov/public/>

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*

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.¹⁴ 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.¹⁵

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.¹⁶ 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.¹⁷ In time, the city could expand the role of the limited-purpose depository institution to take over the banking and cash management work currently done by outside banks.¹⁸ 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.

Money to Work for Massachusetts: Introducing the Massachusetts Partnership Bank. Retrieved from: <http://www.demos.org/sites/default/files/publications/MA%20Paper%20Final.pdf>.

¹⁴ Swayze and Schiltz, at 14.

¹⁵ *Id.* at 14.

¹⁶ Beitel, K. (2016). *Municipal Banking: An Overview*. New York, NY: Roosevelt Institute (p. 8), retrieved from: <http://rooseveltinstitute.org/wp-content/uploads/2016/04/Municipal-Banking-An-Overview.pdf>.

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.¹⁹ 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 law²⁰ by securing a Federal Home Loan Bank (“FHLB”) line of credit.²¹ 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,²² 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.²³

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

¹⁹ Beitel, K. (2016). *The Municipal Bank: Regulatory Compliance, Capitalization, Liquidity and Risk*. New York, NY: Roosevelt Institute, retrieved from: <http://rooseveltinstitute.org/municipal-bank-regulatory-compliance-capitalization-liquidity-and-risk/> (hereinafter “The Municipal Bank”).

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).

²³ Beitel, *The Municipal Bank*, at 13-15.

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

²⁴ Mass. Gen. La. ch. 240, § 180(a), retrieved from: <https://malegislature.gov/Laws/SessionLaws/Acts/2010/Chapter240>.

²⁵ Kodrzycki, Y. and Elamatad, T. (2011). *The Bank of North Dakota: A model for Massachusetts and other states?* Boston, MA: Federal Reserve Bank of Boston, retrieved from: <http://www.monetary.org/wp-content/uploads/2016/03/The-bank-of-north-dakota-a-model-for-mAss.pdf>

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.

³⁰ *Report of the Commission to Study the Feasibility of Establishing a Bank Owned by the Commonwealth.* (2011). Retrieved from: <https://www.politico.com/states/f/?id=0000015b-5330-d932-a97b-f3fc404f0001>.

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.³² Taking matters into their own hands, in December 2013, an advocacy coalition called “Vermonters for a New Economy” commissioned a public bank feasibility report.³³ 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.³⁴ 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.³⁵ 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.³⁶

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.”³⁷ 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.³⁸

³² 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>.

³³ 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.

³⁴ *Id.* at 4.

³⁵ *Id.* at 10-11.

³⁶ *Id.* at 16-17.

³⁷ *Id.* at 17.

³⁸ *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

³⁹ Banking on New Mexico. *A Public Bank for Santa Fe*. Retrieved from: <http://bankingonnewmexico.org/>.

⁴⁰ Updike, K. et al. (2016). *Public Banking Feasibility Study Final Report for the City of Santa Fe*. Retrieved from: bankingonnewmexico.org/pdf/Final_Report_on_Public_Banking_Santa_Fe.pdf.

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.”⁴⁶

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.⁴⁷

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?⁴⁸

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.⁴⁹ 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.⁵⁰

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.⁵¹ A legitimate municipal purpose can be broadly defined and can include goals such as affordable housing and lending to small

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.

⁵³ State Treasurer’s Cannabis Banking Work Group (November 2017). *Banking Access Strategies for Cannabis-Related Businesses*, Sacramento: California, retrieved from: <http://www.treasurer.ca.gov/cbwg/resources/reports/110717-cannabis-report.pdf>.

⁵⁴ Id.

⁵⁵ Davis Polk & Wardwell, *Bank Regulatory Considerations Related to Establishing a Public Bank in the State of California*, retrieved from: http://clkrep.lacity.org/onlinedocs/2017/17-0831_misc_12-13-17.pdf.

- 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,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.”⁵⁷
- FDIC Insurance – Under California law, all state-chartered commercial banks must obtain federal deposit insurance.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.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.”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.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.⁶²

⁵⁶ Federal Reserve Bank of San Francisco, *Membership*, retrieved from: <https://www.frbsf.org/banking/regulation/applications-membership/information/>.

⁵⁷ Davis Polk & Wardwell, *Bank Regulatory Considerations Related to Establishing a Public Bank in the State of California*.

⁵⁸ Cal. Code Regs. Tit. 10 § 10.3520 (2017).

⁵⁹ Cal Gov’t Code § 53652.

⁶⁰ Budget and Legislative Analyst’s Office (2011). *Memorandum re: Community Supportive Banking Options 2011* retrieved from: http://www.sfbos.org/ftp/uploadedfiles/bdsupvrs/committees/materials/cons102411_111056.pdf

⁶¹ Budget and Legislative Analyst’s Office (2017, Nov. 2017). *Memorandum re: Community Supportive Banking Options 2017*, retrieved from: http://s79f01z693v3eco3s3yyjsg1.wpengine.netdna-cdn.com/wp-content/uploads/2017/12/BLA.CommunitySupportiveBanking_112717.pdf.

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.⁶³ 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.⁶⁴

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.⁶⁵ 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.⁶⁶ 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.”⁶⁷ 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 “[i]deally, a legislative solution would be approved in State or federal law that delineates the structure for a public bank.”⁶⁸ The report next details LA’s banking and investment practices, explaining

⁶³ Id. at 36-38.

⁶⁴ Id. at 51-52.

⁶⁵ Los Angeles Motion Wesson-Krekorian CF 17-0831, retrieved from: http://clkrep.lacity.org/onlinedocs/2017/17-0831_mot_07-26-2017.pdf.

⁶⁶ Chief Legislative Analyst (2018). *Public Banking Framework and Existing Housing and Economic Development Funding Programs*, retrieved from: http://clkrep.lacity.org/onlinedocs/2017/17-0831_rpt_CLA_02-26-2018.pdf.

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.⁶⁹ 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.⁷⁰

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

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⁶⁹ Id. at 52.

⁷⁰ Id at 54.