

# REPORT OF THE CHIEF LEGISLATIVE ANALYST

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TO: Honorable Members of the City Council

FROM: Sharon M. Tso *KEK*  
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## PUBLIC BANK FORMATION PROCESS

### SUMMARY

The passage of AB 857 creates a process for local jurisdictions to apply for a Public Bank license similar to the requirements of forming a Commercial Bank. Motion (Wesson-Bonin-Koretz, CF 19-1235) instructs the CLA to report on the scope and costs to obtain consultant services to prepare an application to form a public bank to serve the City of Los Angeles.

This report provides a summary of AB 857 and identifies a potential scope for studies and legal services to inform decisions related to applying for a public bank license. The cost for such studies is not currently known. The process to obtain the studies would include the release of a Request for Proposals (RFP), review and selection of consultants, and development of data and studies to advise the Council.

This report also advises that a decision to form a public bank would require a ballot measure to obtain approval from the voters to move ahead with bank formation. In addition, information is provided concerning the development of State regulations on public bank formation, which are not expected to be approved until late 2021, and findings from a study conducted for the City of San Francisco on public bank formation in that jurisdiction.

### RECOMMENDATIONS

That the City Council:

1. Authorize the Chief Legislative Analyst to release a Request for Proposals (RFP) seeking consultant services needed to conduct policy, fiscal, and economic analyses related to the formation of a public bank serving the City of Los Angeles;
2. Request the City Attorney to retain outside counsel to advise and assist in the preparation of necessary documents related to the formation of a public bank serving the City of Los Angeles; and
3. Instruct the CLA to report with the results of the RFP selection process and a source of funding for the necessary studies.

### FISCAL IMPACT

There is no fiscal impact on the General Fund associated with this action.

## **DISCUSSION**

Motion (Wesson-Bonin-Koretz, CF# 19-1235), adopted by Council on December 12, 2019, instructs the CLA to report on the scope and costs to obtain consultant services to prepare an application to form a public bank to serve the City of Los Angeles. Upon the passage of AB 857, the State of California has created a process for the formation of public banks in the State through the commercial bank process. Using this authority, the City is now able to actively pursue formation of a public bank within a known legal structure.

This report provides the following:

- Summary of AB 857
- Proposed scope for studies related to formation of a public bank
- Discussion of costs for the necessary studies
- Development of State regulations
- Consideration of Charter amendments
- Summary of a study commissioned by the San Francisco Treasurer on municipal banking in that jurisdiction

### **Summary of AB 857**

AB 857 (Chiu) establishes a process under State law for a local agency to apply for a public bank license from the Department of Business Oversight (DBO). The local agency would need to meet the same general requirements and approval criteria as existing law requires of a private sector applicant, including deposit insurance provided by the FDIC. A public bank under AB 857 would be a non-profit mutual benefit corporation, and it is the intent of the legislation that a public bank will partner, and not compete, with local financial institutions.

Under the proposed bill and existing law, both the DBO and FDIC would provide routine supervision and examinations of a public bank to evaluate the nature of the bank's operations, the adequacy of the bank's internal controls and its internal audit function, and the bank's compliance with laws and regulations. If weaknesses are identified, the regulators have tools to correct deficiencies in the bank's risk management practices and address weaknesses in the bank's operations.

In addition to FDIC insurance, existing law provides protections for taxpayer dollars that may be deposited in a public bank. After the bankruptcy of Orange County in the mid-1990s, the Legislature passed laws requiring that funds deposited by a local agency must be protected with special collateral requirements established for local jurisdictions, which govern amounts to be maintained and instruments that qualify as collateral. These requirements ensure that taxpayer funds are protected, even if the size of the local agency's deposit account is greater than the FDIC protection limit of \$250,000. This bill does not exempt a public bank from these collateral requirements.

### **Public Bank Study**

City staff do not have the expertise with federal or State banking law or financing to conduct the analyses or modeling necessary to provide the Council with the information necessary to inform decisions related to formation of a public bank. Consultants will be required to prepare the

policy, financial and legal analyses needed to develop a successful institution. Consultants will require experience with State and federal banking regulations, commercial banking structures and services, municipal finances, and financial modeling.

Consistent with the Motion, the CLA would retain a consultant with the policy and financial skills required to conduct the necessary studies. The City Attorney, however, will need to hire outside counsel with expertise in banking law.

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.

In response to the July 2017 Motion, the CLA provided a report on February 26, 2018, that evaluated public banking. In the conclusion of the report, the CLA identified a proposed scope of work for a consultant team to prepare and present additional information to advance the formation of a public bank in Los Angeles. The proposed scope remains relevant to the work needed to prepare an application to form a public bank, and includes the following tasks:

- develop a detailed statement of purpose for a public bank, including a description of services it would offer and its mission with regard to social, ethical, and environmental standards;
- evaluate formation options for a public bank, including a detailed analysis of issues such as a 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 a public bank.
- identify a management and oversight structure for a public bank 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 Community Reinvestment Act (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 a public bank would create new financial capacity that would benefit the economy; and a comparison of current financial impact of the City compared to the costs associated with starting and operating a bank.

These scope of work elements would be the basis for a Request for Proposals (RFP) seeking consultants with commercial banking policy and financial experience. In addition, the RFP would also include the following optional task:

- prepare an application to form a public bank for submission to the State Commission on Business Oversight

It is recommended that the CLA release an RFP that includes a scope of work substantially as indicated above.

### **Cost of Study**

Studies completed by other jurisdictions for the formation of public banks have relied upon a combination of volunteer assistance, consultants, and staff resources. The City of San Francisco obtained consultant services, at a cost of \$90,000, to support analysis requested by their Municipal Bank Task Force, but city staff prepared the reports.

Due to the complexity of this process, it is recommended that the consultants be retained to conduct the necessary analyses and provide reports as needed. City staff would serve to manage the consultant work program and report to Council on the results.

It is not possible at this time to estimate the cost of the studies and services needed. There is no allocation of funding in the budget for this purpose. At this time, it is recommended that the CLA release an RFP for Consultant Services, including the scope presented above, subject to availability of funds. Concurrently, the City Attorney should be requested to seek outside counsel. When results of the CLA's RFP process and the City Attorney's process are complete, the CLA can report to Council with the results and a request for funds. The recommendation at that time would also identify a source of funds for these services.

### **Additional Considerations**

The passage of AB 857 has raised additional questions about the formation of a public bank. The following addresses key implementation questions.

#### Department on Business Oversight (DBO)

The DBO defines, regulates, and enforces banking laws in the State. AB 857 requires that the DBO include public banks within its regulatory oversight, including developing regulations for

public bank oversight. The DBO process for developing regulations includes development of the proposed regulations, public review and comment, preparation of final regulations, and publication of the final regulations. This process is expected to be completed in late 2021.

The DBO suggests that applications for a public bank would not be rejected should they be submitted prior to the completion of the implementing regulations. AB 857 provides that a public bank is similar to a commercial bank, so the application process will likely be similar to that for a commercial bank. It is not clear how the regulatory process will develop or whether targeted regulations will emerge. Proceeding with the formation of a public bank before State regulations have been finalized could carry some risk that cannot currently be identified. It would likely be premature to prepare an application to form a public bank at this time, but it would be beneficial to begin the study process and develop a better understanding of the full suite of financial issues that require full analysis in order to prepare an application to form a public bank under California State law.

- ▶ Council and Mayor will need to determine whether the City should proceed with the application process to form a public bank prior to the completion of State regulations for public banking in California.

#### Voter Approval

Before submitting an application to form a public bank, a jurisdiction must receive voter approval, except for a Charter City. Since the City is a Charter City, it would be exempt from this provision of State law. The City Charter, however, has a provision that prohibits the City from operating any purely commercial or industrial enterprise, except upon approval of the voters.

The provisions of AB 857 require that the public bank be formed as a nonprofit corporation, suggesting that the public bank would not be a commercial operation. Further, AB 857 prohibits a public bank from competing with commercial banks and that it should partner with a commercial bank or credit union. These provisions of AB 857 suggest that any proposed public bank established by the City would not be a purely commercial operation. The City Attorney has determined, however, that commercial in this context does not relate to profit or partnership, but rather to the activity of banking services. Since those services are purely commercial and governed by commercial banking law, a public bank would be considered “purely commercial” and would require voter approval.

Prior to the passage of AB 857, the City placed a measure before the voters to provide authority to form a public bank. The voters rejected that measure by a vote of 44 percent in favor and 56 percent in opposition. If the Council and Mayor determine to proceed with formation of a public bank to serve the City, the application to the State should be completed and presented to the voters for consideration. Though not required under State law, this would be consistent with the intent of State law.

Should Council place a measure before the voters, a determination will need to be made as to the content of the question. The ballot measure could present a simple question as to whether the City should form a public bank. Alternately, a more detailed question could be presented that

summarizes the purpose and function of the public bank or even a full copy of the application for the public bank that would be submitted to the DBO.

In addition to the broad question of whether or not the City should form a public bank, there are additional Charter provisions that affect operations that would require voter consideration. As noted in our report of February 26, 2018, 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 monies 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 a public bank. Any change to the Treasurer’s fiduciary authority or depository options would require a Charter amendment in addition to potential changes in State law.

### Ballot Timing

Should the Council place the question of forming a public bank before the voters, the first deadline to present a measure to the voters for the November 2020 election is June 19, 2020. Since the City will not have completed the necessary fiscal studies as outlined in AB 857 for the formation of a public bank or completed a draft application to form a bank by that date, the November 2020 ballot does not seem to be the likely or prudent ballot for consideration. If the intent is to prepare a full fiscal analysis before presenting the voters with a measure, then the likely ballots would be either March or November 2022.

Since the State DBO regulations are expected in late 2021, the City’s application could be finalized in the Winter and Spring of 2022, allowing Council and the Mayor to fully review and approve the application in time to place the measure on the November 2022 ballot. For reference, the Council and Mayor must decide to place a measure on a ballot approximately five months prior to an election. To place a measure on the November 2022 ballot, an action of the Council would be required by June 2022.

### **San Francisco Municipal Bank Report**

In March 2019, the San Francisco Office of the Treasurer and Tax Collector issued a report titled “Municipal Bank Feasibility Task Force Report.” The report identifies three models for the formation of a municipal bank and models the capital requirements necessary for implementation. The report evaluated three models to address municipal banking:

1. Reinvest. This is a non-banking model that would invest city funds in housing and small business loans.
2. Divest. This is a banking model that would transfer all city banking services, including cash management and commercial banking functions, to a city-owned municipal bank.

3. **Combination.** This is a combination of the first two models, with a housing and small business loan program and city cash management and commercial banking functions provided by a city-owned municipal bank.

The following provides a summary of the start-up costs, operational subsidy, and capital investment required for each of these models.

	Model 1 Reinvest	Model 2 Divest	Model 3 Combination
Break Even Details			
Years to Break Even	10	31	56
Size at Breakeven	\$1.1 billion	\$3.1 billion	\$10.4 billion
Estimated Appropriation Required to Break Even			
Start-up Costs	\$6 million	\$119 million	\$119 million
Operational Subsidy	\$13 million	\$990 million	\$2.2 billion
Capital Investment	\$165 million	\$460 million	\$1.6 billion
Total	\$184 million	\$1.6 billion	\$3.9 billion

Source: San Francisco Office of the Treasurer and Tax Collector, "Municipal Bank Feasibility Task Force Report."

The report also provided a discussion of other policies and programs that could achieve similar objectives to those of a municipal bank. These include managing existing banking services differently, such as breaking up contracts into smaller portions; establish non-bank lending programs; promote and expand existing lending programs; and expand financial literacy programs.

The consideration of public bank formation in the City of San Francisco is currently under evaluation by the San Francisco Local Agency Formation Commission.

  
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 John Wickham  
 Analyst