

## CONCURRENCE IN SENATE AMENDMENTS

AB 857 (Chiu and Santiago)

As Amended September 6, 2019

Majority vote

**SUMMARY:**

Provides for the establishment of a public bank by a local agency, subject to approval by the Department of Business Oversight (DBO) and Federal Deposit Insurance Corporation (FDIC).

**The Senate Amendments:**

- 1) Require a local agency that is not a charter city to obtain voter approval prior to applying for a public bank charter, as specified.
- 2) Provide that all provisions of law applicable to nonprofit corporations generally shall apply to public banks. If such a provision is inconsistent with a provision of the Public Banking division added by this bill, the provision of the Public Banking division shall apply, and the inconsistent provision applicable to nonprofit corporations shall not apply.
- 3) Restrict the number of public bank licenses that may be approved by the Commissioner of Business Oversight, as follows:
  - a) The commissioner may not issue more than two public bank licenses in a calendar year, nor more than ten in total.
  - b) The commissioner may not issue a public bank license more than seven years after promulgating regulations pursuant to the Public Banking division.
- 4) Require a public bank to conduct retail activities, as defined, in partnership with local financial institutions and prohibit a public bank from competing with local financial institutions, except in the case of local agency banking, infrastructure lending, wholesale lending, and participation lending, as defined.
- 5) Exempt from public disclosure specified information and records of a public bank, as specified.
- 6) Authorize the governing board of a public bank or a committee of the governing board of a public bank to meet in closed session.

**COMMENTS:**

On the heels of the 2007-08 financial crisis, renewed interest in public banking has sparked legislation or feasibility studies in state and local governments around the United States. To date, no state or local government has established a public bank, and feasibility studies often find significant start-up costs and high levels of financial and operational risk associated with public banks.

This bill would specify a process 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. 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. 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.

While collateral requirements protect local government deposits, any capital provided to a public bank by the local government as shareholder equity or as a non-deposit liability may be exposed to losses. Additionally, a local agency may expend significant taxpayer funds in studying the viability of a public bank and in organizational start-up costs, only to later find that the public bank proposal does not meet the requirements of the DBO or FDIC. As fiduciaries and trustees of taxpayer funds, local government officials should carefully consider the cost and risks involved with public bank proposals, particularly in light of their responsibilities under the prudent investor rule.

#### **According to the Author:**

AB 857 provides more local control, transparency, and self-determination in how local taxpayer dollars are leveraged in the banking system by allowing local governments to charter their own public banks. These public banks would have oversight from the Department of Business Oversight (DBO) and a separate, professional board. In contrast to profit-driven commercial banks, the public bank's board of directors will have a fiduciary duty to protect taxpayers' assets... By creating a public bank, taxpayer money will be held by an insured financial institution that measures its return on investment not only by profits, but also by its success in supporting communities.

#### **Arguments in Support:**

According to the California Public Bank Alliance, "Unlike a privately-owned bank, which prioritizes shareholder returns, public banks leverage their deposit base and lending power to benefit the public. This allows public banks to focus on pressing local needs, like affordable housing, small business loans, and public infrastructure projects such as rebuilding after wildfires. A public bank's decisions may consider the needs of the community and leverage public funds to meet those needs at a lower cost than the private sector."

#### **Arguments in Opposition:**

According to the California Bankers Association, "AB 857 infers that banks are not serving their communities, an argument repeatedly made by public bank activists in a variety of forums...Proponents for the creation of a public bank have failed to identify how the current marketplace is not meeting the public's financial needs...Commercial banks, particularly community banks, will be harmed by the taking of local agency deposits which would otherwise be used as a source of liquidity by these banks to make loans into their communities. The notion

that the public bank will cooperate with local financial institutions is illusory and this measure forces community banks to compete on an unlevel playing field."

The California Association of County Treasurers and Tax Collectors states, "there is simply no question that county treasurers complying with state law cannot possibly deposit county funds into a public bank...Moving forward this legislation creates a false sense of hope for proponents who have been repeatedly advised that county pools cannot be used for these purposes, and that critical statutory protections of local dollars cannot be lightly dismissed."

#### **FISCAL COMMENTS:**

According to the Senate Appropriations Committee, this bill will result in significant ongoing costs to DBO for the oversight of newly formed public banks. DBO will incur initial costs to develop regulations for the public banks. Assuming that two public banks are formed in the first year following the promulgation of regulations, and every year thereafter for five years, DBO will incur estimated ongoing costs in the hundreds of thousands of dollars to low millions of dollars per year. These estimates include costs for examiners, managers, legal staff, and support staff. DBO will be able to recoup some of its costs with application fees and annual renewal fees.

This bill may also result in an unknown, potentially significant reduction in tax revenue to the General Fund. Public banks, which will be exempt from the 10.84% of apportioned net income in franchise taxes, will be competitive against commercial banks, which are subject to the franchise tax. As such, the state could incur a reduction in tax revenue from the commercial banks due to the formation of tax-exempt public banks.

#### **VOTES:**

##### **ASM BANKING AND FINANCE: 7-3-2**

**YES:** Limón, Bauer-Kahan, Burke, Gabriel, Mark Stone, Weber, Wicks

**NO:** Chen, Choi, Melendez

**ABS, ABST OR NV:** Cervantes, Grayson

##### **ASM LOCAL GOVERNMENT: 5-2-1**

**YES:** Aguiar-Curry, Bloom, Boerner Horvath, Luz Rivas, Robert Rivas

**NO:** Lackey, Voepel

**ABS, ABST OR NV:** Ramos

##### **ASM APPROPRIATIONS: 11-5-2**

**YES:** Gonzalez, Bloom, Bonta, Calderon, Carrillo, Chau, Eggman, Gabriel, Eduardo Garcia, Quirk, Robert Rivas

**NO:** Bigelow, Brough, Diep, Fong, Obernolte

**ABS, ABST OR NV:** Maienschein, Petrie-Norris

##### **ASSEMBLY FLOOR: 41-29-10**

**YES:** Aguiar-Curry, Arambula, Bauer-Kahan, Berman, Bloom, Bonta, Burke, Carrillo, Chau, Chiu, Chu, Cunningham, Eggman, Friedman, Gabriel, Eduardo Garcia, Gipson, Gloria, Gonzalez, Holden, Irwin, Jones-Sawyer, Kalra, Levine, Limón, Low, Maienschein, McCarty,

Mullin, Nazarian, O'Donnell, Luz Rivas, Robert Rivas, Santiago, Smith, Mark Stone, Ting, Weber, Wicks, Wood, Rendon

**NO:** Bigelow, Boerner Horvath, Chen, Choi, Cooper, Dahle, Daly, Diep, Flora, Fong, Frazier, Gallagher, Cristina Garcia, Gray, Kamlager-Dove, Kiley, Lackey, Mathis, Medina, Melendez, Obernolte, Patterson, Petrie-Norris, Quirk-Silva, Ramos, Blanca Rubio, Salas, Voepel, Waldron

**ABS, ABST OR NV:** Brough, Calderon, Cervantes, Cooley, Grayson, Mayes, Muratsuchi, Quirk, Reyes, Rodriguez

**SENATE FLOOR: 25-11-4**

**YES:** Allen, Archuleta, Atkins, Beall, Bradford, Caballero, Dodd, Durazo, Galgiani, Glazer, Lena Gonzalez, Hill, Hueso, Jackson, Leyva, McGuire, Mitchell, Monning, Portantino, Rubio, Skinner, Stern, Umberg, Wieckowski, Wiener

**NO:** Bates, Chang, Dahle, Grove, Hurtado, Jones, Moorlach, Morrell, Nielsen, Stone, Wilk

**ABS, ABST OR NV:** Borgeas, Hertzberg, Pan, Roth

**UPDATED:**

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