CITY AND COUNTY OF SAN FRANCISCO
BOARD OF SUPERVISORS
BUDGET AND LEGISLATIVE ANALYST

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Policy Analysis Report

To:	Supervisor Fewer
From:	Budget and Legislative Analyst's Office
Re:	Community Supportive Banking Options 2017 Update
Date:	November 27, 2017

Summary of Requested Action

Your office requested that the Budget and Legislative Analyst research options for ways that the City may invest its funds in community-supportive banking institutions, including those that invest more in local small businesses, single family homeowners, and community development. Your office asked us to report on a variety of municipal banking options, including private, credit union, and public banking systems, with a focus on any examples of existing public banks in other jurisdictions.

For further information about this report, contact Fred Brousseau at the Budget and Legislative Analyst's Office.

Executive Summary

- The City and County of San Francisco's use of banks is governed by its operational needs for banking services and State laws requiring that City and County funds are safely invested, remain relatively liquid, and produce a yield or return on funds it controls. The San Francisco Office of the Treasurer and Tax Collector has additional investment policies that address social responsibility matters to be applied in addition and subordinate to State requirements. The social responsibility policies encourage investments in entities that support safe and environmentally sound practices, fair labor practices, non-discriminatory practices, community economic development, and affordable housing, and have a demonstrated commitment to reducing predatory mortgage lending.

Current City banking arrangements and policies

City banking assets
(6/30/16)

Short-term cash accounts:
$228.6 million

accounts: 183

Pooled Fund Portfolio:
$8.3 billion

- The City and County of San Francisco (the City) currently uses large national commercial banks for most of its banking services. While these banks all make loans and provide contributions to socially responsible initiatives such as small business loans and affordable housing programs, such activity is not their primary purpose and San Francisco is not their primary target for such efforts since they operate throughout the country and the world. However, the Office of the Treasurer and Tax Collector reports that using these large national commercial banks is necessary since they are unique in being able to provide all of the City's needed services and can ensure that the City's assets are safe.
- The Office of the Treasurer and Tax Collector has historically deposited a small amount of City funds in credit unions and community development banks that place a greater emphasis on social responsibility and local investment than the large national banks. However, insured funds in such institutions are limited to $250,000 per account so only City funds under that amount can be invested in any one institution, making widespread use of these institutions impractical for City financial operations. As of October 2017, the Office of the Treasurer and Tax Collector has initiated a new program that could result in up to $80 million in City funds being invested in San Francisco-based banks, credit unions, and community development banks within a year. This could result in a higher level of City funds deposited in credit unions and community development banks by October 2018.

The banking industry has become more concentrated in recent years, particularly for large national commercial banks

- The number of banks and credit unions in California decreased between 2011 and 2014, with greater asset concentration in those that remain. State-chartered commercial banks decreased from 188 in 2011 to 135 in 2016, with average assets increasing from $1.3 billion to $3.3 billion. For large national commercial banks such as those used by the City for most of its banking services, the number of institutions decreased from 49 to 30 during the same period, and average assets increased from $3.6 billion to $8.8 billion. Credit unions have also experienced greater concentration, but at a much lower rate.
- The City currently has short-term accounts for funds used for frequent expenses such as payroll and a longer-term account, known as the Treasurer's Pooled Fund Portfolio, for funds that can be invested in longer-term instruments as they are not needed for short-term use. As of

June 30, 2016, the City had $228.6 million in short-term accounts and $8.3 billion in its Treasurer's Pooled Fund Portfolio.

Alternatives for more City resources being used for loans to San Francisco small businesses, low-income residents, and for affordable housing and other community development initiatives

Options for City banking

- Commercial banks
- Credit unions
- Community development financial institutions
- Public bank

- To use more of the City's financial resources in San Francisco for loans to small business, low-income residents and for affordable housing, other institutions and approaches for the City to consider include:
  - placing more City funds in credit unions or community development banks whose purposes are more consistent with serving underserved residents and community development initiatives,
  - expanding existing or establishing new City programs that serve these communities and purposes, and
  - creation of a municipal bank.
- Large commercial national banks currently serving the City do make loans to small businesses and support affordable housing. However, these are not their primary business lines and San Francisco is a small part of their national and international markets. As a result, the City's current banking arrangements are less likely to maximize the use of City funds for San Francisco community and economic development objectives.
- The Office of the Treasurer and Tax Collector points out that greater use of credit unions and community development banks has historically had limited application for the City because their deposits are only insured up to $250,000 and they are not able to provide the diverse mix of services that larger banks can provide. As mentioned above, a new program announced by the Office of the Treasurer and Tax Collector in October 2017 and described further in this report may change this pattern and allow for greater use of San Francisco-based credit unions and community development banks.
- The City currently has a number of programs and services with community development objectives directed to traditionally underserved populations. As of July 2017, these programs have approximately $86.0 million in loans outstanding. For FY 2016-17, the City has appropriated $3,771,663 for financial services for traditionally underserved populations and provided $756,000 in technical assistance services to small businesses in San Francisco. Such programs could be enhanced or added to though the level of funding that could be made available for such purposes from City funds

now deposited with the City's commercial banks could significantly expand funding available for such purposes.

The City Attorney's Office has opined that previously reported legal impediments would not, in fact, prevent the City from creating a public bank

- When the topic of the City creating a public bank was reviewed by the Budget and Legislative Analyst in 2011, we reported that the State law that prohibits counties from giving or loaning their credit to or in aid of any person or corporation[1] precluded the City from establishing a public bank. This conclusion was based on information and City staff representations available at the time. Since then, the City Attorney reviewed pertinent State codes in detail and concluded that, in fact, State law does not preclude the City from creating a bank as a separate legal entity.
- Key findings by the City Attorney's Office are that the State prohibition would not apply to the City creating a public bank because: 1) San Francisco is a charter city and county and the law applies to counties, 2) creation of a bank as a separate legal entity would remove the issue of the county giving or loaning its credit, and 3) a public bank serving a public purpose would be supported by case law.

Though successful, the Bank of North Dakota is currently the only public bank in the U.S.

Snapshot: Bank of North Dakota

- Created 1919
- Receives all State of North Dakota funds as deposits.
- 100+ community partner banks provide loans to local businesses
- Assets (2016): $7.3 billion
- Net Income (2016): $136 million

- The Bank of North Dakota is the only public bank operating in the U.S. at present. Created in 1919, all State of North Dakota funds are constitutionally required to be deposited in the bank. Private citizens may also make deposits in the bank but such deposits constitute a small portion of the bank's business. The Bank of North Dakota makes loans directly and partners with more than 100 other North Dakota community and regional financial institutions that provide loans to local businesses and citizens.
- According to its annual report for 2016, the Bank of North Dakota had assets of $7.3 billion, $136 million in net income, and achieved its thirteenth year of profitability. The Public Banking Institute reported that the State of North Dakota has had one of the lowest unemployment rates in the nation, and withstood the financial

[1] California Government Code Section 23007.

crisis of 2008 by having a steady flow of credit available to its member banks, which provided loans to small businesses and community members when it was difficult to obtain credit from many commercial banks.

A number of cities and states are studying or considering legislation to create a public bank

- A number of cities and states have shown interest in creating a public bank in recent years. The California State Assembly approved a bill in 2011 to establish a task force to study a state bank for California but the Governor did not sign the bill. Another bill was introduced in 2012 to establish a public bank, but was withdrawn before being considered by the State Assembly.
- Other cities considering creation of or feasibility studies for public banks over the last two years include Philadelphia, Santa Fe, and Oakland. Legislation to explore establishing public banks was passed in Philadelphia and Santa Fe, and the Oakland City Council is considering funding a feasibility study to establish a public bank.
- The states of Arizona, Vermont, Minnesota, New Hampshire, and Washington all have legislation pending to establish state banks. Recent proposals in Hawaii, Illinois, and Maine to establish state banks were not passed by their legislatures.

Jurisdictions considering public banks, 2016 and 2017*

Jurisdiction	Bill Status
Oakland, CA	Pending in Committee
Philadelphia, PA	Passed; Hearings held
Santa Fe, NM	Passed
Arizona	Assigned to committee
Hawaii	Deferred by committee
Illinois	Did not pass House by end of session
Maine	Did not pass
Minnesota	Pending in Committee
New Hampshire	Pending in Committee
Vermont	Pending in Committee
Washington	Pending in Committee

*As of August 2017

Creation of a municipal bank in San Francisco would require a number of key steps and investments to become operational

- Key steps for the City to take to create a public bank would include:
    1. Creation of agreed upon goals and a founding policy statement by the Board of Supervisors and other City stakeholders including the Office of the Treasurer and Tax Collector and Mayor.
    2. Retention of staff and/or consultants to conduct detailed financial feasibility studies for the bank and create the administrative infrastructure of the bank.
    3. Appointment of an independent board of directors and creation of articles of incorporation.
    4. Development of a multi-year business plan to: identify amounts and sources of funds to capitalize the bank to meet its reserve requirements and cover ongoing operations, define its ongoing capital structure, determine whether or not to originate loans directly or to partner with other financial institutions, identify ongoing staffing needs and administrative costs, identify reserve requirements, and determine mechanisms for ensuring the bank's accountability and independence.
    5. Determination of whether to be charted by the State of California or the federal government and whether or not to become a Federal Reserve Bank member.
- Sources of funds possibly available for municipal bank capitalization include a General Fund appropriation such as from unassigned fund balance or other sources, monies legally available from other City funds, a City bond issue, and one-time funding from philanthropic organizations. An appropriation of funds without repayment requirements would be preferable; to the extent funds are provided as a loan subject to repayment by the new municipal bank, the less funding it will have available for originating loans and making investments to achieve its community and economic development goals.

A municipal bank could potentially provide banking services for the cannabis industry in San Francisco

- Twenty-six states, including California and the District of Columbia have legalized certain marijuana-related activities. Because marijuana is illegal at the federal level, many marijuana-related businesses do not have access to banking services and have to conduct all their business in cash.

- The Bank Secrecy Act of 1970 requires U.S. financial institutions to report suspicious activity that might signify money laundering to the U.S. government, including reporting on the financial activities of marijuana businesses. Because of this requirement, many banks do not accept marijuana-related businesses as customers.
- If the Board of Supervisors chooses to pursue a public bank, it could explore whether to make serving the cannabis industry one of its principles. This would require monitoring and reporting on those businesses for suspicious activity but would also provide access to banking services to an industry whose access is currently limited. Should the Board of Supervisors choose to pursue a public bank option, it should request an opinion from the City Attorney's Office on legal issues regarding serving the marijuana industry.

Policy Options

In light of the information presented in this report, the Board of Supervisors could consider the following community supportive banking options in the interest of making more use of the City's funds to better achieve community and economic development goals:

1. Recommend to the Office of the Treasurer and Tax Collector more investment of City funds in local credit unions or community development banks whose loan and investment policies are more aligned with the City's City community and economic development objectives.
2. Support additional funding for expansion of existing City community development programs.
3. Take steps to establish a San Francisco public bank.
4. Request that the Office of the City Attorney assess the risk and legal issues associated with a San Francisco public bank serving the cannabis industry.

Project staff: Fred Brousseau, Christina Malamut, and Mina Yu

Overview

This report describes City banking policies and practices and options for ways that the City could invest its funds in community-supportive banking institutions, with a focus on public banks. The report: (1) defines various community-supportive banking institutions and describes pertinent regulatory frameworks and requirements; (2) describes the City's current banking arrangements as well as current City programs that provide loans or banking services to San Francisco residents and small businesses; (3) presents information on the Bank of North Dakota, the only currently existing public bank in the U.S., as well as recent legislative efforts to establish public banks in other jurisdictions; (4) describes considerations for establishing a public bank in San Francisco, with a focus on implementation options; and (5) discusses issues pertaining to a San Francisco municipal bank serving the cannabis industry.

This report is organized as follows:

Background: Update to Legal Issue Pertaining to City Creation of Public Bank

This report is an update to a 2011 Budget and Legislative Analyst report on Community Supportive Banking Options.[2] Based on input from City officials at the time, the Budget and Legislative Analyst concluded in that report that the primary impediment to the City and County of San Francisco creating a public bank was

[2] Budget and Legislative Analyst Report to Supervisor Avalos: Community Supportive Banking Options, September 8, 2011, Updated.

California Government Code Section 23007, which states that “a county shall not, in any manner, give or loan its credit to or in aid of any person or corporation,” and that a change in State law would be required for the City to create a public bank. At the time, the issue had not been researched by the City Attorney and, as is still the case today, no public bank had been created in California or by a city or county anywhere in the U.S. However, as a follow up to the 2011 Budget and Legislative Analyst report, the City Attorney’s Office issued a memorandum on June 21, 2013, to then Supervisor John Avalos, opining that Section 23007 does not present a legal impediment for the establishment of a San Francisco public bank.

The key conclusion in the 2013 City Attorney opinion is that a court would likely conclude that California Government Code Section 23007 does not apply to San Francisco since it is a chartered city and county and the law is directed to counties. Further, the City Attorney pointed out that the City and County of San Francisco’s charter supersedes its county powers, that creation of a bank as a separate legal entity from the City and County of San Francisco (the City) would further remove the applicability of Section 23007 to this situation since the law is directed to counties loaning their credit but not to banks used by counties, and that creation of a public bank would be permissible under case law if it served a public purpose.

1. Spectrum of Banking Options and Regulatory Frameworks

The following types of financial institutions could be used by the City and County of San Francisco to meet its banking needs: commercial banks, credit unions, community development banks, and public banks. Savings and loans are not included in this discussion as they offer more limited services to large institutional customers than commercial banks and because they are limited by law in that most of their loans must be residential. Excluding public banks, none of these types of financial institutions are structured or have the resources to both meet the City’s banking needs and to maximize the investment of City deposits for community development, affordable housing, and related City public policy goals.

A public bank could be better equipped to meet the City’s business needs and public policy goals, but, at present, only one public bank, the Bank of North Dakota, exists in the U.S. While the Bank of North Dakota has operated successfully and met its public policy goals since 1919, it would not likely be a feasible option for it to provide San Francisco’s banking needs since its business operations and public policy goals are geared to the State of North Dakota.

Commercial banks

Large national commercial banks provide most of the City's banking services at present. The Treasurer and Tax Collector's Office, which is responsible for selecting and overseeing the financial institutions that provide the City's banking services, has explained that the size and complexity of the City's banking needs, detailed further below, necessitate the use of larger commercial financial institutions. However, as described below, the Office of the Treasurer and Tax Collector has historically deposited a limited amount of City funds in a number of credit unions and community development banks, some of which have loan policies more aligned with community development goals such as serving small businesses, homeowners and other community development efforts in the City.

A commercial bank is a for-profit financial institution that makes loans and accepts deposits, is owned by private investors, and is organized to provide a financial return to its investors. A commercial bank may offer some of the same services as a credit union, community development bank or other type of financial institution, and may even be chartered or supervised by some of the same regulatory entities, but the profit-generating purpose of commercial bank distinguishes it from these other types of financial institutions that include a community- or member-supportive mission.

Commercial bank regulation in the U.S. is complex and involves several entities and options. Known as a "dual chartering system" or "dual banking system", banks in the U.S. may establish themselves as either national or state-chartered banks but, in either case, they must be overseen by at least one federal banking oversight agency. Choosing whether to be a national or state bank and whether or not to join the Federal Reserve System dictates the regulatory structure for banks, as follows:

- National banks are regulated by the Office of the Comptroller of the Currency within the U.S. Treasury Department. All national banks must become part of the Federal Reserve System, which involves meeting certain reserve requirements and being able to access services from the regional Federal Reserve Bank such as check processing, wire transfer services, and access to loan funds through the Federal Reserve's discount window.
- State banks are regulated by an agency in their state and have the option of joining the Federal Reserve System. Those that choose to join are overseen by a regulatory body in their state and supervised by the Federal Reserve Bank for their region. State banks that do not join the Federal Reserve System are subject to oversight by their relevant state agency and federal supervision by the Federal Deposit Insurance Corporation (FDIC).

These chartering and regulatory agencies ensure that the banks have the necessary capital, expertise, and systems to safely meet the public's banking needs. The various oversight agencies conduct examinations of the banks under their jurisdiction to continually monitor their operations and compliance with applicable banking laws.

Federal Reserve System membership requires that member banks contribute three percent of their capital to their regional Federal Reserve bank and another three percent to the national system. Depending on their level of asserts, they receive a dividend on their capital of six percent or a rate equal to the high yield of the 10-year Treasury note each year that their regional Federal Reserve Bank is profitable.

A bank operating or seeking to operate in multiple states may choose a national charter to have only one regulatory agency, rather than several state agencies with different rules, and to take advantage of Federal Reserve System services. Conversely, a bank operating or seeking to operate solely in one state may choose a state charter, and a single state and a single federal regulatory agency.

The State of California's Division of Financial Institutions within the Department of Business Oversight (DBO) oversees the operations of California's state-chartered banks as well as credit unions and several other types of financial institutions based in California. The DBO asserts that there are several advantages to seeking a State charter, including greater access to DBO's regulatory services than institutions would have with federal regulators, lower fees and assessments, streamlined examination processes, and director training opportunities, among others.[3]

Credit Unions

A credit union is typically defined as a nonprofit cooperative financial institution owned and run by its members. While credit unions offer many of the same banking services as commercial banks, including checking and savings account and loan services, their organizational structure differs from commercial banks. Commercial banks are corporations owned by private investors and organized to return profit to investors, while credit unions are cooperatively owned by members, or depositors, who share in the benefits accrued by the credit union. Credit unions can focus their loans on specific geographic areas and/or types of

[3] "Advantages of State Charter," California Department of Business Oversight, http://www.dbo.ca.gov/cacharter/advantages.asp

loans such as home loans for low-income households. Credit unions are intended to provide their members with a safe place to save and borrow at reasonable rates. They are governed by volunteer boards that are elected by the members[4].

Like commercial banks, credit unions in the U.S. may elect to be chartered either on the federal or state level. Credit unions may be chartered and supervised on the federal level by the National Credit Union Administration (NCUA), an independent federal agency, or on the state level by the state's regulatory body overseeing credit unions. In California, the Credit Union Division of the California Department of Business Oversight oversees State-chartered credit unions. The statutory definition of a credit union provided by California Financial Code Section 14002 is similar to the NCUA definition but does not include the word "nonprofit".

Credit unions do not have the same objective as commercial banks of maximizing financial returns to investors. As of the writing of this report, the City had deposited a small amount of its funds in five credit unions. However, because deposits are insured at each institution for a maximum of only $250,000, City policy is to not invest more than $240,000 in any one institution. While San Francisco-based credit unions generally provide more loans to local residents and businesses for purposes aligned with community development objectives, depositing a large portion of City funds in credit unions would not be very efficient because the funds would have to be spread among many institutions. No City funds were deposited with credit unions as of August 2017.

Community Development Banks

The City also deposits a limited amount of its funds in community development banks. As of August 2017, City funds were deposited in four community development banks.

A community development bank is a mission-driven private financial institution that provides financial services to individuals, businesses, and communities underserved by traditional financial institutions. Though not required, community development banks can be certified by the federal Community Development Financial Institution Fund within the U.S. Treasury Department pursuant to the Community Development Banking and Financial Institutions Act of 1994 (also called the Riegle Community Development and Regulatory Improvement Act of 1994). Certification entitles the community development bank to financial and technical assistance from the Community Development Financial Institution Fund

[4] California law does not allow members of credit union boards of directors to be paid, but this is not true in all states.

and other benefits such as access to the New Markets Tax Credit program, eligibility for partnerships with banks seeking Bank Enterprise Awards from the Fund, and greater stature when seeking grants and state and local funding. While there are many benefits to this federal certification, it is not required and community development banks can operate in the U.S. without it.

The Community Development Financial Institutions Fund (CDFI Fund) was created for the purpose of promoting economic revitalization and community development through investment in and assistance to community development financial institutions (CDFIs). Key attributes of Community Development Financial Institutions are defined in the Riegle Community Development and Regulatory Improvement Act of 1994 as follows:

i. has a primary mission of promoting community development;
ii. serves an investment area or targeted population;
iii. provides development services and equity investments or loans directly, through an affiliate, or through a community partnership;
iv. through representation on its governing board or otherwise, maintains accountability to residents of its investment area or targeted population; and
v. is not an agency or instrumentality of the United States, or of any state or political subdivision of a state.

The CDFI Fund operates several programs whereby monetary awards and the allocation of tax credits support qualifying CDFIs in their economic, business, and community development goals.[5] Only certified CDFIs may access CDFI Fund awards. According to the CDFI Fund, CDFIs include regulated institutions such as community development banks, commercial banks, credit unions, and non-regulated institutions such as loan and venture capital funds, provided they meet the community development criteria spelled out above.[6] Since a CDFI may take these various forms, there are multiple federal regulators of these institutions. For example, a credit union seeking CDFI funds would need to meet the certification and regulatory requirements of the CDFI Fund of the U.S. Department of the Treasury in addition to those of the Federal Deposit Insurance Corporation and National Credit Union Administration if it is a federal credit union, or the Division of Financial Institutions under the California DBO if it is a state-chartered financial institution.

[5] Overview of What We Do, Community Development Financial Institutions Fund, U.S. Department of the Treasury.
[6] CDFI Certification, Community Development Financial Institutions Fund, U.S. Department of the Treasury. < https://www.cdfifund.gov/programs-training/certification/cdfi/Pages/default.aspx>

According to the U.S. Treasury's CDFI Fund website, 98 awards totaling $969.2 million have been granted to 22 CDFIs in San Francisco since the establishment of the Fund in 1996. These awards ranged in size from $11,000 to $85 million, with the average award amounting to $9.9 million and the median award amounting to $1.0 million and were provided to a variety of types of CDFIs, including commercial banks, credit unions, venture funds and other community loan funds. Among the 122 awardees were Citibank, First Republic Bank, Union Bank NA, Northeast Community Federal Credit Union, Pacific Community Ventures, and Northern California Community Loan Fund, to name a few. While the 22 awardees may not represent the total number of certified CDFIs in San Francisco, the award information does indicate that a broad array of types of financial institutions have sought and secured funding from the CDFI Fund.

Public Banks

A public bank is a financial institution owned by a public entity such as a state, city or county. Unlike private banks owned by shareholders seeking the greatest financial returns on their investments, public banks need to earn a sufficient amount to cover their costs and originate new loans but do not operate to maximize profits. Public banks can thus charge more modest interest rates than private banks on loans, maintain a different customer risk profile, and return any profits to their founding entities such as the city, county, or state that established the bank rather than traditional shareholders. Public banks can also be the source of lower cost funding for large public sector capital and other projects that typically rely on issuing debt through private banks. Public banks could establish other objectives such as providing a greater portion of credit issued to underserved businesses and communities.

The only example of a publicly-owned bank in the U.S. is the Bank of North Dakota, which is described in detail below. Public banks are also functioning in other countries including Australia, Canada, Germany, and Switzerland.

Other Vehicles

Other, more specialized financial vehicles exist for community development purposes, including community development loan funds, and community development venture capital funds. Further, public agencies can provide funding directly for community development purposes through appropriations of their own funds or, indirectly, through grant funds.

2. Banking Industry in California

Commercial banks operating in California and available to provide banking services to the City mirror the national industry trend of the concentration of assets in the hands of fewer and fewer institutions. Such concentration is particularly pronounced for national banks such as those that provide most of the City's banking services.

Exhibit 1 below shows the number and asset size of commercial banks and credit unions in California, by federal or state-chartered status, as reported by the California Department of Business Oversight. The Department of Business Oversight also reports on eight other categories of financial institutions including industrial banks, trust companies, international banks and money transmitters.

As of December 2016, there were 30 national commercial banks in California with approximately $263.4 billion in assets in California, or an average of $8.8 billion per institution, and 135 State-chartered commercial banks with approximately $435.6 billion in assets in California, or an average of $3.3 billion per institution. There were 137 State-chartered credit unions in California with approximately $102.4 billion in assets and 191 federal credit unions in California with approximately $74.3 billion in assets.[7]

As shown in Exhibit 1, the large majority of commercial banks (82 percent or 135 of 165 banks) established in California choose to operate under a State charter. By contrast, only 137 of 328 credit unions, or 41.8 percent, established in California choose to operate under a State charter. Commercial banks with greater assets generally operate under federal charters to facilitate interstate banking and, in some cases, to avail themselves of Federal Reserve System banking services. Local regional banks with smaller asset bases tend to operate under State charters.

[7] Financial Institution Overview, as of December 31, 2016, California Department of Business Oversight. <http://www.dbo.ca.gov/Publications/stats/overview/2016/Financial%20Institution%20Overview%2012%2031%2016.pdf>

Exhibit 1: Number and Asset Size of Commercial Banks and Credit Unions in California, 2016

	Count	Assets in California	Average Asset Size per Entity
National Commercial Bank	30	$263.4 billion	$8.8 billion
State-Chartered Commercial Bank	135	$435.6 billion	$3.3 billion
Total banks	*165*	*$699.0 billion*	*$4.2 billion*
State-Chartered Credit Union	137	$102.4 billion	$747.5 million
Federal Credit Union	191	$74.3 billion	$389.1 million
Total: credit unions	*328*	*$176.7 billion*	*$0.5 billion*

Source: California Department of Business Oversight, Financial Institution Overview as of December 31, 2016.

As shown above, most commercial banks established in California operate under a State charter, but the average asset size of these State-chartered commercial banks ($3.3 billion) is significantly less than the average asset size of the national commercial banks ($8.8 billion).

Exhibit 2 below shows that assets have become more concentrated in recent years for all four types of commercial banks and credits unions, with decreases in the number of institutions and increases in average asset size.

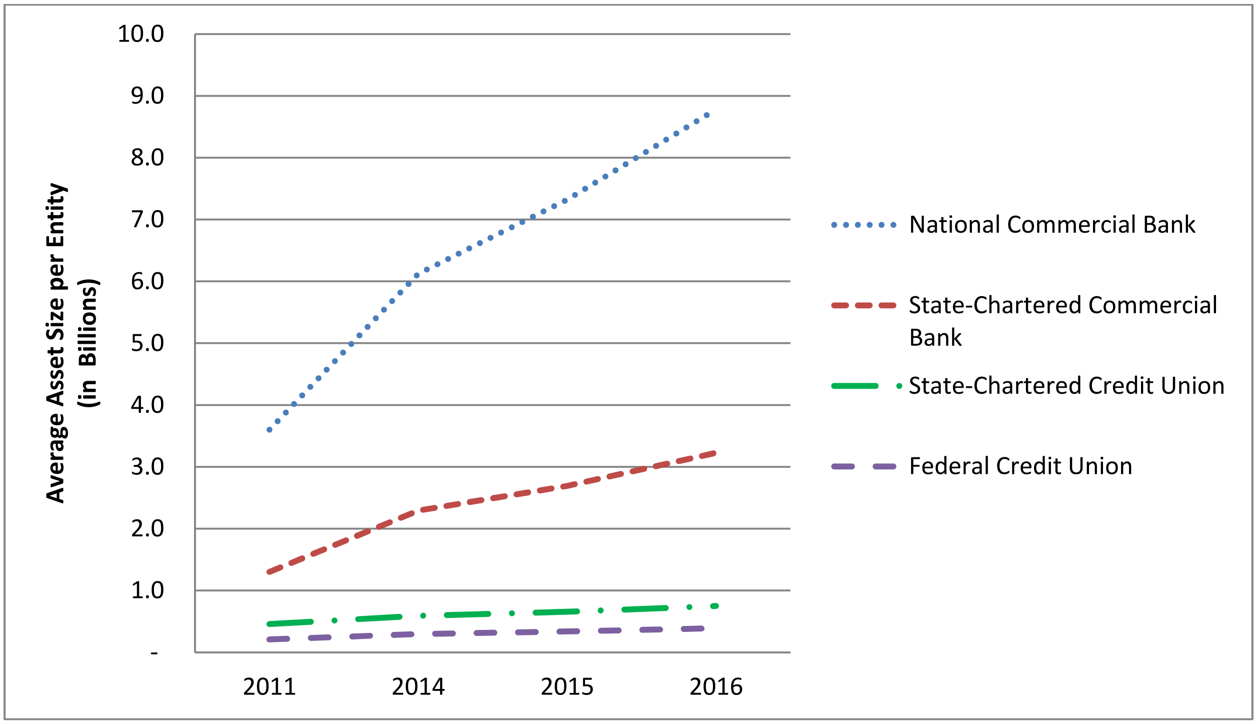
Exhibit 2: Number and Asset Size of Commercial Banks and Credit Unions in California, 2011 and 2014-2016

	3/31/2011	12/31/2014	12/31/2015	12/31/2016
Counts				
National Commercial Bank	49	38	34	30
State-Chartered Commercial Bank	188	155	145	135
State-Chartered Credit Union	160	145	143	137
Federal Credit Union	270	220	205	191
Assets				
National Commercial Bank	$175.0 billion	$232.6 billion	$249.0 billion	$263.4 billion
State-Chartered Commercial Bank	$250.0 billion	$355.2 billion	$390.2 billion	$435.6 billion
State-Chartered Credit Union	$73.0 billion	$85.6 billion	$93.7 billion	$102.4 billion
Federal Credit Union	$56.0 billion	$65.0 billion	$69.1 billion	$74.3 billion
Average Asset Size per Entity				
National Commercial Bank	$3.6 billion	$6.1 billion	$7.3 billion	$8.8 billion
State-Chartered Commercial Bank	$1.3 billion	$2.3 billion	$2.7 billion	$3.3 billion
State-Chartered Credit Union	456.3 million	$590.7 million	$655.0 million	$747.5 million
Federal Credit Union	206.6 million	$295.6 million	$337.0 million	$398.1 million

Source: California Department of Business Oversight, Financial Institution Overview as of December 31, 2016 and March 31, 2011.
Note: Asset size is for assets recorded in California only.

Exhibit 3 below shows that average asset size increased for all types of commercial banks and credit unions between 2011 and 2016, but that this growth was most profound for the larger national commercial banks, or the types of institutions used for most City banking services as the Office of the Treasurer and Tax Collector reports such banks are more able to meet complex City banking needs and to provide adequate security for the City's funds deposited.

Exhibit 3: Average Asset Size of Commercial Banks and Credit Unions in California, 2011 and 2014-2016



Source: California Department of Business Oversight, Financial Institution Overview as of December 31, 2016.

3. Regulation of the Treasury of the City and County of San Francisco

The Office of the Treasurer and Tax Collector is responsible for the banking and investment activities of the City and County of San Francisco. The Treasurer and Tax Collector's Office must carry out these responsibilities in accordance with federal, State, and local law and policies, as outlined in this section.

California Government Code Sections 27000-27013 define the roles and responsibilities of county treasurers in receiving and safely keeping counties' money. Section 27000.5 defines the relative importance of the three primary objectives that a county treasurer and/or board of supervisors must effectuate in all investment practices:

> When investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, the primary objective of the county treasurer or the board of supervisors, as the case may be, shall be to safeguard the principal of the funds under the treasurer's or the board's control. The secondary objective shall be to

> meet the liquidity needs of the depositor. The third objective shall be to achieve a return on the funds under his or her control.

This three-tiered hierarchy is commonly known in the investment field as "SLY," which stands for Safety, Liquidity, and Yield. The fundamental meaning of Section 27000.5 and the SLY concept is that protecting the safety of public funds must always be the first priority in investment decisions and that consideration of liquidity, return on investment, or other concerns is subjugated by the requirement that county officials protect principal.

In addition to State and federal law, the City and County of San Francisco Office of the Treasurer and Tax Collector abides by its own set of investment policies. These policies were approved by the Treasury Oversight Committee,[8] adopted by the Office in May 2016, and last amended in September 2017.[9] Reflecting the three-tiered Safety-Liquidity-Yield hierarchy required by California Government Code Section 27000.5 (shown above), Section 1.0 ("Policy") of the Treasurer and Tax Collector's Investment Policy states:

> It is the policy of the Office of the Treasurer & Tax Collector of the City and County of San Francisco (Treasurer's Office) to invest public funds in a manner which will preserve capital, meet the daily cash flow demands of the City, and provide a market rate of return while conforming to all state and local statutes governing the investment of public funds.

Section 4.0 ("Objective") of the Investment Policy specifies the priority order of these three objectives:

> The primary objectives, in priority order, of the Treasurer's Office's investment activities shall be:
>
> 4.1 Safety: Safety of principal is the foremost objective of the investment program. Investments of the Treasurer's Office shall be undertaken in a manner that seeks to ensure the preservation of capital. To attain this objective, the Treasurer's Office will diversify its investments.

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8 The Treasury Oversight Committee was established by the San Francisco Board of Supervisors in Ordinance No. 316-00. The five-member committee is charged with reviewing and monitoring the Treasurer's Investment Policy and overseeing an annual audit of the Treasurer's Office.

9 Chapter 10 of the Administrative Code includes Article X "Financial Policies" which, at the time of this report, included only a section on reserve policies.

> 4.2 Liquidity: The Treasurer's Office investment portfolio will remain sufficiently liquid to enable the Treasurer's Office to meet cash flow needs which might be reasonably anticipated.
>
> 4.3 Return on Investments: The portfolio shall be designed with the objective of generating a market rate of return without undue compromise of the first two objectives.

Section 13.0 ("Social Responsibility") of the Investment Policy outlines socially responsible investment goals that should be applied "in addition to and subordinate to" the objectives set for Section 4.0 when investing in corporate securities and depository institutions. While these provisions effectively express the City's preference that socially responsible investments be made when safe and otherwise prudent, the primacy of the safeguarding requirement may in practice significantly limit socially responsible investment options available to the Office of the Treasurer and Tax Collector. The two primary subsections on this topic are shown below:

> 13.1 Social and Environmental Concerns
>
> Investments are encouraged in entities that support community well-being through safe and environmentally sound practices and fair labor practices. Investments are encouraged in entities that support equality of rights regardless of sex, race, age, disability or sexual orientation. Investments are discouraged in entities that manufacture tobacco products, firearms, or nuclear weapons. In addition, investments are encouraged in entities that offer banking products to serve all members of the local community, and investments are discouraged in entities that finance high-cost check-cashing and deferred deposit (payday-lending) businesses. Prior to making investments, the Treasurer's Office will verify an entity's support of the socially responsible goals listed above through direct contact or through the use of a third party such as the Investors Responsibility Research Center, or a similar ratings service. The entity will be evaluated at the time of purchase of the securities.
>
> 13.2 Community Investments
>
> Investments are encouraged in entities that promote community economic development. Investments are encouraged in entities that have a demonstrated involvement in the development or rehabilitation of low income affordable housing, and have a demonstrated commitment to reducing predatory mortgage lending and increasing the responsible servicing of mortgage loans. Securities investments are encouraged in financial institutions that have a Community Reinvestment Act (CRA) rating of either Satisfactory or Outstanding, as well as financial institutions that are designated as a Community Development Financial Institution (CDFI) by the United States Treasury Department, or otherwise demonstrate commitment to community economic development.

4. City and County of San Francisco Current Banking Arrangements

The City's monies are divided into two categories: (1) the cash that is used for frequent expenses in the short-term like payroll, residing in bank accounts, and (2) all funds that are not necessary for short-term use, invested in the Treasurer's Pooled Fund Portfolio. Each of these two categories of funds is described in more detail below.

A portion of the funds from both categories could potentially be redirected to community development purposes, particularly if the City and County of San Francisco created a public bank. Rather than loans being made with City funds deposited with the national commercial banks providing banking services to the City, loans could be originated by a public bank targeting more San Francisco residents and businesses and community development objectives. Further, a greater portion of the funds in the Treasurer's Pooled Fund Portfolio could potentially also be targeted for such purposes, subject to all State laws and local investment policies.

Separate from or in addition to creation of a public bank, a greater share of City funds could be appropriated for existing or new City programs aimed at community development and affordable housing in San Francisco. Current City programs with such objectives are discussed in Section 5 of this report.

The structure of the City's banking arrangements is now presented for both demand deposits, or short-term bank accounts, and pooled investment deposits.

Cash Bank Accounts

The City's cash for short-term use such as payroll and operations is held in bank accounts with the following institutions: Bank of America, Union Bank, and US Bank. The balance of cash held in these accounts as of the most recent audited financial statements (June 30, 2016) was $228,638,000.[10] The Treasurer and Tax Collector's Office projects an average balance of $137.8 million for FY 2017-18 allocated by bank as follows.

[10] The Comprehensive Annual Financial Report of the City and County of San Francisco, Notes to the Basic Financial Statements, Note (5)(a) Cash, Deposits and Investments Presentation (page 62).

Exhibit 4: Allocation of City's Short-Term Average Cash Balance, by Bank Projected for FY 2017-18

Bank	Amount
Bank of America	$130,000,000
US Bank	$7,000,000
Union Bank	$800,000
Total	$137,800,000

Source: Treasurer and Tax Collector's Office as of October 2017

The Office of the Treasurer and Tax Collector's estimated annual FY 2017-18 costs for the three institutions providing banking services to the City are shown in Exhibit 5

Exhibit 5: Estimated Annual FY 2017-18 Fees and Charges for Services Provided by the Three Banks Providing Short-term Cash Management Services

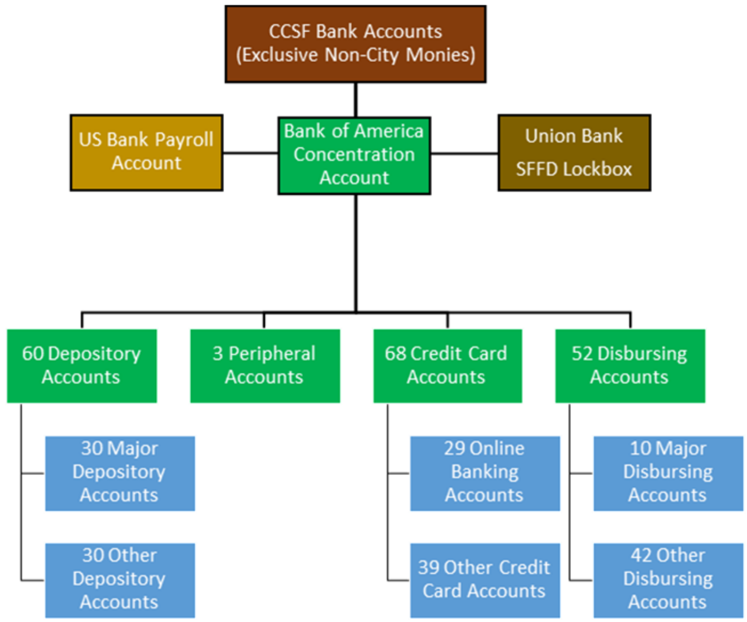
Bank	Annual Fees
Bank of America	$780,000
US Bank	$48,000
Union Bank	$36,000
Total	$864,000

Source: Treasurer and Tax Collector's Office as of October 2017

As shown in Exhibit 6 below, the City's bank account structure includes a total of 183 accounts,[11] including 52 disbursing accounts, 68 credit card accounts, 60 depository accounts, and three peripheral accounts, in addition to the primary Union Bank Lock Box Account, the Bank of America Concentration Account, and the US Bank Payroll Account. These accounts are organized to support City departments and their revenue tender type (cash, credit card, and check).

[11] As of May 10, 2017.

Exhibit 6: City and County of San Francisco Bank Accounts Structure



Total of 183 Accounts. Data as of May 10, 2017
Source: Office of the Treasurer & Tax Collector.

In 2011 and 2012, the Office of the Treasurer and Tax Collector conducted a competitive search for banking services providers. On March 24, 2011, the Office issued a request for proposals (RFP) for Treasury Management Consulting Services and selected US Bank for payroll, paycard, and purchasing card services.

Invested Funds – Pooled Fund

Funds that are not needed for short-term operational use are invested in the Treasurer's Pooled Fund Portfolio. These funds are invested in accordance with California Government Code Sections 27000-27013 and the City and County of San Francisco Investment Policy adopted by the Treasury Oversight Committee. These funds include General Fund and other revenues in excess of short-term needs and bond fund proceeds for capital projects and other purposes that may span multiple years.

As of March 31, 2017, the Pooled Fund Portfolio had an average daily balance of $8,279,920,124. Exhibit 7 below, pulled from the Pooled Fund's March 2017 Investment Report, shows the values of each of the different types of investments in the portfolio, broken out by par value, book value, and market value. The City's securities are held by Citibank, its custodian bank, and several brokers, banks and dealers are used in the buying and selling of securities. Citibank's annual costs for custodial services for the investment pool were $186,000 for FY 2017-18 as of October 2017. This amount is a combination of fixed fees and various fees charged for specific services when they are used, such as securities transactions.

Exhibit 7: Pooled Fund Portfolio Statistics

City and County of San Francisco Pooled Fund Portfolio Statistics For the month ended March 31, 2017				
Average Daily Balance	$8,279,920,124			
Net Earnings	$6,712,212			
Earned Income Yield	0.95%			
Weighted Average Maturity	428 days			
Investment Type	*($ million)*	**Par Value**	**Book Value**	**Market Value**
U.S. Treasuries		$1,490.0	$1,486.0	$1,486.7
Federal Agencies		4,355.9	4,355.5	4,353.8
State & Local Government Agency Obligations		320.5	324.1	321.6
Public Time Deposits		1.2	1.2	1.2
Negotiable CDs		767.8	767.8	768.4
Commercial Paper		940.0	935.5	938.6
Medium Term Notes		92.9	93.1	93.0
Money Market Funds		256.4	256.4	256.4
Supranationals		180.0	179.9	180.2
Total		**$8,404.70**	**$8,399.50**	**$8,399.80**

Source: Office of the Treasurer & Tax Collector March 2017 Investment Report.

The Office of the Treasurer and Tax Collector has historically invested small amounts of money in local credit unions via time deposits. These investments are limited by Office of the Treasurer and Tax Collector policy to a maximum of $240,000 per financial institution, which is just below the $250,000 maximum amount insured by the Federal Deposit Insurance Corporation (FDIC), and by the National Credit Union Administration (NCUA). Any amount above the amount insured by the FDIC/NCUA would not meet the safety requirements of California Government Code Section 27000.5, according to the Office of the Treasurer and

Tax Collector.[12] While the commercial banks with which the City has banking relationships are also subject to the FDIC maximum of $250,000, the City's deposits exceed that limit in those institutions because the Office of the Treasurer and Tax Collector assesses the safety of those large commercial banks to be sufficient to meet State Government Code safeguarding requirements based on evidence of the banks' security provided to guarantee larger deposits. To comply with State law, larger deposits are collateralized by the financial institution by putting securities in escrow with a custodian that exceeds the amount of the deposit. The concept is called "collateralization of public funds" and is mandated by State code. The Office of the Treasurer and Tax Collector only makes collateralized deposits with entities that meet these credit criteria.

As of August 2017, the City had deposits with the following four community development banks:[13]

- Trans-Pacific National Bank
- Bank of San Francisco
- Mission National Bank SF
- Preferred Bank LA

These deposits do not qualify as collateralized deposits and are thus limited to $240,000 per financial institution. No City funds were deposited with credit unions at the time this report was prepared.

As of October 2017 the Office of the Treasurer and Tax Collector reports that they are initiating a new program that will result in up to $80 million in Pooled Investment Fund monies being invested within the next year in San Francisco-based banks, credit unions, and community development financial institutions. The funds invested will be backed by a letter of credit from the Federal Home Loan Bank of San Francisco. If the full $80 million is so invested, this would represent an increase in City funds in local financial institutions, which could include credit unions and community development banks.

[12] CA Government Code 27000.5 states: "When investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, the primary objective of the county treasurer or the board of supervisors, as the case may be, shall be to safeguard the principal of the funds under the treasurer's or the board's control. The secondary objective shall be to meet the liquidity needs of the depositor. The third objective shall be to achieve a return on the funds under his or her control."

[13] Community development banks are one type of community development financial institution that, by law, must direct some of its investments to underserved communities that may otherwise not have access to credit.

5. Funding for Community Development and Affordable Housing through Existing City Programs

In addition to the banking relationships described above, which indirectly make some City funds available for loans to San Francisco residents and small businesses, the City also provides loans directly and partners with non-profit organizations and financial institutions to provide loans and banking services to small businesses, low income residents, and others. Enhancement of existing programs and creation of other programs with similar objectives is another means the City could pursue to enhance goals such as community development and expanded affordable housing.

Current City programs that provide loans or that depend upon partnerships with financial institutions to provide loans or banking services are described below and summarized in Exhibits 8-10. As of the writing of this report, currently active programs have approximately $86.0 million in loans outstanding, while $756,000 was allocated in FY 2016-17 to organizations that provide technical assistance to small businesses and another $3,771,663 was provided through the Treasurer and Tax Collector's Office of Financial Empowerment and the Department of the Environment for financial services targeting populations traditionally underserved by financial institutions.

City Programs that Provide Loans

The City directly funds loans for single family homeowners, including those purchasing their first home, and small businesses. Current loan programs funded by the Mayor's Office of Housing and Community Development (MOHCD) and the Office of Economic and Workforce Development (OEWD) are described below and summarized in Exhibit 8.

1. The **Downpayment Assistance Loan Program (DALP)**, administered by MOHCD, provides down payment assistance loans of up to $375,000 to low to moderate income[14] first time homebuyers purchasing a single family home in the City. These loans require no payments for 30 years. As of May 2017, the program had 1,189 loans outstanding with $82,171,256 disbursed. Funding is provided by a combination of sources including the City's Affordable Housing Fund and State and federal program funds.

[14] Low to moderate income is defined as less than or equal to 175 percent of Area Median Income (AMI). 175 percent of AMI in 2017 for a family of four is $201,800 as published by MOHCD.

2. The **First Responders Downpayment Assistance Loan Program (FRDALP)**, administered by MOHCD, provides down payment assistance loans of up to $375,000 to first time home buyers that earn up to 200 percent of Area Median Income (AMI)[15] and are active uniformed, sworn members of the San Francisco Police Department (SFPD), San Francisco Fire Department (SFFD), and Sheriff's Department. These loans require no payments for 30 years. As of May 2017, the program had 11 loans outstanding with $1,880,250 disbursed. Funding is from San Francisco's Housing Trust Fund.
3. The **Teacher Next Door Downpayment Assistance Loan Program (TND)**, administered by MOHCD, provides forgivable down payment assistance loans of up to $20,000 to first time home buyers that earn up to 200 percent of AMI and are active educators in the San Francisco Unified School District. As of May 2017, the program had 56 loans outstanding with $880,000 disbursed. Funding is from the City's General Fund and a 2015 general obligation bond.
4. The **Mortgage Assistance Loan Program (MALP)**, administered by MOHCD, provides loans of up to $50,000 to households that are earning up to 120 percent of AMI[16] and are behind on mortgage payments, homeowner association dues, or special assessments. As of May 2017, the program had just one loan outstanding with $33,400 disbursed. Funding is from San Francisco's Housing Trust Fund.
5. The **Small Business Revolving Loan Fund**, administered by TMC Working Solutions, a non-profit organization, provides up to $50,000 to start-up businesses and existing small businesses that are seeking capital to expand operations. As of April 2017, the small business revolving loan fund had 66 outstanding loans with $1,049,610 disbursed. Funding is from the City's General Fund, federal Community Development Block Grant monies, and other federal and private sources.

[15] 200 percent of AMI in 2017 for a family of four is $230,600 as published by MOHCD.
[16] 120 percent of AMI in 2017 for a family of four is $138,350 as published by MOHCD.

Exhibit 8: Current Active City Loan Programs

Department	Program	Number of loans outstanding	Loan amounts outstanding as of April/May 2017	Funding Source
Mayor's Office of Housing and Community Development	1. Downpayment Assistance Loan Program	1,189	$82,171,256	Affordable Housing Fund, Homeownership Assistance Loan Fund, Housing Trust Fund, CALHOME[17], HOME[18], 2015 GO Bond[19]
	2. First Responders Downpayment Assistance Loan Program	11	$1,880,250	Housing Trust Fund
	3. Teacher Next Door Downpayment Assistance Loan Program	56	$880,000	General Fund, 2015 GO Bond
	4. Mortgage Assistance Loan Program	1	$33,400	Housing Trust Fund
Office of Economic and Workforce Development	5. Small Business Revolving Loan Fund *(administered by a nonprofit)*	66	$1,049,610	General Fund, CDBGs[20], other federal and private sources
Total		**1,323**	**$86,014,516**	

Sources: Mayor's Office of Housing and Community Development (MOHCD), Office of Economic and Workforce Development (OEWD)

In addition to the active City loan programs shown above that are still issuing new loans, the City also manages outstanding loans for a few inactive programs that are no longer issuing new loans. The City Administrator's Office manages $50,000 in outstanding loans from the Nonprofit Performing Arts Loan Program. MOHCD manages $82,828,150 in outstanding loans from the following inactive loan programs: (1) Police in the Community Downpayment Assistance Loan Program

[17] The Community Development Financial Institutions Fund, administered by the California Department of Housing and Community Development

[18] The HOME Investments Partnerships Program, administered by the U.S. Department of Housing and Urban Development (HUD)

[19] In November 2015, San Francisco voters approved Proposition A, a $310 million General Obligation Bond for affordable housing.

[20] The Community Development Block Grant (CDBG) program is administered by HUD

($80,000 in loans outstanding); (2) Downpayment assistance loans issued by the former San Francisco Redevelopment Agency ($23,097,042 in loans outstanding); (3) the Residential Rehabilitation Loan Program ($8,154,376 in loans outstanding); and (4) the Seismic Safety Loan Program ($51,496,732 in loans outstanding). According to MOHCD, they are currently developing a new short-term loan fund to help property owners address code compliance violations.

City Funding for Economic Development Service Providers that Provide Loans to Small Businesses

In addition to the various City loan programs described above, the City also supports economic development service providers that offer consulting and technical assistance to small businesses to access credit and debt. The City does not directly fund the service providers' community loan products or programs, and City funding may be used for a variety of services[21] including but not limited to loan packaging. These service providers and programs are described below and summarized in Exhibit 9.

1. The **San Francisco Small Business Development Center (SFBDC)** works with financial consultants to help small businesses package loan applications for crowdfunding and microloans to real estate acquisition financing from the U.S. Small Business Administration (SBA). The City provided $166,000 to support this program in FY 2016-17.
2. The **Mission Economic Development Agency (MEDA)** provides technical assistance and offers loans of up to $100,000 per borrower from their Adelante Fund. The City provided $125,000 to support this program in FY 2016-17.
3. The **Southeast Asian Community Service Center (SEACC)** provides consulting services and offers SBA microloans of up to $50,000 per borrower. The City provided $125,000 to support this program in FY 2016-17.
4. **Pacific Community Ventures** provides mentorship and financing from their Small Business Advising Integrated Lending (SAIL) Fund up to $50,000 per borrower. The City provided $50,000 to support this program in FY 2016-17.
5. The **Mission Asset Fund** offers lending circle financing of up to $2,000. The City provided $50,000 to support this program in FY 2016-17.

[21] Services may include marketing assistance, business plan assessment and review, financial consulting, legal assistance, human resources assistance, etc.

6. The **Emerging Business Loan Fund**, administered by Main Street Launch, a community development financial institution, provides loans ranging from $50,000 to $1 million. The City provided $200,000 to support this program in FY 2016-17.

7. The **Energy Watch Microloan Pilot Program**, also administered by the Mission Asset Fund, provides zero percent loans of up to $2,500 to small businesses that enroll in San Francisco Department of the Environment's (SFE's) Energy Watch Program. Loans are intended to cover the customer co-pay for energy efficiency projects. The City provided $40,000 to support this program in FY 2016-17.

Exhibit 9: Service Providers Funded by the City that Provide Technical Assistance to Small Businesses

Department	Service Provider/Program	FY 2016-17 Funding Level	Funding Source
Office of Economic and Workforce Development	1. San Francisco Small Business Development Center (SFBDC)	$166,000	Community Development Block Grant (CDBG)
	2. Mission Economic Development Agency (MEDA)	$125,000	CDBG
	3. Southeast Asian Community Service Center (SEACC)	$125,000	CDBG
	4. Pacific Community Ventures	$50,000	CDBG
	5. Mission Asset Fund (lending circle)	$50,000	CDBG
	6. Emerging Business Loan Fund *(administered by a CDFI)*	$200,000	General Fund
Department of the Environment	6. Energy Watch Microloan Pilot Program[22] *(administered by Mission Asset Fund)*	$40,000	PG&E existing contract, through Department of the Environment
Total		**$756,000**	

Source: Office of Economic and Workforce Development, Department of the Environment

Other Programs that Depend upon Relationships with Financial Institutions

The City's Office of Financial Empowerment (OFE), which is a division within the Office of the Treasurer and Tax Collector, and the San Francisco Department of the Environment (SFE) administer the following non-loan programs that depend upon relationships with financial institutions:

1. **Kindergarten to College**, administered by the Treasurer and Tax Collector's OFE provides college savings accounts containing $50 to every kindergartner in the San Francisco Unified School District, regardless of family income. The program is funded by a combination of City and philanthropic funds. The

[22] The pilot program was initiated in 2016 and received funding of $40,000 in FY 2016-17 through an existing contract with PG&E. The program will be extended in FY 2017-18 with $30,000 in funding through the same contract.

Office of the Treasurer and Tax Collector reports that Citibank was selected through an RFP process to provide the account structure for this program on a pro-bono basis.

2. **Bank on San Francisco**, OFE organizes banks and credit unions to increase access to affordable checking accounts for low-income San Franciscans. According to the Office of the Treasurer and Tax Collector, Bank on San Francisco has helped more than 75,000 low-income San Franciscans get a safe and affordable bank account and has helped reduce San Francisco's unbanked rate to roughly 2 percent.

3. **Smart Money Coaching**, administered by BALANCE, a non-profit counseling agency, provides financial coaching and access to financial products to clients currently receiving services from the Human Services Agency, MOHCD, HOPE SF public housing sites, and OEWD.

4. The **Loan Guarantee & Surety Bond Programs**, administered by Merriwether & Williams Insurance Services and sponsored by the Risk Management and Contract Monitoring Divisions of the Office of the City Administrator, aim to increase participation of Disadvantaged Business Enterprises[23] in City construction and public works projects by assisting contractors and subcontractors in accessing technical assistance, bonding and financing for City construction projects. Small businesses that may not otherwise have access to credit may borrow against an $8,000,000 revolving line of credit—guaranteed by the City—with Union Bank.[24] Funding for administrative and program costs[25]—totaling $1,062,363 in FY 2016-17—is from the operating budgets of General Fund and Enterprise Departments.

5. **GreenFinanceSF**, sponsored by the San Francisco Department of the Environment and administered by multiple third party partners, includes various Property Assessed Clean Energy (PACE) programs, which provide financing for energy improvements on commercial and residential properties that are paid back over time by the property owners. Program funding is provided by private PACE program administrators. Limited City staff funding to support residential sector roll-out and marketing support is from the City's General Fund.

[23] Disadvantaged Business Enterprises are small businesses owned by socially and economically disadvantaged individuals.
[24] The revolving line of credit was increased from $5,000,000 to $8,000,000 in October 2013.
[25] Program costs include fees associated with the $8,000,000 line of credit.

Exhibit 10: FY 2016-17 Funding Levels for Other City Programs that Depend upon Relationships with Financial Institutions

Department	Program	FY 2016-17 Funding Level	Funding Source
Office of Financial Empowerment, Treasurer and Tax Collector's Office	1. Kindergarten to College	$1,490,000	City and philanthropic funds
	2. Bank on San Francisco	$236,400	City and philanthropic funds
	3. Smart Money Coaching	$832,900	City and grant funds
Risk Management Division, City Administrator's Office	4. Loan Guarantee & Surety Bond Programs	$1,062,363	Operating budgets of General Fund and enterprise departments
Department of the Environment	5. GreenFinanceSF	$150,000	General Fund[26]
	Total	**$3,771,663**	

Sources: Treasurer and Tax Collector's Office, City Administrator's Office, Department of the Environment

6. The Bank of North Dakota: successful but currently the only public bank in the U.S.

There is only one publicly-owned bank in the U.S.: the Bank of North Dakota (BND). Founded in 1919 as part of the populist response to problems in the agricultural industry including farmers' poor access to credit, BND was charged with "promoting agriculture, commerce and industry" in North Dakota. BND's business model offers some useful ideas for how the City could approach creation and operation of a municipal bank.

Today, BND, which is overseen by the Industrial Commission of North Dakota, partners with more than 100 other North Dakota financial institutions to, in essence, serve as a central bank with a focus on financing economic development. BND is authorized to make both "direct" loans to individuals and "participation" loans to "lead" financial institutions such as regional or community banks, savings

[26] Department of the Environment received a one-time add back allocation of $100,000 for FY 2015-16 and $150,000 for FY 2016-17.

and loans, or credit unions. Most of its activity is for participation loans rather than direct loans.

All state funds are constitutionally required to be deposited into BND. As a result of the very large amount of money deposited by the state, private citizen deposits account for only a small portion of total deposits. In its 2016 annual report, BND reported assets of $7.3 billion, $136 million in net income, and its thirteenth sequential year of profitability.

Unlike commercial banks, BND is not insured by the Federal Deposit Insurance Corporation (FDIC). Instead, state law provides that all BND deposits are guaranteed by the full faith and credit of the State of North Dakota. It is a member of the Minneapolis Federal Reserve Bank. As such, it has the rights and responsibilities of other Federal Reserve Bank member banks, such as processing checks and carrying out other cash transactions, maintaining an approximate 10 percent reserve requirement (as of January 2017),[27] and meeting all safeguarding requirements of the Federal Reserve Bank.

Advocates of the public bank model point to positive government budget and economic outcomes in North Dakota and tout the Bank of North Dakota's role in influencing those outcomes. For example, in our 2011 report, we cited the Public Banking Institute (PBI) report that the state of North Dakota had the lowest unemployment rate, at 3.2 percent[28], of any state in the country, and that it was the only state to achieve a major budget surplus during the recession starting in 2007/2008.

North Dakota continues to have one of the lowest unemployment rates in the nation today.[29] Public bank proponents argue that since BND does not rely on large national banks, it was not subject to dramatic decreases in access to credit that other states and local governments were affected by during the financial crisis of 2008. As such, BND was able to continue a stable flow of credit to its member banks, which in turn continued to extend credit to small businesses and other community members, all of which had the effect of sustaining the North Dakota economy.

[27] Federal Reserve Bank, "Reserve Requirements." https://www.federalreserve.gov/monetarypolicy/reservereq.htm
[28] July 22, 2011 report for the month of June 2011, Bureau of Labor Statistics, U.S. Department of Labor.
[29] Bureau of Labor Statistics, "Unemployment Rates for States, Seasonally Adjusted." As of April 21, 2017.

Participation Banks

In April 2011, Demos, a non-partisan public policy research and advocacy organization, released a study[30] of "partnership banks", or public banks that could "act as a 'banker's bank' to in-state community banks and provide the state government with both banking services at fair terms and an annual multi-million dollar dividend." In essence, the term "partnership bank" used in the Demos report refers to the same model of a public bank that is exhibited by the Bank of North Dakota, though, as described above, the Bank of North Dakota also makes some direct loans to individual customers, though this represents a small portion of their business.

The Demos study includes a review of the experience of the Bank of North Dakota and focused on several potential benefits of the partnership bank model for public banks, as follows:

- Creates new jobs and spurs economic growth. Partnership banks are participation lenders, meaning they would partner with local banks to drive lending through local banks to small businesses.
- Generates new revenues for establishing public entities directly, through annual bank dividend payments, and indirectly by creating jobs and spurring local economic growth.
- Lower debt costs for local governments. Like the Bank of North Dakota, partnership banks could get access to low-cost funds from regional Federal Home Loan Banks. The banks could pass savings on to local governments when they buy debt for infrastructure investments. The banks can also provide Letters of Credit for tax-exempt bonds at lower interest rates.
- Strengthen local banks, even out credit cycles, and preserve competition in local credit markets. By purchasing local bank stock, partnering with them on large loans and providing other support, partnership banks could strengthen small banks.
- Build up small businesses. Partnership banks could increase lending capabilities at the smaller banks that provide the majority of small business loans in America.

[30] Demos, "Banking on America: How Main Street Partnership Banks Can Improve Local Economies." Jadon Judd and Heather McGhee.

7. Efforts to Establish Public Banks in California and the U.S.

Since the financial crisis of 2008, multiple states and a few cities have considered legislation to establish a public bank or to conduct a feasibility study on establishing a public bank. A few jurisdictions have approved feasibility studies, but no legislative efforts to establish a public bank have passed since the Bank of North Dakota was founded in 1919. A common impediment to creation of public banks according to some analysts, are the startup costs and processes, which requires assembling initial equity or cash for startup operations and assembling and investing in banking, information systems and business expertise before the bank is established and able to earn revenue.[31,32]

Two California legislative efforts and recent efforts in other jurisdictions are described below.

California Legislative Efforts

In 2011, the California State Assembly and Senate approved Assembly Bill 750 to establish the "investment trust blue ribbon task force" to study the concept of a state bank for California, but Governor Jerry Brown refused to sign the bill stating that creating a state bank was well within the scope of the banking committees in the State Senate and Assembly.[33]

If AB 750 had been enacted, the task force would have "consider[ed] the viability of establishing the California Investment Trust, which would be a state bank receiving deposits of state funds." The text of the bill cited the following as potential benefits of a state bank:

- Supporting the economic development of California by increasing access to capital for businesses in the state;
- Providing financing for housing development, public works infrastructure, educational infrastructure, student loans, and community quality of life projects;
- Providing stability to the local financial sector;
- Reducing the cost paid by state government for banking services; and

[31] Massachusetts "Report of the Commission to Study the Feasibility of Establishing a Bank Owned by the Commonwealth." August 8, 2011. <http://www.politico.com/states/f/?id=0000015b-5330-d932-a97b-f3fc404f0001>
[32] Updike, Katherine L. and Erickson, Christopher. "Public Banking Feasibility Study Final Report for the City of Santa Fe." January 2016. <http://www.santafenm.gov/document_center/document/4520>
[33] AB 750 Veto Message. <https://www.gov.ca.gov/docs/AB_750_Veto_Message.pdf>

- Lending capital to banks, credit unions, and nonprofit community development financial institutions to assist in meeting their goals of increasing access to capital and providing banking services.

In 2012 Assembly Member Hueso introduced another bill - this time to establish, not just to study, the viability of a public bank of California or the California Investment Trust through Assembly Bill 2500. He later withdrew that bill for unknown reasons.

Recent Efforts in Other Jurisdictions

There have been recent legislative efforts in three cities and eight states to either study or establish a public bank. The Santa Fe City Council unanimously passed a resolution to create a Public Bank Task Force in April 2017 after a feasibility study found the establishment of a public bank to be feasible in January 2016. Santa Fe's Public Bank Task Force is charged with proposing governing policies for a Santa Fe public bank to the City Council.[34] The Philadelphia City Council authorized and held hearings regarding public banking in 2016, and the Oakland City Council was expected to vote in July 2017 on an ordinance to fund a feasibility study on establishing a public bank.

The states of Arizona and Vermont currently have legislation pending to study state banks, and Minnesota, New Hampshire, and Washington had legislation pending to establish state banks as of the writing of this report. Recent efforts in Hawaii, Illinois, and Maine to establish state banks did not pass.

[34] The Santa Fe New Mexican. "Local business in brief, May 2, 2017" May 1, 2017. Available at http://www.santafenewmexican.com/news/business/local-business-in-brief-may/article_8b88c4a9-8566-56a3-ba63-c4e80fc25252.html

Exhibit 11: Public Bank Legislative Efforts in Other Jurisdictions

Jurisdiction	Bill Type	Bill Status	Last Action
Oakland, CA	Study Municipal Bank	Pending in Committee	4/25/2017
Philadelphia, PA	Hold hearings	Passed; Hearings held	1/21/2016
Santa Fe, NM	Study State Bank (Task Force)	Passed	4/26/2017
Arizona	Study State Bank (Task Force)	Assigned to committee	2/9/2017
Hawaii	Establish State Bank	Deferred by committee	1/27/2016
Illinois	Establish State Bank	Did not pass House by end of session	1/10/2017
Maine	Establish State Bank	Did not pass	4/4/2017
Minnesota	Establish State Bank	Pending in Committee	3/9/2017
New Hampshire	Establish State Bank	Pending in Committee	2/21/2017
Vermont	Study State Bank	Pending in Committee	2/7/2017
Washington	Establish State Bank	Pending in Committee	4/24/2017

Source: Legislative databases of each of the 11 jurisdictions, as of July 2017.

8. Steps for Establishing a Municipal Bank in San Francisco

By becoming the depositary institution for the City and County of San Francisco's funds, a San Francisco municipal bank could make more funds available for loans to support affordable housing, local small business development, housing and other loans to underserved low-income households, and other community development efforts. Funds in the municipal bank could also be loaned and used as funding sources for City housing and infrastructure projects at lower financing costs than if such projects were to rely on debt issued through commercial banks. Depending on the bank's profitability, dividend payments could potentially be provided to the City as the primary shareholder.

Besides deposits of City funds, the municipal bank could also accept deposits from other municipalities, non-profit organizations and other depositors. The bank could potentially issue certificates of deposit and bankers acceptances which would serve as other funding sources.

As discussed earlier in this report, the City Attorney has reviewed key pertinent State laws and concluded that they do not preclude the City from creating its own bank. While there are a number of ways the City could structure its municipal bank, we have identified a number of legal requirements and business steps that would likely have to be followed to establish a viable institution. Key sources for this information are the Roosevelt Institute's publication, "Municipal Banking: an Overview"[1], a report entitled "How to Start a Public Bank" prepared for the City of Oakland by Scott Baker, an affiliate of the Public Banking Institute, and other Public Banking Institute publications. Though established in 1919 and the only public bank in the U.S. at this time, a review of reports and information concerning the operations of the Bank of North Dakota were also reviewed and incorporated as appropriate.

Key steps for the City to take to create a public bank would include:

1. Creation of agreed upon goals and a founding policy statement by the Board of Supervisors and other City stakeholders such as the Office of the Treasurer and Tax Collector and Mayor.
2. Retention of staff and/or consultants to conduct detailed financial feasibility studies for the bank and create the administrative infrastructure of the bank.
3. Appointment of an independent board of directors and creation of articles of incorporation.
4. Development of multi-year business plans, including identification of sources of initial equity (cash for startup years), the ongoing capital structure, or sources or capital to cover ongoing operations and meet reserve requirements, determination of whether or not to originate loans directly or to partner with other financial institutions, identification of ongoing staffing needs and administrative costs, identification of reserve requirements, and developing a means of ensuring accountability and independence.
5. Determination of whether to be chartered by the State of California or the federal government and whether or not to become a Federal Reserve Bank member.

Each of the five steps above is now addressed.

Goals and Policies

Creation of goals and a founding policy statement for a City municipal bank would be a key starting point, with input from the Board of Supervisors, the Mayor, the Treasurer and Tax Collector, and other stakeholders. Creation of an entity legally separate from the City and County of San Francisco would also be a necessary

[1] Beitel, Karl, "Municipal Banking: an Overview", Roosevelt Institute, April 2016.

early step, with the City established as the primary shareholder to ensure that the institution remains committed to the City's municipal bank goals such as providing funding for community development needs. The founding of a separate banking entity would require authorization in the form of an ordinance adopted by the Board of Supervisors and/or a Charter amendment.

Hiring Staff

Banking, business and community development specialists would need to be hired and/or retained as consultants to, among other things, prepare feasibility studies and a business plan with multi-year financial scenarios to determine how the bank could become and remain profitable. This would require estimating the bank's assets, particularly the value and terms of loans that could be issued, required reserves, and liabilities such as deposits received. Startup and fixed costs would need to be identified, including staffing, information technology, office space requirements, and other operating costs.

Appointing Board of Directors

In order to ensure operational autonomy, an independent board of directors would need to be appointed to govern the bank, with a preliminary act of adopting articles of incorporation. Members would likely be appointed by the Board of Supervisors and Mayor but would thereafter need to have full autonomy in overseeing management and insuring that the bank continued to fulfill the goals set forth in the municipal bank's founding policy statement and the articles of incorporation. Board members should be selected according to criteria such as expertise, demonstrated commitment to the mission of the bank, and representation of constituencies typically excluded from decisions about public finance.

Multi-year Business Plan Preparation and Identification of Funding Sources to Capitalize the Bank

All banks need to maintain a certain level of capital to meet regulatory requirements and to be able to meet their operating costs. Since a new bank would not initially have sufficient funding for these purposes, sources of funding would need to be identified to capitalize the municipal bank. The exact amount of funding required for capitalization would need to be determined as part of a multi-year business plan for the municipal bank, particularly the projected timing of its volume of deposits, loans, and loan repayments.

Likely sources of cash for a municipal bank in San Francisco include a one-time appropriation from the City's General Fund, using a General Fund source such as unassigned fund balance, and any legally available monies from other City funds. The City could also explore the possibility of issuing a bond, using the proceeds to capitalize the municipal bank. Issuing a bond would have to be weighed against the costs to the City of bond issuance and repayment vs. a one-time appropriation of funds. One-time donations from philanthropic or other organizations might also be available for startup purposes.

City funds used to meet the capitalization requirements of a municipal bank could be provided as a grant or a loan subject to repayment. To the extent any one-time funds used do not have to be repaid, such as those provided through an appropriation from unassigned fund balance, the faster the municipal bank could earn profits on the loans it originates. The banks net earnings could then be added to its capital, allowing expansion of its lending and investments. Repayment of initial funding, if necessary, would likely take a number of years.

Business plan decisions would include the extent to which the bank would originate loans directly or partner with existing credit unions and Community Development Financial Institutions (CDFIs), with the municipal bank's role being primarily to provide additional mission-consistent funding through participation lending. All lending activity would need to be subject to rigorous evaluation and public accountability to insure that credit issued is fully independent of political considerations and fulfills the public policy and business goals set out in the bank's founding policy statement.

The potential risks associated with a City municipal bank would need to be addressed by the bank's business plan and initial feasibility analyses. There would be some unknown risks associated with being the first in the nation to attempt to establish a municipal bank. The City would have to recruit human capital and build up the technology for this bank. There could be challenges at the outset meeting the 10 percent federal capital reserve requirement[36] and funding on-going operating costs, although the bank would have the advantage of being a depositary institution for the City's funds from the start.

Timing

It would likely take a few years to have a City municipal bank fully up and running and able to serve as the primary financial institution for the City's banking needs. Starting with its initial equity and making loans in its first year, the bank should be

[36] Reserve requirements are set by the Federal Reserve Bank and are subject to change. 10% is the rate applied, as of January 19, 2017, to banks with over $115.1 million in liabilities.

able to gradually build up its assets as loans are repaid with interest and new loans are originated. The City municipal bank would need a transition plan to begin accepting and managing deposits of City funds to ensure the bank's costs are covered and that all funds are available as needed for ongoing City operations. Within a few years, the municipal bank should be able to generate sufficient revenue to be able to cover its costs and serve as the primary financial institution for the City.

The Office of the Treasurer and Tax Collector has pointed out that State law requires that all local agencies can only deposit funds in institutions that have received a "satisfactory" rating in its most recent evaluation by its federal financial supervisory agency in meeting Community Reinvestment Act requirements.[37] Because a municipal City bank would be new, it would not have such an evaluation when it first starts. Other arrangements would need to be made, either through procedures in place for new banks by its supervisory agency or through arrangements negotiated by the new municipal bank. For example, the Office of Comptroller of the Currency in some cases allows banks to be rated based on their strategic plans.

Chartering and Federal Reserve Bank Membership Decisions

As stated above, an early decision that would need to be made in creating a San Francisco municipal bank would be whether to be chartered by the State or federal government. As discussed above in the section about the regulatory structure of banks, obtaining a State charter may be simpler and less costly than obtaining a federal charter and more appropriate given that a San Francisco municipal bank would assumedly not be interested in expanding nationwide. There are other implications for the chartering choice that the City would have to consider.

Under the country's "dual banking system", banks electing to be national are chartered by the federal Office of the Comptroller of Currency (OCC); state banks are chartered by the banking oversight agency in their state. In California, the bank oversight agency is the Department of Business Oversight (DBO). Whichever charter agency a new bank chooses, the chartering agency serves as its primary regulator, responsible for ensuring that the institution has sufficient capital and

[37] California Government Code Section 53635.2 requires this evaluation. The federal Community Reinvestment Act (CRA) was adopted in 1977 to prevent redlining and to help meet the credit needs of low- and moderate-income residents and communities. Pursuant to the Act, federal bank regulators must assess the record of each bank under its jurisdiction in adhering to the provisions of the CRA.

the management and technical expertise to meet their obligations and protect the public from unsound banking practices.

In addition to a chartering agency and primary regulator, all banks also have a secondary federal oversight agency. The secondary oversight agency for all national banks is the Federal Reserve Bank. Membership in the Federal Reserve Bank is also required of all national banks.

State banks have the option of joining the Federal Reserve Bank; if they choose to do so, the Federal Reserve Bank will serve as their federal oversight agency, secondary to their state oversight agency. The Federal Deposit Insurance Corporation provides federal oversight to state banks that do not choose to join the Federal Reserve Bank. Secondary federal oversight agencies supervise and examine the practices at banks under their jurisdiction in cooperation with the banks' primary regulators.

The Federal Reserve Bank also serves as the sole federal oversight agency for all bank holding companies. Banks that are owned by a holding company may choose the Federal Reserve Bank as their secondary regulator so that their entire organization is working with the a single agency as their secondary overseer.

Besides its oversight role, the Federal Reserve Bank offers services to its member banks, though nonmember banks are also able to use these services. The services include electronic payment services, both Automated Clearinghouse (ACH) and wire transfers (Fedwire), check clearing (crediting and debiting financial institutions for checks drawn on other institutions), and the provision of cash and coin. Banks can apply to the Federal Reserve Bank for a master account, which posts all of the bank's debit and credit transactions and maintains any reserve requirements.

As an alternative to obtaining their financial services and maintaining a master account with the Federal Reserve Bank, a financial institution can also obtain such services from bankers' banks or correspondent institutions or other private entities. Further, banks may choose to clear checks directly with each other rather than using the Federal Reserve Bank's check clearing services. However, such arrangements would be fairly restrictive for a bank's operations compared to having a master account through the Federal Reserve Bank.

Other aspects of Federal Reserve Bank membership include voting rights for some members of the board of directors for their area Federal Reserve Bank and a requirement that the banks purchase and hold stock in their local Federal Reserve Bank, with dividends paid based on the member bank's assets.

Based on the information above, a national charter does not appear to be needed for the City and its municipal bank since it is not likely that the bank would choose to become national, or have branches in other states. Membership in and oversight by the Federal Reserve Bank versus oversight by the Federal Deposit Insurance Corporation does not appear to have clear advantages or disadvantages for a City municipal bank. An approach to this choice could be based on municipal bank staff discussions with both federal agencies and an assessment of which agency would work best with the staff.

Use of Federal Reserve Bank services would offer some benefits to a municipal bank but, as mentioned above, these services could be obtained without Federal Reserve Bank membership. Finally, a City municipal bank would not likely be owned by a bank holding company so it would not have the incentive to join the Federal Reserve Bank to ensure coordinated secondary oversight by a single agency since the Federal Reserve Bank serves as the oversight agency to all bank holding companies.

State of California Chartering Requirements

Assuming that the City's municipal bank would not have the goal of becoming a national bank and would therefore elect to be chartered by the State, it would need to meet the requirements imposed by the California Department of Business Oversight (DBO).

The DBO asserts that there are several advantages to seeking a State charter, as described above.[38] If a bank obtains a State charter from DBO, its primary federal regulator would then be either the Federal Reserve Bank (for State-chartered banks that choose to become members of the Federal Reserve System) or the Federal Deposit Insurance Corporation (for state-chartered banks that choose not to become members of the Federal Reserve System).[39] If the City chose not to obtain a State charter from DBO, it would have to obtain a charter to become a "national bank" from the Office of the Comptroller of the Currency.[40]

As discussed earlier in this report, a large majority, approximately 82 percent, of commercial banks established in California choose to operate under a State charter. If a City public bank were to pursue State-chartered status, it would need

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[38] "Advantages of State Charter," California Department of Financial Institutions, available at: http://www.dbo.ca.gov

[39] As described earlier in this report, the Bank of North Dakota, the only example of a public ban in the U.S., is not insured by the Federal Deposit Insurance Corporation. Per state law, its deposits are guaranteed by the full faith and credit of the State of North Dakota. The Bank of North Dakota is a member of the Federal Reserve Bank of Minneapolis.

[40] *The Federal Reserve System: Purposes and Functions*, The Federal Reserve Board, available at www.federalreserve.gov.

to adhere to the DBO's "Guide for Groups Interested in Chartering a State Bank in California",[41] which outlines the steps such banks must follow whether they elect to be a state member bank of the Federal Reserve Bank or choose the Federal Deposit Insurance Corporation as their primary federal regulator. In summary, the process requires an interested party to submit to the DBO a proposal and business plan for its proposed bank; request and attend pre-application meetings between all proposed directors of the proposed bank, representatives of the DBO and representatives of the Federal Reserve Bank and/or the FDIC; file a complete application to the DBO; and comply with field investigative activities during the application review period.

According to the DBO, in evaluating applications for a State charter, reviewers seek to ascertain:

a. That the public convenience and advantage will be promoted by the establishment of the proposed bank or trust company.
b. That the proposed bank or trust company will have a reasonable promise of successful operation.
c. That the bank is being formed for no other purpose than the legitimate objectives contemplated by this division.
d. That the proposed capital structure is adequate.
e. That the proposed officers and directors have sufficient banking or trust experience, ability, and standing to afford reasonable promise of successful operation.
f. That the name of the proposed bank or trust company does not resemble, so closely as to be likely to cause confusion, the name of any other bank or trust company transacting business in this state or which had previously transacted business in this state.
g. That the applicant has complied with all of the applicable provisions of this division.

Additionally, the DBO states that, in reaching its decision, it considers:

a. The character, reputation, and financial standing of the organizers or incorporators and their motives in seeking to organize the proposed bank or trust company.
b. The need for banking or trust facilities or additional banking or trust facilities, as the case may be, giving particular consideration to the

[41] "Guide for Groups Interested in Chartering a State Bank in California," California Department of Business Oversight. http://www.dbo.ca.gov/cacharter/guide.asp

adequacy of existing banking or trust facilities and the need for further banking or trust facilities.

c. The character, financial responsibility, banking or trust experience, and business qualifications of the proposed officers of the bank or trust company.
d. The character, financial responsibility, business experience, and standing of the proposed stockholders and directors.
e. The adequacy of banking facilities to support its operations.
f. The adequacy of capitalization to support the projected volume and type of business.
g. The reasonableness to achieve and maintain profitability.
h. The viability of the business plan given the economic condition, growth potential, and competition of the proposed market area.
i. Whether the bank is free from abusive insider transactions and apparent conflicts of interest.
j. Other facts and circumstances bearing on the proposed bank or trust company and its relation to the locality as in the opinion of the commissioner may be relevant.

City Municipal Bank Ownership

Shares in the bank should be organized into various classes structured to ensure that the City remains the sole controlling interest through exclusive power to appoint the board of directors. Retaining exclusive power of appointment is essential to insuring continued fulfillment of the public purpose and objectives that motivated the establishment of the bank.

The City, as the ultimate controlling interest, could either own the bank in its entirety or sell non-controlling classes of shares to other investors. Owners of these subordinated share classes would be eligible to receive dividend payments, but would not exercise any controlling influence on bank policy or the selection of the board of directors. The City would at all times retain ultimate authority and oversight; any subsequent amendment or dilution of control could occur only through an ordinance whose ratification would also be subject to legislative approval by the Board of Supervisors.

Reserve Requirements

Capital Reserves: The City would be required to meet the Federal Reserve Board's capital reserve requirements, which vary based on the size of the depository institution. As of the writing of this report the rate applied to institutions with liabilities of more than $115.1 million is 10 percent[42]. This means that the City would be required to keep 10 percent of its total funds, or approximately $22.9 million based on the $228.6 million account balance in the City's short-term accounts as of June 30, 2016.[43]

9. Access to Bank Services for Marijuana-Related Businesses

Twenty-six states, including California, and the District of Columbia have legalized certain marijuana-related activities. Because marijuana is illegal at the federal level (as discussed below), many marijuana-related businesses in these states do not have access to bank accounts and have to conduct all business in cash. This lack of access to banking for marijuana businesses has served as an impetus for some public bank efforts in other jurisdictions, such as the City of Oakland. Relevant federal laws and guidance as well as recent efforts to provide access to banking services for marijuana-related businesses are discussed below.

Controlled Substances Act

The Controlled Substances Act (CSA) makes it illegal under federal law to manufacture, distribute, or dispense marijuana. In response to changes in state law discussed above, U.S. Department of Justice Deputy Attorney General James M. Cole issued a memorandum in 2013 (the Cole Memo) to all U.S. Attorneys to provide guidance to federal prosecutors on marijuana enforcement under the CSA.[44] The Cole Memo emphasizes that marijuana distribution and sale is still illegal under federal law and directs federal attorneys and law enforcement to dedicate enforcement resources to persons or organizations whose conduct interferes with the following eight priorities:

1. Preventing the distribution of marijuana to minors;
2. Preventing revenue from the sale of marijuana from going to criminal enterprises, gangs, and cartels;
3. Preventing the diversion of marijuana from states where it is legal under state law in some form to other states;

[42] Reserve Requirements, in Monetary Policy of the Federal Reserve Board; available at: http://www.federalreserve.gov/monetarypolicy/reservereq.htm#table1
[43] $228.6 million was reported in the Comprehensive Annual Financial Report for the City and County of San Francisco, FY 2015-16, Note (5)(a) Cash, Deposits and Investments Presentation.
[44] James M. Cole, Deputy Attorney General, U.S. Department of Justice, *Memorandum for All United States Attorneys: Guidance Regarding Marijuana Enforcement* (August 29, 2013), available at http://www.justice.gov/iso/opa/resources/3052013829132756857467.pdf

4. Preventing state-authorized marijuana activity from being used as a cover or pretext for the trafficking of other illegal drugs or other illegal activity;
5. Preventing violence and the use of firearms in the cultivation and distribution of marijuana;
6. Preventing drugged driving and the exacerbation of other adverse public health consequences associated with marijuana use;
7. Preventing the growing of marijuana on public lands and the attendant public safety and environmental dangers posed by marijuana production on public lands; and
8. Preventing marijuana possession or use on federal property.

Although guidance from the Department of Justice indicates that they will not go after marijuana-related businesses that operate legally under State law and do not implicate one of the Cole Memo priorities above, the Cole Memo could be revoked or altered by the Trump Administration (or any other administration).

Bank Secrecy Act

The Bank Secrecy Act of 1970 (BSA) requires U.S. financial institutions to report to the federal government suspicious activity that might signify money laundering, tax evasion, or other criminal activities. Because the distribution and sale of marijuana is illegal under federal law, financial institutions are required to report the financial activity of marijuana-related businesses. The U.S. Treasury's Financial Crimes Enforcement Network (FinCEN) is responsible for the administration of the BSA and provides guidance for financial institutions seeking to provide services to marijuana-related businesses.[45] The FinCEN Guidance permits financial institutions to provide services to marijuana-related businesses that are operating in accordance with state laws and regulations. It also creates a three-tiered system for filing Suspicious Activity Reports (SARs) regarding marijuana-related businesses. Banks are required to use the following labels when filing SARs based on the bank's reasonable belief as to whether the businesses implicate one of the Cole Memo priorities:

- **Marijuana Limited**: the business does not implicate one or more of the Cole Memo priorities
- **Marijuana Priority**: the business does implicate one or more of the Cole Memo priorities

[45] Department of Justice and the Financial Crimes Enforcement Network division of the Treasury Department *FIN-2014-G001: BSA Expectations Regarding Marijuana-Related Businesses* (February 14, 2014), available at https://www.fincen.gov/sites/default/files/guidance/FIN-2014-G001.pdf

- **Marijuana Termination**: the bank has terminated the relationship with the business

In order to comply with the BSA, banks must conduct customer due diligence when deciding to open, close, or refuse any particular account or relationship. For marijuana-related businesses, key aspects of the due diligence process include verifying the business license and developing an understanding of the normal and expected activity for the business. Banks must monitor behavior on an on-going basis to identify red flags that may indicate that a business is engaged in an activity that implicates a Cole Memo priority. FinCEN identifies 11 scenarios that could raise a red flag, including being unable to provide state licensing documentation and seeking to conceal involvement in a marijuana-related business.

Response to Federal Guidance

In Colorado and other states that have legalized certain marijuana-related activities, some community financial institutions have become more open to serving marijuana-related businesses in light of the guidance provided by the Department of Justice and FinCEN, but most large banks refuse to serve these businesses.[46] According to the California Bankers Association, U.S. Department of Justice and FinCEN guidance alone is not enough because the manufacture, distribution, and sale of marijuana is illegal under federal law, and "the only way to eliminate the risk of criminal prosecution for banks is if Congress changes federal statute."[47]

In May 2014, Colorado lawmakers authorized a credit union for the cannabis industry. However, the Federal Reserve Bank denied the credit union access to a master account, which is needed for electronic transactions between financial institutions, and the National Credit Union Administration refused to insure its deposits.[48]

The credit union sued the Federal Reserve Bank in federal court over the denial. The U.S. District Court for the District of Colorado dismissed the lawsuit, but, upon appeal, the 10th Circuit Court of Appeals vacated the district court's decision,

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[46] Quinton, Sophie. "Why Marijuana Businesses Still Can't Get Bank Accounts." *The Pew Charitable Trusts*. March 22, 2016, available at http://www.pewtrusts.org/en/research-and-analysis/blogs/stateline/2016/03/22/why-marijuana-businesses-still-cant-get-bank-accounts

[47] California Bankers Association. "Frequently Asked Questions: Marijuana and Banking." Accessed on May 18, 2017. <http://www.calbankers.com/post/frequently-asked-questions-marijuana-and-banking>

[48] Quinton, Sophie. "Why Marijuana Businesses Still Can't Get Bank Accounts." *The Pew Charitable Trusts*. March 22, 2016.

allowing the credit union to reapply to the Federal Reserve Bank for a master account. However, in its decision, the appeal court stated that is decision relied on Fourth Corner's representation to serve marijuana-related businesses only when doing so was legal. Marijuana serving businesses are legal in Colorado but not under federal law so the decision does not clearly give the credit union authority to serve marijuana serving businesses as was its original intent.

This case could affect a City municipal bank's ability to obtain a master account and needed insurance if part of the bank's business plan is to serve marijuana serving businesses. This issue would require further legal analysis by the City Attorney or counsel to the separate bank entity when created.

After California voters approved Proposition 64 in November 2016, which legalized recreational marijuana use, State Treasurer John Chiang convened the Cannabis Banking Working Group. The Group is made up of representatives from law enforcement, regulators, banks, taxing authorities, local government, and the cannabis industry and is tasked with identifying practical ways to open access for marijuana-related businesses to the banking system.

Because marijuana is illegal under the Controlled Substances Act, banks could face criminal prosecution for serving marijuana-related businesses. However, guidance from the Department of Justice and FinCEN indicates that they will not go after banks that serve marijuana-related businesses that operate legally under State law and do not implicate one of the Cole Memo priorities, such as funding gang activity. Should the Board of Supervisors choose to pursue a public bank option, it should request an opinion from the City Attorney's Office on the legality and risks of serving the marijuana industry. A San Francisco public bank would have to comply with reporting requirements of the Bank Secrecy Act, and serving marijuana-related businesses would likely increase these compliance costs.

Policy Options

In light of the information presented in this report, the Board of Supervisors could consider the following community supportive banking options in the interest of making more use of the City's funds to better achieve community and economic development goals:

1. **Recommend to the Office of the Treasurer and Tax Collector more investment of City funds in local credit unions or community development banks whose loan and investment policies are more aligned with the City's community and economic development objectives.**

   The Office of the Treasurer and Tax Collector has historically invested small amounts of money in credit unions and community development banks via time deposits. These investments are limited to a maximum of $240,000 per financial institution, which is just below the maximum amount insured by the Federal Deposit Insurance Corporation (FDIC) and by the National Credit Union Administration (NCUA). The Office of the Treasurer and Tax Collector announced in October 2017 a new program that could result in more City funds being deposited with San Francisco-based banks, credit unions and community development banks. The Board of Supervisors could request that when implementing this program, the Office of the Treasurer and Tax Collector specifically increase the level of investment in San Francisco-based credit unions and community development banks.

2. **Support additional funding for expansion of existing City community development programs.**

   As described earlier in this report, the City currently funds a variety of community development programs, including loans for single family homeowners and small businesses. As of the writing of this report, approximately $86.0 million in loans are outstanding from these programs for purposes such as home loans by low and moderate-income residents. Separately, $756,000 in funding was allocated in FY 2016-17 to organizations that provide technical assistance to small businesses and another $3,771,663 in funding was provided through the Treasurer and Tax Collector's Office of Financial Empowerment and the Department of the Environment for financial services targeting populations traditionally underserved by financial institutions.

   The Board of Supervisors could consider appropriating additional funds to expand these programs. For example, the Board could consider increasing the annual funding level for loans to single family homeowners and small businesses or expanding the Kindergarten to College program, which provides savings accounts for kindergartners in the San Francisco Unified School District, by increasing the initial seed deposit, either by obtaining a larger financial commitment from the existing bank partner, or by recruiting other banks to participate in the program. To determine which programs are suitable for additional appropriation of City funds, the Board could request information from the appropriate City departments on the results of existing community investment programs.

3. Take steps to establish a San Francisco public bank.

The Board of Supervisors could consider establishing a public bank. A public bank could use its funding base to support affordable housing and large-scale infrastructure development in San Francisco. In addition, the bank could support economic development in low-income neighborhoods in partnership with local banks and credit unions that have established branches, relationships, and retail lending outlets. Establishment of a municipal bank would require creating a new legal entity separate from the City, meeting all State and federal legal requirements for creating and operating a bank, obtaining initial funding to capitalize the banks in its first years of operations, and investing in startup and ongoing information technology and human resources with banking and necessary legal expertise. As with any new business, there would be risks associated with the City creating a municipal bank, particularly since it would be the first in the nation.

4. Request that the Office of the City Attorney assess the risk and legal issues associated with a San Francisco public bank serving the cannabis industry.

While the manufacture, distribution and dispensing of marijuana is illegal under federal law, these activities are allowed by the State of California. However, because banks are regulated by both the federal and state governments, the industry as a whole has elected not to serve cannabis related businesses such as dispensaries, leaving them without banking services. The Board of Supervisors could request that the Office of the City Attorney investigate the risks and legal issues associated with a San Francisco municipal bank potentially providing banking services to cannabis-related businesses in San Francisco.