

PUBLIC BANK LA

March 22, 2018

Chief Legislative Analyst
City Administrative Officer
Office of Finance

Re: Report of the Chief Legislative Analyst on the Municipal Bank of Los Angeles, CF 17-0831

Dear Chief Legislative Analyst, City Administrative Officer, and Office of Finance,

We commend the Los Angeles City Council via the Ad Hoc Committee on Comprehensive Job Creation Plan on the historic step forward to explore the feasibility and potential benefits of a Municipal Bank of Los Angeles (MBLA). As a publicly owned institution, the MBLA's business practices must take the public good into highest consideration, promote sustainable community development, save the city money, generate new revenues, and reinvest its profits to promote long-term sustainability.

The Municipal Bank of Los Angeles would provide a public alternative to the vital function of banking, maintaining fiduciary responsibility while also upholding social obligations within an ethical framework. The MBLA holds the potential to improve many areas that directly impact our communities including: low-income housing, small business development, infrastructure and energy, and serving the needs of unbanked and underbanked populations.

The February 26, 2018 Report of the Chief Legislative Analyst identifies key areas for consideration associated with forming the Municipal Bank of Los Angeles. Public Bank LA has outlined recommendations addressing some of the required legislative and regulatory amendments to both the city charter and state charter to allow for a municipal bank to operate.

Collateral for City Funds

Current state and city law requires high collateral requirements for banks holding public deposits. This necessary precaution comes from the need to reduce the risk of entrusting public funds to a third party institution. We believe that the need for this type of deposit collateralization should not and will not apply to a public bank. Because the state does not have the ability to conduct day-to-day oversight of a commercial bank's assets, the law requiring deposit collateralization over the Federal Deposit Insurance Corporation (FDIC)-insured amount was understandably put into place to ensure the safety and security of public deposits.¹ When the city owns a public bank, the deposit and reserve levels will be set to meet the cash management needs of the city, which will amount to lower collateral requirements than would be demanded of private depository institutions.

¹ Cal Gov't Code § 53652.

PUBLIC BANK LA

Insurance

Current state and city law requires FDIC deposit insurance for all banks, including those holding public funds. The FDIC was created out of the social contract for government to guarantee the safety of our deposits and, to this day, deposit insurance is something that banks provide -- but not all banks. In contrast to most commercial banks, the Bank of North Dakota (BND) is not a member of the FDIC. North Dakota Century Code 6-09-10 provides that all BND deposits are guaranteed by the full faith and credit of the State of North Dakota. North Dakota's position stems from a recognition that it is the taxpayers who provide the guarantee, insurance or no insurance, so they opt for a conservatively-run bank, thus rendering superfluous the need for costly deposit insurance. MBLA would likely follow the same route, either self-insuring deposits from a guarantee by taxpayer, or through private, non-FDIC insurance approved by the Department of Business Oversight. This would provide the city with the necessary independence and assurance that public deposits are safe and secure.

Capitalization

The chief legislative analyst proposed a number of potential capitalization methods which we agree should be considered as part of founding a public bank.

Corporate Bond - The bank will be an independent financial institution and can borrow on its own credit, as established by the city's deposit guarantee and ongoing interest. The bank could debt finance its capitalization and depend on income from bank activities or direct appropriation to pay debt service and build equity.

Special Tax - A special tax could be levied to create an income stream sufficient to cover some expenses of the bank, including debt service on founding capital. This tax could be targeted to discourage predatory loan practices within the city limits while providing the funds to create a real public alternative for consumers down the road.

State Funds - The state of California has a rainy day fund nearing \$8B. Los Angeles, along with other cities considering municipal banks, could petition the state to invest that fund in these banks. The bank could then provide a letter of credit to the state, providing it with liquidity it needs to support emergency services and budget shortfalls. By investing the rainy day fund in municipal public banks, Los Angeles taxpayers (who make up a large share of contributions) would actually benefit from these funds held by the state.

Investment Portfolio - The city's longer term assets could be used to fund the bank through corporate debt issued by the bank, or directly as equity capital.

General Obligation Bond - We hope the committee will ask the CLA to elaborate on the reasons they believe a general obligation bond issued by the city could not be used to capitalize a municipal bank. We believe this is a viable avenue and should be precisely explored.

We also dispute the amount of \$3.6B as a minimum capitalization as cited by the CLA from the Boston Federal Reserve. The FRBB's method of calculating these costs (at p.19) is dubious at best. The report takes the BND's \$2 million capitalization in 1919, multiplies by 12.5 "adjusting for inflation," then multiplied by another 13 adjusting for "growth," to come up with a figure of

PUBLIC BANK LA

\$325 million. The number is then scaled up again for the size of the Massachusetts economy to arrive at \$3.6 billion as the amount of capital needed to start a bank. We along with public banking experts including Ellen Brown believe this is double-counting. Moreover, there are much more accurate ways of determining capitalization requirements for a modern bank than looking at banking requirements in 1919.

Capitalization needs vary, depending on how large the legislature wants the bank to be. A bank today could be started with as little as \$20 million. The bank can start small and grow. Moreover, its capital base does not need to come from the budget or from tax revenues. “Capital” is an equity investment, not an expenditure. It can come from existing rainy day funds and other investment funds sitting idle, or from a bond issue.

City Charter Amendment

We agree with the CLA report that the city charter may currently prohibit or complicate the necessary functions of a municipal bank. Just like the insurance and collateral requirements cited above, those limitations are justly in place to protect public funds and public trust. A municipal bank would be obligated by its charter and state law to adhere to the prudent investor standard, and to maintain strict transparency, governance, and conflict of interest policies to ensure the safety of all its deposits.

A similar City Charter amendment may be required to designate MBLA as the depository for the Department of Water and Power, Department of Airports, and Harbor Department, if voters agree that those institutions would likewise benefit.

We agree that an amendment to the city charter is necessary to establish a public bank, and that such an amendment would require the city to deposit its funds in a municipal bank, curing the Treasurer of any need to seek competitive bids from depository institutions. Beyond that, the Treasurer and other city offices will be free to seek competitive bids for its debt and other commercial banking services that the bank does not actively provide.

State Charter Amendment

Currently, state law requires cities to choose a nationally or state-chartered commercial bank, savings bank, savings and loan association, or credit union for its deposits and investments. This law would either require MBLA to be established under existing laws as a chartered financial institution, or State law would need to be amended to recognize the organization structure under which MBLA is formed.

State law would also need to be adjusted to define the Treasurer’s fiduciary independence for management of public funds as including the use of a public bank, if one is established.

Public Bank Charter

Public Bank LA and public banking advocates from around the state have proposed a bill directing the Department of Business Oversight to create and administer a Municipal or Regional Public Banking License that would permit the department to issue bank charters to California charter cities, or Joint Powers Authorities qualified to apply under this license. Such a

PUBLIC BANK LA

charter or license would allow and require a municipal or regional public bank to:

- Operate, lend, and take deposits from qualified depositors within the borders of a defined 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 for public funds and affiliate transaction restrictions that would prove antithetical to the bank's purpose;
- 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;
- Maintain active membership in an Association of California Public Banks and adhere to its rules, best practices or other directives.
- Adhere to strict social and environmental responsibility standards in its lending and business practices;
- Provide loans for worker cooperatives, public housing, for both new construction and capital improvements;
- A restriction on investment in fossil fuels, tobacco, weapons, private prisons, companies with hidden overseas wealth or unethical business or labor practices;
- Provide online depository banking services to residents where private banking has not met the depository banking needs of the market in the municipality (e.g. the underbanked and unbanked);
- Will be prohibited from providing commercial loans directly to businesses except in partnership with banks (i.e. Community Banks and Credit Unions) active in the city or region that are accepted by the Governance Committee;

Prudent Investor Rule

The CLA states that to ensure social, ethical and environmental standards, a fiduciary must violate the prudent investor rule, and that the only considerations when choosing an investment are to preserve capital, ensure adequate liquidity, and obtain a sufficient rate of return. We believe this is inaccurate, as the city considers far more than these factors when awarding contracts or acquiring debt, including the long term fiscal position of the city, conflicts of interests, public interest, and federal credit and CRA ratings. In fact, the city considers a whole myriad of factors when making investments or committing resources, as well it should. The social and environmental impacts of city activities are of primary concern, especially when the unsustainability and liabilities presented by those investments threaten city funds down the line. Homelessness, climate change, and aging infrastructure here at home have a material impact

PUBLIC BANK LA

on the city's fiscal health and growth. Failing to consider these externalities when choosing a bank or bond issuer is an abdication of the prudent investor rule. Nothing about a public bank's mission would interfere with this requirement, beyond the adjustments listed above.

Loan Programs

We ask the council to instruct the CLA and CAO to provide a full review of the city's loan programs, including their default rates, credit policies, and earnings, as part of this exercise. Revolving loan programs are not the same as a public bank. These programs are less than ideal as both social impact programs or lending portfolios seeking a return, and are unlikely to compete with the leverage and expertise of a properly staffed public bank. We recommend the city fold these programs into the public bank or turn them into direct spending programs so they can fund projects outside of traditional underwriting profiles.

Sincerely,
Public Bank LA

cc: Ad Hoc Committee on Comprehensive Job Creation Plan
Councilmember Krekorian
Councilmember Wesson
Councilmember Blumenfield
Councilmember Harris-Dawson
Councilmember Englander