Common Misconceptions about the Proposed Municipal Bank of Los Angeles

INDEX

CLAIM: ***The public sector is inefficient—a public bank will squander public funds.***

REALITY: Public sector banks are common and popular in other countries with advanced economies and recent studies[1] have shown that they are more profitable, safer, less corrupt, and more accountable than private banks. Globally, there are approximately 700 public banks worldwide with combined assets of $37.7 trillion. Many, if not most, of these public banks are well-run institutions that play critical roles in the local economic and financial ecosystem. Examples include: Germany's Sparkasse network of 400 municipally-owned public banks instrumental to their renewable energy transition and robust small business and manufacturing sectors; and the Bank of North Dakota (BND), a long-standing, century-old public bank credited with helping the state have one of the healthiest banking ecosystems in the United States.

The Bank of North Dakota has proven to weather and recover from economic and natural disasters better than its neighbors. BND has greater return-on-assets than Goldman Sachs, holds a better credit rating than JPMorgan Chase, and has returned over $1 billion in profits to the state through sound investment and management. Due to BND's financial strength and its prudence in avoiding subprime lending and other risky behaviors typical of Wall Street banks, North Dakota was the only state not left deep in red ink during the Great Recession.

BND recorded its sixteenth consecutive year of record profits in 2019, during which the state's return on its investment was an astonishing 17%. BND's successful model includes prudent management and insulation from political influence. The bank's state-appointed advisory board consists of finance experts; its executives are experienced bankers; and routine lending decisions are made by account professionals, like any other bank.During the COVID-19 pandemic, BND, provided more Paycheck Protection Program (PPP) loans per capita to small businesses than any other state. The bank served as a much needed administrative conduit to the federal government, helping to facilitate distribution of federal aid across its vast network of over 600 local banks.[2]

Public banks are driven by a mission to benefit the community and provide public infrastructure critical to the functioning of a healthy economy (clean energy, transportation, health, education, parks, and affordable housing). Public banks re-center public benefit in the investment and savings of public dollars, enabling these publicly-owned institutions to deploy capital quickly and efficiently.

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[1] https://www.eurodad.org/public_development_banks_towards_a_better_model
[2] https://bnd.nd.gov/pdf/2020_bnd_annual_report.pdf

CLAIM: ***Private banks already do everything a public bank proposes to do.***

REALITY: Public banking is fundamentally about creating a public option where the private sector has left a gap. A public bank would be mandated to support community banks, credit unions, and local non-profit financial institutions. These institutions may offer services to unbanked and underbanked communities but don't have enough capital or resources to expand their footprint or provide services tailored to these communities. By partnering with smaller, local financial institutions, the public bank would offer such banks more liquidity via participation loans, loan loss reserves, and loan guarantees. This would allow local banks to expand their balance sheets, so they can make more loans to fledgling small businesses, and offer a wider variety of services to underserved areas, such as microloans. Increasing the impact and resilience of these valued financial partners is prudent, and binding public money to public good is likewise a good investment. A public bank would do all this without reinventing the wheel, but rather by supporting the institutions already in place within their communities.

CLAIM: ***The public bank will be dominated by special interests and become a tool for government bureaucrats to hand out favors controlled by the Mayor and the City Council.***

REALITY: The public bank will be governed like any bank, by a board of directors qualified and selected based on their reputation, financial and domain area knowledge, and their accountability to a fiduciary duty to advance the mission and soundness of the bank. Shareholders of the bank are local taxpayers, and they will choose the bank's representatives and board. The bank's financials will be audited and subject to public record, and the bank will be governed both at the state level like any other state-chartered bank, and at the local level subject to a regular public review process.

This governing structure does not put politicians in charge of the bank or the board of the bank. It puts the public in charge of selecting and evaluating its own commission by either electing or confirming appointees and attending and contributing to regular, meaningful public meetings as to the business of the bank. A public bank is like any other civic institution—universities, public safety, municipal service and utilities—all areas where people participate both directly and through representatives. The final governance plan must be approved by not only the City Attorney but also the state's banking regulators, who will be looking specifically for areas where political power could adversely affect the bank's soundness and fiduciary duty to its shareholders and depositors.

Through the Democracy Collaborative, researcher Michael Brennan interviewed close to 30 community stakeholders in Los Angeles. Based on these interviews and a study of governance structures throughout the world, he put forward a Governance proposal for the Municipal Bank of Los Angeles, recommending the following mandate for the charter:

> "[The Bank will be] established for the purposes of (1) achieving cost savings, (2) addressing infrastructure and housing needs, (3) promoting equitable recoveries from social, economic, and ecological crises, (4) developing community wealth building institutions and approaches, (5) promoting just transitions to address the climate and biodiversity crises, (6) repairing the historical harms to Black, Indigenous, and immigrant communities, and (7) achieving financial sustainability while avoiding profit seeking."

A multi-chambered board will provide balance between financial experts and community leaders, as the German national bank Sparkassen does, and all bank activity will be fully transparent for scrutiny from both the public and oversight committees to curtail any potential corruption.

Regardless of the final form of a bank, the key distinction from existing banks is that the people of Los Angeles will have a voice in its priorities and leadership. All of this stands in sharp contrast to how banks are currently governed—designed for the purpose of pursuing profit, often extractively, and poorly incentivized to invest in local communities. The public bank of Los Angeles will be a public bank for and by the people of Los Angeles.

CLAIM: ***The City is looking for a blank check to create a public bank.***

REALITY: In October 2021, Los Angeles City Council unanimously approved a motion to move forward with issuing a Request For Proposal to hire a consultant to develop the business plan for the City's public bank. **A sound and economically viable business plan will be developed by this consultant, in conjunction with regular community input meetings.** After the plan is developed, it will be presented to the Council for a vote, and will be implemented by the City upon approval by the state's regulatory agency the Department of Financial Protection and Innovation (DFPI).

The City currently utilizes banks and has bank accounts where income is deposited and expenses are paid. The public bank is just a different entity where the money is held, one that will be required by state law (AB 857) to meet all the same or greater requirements of safety and soundness as the city's current banks. Any funds invested or secured by the bank will be subject to approval by City Council and will be subject to a public standard of fiduciary duty.. It will be subject to extensive scrutiny and financial analysis, and will require ongoing regulation and oversight by banking regulators and the City itself.

The business plan for the Municipal Bank of LA will include a capitalization model to start the bank, which is reviewed and approved by the DFPI. The City currently has approximately $10 billion currently invested in financial assets like US treasuries and the debt obligations of private companies. Over $1 billion of these funds are invested in "short term commercial paper" of large multinational banks and petrochemical companies—funds that invest directly against our City's stated climate goals.

Alternatively, the city could invest some of these funds as start-up capital to open a municipal public bank. Such an investment would be subject to targeted financial returns, like other banks, but would have a broader mandate to serve our communities and local businesses, and invest in a greener, more equitable future for all Angelenos. Rather than investing tax dollars in idle or counter-productive investment funds, public banks can create vehicles for tax dollars to build affordable housing, schools, and green infrastructure - all at lower costs to fund. Public banks return money back to our communities in the form of expanded credit and services, lower the cost of municipal debt, and boost economic growth—from the bottom up.

CLAIM: ***It will cost the taxpayers $1 billion to capitalize a municipal bank.***

REALITY: The most common-sense approach to capitalizing the Municipal Bank of LA would cost taxpayers zero dollars—our City has $10 billion in investments and utilizing a small portion of it to capitalize the LA public bank acknowledges the contribution each of us has made to support the public good. This capital can then be lent out or leveraged to support the city's economy. Through sound management and investment common to any bank, public or private, the Municipal Bank of LA has the potential to return substantial profits back to city coffers while also expanding credit to the City and to working Angelenos.

The funds used to capitalize a public bank do not have to be drawn from the City's general funds. The City could alternatively issue bonds to capitalize the bank and then earn a direct return from bank operations to offset new debt service expenses. The capitalization could also constitute a simple reappropriation of now well-funded reserves to public bank securities with the same return and risk profile of existing city investments. Deployed in this way, these funds would offer the City a multiplier effect on its general fund, helping to pay off a bond and bolstering growth in local economies.

Revenue to the City from taxpayers and other sources that are currently deposited into private banks can also capitalize the municipal bank. Right now, approximately $10 billion of our public assets and upwards of $45 billion in investments for pensions and other funds, are managed through accounts primarily held at Bank of America and JPMorgan Chase. **These commercial banks use the large pools of funds from public entities and pensions to achieve tremendous leverage on their own investments, and derive private profit from public funds, often at the expense of public good. And for these services, those banks charge the City over $1 billion per year in fees and interest!** With public funds invested in a public bank, our city's expenses would be below market rate because funds would be reinvested in local communities. As just one example, instead of a pension fund invested in national corporate securities, it could be invested in affordable housing lending here in Los Angeles, at the same rate of return and with less risk.

There is no minimum of capital needed to start the Municipal Bank of LA, but with more startup funding, the bank can better take advantage of economies of scale, and thereby generate greater revenues for the city through its investments and services.

The Municipal Bank of Los Angeles would likely start as a "banker's bank," servicing the needs of the municipal government by holding City deposits and handling its day-to-day banking needs. As a "banker's bank," the bank would not have branches, ATMs, or any associated brick-and-mortar costs of traditional retail banks. Such a public bank could serve as a market-maker for public debt, including the often expensive debt for school districts, which pay outsized fees to brokers just to finance their operations.

A public bank could also serve as a public partner and deal-enabler for existing community financial institutions and credit unions. The Municipal Bank of Los Angeles could stand in as guarantor or investor for loans underwritten and serviced by existing CDFIs and community-focused lenders and financial service providers, thus expanding credit and resources for truly affordable options for constituents. Such lending support has existed at the state level for over 25 years, and was a vital way of expanding small business lending during the pandemic. The public bank would enable and enhance responsible financial services in the city and help small businesses, often overlooked or unfairly targeted by larger lenders, compete.

CLAIM: ***The LA public bank will fail like the now-bankrupt Los Angeles Community Development Bank.***

REALITY: The Los Angeles Community Development Bank which closed in 2003, was ***not*** in fact a bank—it was a **loan fund** designed to support banks and other lenders, providing loans to LA-based small businesses with higher credit risk.[3] It served a similar function as SBA loan guarantee programs and allowed for more lending to LA-based small businesses. It was designed to lose money so that banks wouldn't need to. A Los Angeles public bank, like the Bank of North Dakota, would be run by seasoned bankers fully mindful of credit risk, interest rate risk, and quality of assets. The Municipal Bank of Los Angeles would also be regulated like other banks, requiring it to maintain capital reserves rather than simply spend down funds.

CLAIM: ***The Bank of Los Angeles won't be FDIC insured and we're going to have to bail it out if something goes wrong.***

REALITY: The California Public Banking Act (AB 857), the law that permits cities and counties to found their own banks, requires California public banks to obtain Federal Deposit Insurance Corporation (FDIC) insurance before the state will approve their charters. Public deposits will be collateralized according to the same rules that apply to all banks. Public banks will have to abide by all regulations that private banks are subject to and will receive the same benefits of deposit protection offered to private financial institutions.

Unlike private commercial Wall Street banks, the continuous solvency of the LA municipal bank is not dependent upon the unpredictable nature of the stock market. By investing in goods and services that all Angelenos rely upon, like affordable housing and green jobs, the bank can act as a "counter-cyclical" economic force, providing economic stability to the City even during a downturn, much like the Bank of North Dakota was able to in the past two recessions.

CLAIM: ***The Bank of Los Angeles will bank cannabis funds.***

REALITY: There is a great deal of interest in providing banking services for the millions of dollars spent on cannabis in California. Many legal distributors have no reliable means for the normal financial services needed to run a business. While public banks are often mentioned as a solution to cannabis business banking, as long as cannabis remains a Schedule 1 federally

[3] Abramowitz et al., 2010. "Community Development Finance in Los Angeles: Challenges and Responses"
https://community-wealth.org/sites/clone.community-wealth.org/files/downloads/paper-abramowitz-et-al.pdf

prohibited drug, they will likely not provide services to these businesses as it would be an impediment to gaining approval from the FDIC and Federal Reserve System.

CLAIM: ***Local public banks will not be diversified enough to outlast local catastrophes.***

REALITY: Should a disaster such as an earthquake or a pandemic occur, the public bank is mandated to act in the public interest. As in the Bank of North Dakota model, the Bank of Los Angeles would become a conduit for federal or state disaster loan assistance distribution. The Bank of North Dakota distributed more PPP loans to local small businesses than commercial banking did in other states. By building local relationships with small businesses and other lenders, the public bank will become more knowledgeable of the local economy, and be inherently better positioned to provide administrative support and technical know-how to connect smaller institutions with federal and state funding programs. As we have seen during the prolonged response to COVID-19, an inadequate response upfront means much greater losses for more people over time. A public bank expands the available tools to respond quickly to emergencies and, over time, reduce the overall loss incurred by the City and all Angelenos.

CLAIM: ***Meeting the liquidity requirements set by the FDIC would be enormously costly for public banks, and subsequently, the City that funds them.***

REALITY: If banking were unprofitable and too risky to be worth it banks wouldn't represent such a major portion of the global economy and trillions in investments across the globe. The FDIC's liquidity coverage ratios would apply to deposits held at the Municipal Bank of LA, just as it applies to other banks. Public funds deposited with the bank would be collateralized by qualifying assets in excess of 100% according to California law. Sound management will allow the bank to gain efficiencies on its balance sheet and support community financial networks through non-competitive partnership banking services. The bank would also be able to benefit from additional federal services that local municipalities cannot access, allowing the bank to maintain the same safety and security as other banks of its size at a comparable cost of capital.