AB 310 California Public Bank Act Frequently Asked Questions

What does the bill do?

The bill does two things: expand capital available for local governments and small businesses; provides a pathway for converting the IBank into the state's public bank.

Expand Lending Capacity: AB 310 requires the State Treasurer to invest 10% of the Pooled Money Investment Account into the IBank. The purpose of the increased investment is to provide lending and credit to local governments and small businesses for purposes of economic recovery.

Convert IBank: The bill also requires the Department of Business Oversight to charter the IBank as a depository institution by January 1, 2022. The Treasurer is required to transfer 20% of state deposits into the IBank within one year of it becoming a depository institution; and 100% of state deposits within five years.

Expand Lending Capacity.

Financing of Local Governments. The funds transferred to the IBank from the PMIA can immediately be used to buy municipal bonds at below-market rates that still generate a return to the PMIA that exceeds or compares to the yield received currently (which is an average of 1.7% for 2020). By buying bonds with even a 50 bps spread, the IBank will receive comparable returns to what it is getting from investing in federal treasuries, but will lend to local governments at a far cheaper rate than what local governments can get under the federal Municipal Liquidity Facility. The Washington State Treasurer found that the interest rate on the MLF is "between 2.3 and 2.8 times higher than the comparable interest rate for a loan obtained through the traditional municipal bond market." The State Treasurer would be directed to transfer 10% of the PMIA into the IBank by purchasing securities of the IBank.

Equitable Small Business Recovery. The bill directs the IBank to expand its existing small business loan guarantee program to allow it to directly partner with CDFIs, credit unions and banks, referred to as "participating lenders". The bill requires the existing small business loan guarantee program to target 60% of loan guarantee dollars to underserved and disadvantaged small businesses in urban and rural areas, referred to as "Target Borrowers". The bill directs the IBank to add a new small loan guarantee program focused exclusively on Target Borrowers, providing participating lenders a 100% guarantee for such loans. Finally, the bill provides the IBank with tools to significantly increase the lending capacity of financial institutions serving low-income communities, including CDFIs, community development credit unions and local public banks, by providing them with long-term subordinated debt at favorable terms and by offering them full or partial loan repurchases.

How does AB 310 advance racial justice and immigrant justice?

Small businesses have been hit especially hard by COVID-19, and national data shows that African-American, Latinx, Asian, and immigrant business ownership has declined dramatically from February to April 2020. For example, whites experienced a 17 percent loss in business ownership over this time, compared to 41 percent for Blacks, 32 percent for Latinx, and 26 percent for Asians. Business ownership among immigrants dropped 36 percent, compared to 18 percent among U.S.-born business owners.[1] In California, very small businesses (with fewer than 50 employees) in the industries that have been hardest hit by COVID-19, like restaurants and retail, have higher rates of Asian (33%) and Latinx (13%) ownership.

By focusing the IBank's recovery activities on underserved urban and rural communities, and by providing a new 100% guarantee for "Target Borrowers" who are small businesses in disadvantaged communities, this bill ensures that the IBank's lending is focused on equitable economic recovery.

What is the specific benefit of converting the IBank from a loan fund into a depository bank? How will this help California communities?

As a depository institution, the State Public Bank would be able to access the Federal Reserve's borrowing window, which is currently at 1.25% for a de novo bank accessing the primary credit discount window. The Fed's discount window is the least expensive source of credit for banks in the global economy. This discount window would have provided the State a critical lifeline in the COVID-19 induced economic recession. Instead, the Federal Reserve has created the Municipal Liquidity Facility, which according to the Washington State Treasurer would provide an interest rate that is "between 2.3 and 2.8 times higher than the comparable interest rate for a loan obtained through the traditional municipal bond market." The Federal Reserve's discrimination against states and municipalities, and favorable treatment of Wall Street Banks is a major flaw in our current banking system. We cannot wait for parity in the Fed's treatment of banks and states. Instead, AB 310 requires the IBank to convert to a depository bank to access the full benefits of the Federal Reserve System, similar to our nation's two other public banks: the Bank of North Dakota and the Territorial Bank of American Samoa. As long as the IBank remains a loan fund and not a bank, it cannot access abundant low-cost, credit available from our national government.

Access to the Federal Reserve will also allow the State Public Bank to provide local California governments and communities less expensive debt to recover and rebuild. The

[1] Fairlie, Robert W. (2020) "The Impact of COVID-19 on Small Business Owners: Evidence of Early-Stage Losses from the April 2020 Current POpulation Survey." (NBER Working Paper 27309). Retrieved from National Bureau of Economic Research website: http://www.nber.org/papers/w27309

State Public Bank would also accept deposits and handle accounts for California local agencies and governments, functioning for local agencies as a credit union functions for individuals. Over time, the public bank would provide local agencies credit, lending, and cash management, payroll and other services at-cost, rather than the premiums they currently pay to Wall Street banks. This would offer local governments savings on fees and interest they are currently paying to private banks. Other services could include overnight funds, check services, electronic payments, and transfers.

The State Public Bank will pool risk from deposits to provide enhanced liquidity to local agencies. Its primary depositor will be the State Treasury. The bill requires the Treasurer to transfer all of the state's deposits to the public bank within five years of the State Public Bank receiving a depository license. This deposit base will form the basis for the state to conduct lending to agencies and local financial institutions.

How does AB 310 protect the Pooled Money Investment Account (PMIA)?

Over half of the PMIA ($52.2 billion) is invested in federal treasuries offering around 1% interest. The current performance of the PMIA for 2020 is about 1.7% yield.

The funds invested into the IBank can immediately be used to buy municipal bonds at below-market rates that still generate a return to the PMIA that exceeds that received by Treasuries in the current rate environment. By buying bonds with even a 50 bps spread, the IBank will receive comparable returns to what it is getting from Treasuries, but will capitalize municipalities at a far cheaper rate than what they can get under the federal Municipal Liquidity Facility. The short-term securities purchased by the PMIA can be rolled over to match the maturity on 1- or 2-year municipal bonds, e.g. 180-day notes renewed to match a 1-year bond.

Is AB 310 based upon previous bills?

The bill draws from the framework of SB 528 (Hueso), but would make major modifications address specific concerns with that legislation that were raised by committee consultants during the course of bill hearings, namely:

Source of Capital: Unlike in SB 528, the State Public Bank would be capitalized by the PMIA. The PMIA would purchase equity in the IBank pursuant to specific statutory authorization in Government Code Section 16430. We note that there is precedence for this. The PMIA was authorized to invest in the "operations and startup" of the IBank pursuant to Government Code Section 63031.

Governing Board: The bank will be under the authority of a Commission composed of the Governor, Treasurer and Controller. The Commission appoints the board of directors, who in turn, appoints the executive director. This is modeled after best practices in corporate governance, wherein the State of California is the shareholder and the Commission is its representative.

The commission will not include the former Governor, as was provided in SB 528, nor will appointments of the board of directors or executive director require confirmation of the legislature.

Viability of the bank. The Senate Banking and Finance Committee consultant relied upon the San Francisco Treasurer's Task Force Report to note that the cost of forming a state bank is not negligible. However, the consultant's analysis failed to acknowledge critical differences between a state and municipal bank. First, unlike a municipal public bank, the state bank does not need FDIC insurance because it is not holding consumer deposits and it is able to self-insure. Second, the state has access to the entire state economy, a much wider pool of depositors, including the State, its agencies, local agencies, and retirement plans set up by local agencies. Many local agencies would be incentivized to join the state bank as depositors in order to use its services.

How would the State Public Bank start: The State Public Bank will take a phased approach by expanding the IBank's core competencies in municipal lending and partnership co-lending with local financial institutions. From there, it will work with the Department of Business Oversight to receive depository authority by January 2022.

How would this bill expand the credit available to small businesses?

The State Public Bank bill dramatically expands the IBank's Small Business Loan Guarantee Program and creates a new loan guarantee for underserved and disadvantaged small businesses. It also allows the IBank to expand its small business partnership lending.

As a loan guarantor, the impact of the IBank would not be limited to direct lending, but by the demand in secondary markets for government-guaranteed debt securities, which could be many times larger, potentially in the trillions of dollars. A loan program targeted at lending to Black-owned businesses, for example, with even a partial guarantee of principal would be a safe and secure investment for institutional investors such as pension and insurance funds. These funds would purchase guaranteed public bank loans in bulk, allowing the bank to recycle its funds into new qualified loans, growing the pie. By carrying a lower risk profile, they could demand a lower interest rate, which would lower the cost of capital for all borrowers while focusing those benefits on the areas of the economy that need them most.

What does the IBank currently do for financing local government and infrastructure projects?

The California Infrastructure and Economic Development Bank (I-Bank) is a revolving fund established in 1994 with state funds. It operates under the Governor and the Governor's Office of Business and Economic Development (GO-Biz). The I-Bank has grown over the past two decades, and is currently providing infrastructure financings using funds from tax-exempt revenue bonds and the profits from its financings. Financings by the I-Bank are done at an average of 3 percent; this equals its own cost of borrowing and is below the interest paid by public entities for their own financings in the public market. The origination and issuance fees of the I-Bank are lower than those of commercial banks, at 2 to 3 bps versus 6 to 10 bps.

IBank has financed more than $40.5 billion of infrastructure and economic development projects that promote a healthy climate for jobs, contribute to a strong economy, and improve the quality of life for Californians.

IBank financed more than $720 million in low-cost Infrastructure State Revolving Fund (ISRF) loans to State and local governmental entities for infrastructure and economic expansion projects since 1999. Since 2014, IBank has financed more than $270 million in ISRF loans that have had an enormous economic impact throughout the State in projects and creating and retaining jobs.

IBank issued more than $39 billion of tax-exempt and taxable conduit bonds for public agencies, nonprofits, manufacturing companies, and exempt facilities since 1995. The IBank receives fees for handling this conduit service.

Since 2002, IBank issued more than $480 million of ISRF Bonds to provide the revenue source for direct, low-cost financing to public agencies for infrastructure and economic expansion projects.

What is the mission of the State Public Bank?

The State Public Bank will be established for the people of California to bank the state's funds, make credit available to local governments, affordable housing, locally-owned renewable energy, local small businesses, and expand financial services for all residents of the State.

The State Public Bank will develop standards to prevent discrimination in financial services and markets (e.g. redlining and racial disparities in housing policy), expand investment in public goods, and provide services to workers and businesses to ensure they benefit from the full value of the work they do.

The State Public Bank will support a network of local public banks to develop financial centers of excellence that address local issues with local expertise and accountability.

How would the State Public Bank be governed?

The State Public Bank will be overseen by a Commission consisting of the Governor, Treasurer and Controller. The Commission will appoint the board of directors of the bank, which includes finance/banking professionals and representatives of communities of focus (labor, housing, environmental justice, frontline communities, technology)

Is this a short-term fix?

The compelling justification for the creation of a State Public Bank goes well beyond economic recovery. AB 310 provides long-term benefits, so it is not simply a short-term fix.

Creation of the bank is the first step in creating a shared infrastructure from which local funds can be directed to address local priorities in a locally accountable manner; the long term needs of our communities are divorced from the short-term priorities of Wall Street; we fully utilize the financial and human resources of California to reverse generations of disinvestment, economic disparity and income inequality in a manner that is financially sustainable, fiscally responsible, and in alignment with <u>our</u> values, irrespective of who is in the White House.

How does the bill help the formation of local public banks?

The bill requires the state bank to assist the formation of local public banks by providing technical assistance for local public bank viability studies, business plans and charter applications; developing loan facilities and credit for public banks; liaising with the Federal Reserve and federal agencies on behalf of local public banks; and developing a plan to create a network of public banks to pool risk, insurance, technology, compliance, and administrative capacity.

Local public banks should be thought of as "financial centers of excellence" to deal with specialized rural, agricultural, coastal, urban and cultural markets. They will serve as centers of gravity in local areas and provide a continuum of services from state and federal programs connected to local priorities. Conventional large banks don't have the same on-the-ground knowledge and local community banks are disappearing quickly.

Having a source of expertise and capital from which communities and businesses can turn to, and from which large and small banks can partner with, is a blinding flash of the obvious which would spur the deployment of capital, growth of businesses, and the creation of jobs while sharing the risk and providing a stable return on investment of taxpayer funds.

How would the State Public Bank expand its partnerships with local banks?

The IBank already has partnerships with local banks, in which it provides loan guarantees. In order to expand into co-lending and partnership lending, in Step 1, the bank would establish a program with underwriting standards, forms and guidelines and expand its staff of experienced underwriters and compliance professionals to ensure the soundness and completeness of all qualified loans and lenders. The State Public Bank would distribute program standards and guidelines to licensed California lenders and establish a point of business for participants to apply for qualification. When approved, the lender would then market the credit product to their customers, such as local businesses, and perform all preliminary and primary underwriting and qualification. Once a borrower satisfies a lender's standards and completes a qualified loan package, the lender would advance loan funds and later transfer the loan to the state bank, or submit the loan in advance of closing with the state bank as the originating lender or beneficiary. The details of each program would vary with the loan size, borrower profile, and lender specialization.

What effect will the State Public Bank have on the banking industry as a whole?

A State Public Bank is a policy tool to set higher banking standards and address issues of financial discrimination and redlining.

As a dominant actor in the state economy, the State Public Bank has power to influence and set standards for the local banking industry. If local banks want to participate with the Public Bank, they will need to maintain or adopt high standards.

A State Public Bank would bring back revenues and profits to California rural and urban communities representing viable banking markets that are currently ignored by Wall Street Banks. By correcting a market inefficiency (both the decreased credit availability to affordable housing, small businesses, and renewable energy and the extraction of profits and tax base from local jurisdictions), public banks build a stronger foundation for an equitable economy.

How would the State Public Bank avoid competing with private banks?

The IBank is currently prohibited from accepting deposits or engaging in individual retail services. It is also prohibited from competing with banks. It can provide loans, as evidenced through its Jump Start Program, but those loans are targeted to disadvantaged individuals. AB 310 would similarly limit the ability of the state bank to accept retail deposits. It would only accept state and local government deposits. On the lending side, its primary focus is as a partner lender.

What are other key points about public banks, including a California State Public Bank?

- Address local issues: 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.
- Partnership with local banks: Public banks bolster and enhance local bank and credit union activities, enabling lending capital for local businesses.
- Address housing crisis: Public banking enables a viable means of publicly financing housing and infrastructure projects to remediate our statewide housing crisis.
- Protection during downturns: A robust public banking network in California provides strong protections against insolvency of large banks in periods of economic duress.
- Builds assets for local constituents: Public banks return interest and fee revenues to the communities they serve, creating value revenue reserves for local constituencies.
- Public accountability: Unlike commercial banks which must prioritize shareholder returns over obligations to the public, Public banks promote a transparent, independent and publicly governed finance system that is accountable to the people they serve.
- Provides a mechanism for divestment: Public banks create a stable means of divestment of public deposited funds and investments from unethical banking organizations and industries.

How does the Bank of North Dakota relate to this bill?

The Bank of North Dakota provides an example of the long-term benefits of a fiscally prudent public bank that focuses on local needs alongside local partners.

Established by the North Dakota legislature in 1919, the Bank of North Dakota (BND) is the oldest publicly owned bank in the United States. BND, in partnership with local banks and credit unions, promotes economic development within the state and has been profitable for many years. Recently, several states and cities across the nation have started exploring the feasibility of creating public banks.

The Bank of North Dakota relies on the guarantee of the full faith and credit of the State of North Dakota and does not carry FDIC insurance. It has access to the Federal Reserve system via a master account number.