CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

RULES COMMITTEE: 5/15/19
ITEM: G.3

CITY COUNCIL ACTION REQUEST			
Departments: Finance City Manager's Office	**Date:** 5/8/19	**Coordination:** City Attorney's Office	**Dept. Approval:** /s/ Julia H. Cooper /s/ Lee Wilcox **CMO Approval:** D-DSyL

SUBJECT: AB 857 (CHIU AND SANTIAGO): PUBLIC BANKS

RECOMMENDED POSITION: Support if Amended

RECOMMENDED ACTION:

1. Adopt a support if amended position on AB 857 (Chiu and Santiago) on public banks.

2. Recommend this item be agendized for the May 21, 2019 City Council Meeting so that the City's Legislative Representatives can advocate the City's position for AB 857.

BILL SYNOPSIS:

AB 857 (Chiu and Santiago) would set state rules around public banks and allow a local government or two or more local governments together to charter its own public bank to provide banking services to the local community. Local governments include a city, county, or a joint powers authority. The public bank would identify in its articles of incorporation either a social purpose or a public benefit such as supporting community economic development, addressing local infrastructure and housing needs, and providing banking services to the unbanked or underbanked. AB 857 requires public banks to obtain and maintain Federal Deposit Insurance Corporation (FDIC) insurance, and to comply with all requirements of the Financial Institutions Law and the Banking Law. The bill authorizes a public bank to engage in a variety of banking activities including infrastructure lending, wholesale lending, participation lending, and retail lending.

Recent amendments to AB 857 also require that the local jurisdiction undertake a feasibility study that includes the reasons for forming a public bank, the costs of forming a public bank, an estimate of the initial amount of capital needed, financial projections, a legal analysis on the whether or not a public bank complies with the state constitution, and an analysis on how the governance structure would protect the bank from insider transactions and conflicts of interest. The study may also examine the fiscal and qualitative benefits of a public bank, current fees paid to traditional banks, and the cost of staying with a traditional bank.

IMPACTS TO CITY OF SAN JOSE:

AB 857 provides a state framework for any local jurisdiction(s) that would like to form a public bank. The bill includes useful controls including FDIC insurance and a comprehensive feasibility study to guide local governments that wish to establish a public bank. This framework would be helpful if the City decides in the future to pursue a public bank. There is only one public bank operating at scale in the United States, the Bank of North Dakota. The Assembly Banking and Finance Committee analysis of the bill states that although several local and state governments have explored public banks, feasibility studies "often find significant start-up costs and high levels of financial and operational risk association with public banks."

Staff committed to providing the Council with a summary of feasibility analysis and reports prepared by other local agencies on the viability of a local public bank. Staff expects to provide this work to the Council by June 2020 in conjunction with recommendations on how to proceed with a banking services Request for Proposals. Preliminary research suggests that the type of capital needed to establish a public bank can be cost prohibitive for a single city. Instead, economies of scale argue that a state or federal public bank with a greater pool of resources may be more viable.

The Administration recommends a support if amended position because AB 857 does not propose a state public bank. In the 2011-2012 legislative session, Assemblymember Hueso introduced AB 2500 to establish a public state bank, but the policy committee did not hear the bill at the request of the author. The Council may wish to ask the authors to amend AB 857 to create a state public bank in addition to providing a framework for local government public banks.

POLICY ALIGNMENT:

AB 857 aligns with the Legislative Guiding Principle to "protect and increase funding to deliver city services, build infrastructure, and serve the San Jose community" and "protect local control."

SUPPORTERS/OPPONENTS:

Supporters
350 Bay Area Action
350 Conejo San Fernando Valley
350 Riverside
350 Santa Cruz
350 Silicon Valley
350 South Bay Los Angeles
AFSCME Council 57
Alliance for Community Transit – Los Angeles
Alliance of Californians for Community Empowerment Action
American Indian Movement SoCal
Asian Pacific Environmental Network
Backbone Campaign
Beneficial State Foundation
California Environmental Justice Alliance
California Faculty Association, San Francisco State University
California Nurses Association
California Progressive Alliance
California Public Banking Alliance (sponsor)
California Reinvestment Coalition
Campaign for Sustainable Transportation, Santa Cruz
Center for Community Action and Environmental Justice
City and County of San Francisco
Mayor Jesse Arreguin, City of Berkeley
City of Los Angeles
City of Oakland
Coleman Advocates for Children and Youth
Commonomics
Communities for a Better Environment

Community Financial Resources
Cooperation Humboldt, Eureka
Courage Campaign
Democracy Collaborative
Democratic Party of the San Fernando Valley
Democratic Socialists of America, Los Angeles
Divest LA
Friends of the Earth
Fossil Free California
Friends of the Earth U.S.
Green Party of Santa Clara County
Healthcare for All
Home It
Hubert H. Humphrey Democratic Club
Idle No More – San Francisco Bay
Indivisible California, CA-33
Indivisible California Green Team
Indivisible CA: Statestrong
Indivisible East Bay
Indivisible Los Angeles, CA-43
Lawyers' Committee for Civil Rights of the San Francisco Bay Area
Local Clean Energy Alliance
Los Angeles County Democratic Party
Mcgee-Spaulding Neighbors in Action
Media Alliance
NAACP, Santa Cruz Chapter
Orange County Poor Peoples Campaign
Our Revolution Long Beach
People for Public Banking Santa Cruz
People Organizing to Demand Environmental and Economic Rights
Progressive Asian Network for Action
Public Bank East Bay
Public Bank Los Angeles
Public Bank San Diego
Public Bank Santa Barbara
Public Banking Institute
Resistance – Northridge, Indivisible
Revolution LA
San Francisco Berniecrats
San Francisco Living Wage Coalition
San Francisco Public Bank Coalition
San Francisco Rising
Santa Cruz Climate Action Network
Santa Cruz for Bernie
SEIU State Council
SoCal 350 Climate Action
South Bay Progressive Alliance
Sunrise Movement Los Angeles
Sustainable Economics Law Center
Unites Educators of San Francisco
Women's International League for Peace and Freedom

Opponents
Bay Area Council
California Association of County Treasurers & Tax Collectors
California Bankers Association
California Chamber of Commerce
California Community Banking Network
California Credit Union League
Howard Jarvis Taxpayers Association

STATUS OF BILL:

AB 857 passed out of the Assembly Local Government Committee on April 24, 2019, and is in the Assembly Appropriations Committee.

FOR QUESTIONS CONTACT: Bena Chang, Intergovernmental Relations, 408-975-3240.

Attachments:

Bill Text
Committee Analysis

AMENDED IN ASSEMBLY APRIL 29, 2019

AMENDED IN ASSEMBLY MARCH 19, 2019

CALIFORNIA LEGISLATURE—2019–20 REGULAR SESSION

ASSEMBLY BILL No. 857

Introduced by Assembly Members Chiu and Santiago
(Coauthors: Assembly Members Kalra, Mark Stone, Ting, and Wicks)
(Coauthors: Senators Beall, Skinner, and Wiener)

February 20, 2019

An act to amend Section 119 of the Financial Code, ~~and~~ to amend Sections 23007, 53601, 53635, and 53635.2 of, and to add Division 5 (commencing with Section 57600) to Title 5 of, the Government Code, and to add Section 23701aa to the Revenue and Taxation Code, relating to public banks.

LEGISLATIVE COUNSEL'S DIGEST

AB 857, as amended, Chiu. Public banks.

Existing law, the Financial Institutions Law, regulates the activities of various financial entities, including commercial banks, industrial banks, trust companies, credit unions, and savings associations. The Banking Law defines and regulates state banks and commits the enforcement of banking laws to the Commissioner of Business Oversight.

Existing law prohibits a county from giving or loaning its credit to, or in aid of, any person or corporation. Existing law requires a local agency, as defined, to deposit all money belonging to, or in the custody of that local agency, into specified state or national banks, as defined. Existing law regulates the investment of public funds by local agencies.

Existing law generally governs benefit corporations and requires that a benefit corporation make an annual report to shareholders, as specified. Existing law, the Social Purpose Corporations Act, generally governs social purpose corporations and requires that a social purpose corporation make a specified annual report to shareholders.

This bill would define the term "bank" for purposes of the Financial Institutions Law and the Banking Law to include a public bank. The bill would define the term "public bank" to mean a corporation, organized for the purpose of engaging in the commercial banking business or industrial banking business, that is wholly owned by a local agency, local agencies, a joint powers authority, or a special district.

The bill would require a public bank to comply with all requirements of the Financial Institutions Law and the Banking Law and to obtain and maintain insurance, subject to specified requirements. *The bill would require a local agency to conduct and approve, as specified, a study of the viability of a public bank containing specified elements before submitting an application to the commissioner to organize and establish a public bank.* The bill would authorize a county to lend its credit to a public bank. The bill ~~would~~ also would authorize a local agency to deposit funds in a public bank, and to invest in a public bank, subject to certain requirements.

The bill would further require a public bank to identify in its articles of incorporation either a special purpose or a special public benefit. The bill would authorize, but not require, a public bank to incorporate as a benefit corporation or a social purpose corporation but would require a public bank to comply with the reporting requirements to which a social benefit or social purpose corporation are held, as specified.

The Corporation Tax Law imposes a franchise tax on financial corporations, but provides that the tax is in lieu of all other state and local taxes and licenses, with certain exceptions. That law also exempts specified classes of entities from the franchise and income taxes imposed by that law, including state-chartered credit unions.

This bill would additionally exempt from those franchise and income taxes any public bank. This bill would also exempt a public bank from all other state and local taxes and licenses, with certain exceptions.

Vote: majority. Appropriation: no. Fiscal committee: yes. State-mandated local program: no.

The people of the State of California do enact as follows:

SECTION 1. It is the intent of the Legislature that this act authorize the lending of public credit to public banks and authorize public ownership of stock in public banks for the purpose of achieving cost savings, strengthening local economies, supporting community economic development, and addressing infrastructure and housing needs for localities.

SEC. 2. Section 119 of the Financial Code is amended to read:

119. "Bank" or "banks" includes a public bank, as defined in Section 57600 of the Government Code, commercial banks, industrial banks, and trust companies unless the context otherwise requires. However, "bank" does not include a savings association or a credit union.

SEC. 3. Section 23007 of the Government Code is amended to read:

23007. Except as specified in this chapter, a county shall not, in any manner, give or loan its credit to or in aid of any person or corporation that is not a public bank, as defined in Section 57600. An indebtedness or liability incurred contrary to this chapter is void.

SEC. 4. Section 53601 of the Government Code is amended to read:

53601. This section shall apply to a local agency that is a city, a district, or other local agency that does not pool money in deposits or investments with other local agencies, other than local agencies that have the same governing body. However, Section 53635 shall apply to all local agencies that pool money in deposits or investments with other local agencies that have separate governing bodies. The legislative body of a local agency having moneys in a sinking fund or moneys in its treasury not required for the immediate needs of the local agency may invest any portion of the moneys that it deems wise or expedient in those investments set forth below. A local agency purchasing or obtaining any securities prescribed in this section, in a negotiable, bearer, registered, or nonregistered format, shall require delivery of the securities to the local agency, including those purchased for the agency by financial advisers, consultants, or managers using the agency's funds, by book entry, physical delivery, or by third-party custodial agreement. The transfer of securities to the counterparty

bank's customer book entry account may be used for book entry delivery.

For purposes of this section, "counterparty" means the other party to the transaction. A counterparty bank's trust department or separate safekeeping department may be used for the physical delivery of the security if the security is held in the name of the local agency. Where this section specifies a percentage limitation for a particular category of investment, that percentage is applicable only at the date of purchase. Where this section does not specify a limitation on the term or remaining maturity at the time of the investment, no investment shall be made in any security, other than a security underlying a repurchase or reverse repurchase agreement or securities lending agreement authorized by this section, that at the time of the investment has a term remaining to maturity in excess of five years, unless the legislative body has granted express authority to make that investment either specifically or as a part of an investment program approved by the legislative body no less than three months prior to the investment:

(a) Bonds issued by the local agency, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the local agency or by a department, board, agency, or authority of the local agency.

(b) United States Treasury notes, bonds, bills, or certificates of indebtedness, or those for which the faith and credit of the United States are pledged for the payment of principal and interest.

(c) Registered state warrants or treasury notes or bonds of this state, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the state or by a department, board, agency, or authority of the state.

(d) Registered treasury notes or bonds of any of the other 49 states in addition to California, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by a state or by a department, board, agency, or authority of any of the other 49 states, in addition to California.

(e) Bonds, notes, warrants, or other evidences of indebtedness of a local agency within this state, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the local agency, or by a department, board, agency, or authority of the local agency.

(f) Federal agency or United States government-sponsored enterprise obligations, participations, or other instruments, including those issued by or fully guaranteed as to principal and interest by federal agencies or United States government-sponsored enterprises.

(g) Bankers' acceptances otherwise known as bills of exchange or time drafts that are drawn on and accepted by a commercial bank. Purchases of bankers' acceptances shall not exceed 180 days' maturity or 40 percent of the agency's moneys that may be invested pursuant to this section. However, no more than 30 percent of the agency's moneys may be invested in the bankers' acceptances of any one commercial bank pursuant to this section.

This subdivision does not preclude a municipal utility district from investing moneys in its treasury in a manner authorized by the Municipal Utility District Act (Division 6 (commencing with Section 11501) of the Public Utilities Code).

(h) Commercial paper of "prime" quality of the highest ranking or of the highest letter and number rating as provided for by a nationally recognized statistical rating organization (NRSRO). The entity that issues the commercial paper shall meet all of the following conditions in either paragraph (1) or (2):

(1) The entity meets the following criteria:

(A) Is organized and operating in the United States as a general corporation.

(B) Has total assets in excess of five hundred million dollars ($500,000,000).

(C) Has debt other than commercial paper, if any, that is rated in a rating category of "A" or its equivalent or higher by an NRSRO.

(2) The entity meets the following criteria:

(A) Is organized within the United States as a special purpose corporation, trust, or limited liability company.

(B) Has programwide credit enhancements including, but not limited to, overcollateralization, letters of credit, or a surety bond.

(C) Has commercial paper that is rated "A-1" or higher, or the equivalent, by an NRSRO.

Eligible commercial paper shall have a maximum maturity of 270 days or less. Local agencies, other than counties or a city and county, may invest no more than 25 percent of their moneys in eligible commercial paper. Local agencies, other than counties or

a city and county, may purchase no more than 10 percent of the outstanding commercial paper of any single issuer. Counties or a city and county may invest in commercial paper pursuant to the concentration limits in subdivision (a) of Section 53635.

(i) Negotiable certificates of deposit issued by a nationally or state-chartered bank, a savings association or a federal association (as defined by Section 5102 of the Financial Code), a state or federal credit union, or by a federally licensed or state-licensed branch of a foreign bank. Purchases of negotiable certificates of deposit shall not exceed 30 percent of the agency's moneys that may be invested pursuant to this section. For purposes of this section, negotiable certificates of deposit do not come within Article 2 (commencing with Section 53630), except that the amount so invested shall be subject to the limitations of Section 53638. The legislative body of a local agency and the treasurer or other official of the local agency having legal custody of the moneys are prohibited from investing local agency funds, or funds in the custody of the local agency, in negotiable certificates of deposit issued by a state or federal credit union if a member of the legislative body of the local agency, or a person with investment decisionmaking authority in the administrative office manager's office, budget office, auditor-controller's office, or treasurer's office of the local agency also serves on the board of directors, or any committee appointed by the board of directors, or the credit committee or the supervisory committee of the state or federal credit union issuing the negotiable certificates of deposit.

(j) (1) Investments in repurchase agreements or reverse repurchase agreements or securities lending agreements of securities authorized by this section, as long as the agreements are subject to this subdivision, including the delivery requirements specified in this section.

(2) Investments in repurchase agreements may be made, on an investment authorized in this section, when the term of the agreement does not exceed one year. The market value of securities that underlie a repurchase agreement shall be valued at 102 percent or greater of the funds borrowed against those securities and the value shall be adjusted no less than quarterly. Since the market value of the underlying securities is subject to daily market fluctuations, the investments in repurchase agreements shall be in

compliance if the value of the underlying securities is brought back up to 102 percent no later than the next business day.

(3) Reverse repurchase agreements or securities lending agreements may be utilized only when all of the following conditions are met:

(A) The security to be sold using a reverse repurchase agreement or securities lending agreement has been owned and fully paid for by the local agency for a minimum of 30 days prior to sale.

(B) The total of all reverse repurchase agreements and securities lending agreements on investments owned by the local agency does not exceed 20 percent of the base value of the portfolio.

(C) The agreement does not exceed a term of 92 days, unless the agreement includes a written codicil guaranteeing a minimum earning or spread for the entire period between the sale of a security using a reverse repurchase agreement or securities lending agreement and the final maturity date of the same security.

(D) Funds obtained or funds within the pool of an equivalent amount to that obtained from selling a security to a counterparty using a reverse repurchase agreement or securities lending agreement shall not be used to purchase another security with a maturity longer than 92 days from the initial settlement date of the reverse repurchase agreement or securities lending agreement, unless the reverse repurchase agreement or securities lending agreement includes a written codicil guaranteeing a minimum earning or spread for the entire period between the sale of a security using a reverse repurchase agreement or securities lending agreement and the final maturity date of the same security.

(4) (A) Investments in reverse repurchase agreements, securities lending agreements, or similar investments in which the local agency sells securities prior to purchase with a simultaneous agreement to repurchase the security may be made only upon prior approval of the governing body of the local agency and shall be made only with primary dealers of the Federal Reserve Bank of New York or with a nationally or state-chartered bank that has or has had a significant banking relationship with a local agency.

(B) For purposes of this chapter, "significant banking relationship" means any of the following activities of a bank:

(i) Involvement in the creation, sale, purchase, or retirement of a local agency's bonds, warrants, notes, or other evidence of indebtedness.

(ii) Financing of a local agency's activities.

(iii) Acceptance of a local agency's securities or funds as deposits.

(5) (A) "Repurchase agreement" means a purchase of securities by the local agency pursuant to an agreement by which the counterparty seller will repurchase the securities on or before a specified date and for a specified amount and the counterparty will deliver the underlying securities to the local agency by book entry, physical delivery, or by third-party custodial agreement. The transfer of underlying securities to the counterparty bank's customer book-entry account may be used for book-entry delivery.

(B) "Securities," for purposes of repurchase under this subdivision, means securities of the same issuer, description, issue date, and maturity.

(C) "Reverse repurchase agreement" means a sale of securities by the local agency pursuant to an agreement by which the local agency will repurchase the securities on or before a specified date and includes other comparable agreements.

(D) "Securities lending agreement" means an agreement under which a local agency agrees to transfer securities to a borrower who, in turn, agrees to provide collateral to the local agency. During the term of the agreement, both the securities and the collateral are held by a third party. At the conclusion of the agreement, the securities are transferred back to the local agency in return for the collateral.

(E) For purposes of this section, the base value of the local agency's pool portfolio shall be that dollar amount obtained by totaling all cash balances placed in the pool by all pool participants, excluding any amounts obtained through selling securities by way of reverse repurchase agreements, securities lending agreements, or other similar borrowing methods.

(F) For purposes of this section, the spread is the difference between the cost of funds obtained using the reverse repurchase agreement and the earnings obtained on the reinvestment of the funds.

(k) Medium-term notes, defined as all corporate and depository institution debt securities with a maximum remaining maturity of five years or less, issued by corporations organized and operating within the United States or by depository institutions licensed by the United States or any state and operating within the United

States. Notes eligible for investment under this subdivision shall be rated in a rating category of "A" or its equivalent or better by an NRSRO. Purchases of medium-term notes shall not include other instruments authorized by this section and shall not exceed 30 percent of the agency's moneys that may be invested pursuant to this section.

(*l*) (1) Shares of beneficial interest issued by diversified management companies that invest in the securities and obligations as authorized by subdivisions (a) to (k), inclusive, and subdivisions (m) to (q), inclusive, and that comply with the investment restrictions of this article and Article 2 (commencing with Section 53630). However, notwithstanding these restrictions, a counterparty to a reverse repurchase agreement or securities lending agreement is not required to be a primary dealer of the Federal Reserve Bank of New York if the company's board of directors finds that the counterparty presents a minimal risk of default, and the value of the securities underlying a repurchase agreement or securities lending agreement may be 100 percent of the sales price if the securities are marked to market daily.

(2) Shares of beneficial interest issued by diversified management companies that are money market funds registered with the Securities and Exchange Commission under the Investment Company Act of 1940 (15 U.S.C. Sec. 80a-1 et seq.).

(3) If investment is in shares issued pursuant to paragraph (1), the company shall have met either of the following criteria:

(A) Attained the highest ranking or the highest letter and numerical rating provided by not less than two NRSROs.

(B) Retained an investment adviser registered or exempt from registration with the Securities and Exchange Commission with not less than five years' experience investing in the securities and obligations authorized by subdivisions (a) to (k), inclusive, and subdivisions (m) to (q), inclusive, and with assets under management in excess of five hundred million dollars ($500,000,000).

(4) If investment is in shares issued pursuant to paragraph (2), the company shall have met either of the following criteria:

(A) Attained the highest ranking or the highest letter and numerical rating provided by not less than two NRSROs.

(B) Retained an investment adviser registered or exempt from registration with the Securities and Exchange Commission with

not less than five years' experience managing money market mutual funds with assets under management in excess of five hundred million dollars ($500,000,000).

(5) The purchase price of shares of beneficial interest purchased pursuant to this subdivision shall not include commission that the companies may charge and shall not exceed 20 percent of the agency's moneys that may be invested pursuant to this section. However, no more than 10 percent of the agency's funds may be invested in shares of beneficial interest of any one mutual fund pursuant to paragraph (1).

(m) Moneys held by a trustee or fiscal agent and pledged to the payment or security of bonds or other indebtedness, or obligations under a lease, installment sale, or other agreement of a local agency, or certificates of participation in those bonds, indebtedness, or lease installment sale, or other agreements, may be invested in accordance with the statutory provisions governing the issuance of those bonds, indebtedness, or lease installment sale, or other agreement, or to the extent not inconsistent therewith or if there are no specific statutory provisions, in accordance with the ordinance, resolution, indenture, or agreement of the local agency providing for the issuance.

(n) Notes, bonds, or other obligations that are at all times secured by a valid first priority security interest in securities of the types listed by Section 53651 as eligible securities for the purpose of securing local agency deposits having a market value at least equal to that required by Section 53652 for the purpose of securing local agency deposits. The securities serving as collateral shall be placed by delivery or book entry into the custody of a trust company or the trust department of a bank that is not affiliated with the issuer of the secured obligation, and the security interest shall be perfected in accordance with the requirements of the Uniform Commercial Code or federal regulations applicable to the types of securities in which the security interest is granted.

(o) A mortgage passthrough security, collateralized mortgage obligation, mortgage-backed or other pay-through bond, equipment lease-backed certificate, consumer receivable passthrough certificate, or consumer receivable-backed bond. Securities eligible for investment under this subdivision shall be rated in a rating category of "AA" or its equivalent or better by an NRSRO and have a maximum remaining maturity of five years or less. Purchase

of securities authorized by this subdivision shall not exceed 20 percent of the agency's surplus moneys that may be invested pursuant to this section.

(p) Shares of beneficial interest issued by a joint powers authority organized pursuant to Section 6509.7 that invests in the securities and obligations authorized in subdivisions (a) to (q), inclusive. Each share shall represent an equal proportional interest in the underlying pool of securities owned by the joint powers authority. To be eligible under this section, the joint powers authority issuing the shares shall have retained an investment adviser that meets all of the following criteria:

(1) The adviser is registered or exempt from registration with the Securities and Exchange Commission.

(2) The adviser has not less than five years of experience investing in the securities and obligations authorized in subdivisions (a) to (q), inclusive.

(3) The adviser has assets under management in excess of five hundred million dollars ($500,000,000).

(q) United States dollar denominated senior unsecured unsubordinated obligations issued or unconditionally guaranteed by the International Bank for Reconstruction and Development, International Finance Corporation, or Inter-American Development Bank, with a maximum remaining maturity of five years or less, and eligible for purchase and sale within the United States. Investments under this subdivision shall be rated in a rating category of "AA" or its equivalent or better by an NRSRO and shall not exceed 30 percent of the agency's moneys that may be invested pursuant to this section.

(r) Commercial paper, debt securities, or other obligations of a public bank, as defined in Section 57600.

SEC. 5. Section 53635 of the Government Code is amended to read:

53635. (a) This section shall apply to a local agency that is a county, a city and county, or other local agency that pools money in deposits or investments with other local agencies, including local agencies that have the same governing body. However, Section 53601 shall apply to all local agencies that pool money in deposits or investments exclusively with local agencies that have the same governing body.

This section shall be interpreted in a manner that recognizes the distinct characteristics of investment pools and the distinct administrative burdens on managing and investing funds on a pooled basis pursuant to Article 6 (commencing with Section 27130) of Chapter 5 of Division 2 of Title 3.

A local agency that is a county, a city and county, or other local agency that pools money in deposits or investments with other agencies may invest in commercial paper pursuant to subdivision (h) of Section 53601, except that the local agency shall be subject to the following concentration limits:

(1) No more than 40 percent of the local agency's money may be invested in eligible commercial paper.

(2) No more than 10 percent of the total assets of the investments held by a local agency may be invested in any one issuer's commercial paper.

(b) Notwithstanding Section 53601, the City of Los Angeles shall be subject to the concentration limits of this section for counties and for cities and counties with regard to the investment of money in eligible commercial paper.

(c) A local agency subject to this section may invest in commercial paper, debt securities, or other obligations of a public bank, as defined in Section 57600.

SEC. 6. Section 53635.2 of the Government Code is amended to read:

53635.2. As far as possible, all money belonging to, or in the custody of, a local agency, including money paid to the treasurer or other official to pay the principal, interest, or penalties of bonds, shall be deposited for safekeeping in state or national banks, public banks, savings associations, federal associations, credit unions, or federally insured industrial loan companies in this state selected by the treasurer or other official having legal custody of the money; or may be invested in the investments set forth in Section 53601. To be eligible to receive local agency money, a bank, savings association, federal association, or federally insured industrial loan company shall have received an overall rating of not less than "satisfactory" in its most recent evaluation by the appropriate federal financial supervisory agency of its record of meeting the credit needs of California's communities, including low- and moderate-income neighborhoods, pursuant to Section 2906 of Title

12 of the United States Code. Sections 53601.5 and 53601.6 shall apply to all investments that are acquired pursuant to this section.

SEC. 7. Division 5 (commencing with Section 57600) is added to Title 5 of the Government Code, to read:

DIVISION 5. PUBLIC BANKS

57600. For purposes of this division:

(a) "Local financial institution" means a certified community development financial institution, a credit union, or a small bank or an intermediate small bank, as defined in Section 25.12 of Title 12 of the Code of Federal Regulations.

(b) "Public bank" means a corporation, organized for the purpose of engaging in the commercial banking business or industrial banking business, that is wholly owned by a local agency, local agencies, a joint powers authority formed pursuant to the Joint Exercise of Powers Act (Article 1 (commencing with Section 6500) of Chapter 5 of Division 7 of Title 1) that is composed only of local agencies, or a special district.

~~(c) "Self-insurance" means deposits guaranteed by the owners of the public bank in an amount approved by the Commissioner of Business Oversight.~~

57601. (a) A public bank shall identify in its articles of incorporation either a social purpose, as provided in paragraph (2) of subdivision (6) of Section 2602 of the Corporations Code, or a specific public benefit, as provided in Section 14610 of the Corporations Code. Examples of a social purpose or a specific public benefit include, but are not limited to, strengthening local economies, supporting community economic development, addressing infrastructure and housing needs for localities, and providing banking services to the unbanked or underbanked.

(b) A public bank may, but is not required to, incorporate as a benefit corporation or a social purpose corporation.

(c) Notwithstanding subdivision (b), a public bank that identifies a social purpose in its articles of incorporation shall comply with Section 3500 of the Corporations Code, and a public bank that identifies a specific public benefit in its articles of incorporation shall comply with Section 14630 of the Corporations Code.

57602. (a) A public bank shall obtain and maintain deposit insurance ~~approved by the Commissioner of Business Oversight,~~

~~either~~ *provided* by the Federal Deposit Insurance Corporation under the Federal Deposit Insurance Act ~~(12 U.S.C. Sec. 1811 et seq.), private share insurance, or self-insurance.~~ *(12 U.S.C. Sec. 1811 et seq.).*

(b) In seeking and retaining insurance, a public bank may do all things and assume and discharge all obligations required of it that are not in conflict with state law.

57603. (a) A public bank shall comply with all requirements of the Financial Institutions Law (Division 1 (commencing with Section 99) of the Financial Code) and the Banking Law (Division 1.1 (commencing with Section ~~1000))~~ *1000)* of the Financial ~~Code,~~ *Code),* except to the extent that a requirement of those laws is inconsistent with a provision of this division, in which case the provisions of this division shall prevail.

(b) A public bank shall comply with the requirements of Section 53638 unless the public bank and the depositor agree otherwise.

(c) Notwithstanding Section 23010, a county may lend its credit to any public bank.

(d) Notwithstanding Section 53601, any local agency that does not pool money in deposits or investments with other local agencies that have separate governing bodies may invest in debt securities or other obligations of a public bank.

(e) Notwithstanding Section 53635, any local agency that pools money in deposits or investments with other local agencies, including local agencies that have the same governing body, may invest in debt securities or other obligations of a public bank.

(f) Notwithstanding Section 53635.2, a public bank shall be eligible to receive local agency money.

57604. (a) Wherever possible, any retail services of a public bank shall be conducted in partnership with local financial institutions.

(b) Notwithstanding subdivision (a), a public bank may do both of the following:

(1) Engage in banking activities, ~~including~~ *including,* but not limited to, infrastructure lending, wholesale lending, and participation lending.

(2) Engage in retail activities that are not provided by local financial institutions in the jurisdiction of the local agency or agencies that own the public bank.

57605. For the purposes of Section 1280 of the Financial Code, any person or entity, including a local agency, that owns, controls, or holds an ownership interest in a public bank is not a bank holding company by reason of that ownership interest.

57606. (a) Before submitting an application to organize and establish a public bank pursuant to Section 1020 of the Financial Code, a local agency shall conduct a study to assess the viability of the proposed public bank. The study shall include, but is not limited to, all of the following elements:

(1) A discussion of the purposes of the bank including, but not limited to, achieving cost savings, strengthening local economies, supporting community economic development, and addressing infrastructure and housing needs for localities.

(2) A fiscal analysis of costs associated with starting the proposed public bank.

(3) An estimate of the initial amount of capital to be provided by the local agency to the proposed public bank.

(4) Financial projections, including a pro forma balance sheet and income statement, of the proposed public bank for at least the first five years of operation. The financial projections shall include an estimate of the time period for when expected revenues meet or exceed expected costs and an estimate of the total operating subsidy that the local agency may be required to provide until the proposed public bank generates sufficient revenue to cover its costs. In addition to projections that assume favorable economic conditions, the analysis shall also include a downside scenario that considers the effect of an economic recession on the financial results of the proposed public bank. The projections may include the downside scenario of continuing to do business with the local government's current banker or bankers.

(5) A legal analysis of whether the proposed structure and operations of the public bank would likely comply with Section 6 of Article XVI of the California Constitution, but nothing herein shall compel the waiver of any attorney-client privilege attaching to that legal analysis.

(6) An analysis of how the proposed governance structure of the public bank would protect the bank from unlawful insider transactions and apparent conflicts of interest.

(b) The study may include any of the following elements:

(1) A fiscal analysis of benefits associated with starting the proposed public bank, including but not limited to, cost savings, jobs created, jobs retained, economic activity generated, and private capital leveraged.

(2) A qualitative assessment of social or environmental benefits of the proposed public bank.

(3) An estimate of the fees paid to the local agency's current banker or bankers.

(4) A fiscal analysis of the costs, including social and environmental, of continuing to do business with the local agency's current banker or bankers.

(c) The study required by subdivision (a) shall be presented and approved by the governing body of the local agency at a public meeting prior to the local agency submitting an application pursuant to Section 1020 of the Financial Code.

(d) The local agency shall make available to the public the financial models and key assumptions used to estimate the elements described in paragraphs (2) through (4) of subdivision (a) before presenting the study to the governing body of the local agency as required by subdivision (c).

SEC. 8. Section 23701aa is added to the Revenue and Taxation Code, to read:

23701aa. A public bank as defined in Section 57600 of the Government Code. In addition, a public bank is exempt from all other taxes and licenses, state, county, and municipal, imposed upon a public bank, except taxes upon its real property, local utility user taxes, sales and use taxes, state energy resources surcharges, state emergency telephone users surcharges, motor vehicle and other vehicle registration license fees, and any other tax or license fee imposed by the state upon vehicles, motor vehicles, or the operation thereof.

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Date of Hearing: May 8, 2019

ASSEMBLY COMMITTEE ON APPROPRIATIONS
Lorena Gonzalez, Chair
AB 857 (Chiu) – As Amended April 29, 2019

Policy Committee:	Banking and Finance	Vote: 7 - 3
	Local Government	5 - 2

Urgency: No State Mandated Local Program: No Reimbursable: No

SUMMARY:

This bill authorizes local agencies to create and operate publicly owned banks. Specifically, this bill:

1) Defines a public bank as a corporation, organized for the purposes of engaging in the commercial banking business or industrial banking business that is wholly owned by a local agency, local agencies, a joint powers authority that is composed only of local agencies, or a special district.

2) Places a range of restrictions on a public bank, including that it must: (a) identify in its articles of incorporation either a social purpose or a specific public benefit; (b) obtain and maintain deposit insurance provided by the Federal Deposit Insurance Corporation (FDIC); (c) Conduct retail services in partnership with financial institution, when possible; and (d) comply with all the requirements of the Financial Institutions Law and the Banking Law.

3) Requires a local agency to conduct a viability study of a proposed public bank prior to submitting an application to the Department of Business Oversight (DBO).

4) Exempts a public bank from state and local taxes, with specified exceptions.

FISCAL EFFECT:

Significant costs to DBO to process and review applications for a public bank. These costs are subject to significant uncertainty and depend on the number of public bank applications. If 50 applications were submitted to DBO in initial years, personnel and legal costs could exceed $800,000 (for three attorneys and three support staff).

The above scenario is likely conservative. Given that AB 857 authorizes thousands of public agencies to form a public bank, there could be hundreds of applications in initial years. Such a surge in applications would require DBO to add a large number of new legal staff, resulting in millions of dollars in personnel costs for DBO.

COMMENTS:

1) **Background and purpose.** Public banks are financial institutions owned by a governmental identity, such as a state or municipality. The idea behind a public bank is to remove banking from profit motives and instead focus on community goals. A number of local governments,

including Oakland and Los Angeles, have started studying the potential benefits of a public bank.

This bill authorizes a local government to establish a public bank. The author argues this will "provide more local control, transparency, and self-determination in how local taxpayer dollars are leveraged in the banking system." The California Public Banking Alliance, writing in support, argues public banks "can leverage their deposit base and lending power to benefit the public."

2) **Recent amendments and staff comment**. Recent policy committee amendments add new requirements for local agencies seeking to start a local bank. First, the bill no longer allows for self-insurance and instead requires public banks to receive FDIC insurance. Second, a local agency must now conduct a robust viability study.

   The required study is an important and welcome amendment. However, as drafted, AB 857 does not require the study be part of the application process to DBO. The committee may wish to consider a more explicit linkage.

3) **All eyes on DBO.** There remain some important questions about the long-term viability of a local public bank. How will the governance structure of a public bank work, and how will it protect itself from undue political influence? How will a public bank achieve its public benefit goals while remaining financially viable? While a local agency will attempt to answer these questions through the required viability study, DBO will ultimately be the entity that decides whether these questions have been sufficiently answered.

   DBO reviews applications for new banks to determine if the new bank will meet basic requirements that allow it to service its community. These examinations tend to look at a bank's capital, asset quality, management expertise, earnings potential and sensitivity to market risk. This process is intensive and thorough.

   There is no guarantee DBO would grant a state charter to a public bank. Given the uncertainty around the public bank model, it may be years until DBO approves such an institution. And, it is unlikely a public bank that ultimately receives a charter will resemble the kind of entity envisioned by supporters.

4) **Local fiscal concerns**. Local costs are beyond the purview of this committee if they do not result in a state reimbursable mandate. However, it is notable that the California Association of County Treasurers and Tax Collectors (CACTTC) opposes this bill because of its implications for local finances. CACTTC notes in its opposition letter it is unlikely a county treasurer would ever utilize a public bank because of the potential risk doing so could endanger a county treasury's ability to pay near-term obligations.

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