

# AB 857 Overview

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# Section 16 contents

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- 57600 - definitions
- 57601 - entity formation
- 57602 - FDIC insurance requirement
- 57603 - operations/local agencies
- 57604 - noncompetition
- 57605 - not a bank holding company
- 57606 - viability study and other pre-application requirements
- 57607 - pilot program limits

# FYI: other parts of the bill

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- Allows local agency investments in commercial paper, debt securities, or other obligations of a public bank
- Exempt from state, county, and municipal taxes
- Open meetings (Brown Act) requirements apply except for provisions allowing for closed sessions for loan/investment decisions; internal audit, compliance, or governance committee meetings; or meetings with state/federal regulators

# § 57600 – definitions

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- **Local financial institution:** CDFI, credit union, or small/intermediate bank per federal Community Reinvestment Act regulations
- **Public bank:** *nonprofit mutual/public benefit corporation* organized for the purpose of engaging in banking “that is wholly owned by a *local agency*, local agencies, or a joint powers authority ...composed only of local agencies”
  - If local agency is within a county with population < 250,000, must be through JPA
- **Public bank license:** certificate of authorization to transact business as a bank

# What is a “local agency”?

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Government Code § 50001:

“Local agency” as used in this *division* means county, city, or city and county, unless the context otherwise requires.

Other uses of “local agency” in the Government Code include school districts, water districts, CCAs and other public corporations

# § 57601 - entity formation

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- In California, there are two types of nonprofit corporations:
  - Mutual Benefit - benefits members
  - Public Benefit - benefits the public
- Tax-exempt status (at federal level) is sought and received separately from entity formation
- Public banks may make distributions to members

# § 57602 – FDIC insurance requirement

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(a) A public bank shall obtain and maintain deposit insurance provided by the Federal Deposit Insurance Corporation under the Federal Deposit Insurance Act (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 – operations/local agencies

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(a) Before engaging in business, a public bank shall obtain a certificate of authorization to transact business as a bank pursuant to Division 1.1 of the Financial Code (commencing with Section 1000).

(b) A local agency shall comply with the requirements of [Section 53638](#) with respect to its deposits in a public bank unless, with the prior approval of the Commissioner of Business Oversight [DFPI], the public bank and the local agency depositor agree otherwise.

- Deposit cannot exceed depository's equity

# § 57603 – operations/local agencies

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- (c) Notwithstanding [Section 23010](#), a county may **lend** any of its available funds 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 – noncompetition – definitions

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- (1) “**Conducted in partnership with**” means pursuant to a written agreement with a local financial institution to provide financial products and services to the public located within the jurisdiction of the public bank.
- (2) “**Infrastructure lending**” means granting a loan or extending credit to a local agency for the purpose of building or improving public infrastructure, including housing projects, as defined in [Section 34212](#) of the Health and Safety Code, and affordable housing, as defined in subdivision (a) of [Section 62250](#).
- (3) “**Local agency banking**” means providing any of the following services to a local agency:
  - (A) Accepting a deposit of any kind.
  - (B) Granting a loan or extension of credit of any kind.

# § 57604 – noncompetition – definitions (cont'd)

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(4) “**Participation lending**” means purchasing or selling an interest in a loan or loans originated by or sold to a local financial institution, or originating, leading, or directing a loan transaction involving a local financial institution pursuant to a written agreement with the local financial institution.

(5) “**Person**” means a person as defined in [Section 127](#) of the Financial Code, except that a person does not mean a local agency as defined in [Section 50001](#) of the Government Code, but includes any individual employed by a local agency.

(6) “**Retail activities**” means providing any kind of financial product or service to a person that is typically offered or provided by a local financial institution, including, but not limited to, all of the following:

(A) Accepting a deposit of any kind from a person, including the issuance of shares by a credit union.

(B) Granting a loan or extension of credit, of any kind, to a person.

(7) “**Wholesale lending**” means granting a loan or extension of credit to a local financial institution.

# § 57604 – noncompetition

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(b) *Except as provided in paragraph (2) of subdivision (c), a public bank shall conduct retail activities in partnership with local financial institutions and shall not compete with local financial institutions.*

(c) A public bank may do both of the following:

(1) Engage in all of the following banking activities:

(A) Local agency banking.

(B) Infrastructure lending.

(C) Wholesale lending.

(D) Participation lending.

(2) **Engage in retail activities without partnering** with a local financial institution, **if those retail activities are not offered or provided by local financial institutions in the jurisdiction** of the local agency or agencies that own the public bank.

# § 57605 – not a bank holding company

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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 – viability study

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Before submitting application, “local agency shall conduct a study to assess the viability of the proposed public bank”.

## **Required elements of study:**

- 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.
- A **fiscal analysis of costs** associated with starting the proposed public bank.
- An estimate of the **initial amount of capital** to be provided by the local agency to the proposed public bank.
- **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.
  - 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.
- Legal analysis on whether structure/operations of PB comply with [Article XVI, Sec. 6](#) of the CA Constitution
- Analysis of governance structure and protection against insider transactions and apparent conflicts of interest

# § 57606 – viability study (cont'd)

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## Optional elements:

- Benefits of proposed public bank:
  - **Fiscal analysis of benefits**, e.g.: cost savings, jobs created, jobs retained, economic activity generated, and private capital leveraged
  - **Qualitative assessment of social or environmental benefits**
- Costs of current bank:
  - **Estimate of the fees paid** to the local agency's current banker or bankers.
  - **Fiscal analysis of the costs**, including social and environmental, of continuing to do business with the local agency's current banker or bankers.

# § 57606 – viability study approval

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- Study must be presented to and approved by majority of local agency governing body (City Council or Board of Supervisors)
- **Not applicable to charter cities:** Voter referendum “the motion to move forward with an application for a public banking charter shall be subject to voter approval at the next regularly scheduled election held at least 180 days following the vote of the governing body.”
- Local agency must make publicly available the **financial models** and **key assumptions** from the viability study prior to presentation of study for governing body approval

# § 57607 – pilot program limits

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- ≤ 2 licenses issued per calendar year
- 10 licensed public banks maximum
- After issuance of 10th license, DFPI has two years to conduct a study on public banking in the state
- “(d) The Commissioner of Business Oversight [DFPI] shall not issue a public bank license after the expiration of a period of seven years from the date upon which the commissioner first promulgates regulations for the purpose of carrying out the commissioner’s duties under this division.”
  - Clock starts running at finalization of regulations: September 14, 2021

# Regs: Financial Product definition

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## § 10.131.7. Financial Product or Service.

(a) For purposes of Government Code [section 57604](#), “financial product or service” means a type of product or service offered by a financial institution, such as a loan or a checking account or a savings account. Products and services are considered the same if they are in the **same product category** such as being a loan, a checking account or a savings account, and offer the **same, or substantially similar product features, benefits and terms** such as fees and interest rates charged or earned.

# Regs: Financial Product definition (cont'd)

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- $\leq 90$  days before offering: submit comprehensive documentation to support that a product is not offered by a local financial institution
  - Local market product offering surveys, including type, fees, interest rates, additional terms
  - Any other information, e.g. declarations from “secret shoppers”
- $\geq 30$  days before offering: submit written request to DFPI for approval to offer product
- If no answer from DFPI in 30 days, OK to offer

# Proposed Regs: Local Financial Institution

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## § 10.140.6. Local Financial Institution.

- For purposes of Government Code [section 57604](#):
  - § [57600](#) definition applies: CDFI, credit union, or small/intermediate bank per federal CRA
  - Further defined: financial institution that has a **physical presence** within the jurisdiction of the public bank at issue
- **Physical presence:** one or more **branch offices**. A financial institution shall not be considered as having a physical presence within the jurisdiction of a public bank solely because the financial institution has [ATMs], loan production office(s), or non-banking office(s) performing only corporate, administrative or back office functions within such jurisdiction.

# Regs: Reasonable Promise of Successful Operation

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## § 10.3301.1. Reasonable Promise of Successful Operation.

In evaluating an application for authority to organize and establish a corporation to engage in the banking or trust business, Financial Code [section 1023](#) requires the commissioner to ascertain whether a proposed applicant will have a reasonable promise of successful operation. As an administrative standard, reasonable promise of successful operation is evaluated by the **likelihood of achieving the goals laid out in the applicant's financial projections**, such as **financial stability, solvency, and reserves**.