The CO Public Banking Coalition: Public Banking FAQ’s

What is a Public Bank?

Answer: A Public Bank is a bank owned by a national, state, or local government in which all of its funds, taxes, and revenues are deposited. It is mandated to serve a public mission that reflects the values and needs of the public it represents.

What is the most basic difference between a public and private bank?

Answer: The most fundamental difference is that a public bank has a mission to serve the public interest while private banks are owned by shareholders and their primary goal is to maximize profit for their shareholders, which can work against the public interest.

Common Public Banking Misconceptions Explained: What are the main arguments raised against public banks, and are they valid?

1) **Public Banks are run by politicians and governments, making them vulnerable to corruption and fraud.**
   Answer: This argument is incorrect. Public banks like the Bank of North Dakota (BND) are run by experienced and independent banking professionals, not by politicians. The BND has been very well run without fraud or financial scandal for 101 years and has made North Dakota’s economy the strongest and most stable of any state in the country. The charter of a public bank imposes strict rules to prevent improper political or corporate influence and conflicts of interest from influencing lending and other important decisions of the bank. In contrast, the big Wall Street banks have repeatedly brought the nation’s economy down through unwise and risky lending practices and have repeatedly engaged in and been heavily fined for fraudulent and illegal lending practices that badly hurt the public and their own customers. Their lending practices cause the so-called “business cycle” in which the entire economy crashes every six years or so, causing economic devastation, followed by bailouts of Wall Street for which taxpayers bear the burden through increased taxes or reduced services or both.

2) **Public banks are too risky.**
   Answer: This argument fails because the Bank of North Dakota has been strong and stable over the past 101 years. It has achieved record profit each year for the past eighteen years, averaging 20.2% return on equity over this period. As explained elsewhere in our FAQs, BND made North Dakota the only state that experienced no

recession in 2008 but record income instead. In contrast, the major private banks have repeatedly failed due to the boom and bust economy they create. Because they have conditioned political leaders and the public to believe (incorrectly) that they are "too big to fail" they have been repeatedly rescued or bailed out by the government or Federal Reserve, which for taxpayers bear the burden.

3) **Public banks compete unfairly with private banks.**
Answer: (1) In our plan a state public bank would not take deposits from private persons or corporations, and would not compete with private banks for private depositors, taking only deposits of government instead. (2) Instead of competing with private banks a public bank would partner with local private community banks in making loans, as the Bank of North Dakota does. That practice has resulted in stronger community banks and no bank failures in North Dakota for many years and far more community banks per capita than any other state. (3) Some may argue that it would be unfair for a public bank to take deposits from governmental entities. But that implies that a government and its people don't really own their own money, that it belongs to the big Wall Street banks. Our answer is that a sovereign government must have the right to decide where to put and invest its own money, and not be forced to turn it over to the major banks to use for their own advantage at public expense. Further, when governments put their money in private banks, as they do presently (except in North Dakota), they violate their trust obligation to use the money to serve the public interest of the people and community. (See answer to next Question 4).

What are the primary advantages to a state, city, or county of having a public bank?

Answer:

1) Public banks invest in the local community--in small and medium sized businesses, infrastructure, affordable housing, renewable energy, health care, sustainable agriculture, education, student loans, and other sustainable and locally beneficial enterprises. In contrast, private banks often invest primarily in high profit or risky non-sustainable enterprises elsewhere, such as weapons and war, fossil fuels, big pharma, chemical agriculture, private prisons, privatization of public assets through public-private partnerships (3Ps), and outright sale of public assets, causing big increases in fees and tolls and decreased public access.

2) Public banks create many more jobs in local communities.

3) Public banks like the Bank of North Dakota lend in partnership with local private community banks, enabling community banks to take on loans they could not otherwise

take on, to be more profitable, to help them comply with burdensome regulations, and for them together to better serve the local community.

4) Public banks operate with very low overhead: no advertising, no ATMs, no huge salaries or bonuses, no branches; local community banks serve as their front office; and they have no shareholders to whom to pay dividends.

5) Public banks lend conservatively and avoid speculative lending, making them very stable.

6) As a result of these practices, public banks are more profitable and more stable, often considerably more so than the major Wall Street banks. They thus can avoid and end the recurrent so-called "business cycle" to which the normal business practices of the major banks are a substantial contributor. In contrast, public banks through their countercyclical lending, as explained below, help prevent and dampen the business cycle.

7) Public banks provide a major source of new income to a community without raising taxes, and may sometimes enable a reduction of taxes.

8) Public banks lend counter-cyclically. Thus, they lend more in a recession to offset the decline, thus preventing and reversing the recession, while major private banks always cut lending in a recession, making it worse if not severe as in the Great Recession of 2008. For example, the public Bank of North Dakota enabled North Dakota to be the only state to experience no recession in 2008, but record income each year instead. Some said that oil was the reason why North Dakota experienced no recession in 2008. However, Montana and Alaska had as much oil as North Dakota but unlike North Dakota experienced high unemployment and budget deficits. Further, the oil income from fracking did not kick in until 2010. In 2015, when the price of oil collapsed, the Bank of North Dakota and its state again had record profits unlike other oil-rich states.

9) In a recession, public banks work with borrowers to refinance loans and to ensure payment, while private banks often move quickly to foreclose on property, knowing they can resell it, or can buy foreclosed properties, businesses, and smaller banks for a fraction of their real value, siphoning ever more of the country's wealth into the hands of the richest members of society.

10) Unlike private banks, public banks do not pay commissions and fees to loan officers for making loans. This aspect of counter-cyclical lending helps prevent unpayable loans, "liar's loans," and bubbles, which inevitably burst, causing economic collapse and recession.

11) Public banks lend to create new goods and services, whereas private banks often lend for investment in existing assets such as stocks, real estate, or commodities, which promotes

inflation and bubbles. Investing in real goods and services helps prevent inflation because the new money or demand is balanced by the supply, or the new goods and services.

How do we know a public bank won't be improperly run by politicians and insiders for their own benefit?

Answer: In existing and proposed US Public Bank models, skilled bankers, not the government, make bank decisions and provide accountability and transparency to the public for how public funds are used, unlike private banks. A public bank will be run by professional bankers in the public interest and accountable to publicly elected officials. Rules will be carefully written to protect the bank's operations from conflicts of interest involving politicians, insiders, and corporate interests. Operations will be monitored for compliance and such rules will be strictly enforced against infractions. public accountability and the financial operations of the bank will be publicly disclosed on-line

Leaders of the Colorado Public Banking Coalition and the Rocky Mountain Public Banking Institute have no personal financial interest in having a public bank except the benefits that will accrue to all citizens. Public banking is distinguished from private banking in that its mandate begins with the public's interest. Privately-owned banks, by contrast, have shareholders who generally seek short-term profits as their highest priority. Public banks sometimes enable the reduction of taxes because their profits can be paid into the general fund of the government. The costs of public projects undertaken by governmental bodies are also greatly reduced, because public banks do not need to charge interest to themselves,thus eliminating an average of 50% (ranging from 35% to 77%) of the cost of such projects that consists of interest.

Why is Public Banking important now?

Answer: The 2020 Colorado budget is $12.6 billion and the projected deficit is at least $3 billion. This means that either the difference is made up by the federal government, which is highly improbable, or that vital services to the people of Colorado must be substantially curtailed. Public banks in Colorado could avoid that disastrous effect assuming they are adequately funded. Rocky Mountain Public Banking Institute has conducted informal surveys of needs in Colorado indicating that cities, counties, the state, and educational systems are strapped for funds, face cuts of services, and in some cases a request to sell off valuable assets. A public bank could enable local governments to make much more money available by loans for urgent needs such as affordable housing, clean energy, infrastructure (roads, bridges, parks), health care, education, student loans, environmental cleanup, sustainable agriculture, broadband, and independent media, according to the community's needs, creating a much larger tax base to restore the lost funds, and some of the banks' income could be paid into the government's general fund.

Are public banks legal under the Colorado constitution?

Answer: Very likely Yes**.** In October 2019, Colorado's Office of Legislative Legal Services (OLLS) issued a Legal Opinion to State Representative Jonathan Singer in which it concluded that a state public bank that qualifies as a "TABOR enterprise" would not violate the provisions of Article XI of the Colorado constitution. Thus, a public bank would not violate Article XI, section 1, which prohibits a state or local subdivision from "lending its credit" to another; nor would a public bank violate Article XI, section 2, which prohibits a state from mingling its funds with a private entity because the public bank's funds would not be mingled with funds of a private entity and the public bank would serve a public purpose; finally, a state public bank would not violate Article XI, section 3, which prohibits the state from contracting for debt except for limited exceptions. The opinion further stated that there is a "heavy presumption" of constitutionality of legislation, and that a party challenging the bank on constitutional grounds would have to prove its unconstitutionality "beyond a reasonable doubt." Therefore, a high probability exists that legislation to establish a state public bank would be upheld as constitutional by the courts if challenged.

Can a city or county establish a public bank? By what methods?

Answer:

a. **By legislation:** For the same reasons that OLLS concluded that a state public bank would probably not violate the Colorado constitution, on December 19, 2019 OLLS Managing Senior Attorney Thomas Morris wrote that it was "equally certain" that state legislation to authorize cities and counties to create public banks would be constitutional. The memo also stated that home rule cities and counties could establish their own public banks without the need for state legislation as long as they restrict their operations to their own community. The heavy presumption of constitutionality would apply and a challenger would have to show its unconstitutionality beyond a reasonable doubt. The local public bank could apply for a charter with the Colorado banking board.

b. **By executive order:** Furthermore, the same presumption of constitutionality applies to an executive order of a governor, mayor, city manager or other officer authorized to issue executive orders. We are seeking legal advice to verify that an executive order could be used to establish a public bank.

Would a public bank be subject to the limits on revenue and expenditures imposed by the TABOR Amendment?

Answer: If a public bank is established as a self-sustaining "TABOR enterprise" under section 2(d) of the TABOR Amendment, the Amendment provides that the bank would not be a "district" as defined in the Amendment. Therefore, all of its income and expenditures would be exempt from the TABOR limits on income and expenditures, and any or all of its income could be paid into the general fund of the government that owned the bank and used for any legitimate government purpose. The enterprise exemption applies as long as the bank is government owned, receives less than 10% of its income each year from state or local government, and is authorized to issue revenue bonds, all as required by section 2(d) of TABOR. A public bank could easily meet these conditions.

How will public banks help during the current pandemic?

Answer: Public banks could make loans to greatly increase the purchase of necessary COVID-19 testing equipment and all necessary protective gear for first responders such as doctors, nurses, and EMTs, as well as to make loans to facilitate the use of the most effective means found to treat and cure the infection.

Secondly, to overcome the financial crisis caused by COVID-19, public banks could lend much more money to state and local governments to build affordable housing and infrastructure, and can lend money to restore small businesses, to refinance student loans, and to convert from fossil fuels to clean energy, including job retraining.

Where would the state get the money to create its own public bank?

Answer: Although some legislators and public officials say the state does not have any money lying around that it could use to create a public bank, the state and local governments actually have a number of resources they could use to create public banks.

1) **Transfer deposits**. Colorado and its local governments currently keep their money and liquid assets in JP Morgan Chase, Wells Fargo and other banks. These would be transferred to a public bank and could furnish some of the necessary capital and deposits. That is how the Bank of North Dakota started in 1919, in addition to issuing $2 million in bonds.

2) **Transfer a portion of unrestricted investments.** These are often substantial and appear as assets in the government's CAFR (annual financial report) and a portion of these might be put to better use to help create a public bank.

3) **Revenue bonds.** The state and local governments or a public bank could issue revenue bonds to start a public bank. Unlike general obligation bonds, revenue bonds do not create a general obligation of the government. By definition, the revenue to pay the bondholders comes solely from the interest and other income of the public bank or other entity. No vote of the people is required. The bank can and should be made large enough to fully restore the economy. If its management and lending operations were properly planned and comparable to the low overhead and sound lending of the Bank of North Dakota, it would be highly profitable from the first year onward.

4) **Transfer existing loan funds.** The state and local governments have established loan funds for essential purposes, such as the Colorado Housing and Finance Authority (CHFA). These are revolving loan funds. They could be transferred to a public bank as capital and generate 10 times as much money through loans. California and Washington state have pending legislation to do the equivalent.

5) **Investment pools.** The state could authorize existing government investment pools to be used as capital and/or deposits for a state public bank or local public banks.

6) **Pension funds.** Pension funds are a significant potential source of funds to start a public bank. Much of the pension funds in Colorado are currently invested in risky enterprises producing low returns and sometimes big losses. It is recommended that pension boards such as PERA authorize the investment of up to 5% or 10% of pensions as capital for a state or local public bank. PERA now has $52 billion in pension assets. If just 5% of that or $2.6 billion were used as capital to start a public bank, it could be used to generate 10 times as much or $26 billion in loans to create a stronger and more stable economy, protect jobs and pensions, and could pay a higher and steadier average return to PERA than it has been receiving from its current investments in volatile stocks and hedge funds. If Colorado had a public bank proportional in size to the public bank of Alberta province in Canada, for our population, the bank would have $60 billion in loans, enough to overcome our $3 billion deficit.

7) **Cares Act Funds.** It might be possible that some of the federal Cares Act funds could be used for capital for a public bank. The U.S. Treasury Department's guidelines for Cares Acts funds allow them to be used to make grants to businesses that lost income due to the shut down orders and encourages states and local communities to use their reasonable judgment in using the funds. If such funds were used as capital, they could create 10 times as much in loans to businesses harmed by the shut down orders as they could by making grants of the same money, producing substantially more benefit to the economy.

8) **Any combination of the above.** If sufficient money were put into one or more public banks, we could rapidly restore our entire economy.

How would a public bank be structured?

Answer: Several alternative models could be used in Colorado:

1) **Self-regulation by statute and by-laws.** The Bank of North Dakota model has worked very well for 101 years. The BND was established by making the governor, the attorney general and the commissioner of agriculture the board of directors of the bank. The board then appointed an experienced banker to manage the bank, In 1969 they added an advisory board that reviews policies annually and makes written recommendations for any changes to the executive committee and board. State legislation and the bank's

by-laws established the rules governing the bank. The BND is managed directly by its own executive committee and board rather than by the banking board that oversees private banks licensed in the state. That model would be the simplest and least costly for a public bank for the state of Colorado and has been very successful for the BND. A state public bank (i) can and should operate with very low overhead, (ii) would make loans in partnership with local private community banks which would serve as the state bank's front office, with the state bank providing a second tier review of the soundness of each loan, (iii) would avoid speculative and risky loans, (iv) would not pay commissions or fees for making loans, and (v) would invest in new goods and services rather than existing assets or commodities, and by following these practices would not create bubbles.
We believe the better policy would be to follow the BND model. Thus, the state bank would not be regulated by the state banking board, which is oriented to regulate private banks, but by its own board and its organizing documents. When local public banks are formed, it may make sense that they be licensed and regulated by a separate division of the banking board devoted solely to licensing and regulating public banks, based upon their different mission, goals, and operations, even though they will be making joint loans.

2) **A public bank as an LLC**. Colorado banking statutes allow an LLC (limited liability company) to apply for a bank charter. Colorado's LLC statutes allow a non-human entity to own an LLC, and allow an LLC to have only one owner. Under the Colorado constitution, a home rule city or home rule county can generally do anything as long as it's not prohibited by the constitution or statute. There do not appear to be any constitutional or statutory provisions that would prohibit a home rule city or county from owning and operating a public bank. (see OLLS Legal Opinions referred to above). Therefore, OLLS concluded that a home rule city or county could probably operate a public bank without the need for state legislation if it limited its operations to its own jurisdiction. For these reasons we believe a home rule city or county could form an LLC to apply for a bank charter. That could work quite well as long as the bank's enacting legislation incorporates all the necessary governance measures necessary to ensure that the bank serves the public interest, is professionally managed, and is fully protected from political and corporate interference and from conflicts of interest in its governance and operations.

3) **The banking corporation model doesn't fit**. Colorado banking statutes also authorize a banking corporation to apply for a charter. This requires five individuals to apply for the charter, each of whom has paid for 1% of the capital stock of the bank. This model could theoretically be used if the individuals were all pledged to solely serve the public interest, but it is an awkward fit for a public bank and so we strongly recommend against it.

4) **Public banks for non-home rule communities**. Only two of the 64 counties in Colorado (Weld and Pitkin) have home rule so the above opportunity for home rule counties will not be available in most counties unless they adopt home rule by charter amendment. Therefore, it would make sense to pass state legislation to authorize cities and counties to have publicly owned banks even if they don't have home rule and to

authorize cities, towns, and counties to pool their resources to create a public bank. California's statute AB-857 signed into law October 2019 includes these measures.

5) **Public banks as public benefit corporations and cooperatives**. We also propose legislation authorizing public banks to be formed as public benefit corporations and/or as cooperatives, which California's enacted statute AB-857 also provides. A public benefit corporation is required to serve public purposes and is thus more suitable for a public bank than an LLC form of organization.

How would a city or county bank be governed?

Answer: One model, analogous to the Bank of North Dakota, would be for the managers of the LLC for a city public bank to be the City Manager, Law Director, and Planning and Development Director, or their designee. The managers would hire the president of the bank, and so on, analogous to the state model, including an advisory board broadly representative of the community.

Should a public bank on the BND model be required to do a feasibility study before being approved?

Answer: No. The BND provides sufficient proof that a public bank based upon its business model can be successful and profitable year after year, even during a recession. The BND has averaged 20.2% return on equity over the past 18 years. (link) Therefore, a feasibility study to prove that a public bank would work is unnecessary and would be a waste of time and money. Some cities and states have conducted feasibility studies. However, they relied upon finance experts with little if any understanding of public banks and their important differences from private banks. Therefore, their basic assumptions about a public bank were largely incorrect, causing their conclusions to be incorrect. Moreover, private banks are not required to provide a feasibility study to prove that the concept of a private bank is viable in order to be licensed. As explained above, banks create new money out of thin air when they make loans, making it easy to make a profit if the bank has low overhead and makes safe loans, as BND does. In Colorado the maximum interest rate a bank can charge is 45% per year. (C.R.S. §5-12-103). A bank charging an average of just 2.5% interest on its loans that lends 10 times its capital would gross 25% of its capital annually (10 X 2.5% = 25%) (i.e. 25% return on equity (ROE) before subtracting overhead). If its overhead matched the BND's most recent (2018) reported overhead, which is ~16.7% of its income, its ROE would be 20.75%, or slightly higher than BND's ROE over the past 18 years. So a study to show that a public bank is feasible is not necessary.

Should a public bank complete a business plan before being created?

Answer: Yes, but it should be easier and less expensive than the usual business plan. A bank like any business needs a business plan to show what its purpose is, where it will obtain its initial capital and deposits and the amount thereof, the customers and projects for which it plans to make loans, and its projected operating expenses and earnings. For a private bank such plans are expensive, requiring many hours of time to put together, usually by a lawyer. The usual cost of such a plan is roughly $500,000. Interestingly, the Bank of North Dakota apparently did not prepare a business plan before going into operation. However, their leaders had roughly calculated the large amount of money the public bank would save the citizens of North Dakota. Previously, 69% of their money had been deposited in out-of-state banks and farmers were paying high rates of interest on farm loans that could be much lower if the state had its own state-owned bank. Finally, the interest income for a state public bank on loans to the state's farmers would stay in the state and benefit its own citizens. Based upon a few detailed estimates of these benefits, a Non-Partisan League pamphlet concluded "It is not an unreasonable estimate that in interest rates and in increased funds available for business within the state it will be worth $20,000,000 a year to the people of North Dakota." (*The Bank of North Dakota: From Surviving to Thriving - The First 100 Years*, by Mike Jacobs, 2018, page 33).

A business plan for a state public bank or local public bank based upon the model of the BND would be simpler in every important respect than that of a private bank. For example, its deposits and capital will consist in part of its own money and liquid assets currently in Wall Street banks, to which could be added deposits from political subdivisions. In addition, the bank could use any one or combination of the other sources of initial capital and deposits discussed above, such as revenue bonds, unrestricted investments, a small percentage of pension funds (e.g. 3-5%), CHFA and other existing public loan funds, investment pools, and federal Cares Act funds. As explained above, the operating costs would be very low and help ensure profitability from the first year. Determining to whom loans will be made is also considerably easier for a public bank. No advertising would be required because it would already have a large backlog of important lending opportunities desperately needing credit, such as infrastructure (both new and badly needed maintenance of existing infrastructure), affordable housing, conversion to renewable energy, refinancing student loans, education, loans to small and medium-sized businesses, sustainable agriculture, federally insured home mortgages, and health and hospital care, most of which would be through joint loans with and guarantees to local community banks. With loans averaging 2.5% interest, and operating costs consisting of about 17% of income (the current proportion for BND), the bank could have a projected return on equity of 20.75% to start.