

SENATE BILL REPORT

SB 5188

As Reported by Senate Committee On:
Business, Financial Services & Trade, February 9, 2021
Ways & Means, February 22, 2021

Title: An act relating to the creation of the Washington state public bank.

Brief Description: Concerning the creation of the Washington state public bank. [**Revised for 2nd Substitute:** Concerning creation of the Washington state public financial cooperative.]

Sponsors: Senators Kuderer, Nguyen, Conway, Darneille, Das, Dhingra, Hasegawa, Hunt, Lias, Lovelett, Stanford, Van De Wege, Wellman and Wilson, C..

Brief History:

Committee Activity: Business, Financial Services & Trade: 1/28/21, 2/09/21 [DPS-WM, DNP].

Ways & Means: 2/18/21, 2/22/21 [DP2S, DNP, w/oRec].

Brief Summary of Second Substitute Bill

- Activates a public financial cooperative as a cooperative membership organization to lend to state, local, and tribal governmental entities.
- Establishes the public financial cooperative to issue debt in the name of the bank rather than the state of Washington.

SENATE COMMITTEE ON BUSINESS, FINANCIAL SERVICES & TRADE

Majority Report: That Substitute Senate Bill No. 5188 be substituted therefor, and the substitute bill do pass and be referred to Committee on Ways & Means.

Signed by Senators Mullet, Chair; Hasegawa, Vice Chair; Frockt and Hobbs.

Minority Report: Do not pass.

Signed by Senators Dozier, Ranking Member; Brown and Wilson, L.

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not part of the legislation nor does it constitute a statement of legislative intent.

Staff: Clinton McCarthy (786-7319)

SENATE COMMITTEE ON WAYS & MEANS

Majority Report: That Second Substitute Senate Bill No. 5188 be substituted therefor, and the second substitute bill do pass.

Signed by Senators Rolfes, Chair; Frockt, Vice Chair, Capital; Carlyle, Conway, Darneille, Dhingra, Hasegawa, Hunt, Keiser, Liias, Mullet, Pedersen, Van De Wege and Wellman.

Minority Report: Do not pass.

Signed by Senators Wilson, L., Ranking Member; Brown, Assistant Ranking Member, Operating; Honeyford, Assistant Ranking Member, Capital; Schoesler, Assistant Ranking Member, Capital; Braun, Gildon, Muzzall, Rivers, Wagoner and Warnick.

Minority Report: That it be referred without recommendation.

Signed by Senator Robinson, Vice Chair, Operating & Revenue.

Staff: Julie Murray (786-7711)

Background: Public Banking in the United States. A public bank is a bank, a financial institution, in which a state, municipality, or public actors are the owners. As of 2021, the Bank Of North Dakota is the only state public bank in the United States. Under North Dakota State law, the bank is the State of North Dakota doing business as the Bank of North Dakota. The bank is the only legal depository for all state funds. The state and its agencies are required to place their funds in the bank, but local governments are not required to do so. Profits from the bank are either deposited in North Dakota's general fund, or are used to support economic development in the state. The bank is permitted to collateralize government deposits.

State Lending Programs for Local Governments. Washington has more than 80 programs and subprograms administered by 12 agencies that provide financial support to local governments in the state. Some of the larger examples include:

- Public Works Trust Program—provides planning, pre-construction, construction and emergency loans for local infrastructure improvements;
- Water Pollution Control Revolving Loan Program—provides low-interest loans for planning, design, acquisition and construction of water pollution control facilities and nonpoint source pollution control activities;
- The Drinking Water State Revolving Fund —provides low-interest loans for public water systems to publicly owned—municipal—and privately owned drinking water systems statewide;
- The Community Economic Revitalization Board—provides loans and grants to finance public infrastructure improvements that encourage new business development and expansion in areas seeking economic growth; and

- The Housing Trust Fund—provides loans and grants for construction, acquisition and rehabilitation of low-income multi-family and single-family housing.

Two programs provide local governments with access to capital via the municipal bond market through programs administered by the Office of the State Treasurer. The LOCAL Program allows Washington municipalities to finance essential real estate and equipment as either a financing contract or lease, also known as certificate of participation). While these certificates are issued by the state, the state's obligation is limited to the extent that the state is an obligor in the certificates; otherwise local governments participating in a specific contract are named as the obligor. The School Bond Guarantee Program was established in 1999, following a voter-approved constitutional amendment. School districts must apply to the State Treasurer's Office and demonstrate that their general obligation bonds were approved by voters. The program provides a backup general obligation pledge to school district's bonds, providing a lower interest rate to the borrowing district.

Washington State Bank Business Plan. In the 2018 supplemental budget, the Legislature included a proviso for the Washington State Office of Financial Management to contract with an entity or entities with expertise in public finance, and commercial and public banking to evaluate the benefits and risks of establishing the bank, and to develop a business plan for its creation and launch. This report was transmitted to the Legislature in May 2020.

Summary of Bill (Second Substitute): Establishment and Activation of a State Public Financial Cooperative . A public financial cooperative is established as a public body corporate and politic, and as an instrumentality of the state of Washington. The financial cooperative may be activated under the following conditions:

- the state treasurer completes a study that provides recommendations on staffing and operational needs for the financial cooperative;
- an appropriation is provided from the state that is sufficient to allow the state to issue debt with a competitive rating;
- articles of activation are completed in a format approved by the State Finance Committee and filed with the Secretary of State; and
- a duplicate of the original articles of activation and additional information is filed with the Department of Financial Institutions.

Local governments and tribes are permitted to invest in the financial cooperative, and the articles of activation must be approved by each, the member local, or tribal governments, that become a member. The State Finance Committee is directed to approve an amount for an initial contribution by local and tribal governments. Five years after activation, the financial cooperative shall have a goal of providing 35 percent of the amount it lends on an annual basis to support housing in low to moderate-income areas. The state treasurer is authorized to reinvest balances that are more than sufficient to meet the current expenditures into a public financial cooperative.

Operating Board Membership. The operating board consists of nine members including:

- five member appointed directors selected by a majority of the members of the financial cooperative;
- three of the members appointed by the Governor and confirmed by the Senate; and
- the state treasurer serving as an ex-officio member.

One of the three public members appointed by the Governor shall be appointed as the chair of the board and serve at the pleasure of the Governor, with the initial chair having to serve a full four-year term. The state treasurer may designate an employee to act on their behalf. A majority of directors constitutes a quorum. Directors of the financial cooperative serve without compensation, but are entitled to reimbursement from the funds of the financial cooperative.

Powers of the Operating Board. The board has the authority to hire and fire an executive director. The board must approve the budget of the financial cooperative on an annual basis. The board is directed to establish an internal audit committee.

Employees of the Washington State Housing Finance Commission (WSHFC) will administer and operate the financial cooperative. The executive director is funded through the WSHFC budget. The financial cooperative may consult with other state agencies at its discretion and without the approval of the WSHFC.

State Oversight of the Public Financial Cooperative . The state finance committee serves as the oversight board of the financial cooperative. The state finance committee may require independent audits, and is subject to audits by the state auditor. The Department of Financial Institutions (DFI) may review the deposits and transactions of the financial cooperative.

Powers and Limitations on the Public Financial Cooperative. The financial cooperative is authorized to:

- sue and be sued in its own name;
- adopt and alter an official seal;
- establish rules to conduct its business;
- engage independent experts and enter into contracts that the financial cooperative may find necessary to conduct its business;
- receive deposits from state, local or tribal governments and invest the deposits in lawful funds;
- open and maintain accounts in qualified public depositories in the Federal Reserve Bank of San Francisco, the National Cooperative Bank, a federal home loan bank, or any other federal financing entity;
- procure insurance;
- apply for and accept grants, loans, advances, and from any source of money, property, labor, or other things of value;
- borrow money and issue its bonds consistent and provide for and secure their

- payment;
- develop and conduct a program to make loans to borrowers for project costs of infrastructure and economic development projects;
 - establish, revise, and collect member contributions and fees as the financial cooperative deems necessary;
 - charge for its costs and services in review or consideration of a proposed loan to a local or tribal government regardless of whether a loan is made;
 - make expenditures as are appropriate for paying administrative expenses;
 - establish reserve funds;
 - provide financial assistance and other forms of assistance to local or tribal governments;
 - make distributions to members of amounts that the board deems surplus to the needs of the financial cooperative, subject to a two-thirds majority of the board; and
 - engage outside legal counsel.

The financial cooperative must not:

- constitute a bank or trust company within the jurisdiction under the control of DFI, the controller of the currency of the United States of America, or the United States Department of the Treasury; and
- constitute a bank, broker, or dealer in securities.

Financing Powers of the Public Financial Cooperative. Bonds issued by the financial cooperative are not obligations of the state of Washington, and are only obligations of the financial cooperative. Such funds are not public moneys or funds of the state and at all times must be kept segregated and set apart from other funds. Obligations of the financial cooperative are not obligations of the state of Washington.

Bonds of the financial cooperative are subject to such terms, conditions, covenants, and protective provisions as are found necessary or desirable by the financial cooperative. Any bonds issued by the financial cooperative may be secured by a financing document between the financial cooperative and the purchasers or owners of the bonds. The bank may purchase its bonds with any of its funds available for purchase, and purchase its bonds in the open market. Any issuance of bonds requires advance notice to the chair of the state finance committee.

The financial cooperative, the members, the directors or agents, nor financial cooperative employees are personally liable on bonds or subject to any personal liability or accountability. Any owner of bonds issued by the financial cooperative may become a purchaser at any foreclosure sale if the person is the highest bidder.

Depending on the contracts between the financial cooperative and its borrowers, the financial cooperative may modify the rate of interest, time, and payment of installment of principal.

Exemption from Disclosure. The following are exempt from disclosure:

- financial and commercial information supplied by businesses or individuals during the application for loans or program services and records; and
- examination reports and information obtained by DFI from banks, savings and loans, and credit unions.

EFFECT OF CHANGES MADE BY WAYS & MEANS COMMITTEE (Second Substitute):

The state treasurer is required to conduct a study that provides recommendations on staffing and operational needs for the cooperative. The study must ensure the administration of the cooperative does not interfere with the mission of the Washington State Housing Finance Commission. The requirement that DFI issue the cooperative a charter is removed. The cooperative is directed to file a duplicate of the original articles of activation and amended articles with DFI. Various administrative requirements for the cooperative's filing with DFI are added. The ability for local governments to invest in bonds issued by the public financial cooperative is clarified.

EFFECT OF CHANGES MADE BY BUSINESS, FINANCIAL SERVICES & TRADE COMMITTEE (First Substitute):

The title of the bill is amended to "An act relating to the creation of the Washington State public financial cooperative" and various references to a public bank are replaced with references to a public financial cooperative. The state is not allowed to borrow from the public cooperative bank. DFI is directed to issue a charter rather than the secretary of state. Additional language is provided to ensure that the the public cooperative is not a public depository and does not create state debt.

Appropriation: None.

Fiscal Note: Available.

Creates Committee/Commission/Task Force that includes Legislative members: No.

Effective Date: Ninety days after adjournment of session in which bill is passed.

Staff Summary of Public Testimony on Original Bill (Business, Financial Services & Trade): *The committee recommended a different version of the bill than what was heard.*

PRO: The idea for a public bank has been around for a decade. The idea has evolved and the work that has come out of the task force is a professional business plan, that created the structure for this bill. This will provide an additional option for governments to finance needed improvements. Banks are accountable to their shareholders. This bank would be accountable to the taxpayers. A public cooperative bank can partner with other state programs to fill the gaps. The state would share in profits that would be returned to the

community. Members pay themselves back, and the profits work for the people. This bill would provide more options to help connect last mile projects like connecting broadband networks to small communities. This will be an independent bank run by banking officials, and be accountable to the public. The public cooperative bank will not be susceptible to fund sweeps because it will be an independent entity. It is a bank of the people for the people. An additional lending authority for communities fighting issues like gentrification and redlining. This is good public policy. Operations would be lower because they would not have branches. There would be more public oversight and transparency because it would be accountable to our elected officials. Counties need reliable resource for investment—private banks are reluctant to invest. This would take the middleman out of what the government takes through taxes and what it pays for with respect to public improvements.

CON: This is a risky use of taxpayer funds and will be more expensive to use than what is currently available. There are examples of governmental entities going into default and having to be bailed out by counties, and the fear is that this could happen on a broader scale if we had a state bank. Only two public banks, North Dakota and American Samoa, are open while many others have failed. Many programs exist to assist rural counties. Many jurisdictions have studied to start a public bank, and no new banks were adopted as a result of those studies. There could conceivably be capital calls to members, and members might not have reserves to pay for those capital calls. The name bank and trust should not be used to describe this entity if you go forward. The public deposit board does not meet frequently enough for oversight. This structure mimics a credit union. This is not a public bank. Oversight is by elected officials, which makes it political. This is an intrusion by the government.

OTHER: Some cities find this concept intriguing. There are questions related to how this feels needed. Cities want grants for projects to keep utilities low. A lot of time cities have no payback options to pay for loans. They need to have very low interest rates. Smaller jurisdictions do not have reserve dollars necessary to fund this. This needs to be additive and not supplant programs. There are a lot of programs out there that need to be maintained. The Housing Commission is supportive of the underlying goals. The Board of Commissioners have not had a chance to meet and determine a position for the board. There is a concern that supporting the bank may detract from the Commission's mission to prevent homelessness and affordable housing.

Persons Testifying (Business, Financial Services & Trade): PRO: Senator Patty Kuderer, Prime Sponsor; Cynthia Stewart, League of Women Voters of Washington; Ruth Fruland, citizen; Stoney Bird, citizen; Toyoko Tsukuda, League of Women Voters of Washington; John Comerford, RetireCorp, SPC; John Holdsclaw, National Cooperative Bank; Dennis Ortblad, citizen; Paula Sardinias, Washington Build Back Black Alliance.

CON: Jeff Pack, citizen; Meredith Green, Kitsap County/Washington State Association of County Treasurers; Brad Tower, Community Bankers of Washington.

OTHER: Candice Bock, Association of Washington Cities; Steve Lindstrom, Sno-King Water District Coalition; Steve Walker, Washington State Housing Finance Commission.

Persons Signed In To Testify But Not Testifying (Business, Financial Services & Trade): No one.

Staff Summary of Public Testimony on First Substitute (Ways & Means): *The committee recommended a different version of the bill than what was heard.* PRO: I support this bill because it provides an opportunity for local governments to pool resources to fund their infrastructure needs. As a public entity, the cooperative should have lower operating costs they can pass onto their clients. The low-income housing goal is good. The International Monetary Fund has endorsed the use of public banks by states to relieve the pressure of COVID-19 on the financial markets. This bill fulfills the International Monetary Fund's concept. Will provide the state with stronger economy and infrastructure. There is not enough funding to cover local government infrastructure needs and local governments need access to low interest loans. The cooperative should not be a replacement for state support for infrastructure such as the Public Works Trust Fund and local governments should not be mandated to participate. The report may have assumed city reserves would be a good source of deposits to help capitalize the cooperative, but those reserves generally need to be liquid and available.

CON: We do not support this proposal, not because it creates competition, but because it injects risk into our public funds. The Department of Financial Institution's fiscal notes assumes it is only doing ministerial activities and not regulating the public cooperative. Commercial lenders are required to retain 10 percent to 33 percent of operating costs in reserves to cover those regulatory costs. Lending is inherently risky. The Housing Trust Fund Commission expenses will need to be made up for in the interest rates charged on those loans. If you want low interest rates, then depositors will be subsidizing that low rate. Calling this bank public is an extreme misnomer. It is an example of crony capitalism with hand picked political appointees on the board. If we need a public bank to lend, when there is lots of money out there to be had, causes me concern because why can they not get that money.

OTHER: We support the concept to a public entity to access loans for infrastructure. Although the bill gives the Housing Trust Fund Commission a significant role, the Commission was not involved in development of the bill or the study. Our Commission expresses their unease that administering the public cooperative. It is well beyond the Commission's purpose and expertise and could severely impact its core work of affordable housing, particularly during a pandemic. The start-up and administration involved in a public cooperative could be a significant drain on resources.

Persons Testifying (Ways & Means): PRO: Cynthia Stewart, League of Women Voters of Washington; Dennis Ortblad.

CON: Brad Tower, Community Bankers of Washington; Jeff Pack.

OTHER: Candice Bock, Association of Washington Cities; Steve Walker, Washington State Housing Finance Commission.

Persons Signed In To Testify But Not Testifying (Ways & Means): No one.