

**SENT VIA EMAIL**

March 2, 2018

California State Treasurer John Chiang  
Attn: Kim Stevens  
State Treasurer's Office  
915 Capitol Mall, Room 110  
Sacramento, CA 95814

Re: Response to RFI

Dear Treasurer Chiang,

This letter is submitted in response to the Request for Information (RFI) dated January 29, 2018. Each of the authors of this letter is involved in her/his respective municipal or regional public banking advocacy efforts in Los Angeles, Santa Cruz, San Jose, Oakland, San Francisco, Santa Rosa, and Eureka. As part of the grassroots public banking movement, the undersigned are active in addressing many of the issues identified in the RFI. We recognize your leadership on this matter and are glad that you have structured this process to allow for our perspectives to be shared.

We are cognizant of the request in the RFI to make suggestions that help identify the “most expeditious method of examining the efficacy or desirability of establishing a public bank or state-backed financial institution dedicated entirely, or predominantly, to the cannabis industry in California.” Toward that end, we have provided suggestions on many of the specific topics that you have requested.

In this letter we outline seven suggested approaches:

**1) Expand the vision for a public bank and combine it with a phased approach to keep the public bank from being viewed as exclusionary.**

We invite you to share our vision: a network of public banks (intrastate municipal/regional banks and interstate state banks) that provides a distinct alternative to depositing public monies into Wall Street banks, reflects California’s environmental priorities and social values, and becomes California’s legacy for future generations.

Public banking, at its core, is a shift in the state’s role from mainly providing bank regulatory oversight to also providing banking services, thereby addressing commercial banking market failures. Public banking shares the original ambitions of the postal

service, delivering mail to every household, and the rural electrification program, electrifying all of rural America. In our envisioned network, each public bank will provide banking services to its defined community – filling gaps where the market has failed to fully provide affordable deposit, credit, and other investment services. State banks would provide low-cost (probably internet-based) deposit services to large segments of the unbanked population and create pools of credit for large infrastructure projects, affordable housing, and student loans. Municipal and regional banks would focus on developing the small business lending and local investment market; developing financially-responsible alternatives to predatory financial schemes, such as bail bonds and payday lending; and financing local infrastructure projects, including renewable energy and disaster recovery.

The failure of the market is profound and more widespread than is commonly understood. The lack of banking services for the cannabis industry is only one example of this failure. Over 20% of California households are un/underbanked, as documented in 2015 by the FDIC.<sup>1</sup> And, given the ongoing disaster recovery efforts in northern and southern California, the lack of immediate and affordable credit for municipal governments as these communities struggle to rebuild after the fires and floods is a clear shortcoming of the market.<sup>2</sup> Unfunded infrastructure, unfunded new Community Choice Energy organizations<sup>3</sup>, and unfunded affordable housing for public service workers can be financed through a state or municipal public bank. Finally, the state’s revenue shortfall and liquidity crisis during the Great Recession, made worse by the refusal of banks to honor the state-issued IOUs, is another critical example of the need for credit.

Without a broader vision, this particular public bank effort by your office may be perceived as exclusive or discriminatory. Such a perception so early on in the public bank feasibility process may be cause for otherwise avoidable resistance from both the public and the Federal Reserve, which may view a public bank “dedicated entirely, or predominantly, to the cannabis industry” as concentrated deposit risk. Moreover, since the Federal Reserve is tasked with addressing financial inclusion, it may be receptive to an expanded definition of financial inclusion based upon a critical analysis of the market failures of the commercial banking system.

*However*, we believe you can have it both ways: a broader vision that is implemented in a phased approach, first with automated payments for the cannabis industry, followed by phased implementations of banking services to other unbanked segments, and then

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<sup>1</sup> See <https://www.fdic.gov/householdsurvey/>

<sup>2</sup> See Bank of North Dakota’s approach to the 1997 Grand Forks flood and fire, *available at* <http://www.skyvalleychronicle.com/BREAKING-NEWS/HURRICANE-SANDY-THE-GREAT-RED-RIVER-FLOOD-BR-I-How-the-Public-Bank-of-North-Dakota-saved-Grand-Forks-I-1165139>

<sup>3</sup> See SB 790 (Leno), 2011.

enabling various state social, economic, and environmental policy objectives (see #4 below). Starting with automated payments for the cannabis industry is a sensible strategy and, together with state laws that codify this approach, can be an immediate remedy to the public safety issues raised by the cash-only cannabis industry.

## **2) Separate payment automation from banking services.**

A public bank that initially provides depository services to the cannabis industry needs a front-end – a payment system – to get money into the deposit accounts. Cash is a public safety issue (even if it can be deposited in a bank) and the Visa/MasterCard/AMEX card associations do not allow their networks to be used for cannabis transactions. But various new payment systems exist (Amazon Pay, Apple Pay, Google Pay, etc.) and technological development is taking place in the payments industry that will soon make settlements even faster and more secure.<sup>4</sup> For the cannabis industry, payment automation technologies are as varied as closed-loop payment systems and more standard platforms involving existing technology, some with mobile app front-ends.

But it would be a mistake to conflate payments with banking. Both are needed to solve the public safety issue of cash in the cannabis industry, but a payment system is distinct from (but still dependent upon) the bank deposit accounts, where the money is actually stored.

What would this look like? The state public bank we envision is a digital bank with internet access and minimal need for over-the-counter retail banking services. In other words, when payments in marijuana-related businesses (MRBs) are largely automated there is no need for multiple locations of public bank branches throughout the state to accept cash deposits from MRBs. Internet access to deposit account holders would be provided, along with other technologies to enable bank customer self-service, and a call center for customer support.

Cash payments made to the MRB by a customer could be accepted, but discouraged through a surcharge. It would be best to eliminate cash (certainly the money coming from new transactions) and avoid “paving the cow paths,” a reengineering term that cautions against over-investing in soon-to-be-extinct processes.

From the point of view of state-licensed MRBs, the state bank would offer the ability to engage in payment automation and digital banking activities. The MRB would open a deposit account, enroll in a standard ACH payments process (as one of multiple payment alternatives), and conduct business with consumers using this automated payment

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<sup>4</sup> See <https://fedpaymentsimprovement.org/>

software (an app on their phones), with the payments electronically deposited into the MRB public bank account. The MRB would then use internet access to the account to pay bills and taxes, conduct automated payroll, transfer money to other bank accounts, etc.

The advantage of separating the payments piece of from banking is that automated payments can be a dedicated solution for the cannabis industry, while the public bank can serve many other sectors of the economy that do not have access to affordable banking services (*see #1*).

### **3) Develop plans (in-house or a partnering strategy) to automate retail cannabis payments.**

There are multiple ways to automate cannabis payment transactions, eliminate cash, and to generate much of the data needed for the data portal and for compliance with FinCEN guidelines. The state could roll out a payments portal that offers a pre-defined way to transact every pre-approved product sale, with the dispensary being able to customize the product, pricing and other information. The state, acting as an intermediary with this in-house approach, would collect the payment and then disburse funds accordingly, with money being placed into the MRB deposit account once settlement occurs. Variations to this approach include using an alternative currency or using the money collected to prepay taxes and issuing credits for the balance.

Another approach is to outsource the payments piece to technology companies that have proven payment systems that are being used in the cannabis industry. There already exists standard payment software that utilizes the Automated Clearing House (ACH) network, is transparent, does not use foreign intermediaries or cryptocurrency, does not use the VISA/MasterCard/AMEX card associations, and complies with the FinCEN guidelines. This software can be integrated with Point of Sale systems, requires the buyer (consumer) to download and use an app, and effectively automates payments between the consumer's bank account and the MRB deposit account in the public bank, using the established, well-regulated, and proven ACH network.

Software vendors with this capability include Hypur<sup>5</sup> Commerce and CanPay<sup>6</sup>. Both are immediately available and are proving themselves as effective payment methods in the cannabis industry in numerous states outside of California. As a bonus, compliance software from Hypur or from Nationwide Compliance Specialists<sup>7</sup> works with the

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<sup>5</sup> See <https://www.hypur.com/>

<sup>6</sup> See <https://www.canpaydebit.com/>

<sup>7</sup> See <http://www.nationwidecomply.com/>

ongoing data generated from the payment system to provide a robust data portal with document and license management, transaction monitoring, enhanced due diligence, and visualization/analytical capabilities that enhance their reporting features.

Automating payments using standard software builds affordable productive capacity while establishing low cost best practices in order to meet and exceed the FinCEN guidelines. It is a highly scalable way to handle the payment of taxes and fees and will minimize the risks to stakeholders. In addition, payment automation generates audit trails for the data portal. Finally, an automated payments system/compliance platform and a partnership with a trusted technology vendor will help manage change, should FinCEN guidelines evolve with more specificity.

**4) Conduct an “intersection” study throughout state government and its agencies that identifies the specific state social, economic, and environmental policy objectives that a public bank can achieve.**

Public banks have the ability to achieve more than merely accept in deposits and issue credit. They are uniquely able to further policy objectives, especially through their loan programs, but in other ways as well. In Germany, the Sparkassen-Finanzgruppe public banks enable the country’s commitment to the Paris Climate Accord and, with 40% share of the total banking assets in Germany, have financed 72.5% of their renewable energy projects. To reach the rural population located in areas without banking facilities in southern Germany, it has launched a “mobile bank,” that visits rural locations on a regular basis.<sup>8</sup> In Chile, the Banco del Estado de Chile educates families on financial literacy and the importance of saving. The Bank of North Dakota (BND), while not emphasizing renewable energy development, similarly uses its loan programs to address policy objectives. BND, as an incentive to manufacturing relocation and expansion, buys down commercial loan interest rates to as low as 1%<sup>9</sup> through use of municipal and state sales tax revenue. When natural disasters hit, it provides assistance through various different Disaster Relief Loan Programs.<sup>10</sup> BND provides funding<sup>11</sup> to the North Dakota Community Foundation, forgives loans for teachers<sup>12</sup> who work in areas where there are teacher shortages, and funds higher education opportunities to low-income women.<sup>13</sup>

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<sup>8</sup> See <https://www.lesaffaires.com/strategie-d-entreprise/10-choses-a-savoir/10-choses-a-savoir-mardi-27-fevrier/600832>

<sup>9</sup> See <https://bnd.nd.gov/business/pace-program/#1444412583755-af84c874-0a21>

<sup>10</sup> See <http://www.nd.gov/ndic/ic-press/bnd-disaster-loan.pdf>

<sup>11</sup> See <https://ndcf.net/receive/scholarships/>

<sup>12</sup> See <http://www.ndus.edu/students/paying-for-college/grants-scholarships/#TSLPF>

<sup>13</sup> See <http://cawsnorthdakota.org/index.php/aboutus/womensopp/>

In addition to identifying these policy priorities, we recommend using an intersection study to document all existing loan programs provided by state agencies, identify funding constraints, and identify existing grant programs. Many, if not most, of these can be brought under the oversight of the public bank and can use lower-cost credit instead of taxpayer dollars as the source of the money being loaned.

An intersection study will show how the state of California, the world's 6th largest economy, can further its social, economic, and environmental policies through use of a state bank and provide a blueprint for where the bank should provide additional services.

**5) Conduct an audit that identifies California statutes that pertain to commercial banks (specifically insurance, deposit collateralization, governance, capitalization, etc.) but do not pertain to California public banks.**

Many of the concerns around public banking come from the assumption that a public bank would be chartered and run like a private commercial bank, hence trying to fit the public bank square peg into the commercial bank round hole. We suggest identifying the statutes that do not pertain to a public bank. As one example, we believe that the need for deposit collateralization should not apply to a public bank. Because the state does not have the ability to conduct oversight of a commercial bank, the law requiring deposit collateralization over the FDIC-insured amount was understandably put into place to ensure the safety and security of public deposits.<sup>14</sup> However, if the state owns the public bank, the need for this regulation is mitigated precisely because the state would have the oversight and authority as per the Public Bank Charter (see #6 below).

Another example is deposit insurance. The FDIC was created out of the social contract arising from the need for government to guarantee the safety of bank customer deposits during the Great Depression. To this day, deposit insurance is something that banks provide -- but not all banks. In contrast to most commercial banks, BND is not a member of the Federal Deposit Insurance Corporation (FDIC). North Dakota Century Code 6-09-10 provides that all BND deposits are guaranteed by the full faith and credit of the State of North Dakota.<sup>15</sup> North Dakota's position stems from a recognition that it is the taxpayers who provide the guarantee, insurance or no insurance, so they opt for a conservatively-run bank, thus rendering superfluous the need for costly deposit insurance.

The purpose of an audit would be to identify existing statutes that would keep a public bank from being an efficient and financially responsible institution with a low cost basis.

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<sup>14</sup> Cal Gov't Code § 53652.

<sup>15</sup> See <http://www.legis.nd.gov/cencode/t06c09.pdf>

- 6) Work with the legislature to pass a comprehensive enabling statute that creates a new “Public Bank Charter” which would allow for the creation a state, regional or municipal public bank, and which would exempt California public banks from the requirements identified in (#5).**

We recommend developing a new public bank charter, issued by the Department of Business Organizations or another state agency, providing clear constraints and permissions (specifically insurance, deposit collateralization, governance, and capitalization). In addition, by setting limits on the public bank’s ability to conduct direct commercial lending, a public bank charter would clarify the relationship between public banking and commercial banking, thus dispelling fears of unfair competition.

We are currently developing a draft charter for municipal and regional public banks, drawing on governance documents from the Sparkassen network of public banks in Germany. Once complete, we will be happy to provide your office with this document and any supporting documentation. Importantly, we envision the charter as a way to codify a California public bank’s social and environmental priorities, governance and oversight requirements, and permissible activities in the commercial lending market.

We see cooperation on state legislation as critical towards creating a policy environment that would allow state, regional, and municipal public bank efforts to further develop. Three major California cities are currently conducting feasibility studies, and at least three more are considering studies, to establish municipal or regional public banks. A single enabling statute authorizing Public Bank Charters, would prevent the need for separate legislation covering each individual municipal effort. The state would benefit from such an approach because regulations could be developed and codified according to the framework provided by a single public banking law.

- 7) Submit a public bank business plan to the Federal Reserve of San Francisco.**

Consensus building is always a little tricky. Start too early and you risk setting expectations that cannot be met. Start too late and you run out of time. But there is one player that needs to come on board sooner rather than later – the Federal Reserve of San Francisco. We believe that the way to do this, before much money is spent and certainly before any capital outlay, is to initially develop and build consensus with major stakeholders around a financial pro forma and then to submit a well-defined state-level public bank business plan that reflects a broad vision (including phasing) to the Federal Reserve Bank of San Francisco. Developing this business plan, coupled with an enabling statute (#6) should be the overriding near-term objectives. While a feasibility study and

risk analysis are part of a business plan, a business plan is distinct because it can help narrow the set of options with a cost/benefit analysis for each. Without a cost/benefit analysis for each of multiple options, stakeholders will not have a good foundation for their commitment.

The SF Fed will issue a master account number – or not – and it is dialogue with this potential partner on the specifics contained in a business plan that will help to clarify the path forward. Because obtaining a master account number is on the critical path towards establishing any bank, public or private, and this is the decision of the Federal Reserve, the development of a business plan and the consensus it represents is of utmost importance.

In conclusion, we believe that this approach will lower the evaluation costs of this process and help to manage the risk associated with this venture. This outline of steps leading up to the development of a business plan will provide the clarity and consensus needed for an automated payment system for the cannabis industry and a state-owned public bank that supports California’s many social, economic, and environmental policy objectives.

Thank you for considering our suggestions and, again, for your visionary leadership on public banking.

Sincerely,

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