January 21, 2021
Department of Financial Protection and Innovation
300 S. Spring Street, Suite 15513
Los Angeles, California 90013

Re: PRO 01/20 Notice of Proposed Rulemaking

To the Regulations Coordinator:

Thank you for the opportunity to provide comments on the proposed regulations implementing AB 857 (Chiu and Santiago). The California Public Banking Alliance ("CPBA") was the sponsor of this legislation. We are a network of public banking advocacy groups from around the state, representing Los Angeles, San Francisco, the East Bay (Oakland), the South Bay (San Jose), Humboldt, San Diego, Santa Barbara, Santa Rosa, Santa Cruz, and Orange County. Beneficial State Foundation, Lawyers' Committee for Civil Rights of the San Francisco Bay Area, and Friends of the Earth are also members of CPBA. We appreciate the thoughtfulness demonstrated in this proposed rulemaking as well as the opportunity to provide our feedback on the proposed regulations. We would welcome the opportunity to meet and discuss these comments with you.

1. § 10.131.7 Financial product or service

The proposed regulations define "financial product or service" to mean "a type of product or service offered by a financial institution, such as a loan or checking account. …Products and services are not considered different due to differences such as interest rates or other product features at which competing financial institutions offer the same type product or service to attract business." Under AB 857, public banks may only conduct "retail activities," meaning "providing any kind of financial product or service to a person that is typically offered or provided by a local financial institution," in partnership with a local financial institution unless the retail activity is not offered by local financial institutions in the jurisdiction of the local agency or agencies that own the public bank. If proposed § 10.131.7 is adopted, then a public bank could not independently offer a particular *type* of product or service, such as a loan, if a local financial institution in the relevant jurisdiction already provides the same product type.

In order to give effect to the legislative intent behind AB 857, DFPI should adopt a definition based on the *terms* of the product or service offered, with a provision that the product or service should constitute a material portion of the local financial institution's business, instead of the proposed definition based on product *type*. As it relates to the law's noncompetition provision, the Legislature's intent was to allow public banks to directly offer retail products or services only when such an offering does not compete with local financial institutions. This intent would be frustrated if a public bank were barred from offering, for example, low-fee or no-minimum balance checking for low-income customers because a local financial institution in the relevant jurisdiction offers a checking product which requires a $1,000 monthly minimum balance. Likewise, the Legislature's intent would be frustrated if a local financial institution could prevent a public bank from providing a direct retail service if the local financial institution merely lists a product or service as available, but the terms or features of the product are not competitive or not actually used by customers in the area. In addition, the local financial institution must have offered the product or service for an extended period of time, and the product or service must

constitute a material part of their business. For example, a public bank should not be prevented from directly offering a no-minimum balance personal checking account with online banking if a local financial institution in the relevant jurisdiction offers a personal checking account with a $100,000 minimum balance and no online access, which is used by zero residents in the area. Similarly, if a local financial institution offers small business loans with certain terms, *and* the lending volume from that product is material to that local financial institution, then a public bank would be barred from offering, in partnership with another local financial institution, small business loans with the same terms.

Moreover, the proposed definition does not clarify how to distinguish product types, leading to continued confusion and questions from stakeholders. For example, under the proposed definition, it remains unclear whether a business checking account and a personal checking account are the same product type because they are both kinds of checking accounts, or if they count as different product types of because they are offered with different terms and features.

The definition of "financial product or service" should distinguish products or services based on terms and features, and incorporate a materiality provision to reflect whether the product or service actually implicates competition in the area.

2. § 10.140.6 Local Financial Institution

The proposed regulations adopt the statutory definition of "local financial institution" in Govt. Code § 57607 and further specify that the term means "a financial institution that has a physical presence within the jurisdiction of the public bank at issue." According to the Initial Statement of Reasons ("ISOR"), this specification is necessary "to make clear which local financial institutions a public bank is prohibited from competing with under Government Code section 57604 – specifically, the local financial institutions in the same geographic market as the public bank." ISOR at 7. The ISOR also notes that "[i]dentification of the relevant market is crucial to being able to determine which financial institutions compete within the market" and that for private sector banks, "the primary determinant of market competition is entities operating in or servicing the same geographic area." *Id*. at 7-8.

We agree with DFPI that in implementing the noncompetition provision in Govt. Code § 57604, the relevant geographic area should be primarily determined by the area over which the local agency or agencies that own the public bank exercise jurisdiction. However, a financial institution's maintenance of mere "physical presence" of, for example, an ATM, loan production office, or a non-banking service office in a certain geographic area does not provide sufficient information to make determinations related to the competitive environment in that area. Notably, under the Community Reinvestment Act ("CRA"), factors such as main office and branch locations, as well as loan originations and purchases are incorporated in defining a bank's assessment areas. 12 C.F.R. § 228.41. Using these and other factors, CRA examinations account for a bank's performance context, including the area's competitive environment.

In identifying which financial institutions compete in a particular geographic area, DFPI should incorporate additional factors beyond physical presence, such as the number of loans provided, deposits received, and other business conducted in the area. A local financial institution should not be considered to maintain a "physical presence" in an area if it merely provides an ATM, loan production office, or a branch office offering only limited services. Under the proposed definition, a public bank directly offering small business loans could be determined to be competitive with a bank which maintains only

an ATM in the area and does not provide a way for residents to apply for a business loan in the area. Instead, for the purposes of implementing the law's noncompetition provision, a local financial institution should not only have a physical presence in the area with a full-service banking office, but also conduct a material amount of business in the area, including the actual provision of products and services, like accepting business loan applications. If a full-service banking office does not generate 15% of the income or assets of the local financial institution, then that office should be considered as having a nominal impact on the local financial institution as a whole. Alternatively, we encourage DFPI to consider specifying that "physical presence" requires that the local financial institution to maintain its head office in the relevant geographic area.

Therefore, for the purpose of implementing the law's noncompetition provision, we urge DFPI to define "local financial institution" with additional factors beyond mere physical presence in the local agency's jurisdiction to better reflect the factors relevant to the competitive environment.

3. § 10.3301.1 Reasonable promise of successful operation

Proposed § 10.3301.1 provides, in part: "As an administrative standard, reasonable promise of successful operation is evaluated by the likelihood of achieving the goals laid out in the applicant's financial projections, such as financial stability, solvency, and reserves." The ISOR notes that "[p]rivate applicants for a bank charter are assessed based on financial viability, which is the accepted standard for determining the likelihood success for any enterprise." ISOR at 11.

Evaluating a public bank's application solely on financial viability would frustrate the legislative intent of AB 857, which was passed to ensure that public banks could pursue social policy goals in addition to cost savings and other financial goals. As noted in the ISOR, "a public bank may have goals other than financial stability, such as social policy goals and improved benefits to the general community." *Id*. The law's provisions regarding the local agency viability study specifically call for a "qualitative assessment of social or environmental benefits of the proposed public bank" as well as a "fiscal analysis of the costs, including social and environmental, of continuing to do business with the local agency's current banker or bankers." Govt. Code § 57606(b)(2) and (4). These provisions show that the Legislature conceived of a proposed public bank's viability as encompassing social and environmental factors in additional to financial ones.

In order to effectuate the Legislature's intent in enacting AB 857, the administrative standard for evaluating a public bank applicant's "reasonable promise of success" must account for any social or environmental goals identified in the applicant's viability study and business plan, in addition to the applicant's financial goals and projections. While the ISOR states that "[t]he reasonableness of achieving intangible goals …is highly subjective and does not lend itself to a clear standard of review," institutions, investors, and regulators regularly consider and evaluate intangible goals. *Id*. In fact, environmental, social, and governance ("ESG") ratings, criteria, and metrics are now routinely used in various contexts, from the United Nations' Sustainable Development Goals and corresponding specific targets and indicators,[1] to business-specific tools like the B Impact Assessment[2] and Future-Fit Business Benchmark.[3] The State of California has recognized the importance and practicality of incorporating ESG

[1] https://sdgs.un.org/
[2] https://bimpactassessment.net/
[3] https://futurefitbusiness.org/explore-the-benchmark/

principles in investment decisions, as the California Public Employees' Retirement System, California State Teachers' Retirement System, and University of California have. Last year, in response to Executive Order N-19-19, the Governor released the California Climate Investment Framework, recommending that the state develop a "practical and comprehensive climate-risk disclosure standard" and that state pension funds' investment portfolios "increase their usage of low-carbon strategies."[4] In the context of banking, various standards, principles, guidelines, and assessment tools have been developed to evaluate the environmental and social impacts of financial institutions, such as the Global Alliance for Banking on Values' "Principles of Values-based Banking"[5] and associated scorecard or the Sustainability Accounting Standards Board's Standards for Commercial Banks,[6] and we expect this field will continue to see rapid advances in the near future.

In addition, we encourage DFPI to consider incorporating in its financial analysis accounting for those social and environmental costs or risks that are generally accepted and quantifiable, including opportunity costs. For example, in analyzing a public bank applicant's proposal to finance housing for 100 people experiencing homelessness, the evaluation should account for the cost to the local agency of 100 people experiencing homelessness in their jurisdiction. We also encourage DFPI to incorporate the climate-risk disclosure standard currently in development by the state in evaluating a public bank applicant's "reasonable promise of success." Furthermore, we note that public bank applications can only be submitted to DFPI after a local agency or agencies have approved a viability study, indicating that the local agency has evaluated the proposed public bank's financial projections and expected public policy impacts and determined that the proposed public bank has a reasonable promise of success. Considering local agencies' unique competence in evaluating their own finances and public policy goals, we believe DFPI should take the local agency's determination into account in evaluating public bank applications.

We respectfully urge DFPI to amend the administrative standard described in proposed § 10.3301.1 to include an evaluation of the qualitative social and environmental goals laid out in the applicant's viability study and business plan, and to incorporate generally accepted and quantifiable social and environmental costs in evaluating the applicant's financial goals and projections.

4. § 10.3402 no exemption for pre-opening solicitation of funds

Section 10.3402 refers to transactions described in (a) and (b) as "exempted from" and "not being comprehended within the purposes of Section [10.3401]." The proposed regulations add a new subsection (c), which clarifies that "[t]ransactions involving a subject institution which is a proposed public bank are not eligible for this exemption even if the transactions otherwise meet the requirements in subdivision (a) or (b) of this Section." Section 10.3401 reads, in its entirety: "Except as otherwise provided in Section 10.3402 of this Chapter, no proposed director, proposed officer, or organizer of a proposed subject institution shall solicit or accept pre-opening funds for such proposed subject institution from any person unless the Commissioner has approved such solicitation and acceptance."

According to the ISOR, eliminating this exemption for public bank applicants is necessary to protect public funds. ISOR at 12. However, as acknowledged in the ISOR, AB 857 already provides several other

[4] https://www.gov.ca.gov/2020/09/24/governor-newsom-releases-california-climate-investment-framework/
[5] http://www.gabv.org/about-us/our-principles
[6] https://www.sasb.org/wp-content/uploads/2018/11/Commercial_Banks_Standard_2018.pdf

mechanisms to ensure that public funds are prudently used in advance of applying for a public bank charter, including requirements that a local agency's governing board conduct and approve a viability study of the proposed public bank, as well as a voter referendum, except in the case of charter cities. *Id*. In addition, other existing provisions of the Banking Law and Government Code establish a robust system of protections for public funds.

This elimination of exemption puts public bank organizers at a distinct practical disadvantage relative to private sector bank organizers by creating a new requirement for Commissioner approval which was not imposed by the Legislature and restricts the autonomy of local agency officials. For example, under the proposed definition, it appears that a City Councilmember could not propose a budget expenditure to commission a viability study without prior approval from the Commissioner, as such activity could be construed as soliciting pre-opening funds for a proposed public bank.

We respectfully urge DFPI to withdraw the proposed § 10.3402(c) and instead clarify that § 10.3401 does not apply to proposed public banks.

Respectfully submitted,

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