The Public Banking Workbook

Prepared by the Public Banking Writing Team

V5.4 - November 21, 2013

Acknowledgement:

This page is to acknowledge all of the contributors to the Public Banking Writing Effort. The effort required over four months of effort in writing, re-writing, and perseverance in reviewing the final copy of the Workbook.

The Workbook will be used by many to gain a basic understanding of the tasks involved in preparing for and completing the efforts to establish a public bank in their community.

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The Public Banking Workbook Course

PART 1: Welcome & Introduction to the Public Banking Workbook

Prologue

This Course Workbook on Public Banking responds to the growing number of people in communities across the country concerned about the unsustainability of the current banking system, and who have made a commitment to learn how to create a public bank in their communities.

<u>The goal of this Public Banking Course is twofold:</u>

1. Provide participants with practical education, guidelines, and the tools they will need to start a public bank in their communities; and educational materials

2. Support the growing interest in public banking through on-line access to Gain knowledge about public banking benefits, terminology, financing, and governance at the level the participant is ready to tackle – either:

- <u>Basic knowledge</u>: for those who are fairly new to banking in general, as well as public banking.
- <u>Advanced knowledge</u>: for those who are already familiar with banking terminology, finance and governance, and want to sharpen their knowledge of public banking in particular

<u>Participants completing this course will:</u>

a. Help participants select the knowledge level needed, certain sections will include a box in the margins with either:

BASIC LEVEL or ADVANCED LEVEL

b. Identify options for financing a public bank in their communities

c. Understand guidelines & steps for outreach to elected officials & community members

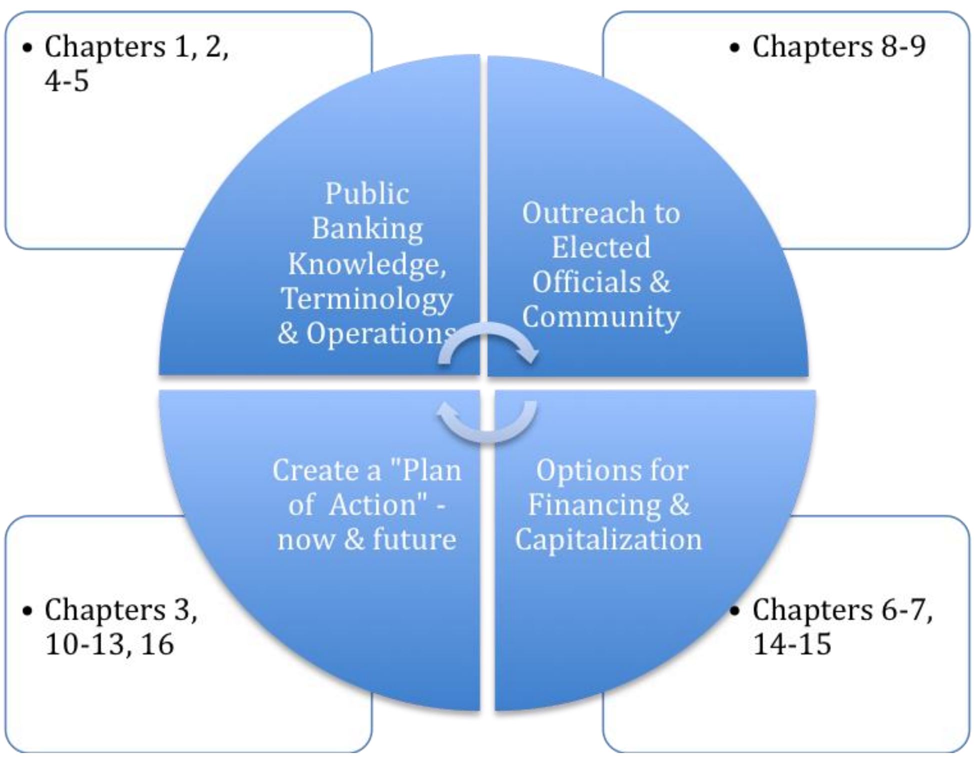
d. Create a "plan of action" for moving ahead

How to use the Workbook:

The Workbook is structured to build your knowledge, understanding and application chapter by chapter – so that, by the time you've completed the Workbook, you've actually drafted the outline of a plan for a public bank based on the needs of your community.

You may need to do research, gather additional materials and talk to key people in order to draft the outline of your plan.

This graphic shows the four main areas of learning listed above (a-d), and the Workbook chapters where you will find the primary information related to each area:



At the end of each chapter is a "Self-check" to verify your learning before moving ahead to the next chapter.

Support after Course completion:

Once participants have completed the course and engage in starting their local public bank, the Public Banking Institute is planning to make available a group of “mentors,” i.e. a person to talk with, to discuss issues or roadblocks that participants may encounter that may require another perspective to arrive at a resolution of an issue or to create a solution to the problem.

Overview - Key Principles of Public Banking:

The following graphic illustrates 5 Key Principles which live at the heart of Public Banking and are necessary to its success in any community.

These 5 Key Principles are emphasized throughout the Workbook to illustrate how and why Public Banking practices generate positive social change, and to support participants in communicating the value of public banking to their communities:

Key Principle #1: Thriving, Sustainable Communities

The Public Bank is committed to the long-term health and prosperity of the community, not short-term profits.

Key Principle #2: Transparent Practices

The Public Bank practices transparency in all facets of accounting, finance, and governance.

Key Principle #3: Public Priorities

The Public Bank invests in the public good by funding local priorities and meeting community needs in practical ways.

Key Principle #4: Multi-Stakeholder Governance

The Public Bank is accountable to all stakeholders regardless of economic status, and is governed democratically.

Key Principle #5: Trust & Confidence in Banking

The Public Bank builds long-term trust within communities through practicing ethical banking decisions and operations.

Chapter 1 – What is Public Banking and How Does it Benefit Communities?

Public Banking has been utilized in many countries for many years. Public banking frees the credit potential of public revenues and then harnesses this public wealth to create affordable credit. This credit supports our economy and its citizens to build their own economic capacity with projects that the large private banks do not fund.

Lessons to be Learned in Chapter 1:

1. What is public banking?
2. How does public banking differ from private banking?
3. Why is public banking good for communities and society?
4. What specific benefits does public banking offer communities?
5. What are the various types of public banks?
6. How do you choose your Banks Charter?
7. How and when did banking get off-track? A historical perspective of regulation and deregulation of the banking industry

1.1 What is public banking?

Public banking is banking operated in the public interest through institutions owned by the people through their representative governments. Public Banks can exist at all levels, from local to state to national, multi-national and international. Any governmental body which can meet local banking requirements may, theoretically, create such a financial institution.

The Quakers first introduced public banking in the United States in the original colony of Pennsylvania. Other colonial governments also established publicly-owned banks. The concept was later embraced by the State of North Dakota, the only state to currently own its own bank.

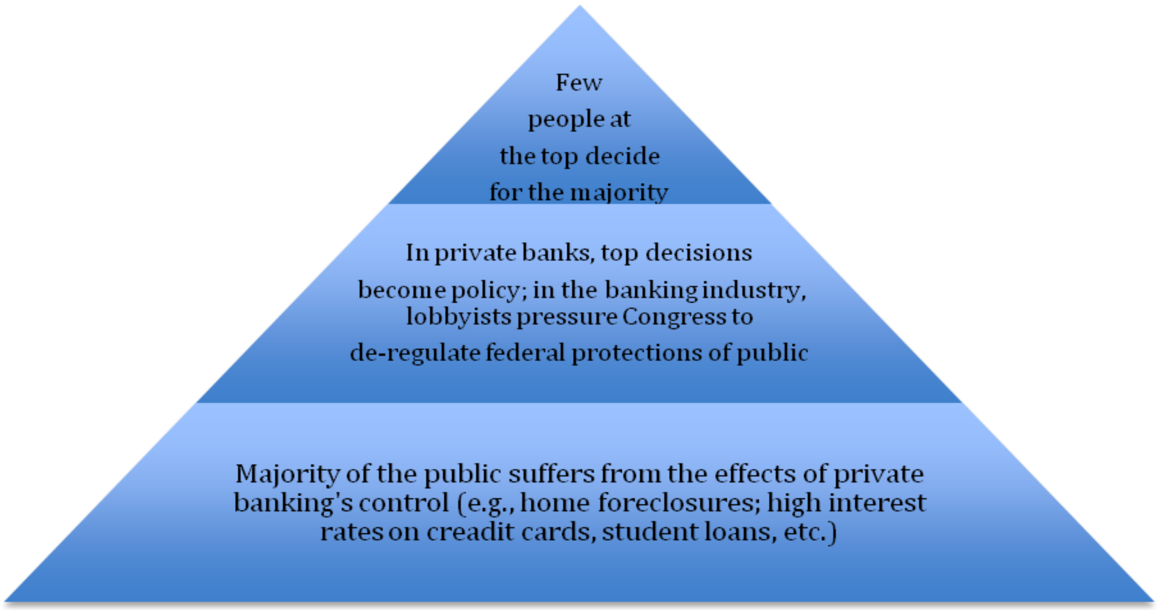
1.2 How does public banking differ from private banking?

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.
Three ways that distinguish a public bank from a private bank are:

- A public bank is capitalized and initially funded through public funds
- A public bank's mission supports the people & infrastructure of its region
- A public bank's loans are for the public welfare

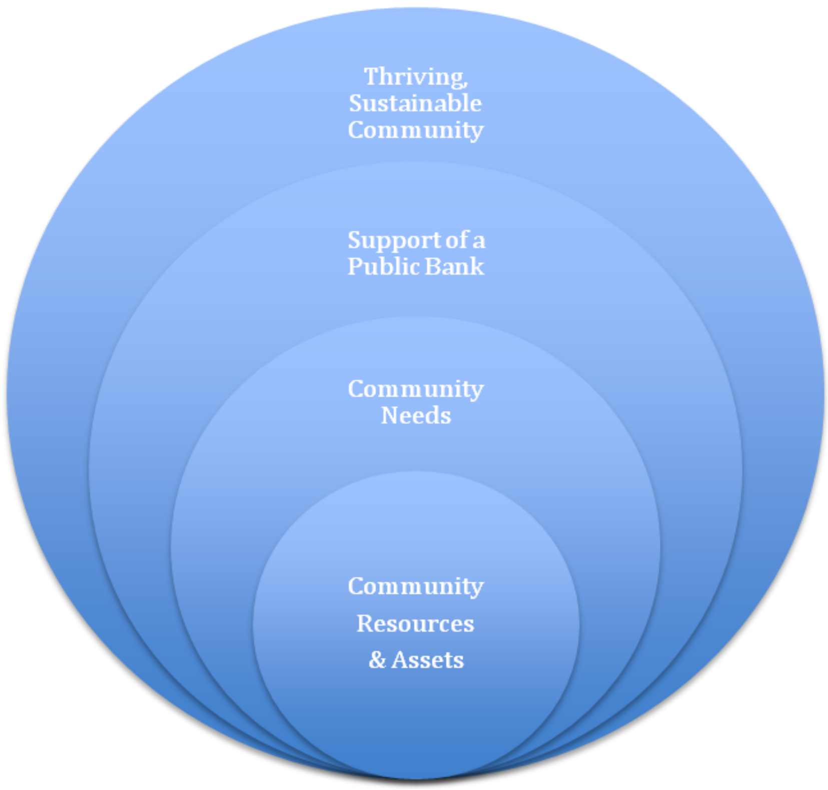
Private Banking:

In large private banking, a small number of executives have made decisions with long-lasting impacts on the majority of society. A private bank is a hierarchy of top-down power within each institution. Banking has been able to manipulate the economy through lobbyists who pressure Congress for de-regulation of federal oversight, and public protections (e.g. the reversal of the Glass-Steagall Act in 1999).   In private banking, the few have power over the many.



In terms of the volume of money, the pyramid is upside-down.   Since the 1970's in the United States, an escalating percentage of money has gone to the few who benefit from private banking:

Public Banks:
In contrast to private banks and their top-down pyramid, a public bank is for the public good. Public banks are like nested circles: they build from community resources, meet community needs through funding, support through transparent governance, and result in long-term sustainability for the community:



Unlike private commercial and investment banks which focus on short-term profits, public banks are oriented towards the long-term view of profit sustainability. They are governed by community stakeholders, and motivated by social or public mandates. Examples include savings banks, cooperative banks, regional mutual guarantee associations and development/special purpose banks.

Long-term profit and sustainability: Public banks generate profit to sustain operations and carry out their mission to the community, but do not seek to maximize profit. Public banks backed by state, county or municipal funds have enough capital to be sustainable and still generate funds for their mission. Alternatively, large private banks, as their first and primary order of business, have a legal responsibility to make maximum profit for their stockholders.

Stakeholder governance: Depending on its mission and purpose, a public bank might coordinate its governance with public officials, social institutions, political representatives, industry leaders, or company employees. Some stakeholders may still be appointed as Advisory for the Board of Directors (the public officers), and others will be chosen to serve on the Steering Committee for the Banking Executives. In private banks, shareholders both delegate and advise governance to the bank executives and board of directors.

Social or public mandates: The starting point for a public bank – and its fundamental difference from a private bank – is that its mission and social purpose are for community benefit. The public bank develops a collaborative relationship with its surrounding community.

1.3 Why is public banking good for communities and society?

- Public banks respond fast to community needs:

When the public interest demands, the mission of public banks is to respond immediately, to assure the long-term prosperity of the community. In the U.S., the Bank of North Dakota (BND) is a prime example of such a public bank. For example, after the flood damage in Grand Forks in April 1997, the BND was able to support the community revitalization quickly, in ways that could not have been accomplished without a public bank.

- Public banks reinvest in the community:

While private banks invest in stock trades and other deals which may never bring a local benefit, public banks invest locally in the people, businesses, and community projects that keep local resources circulating locally – creating healthier, thriving communities.

- Public banks strengthen local employers and local employment:

By making low-interest loans available to small businesses and other employers, more local jobs are created which supports an increased quality of life for more community members.

- Healthier local communities have a greater positive impact on society

Communities supported by the financial sector allow a greater participation on the part of their citizenry to business and community events. People feel freer to interact with their economy.

1.4 What specific benefits does public banking offer communities?

There are many practical, specific benefits public banking offers:

1. Provides credit and low-interest loans to small businesses in the local community
2. Provides student loans at lower interest rates
3. Lowers the Community's debt by the County borrowing from itself
4. Can enable a reduction in taxes within the jurisdiction because profits are returned to the general fund of the public bank
5. Lowering interest charges has reduced the average project cost by 37%.
6. Debt servicing costs can be greatly reduced. The public bank can lend money to its government to retire or purchase some of its bonds, as well as some of the loans needed by the bank to cover its capital requirements.
7. The new economy (local production of food and energy) can be funded with affordable debt capital.
8. Some government formed public banks will be able to concentrate on being "wholesale" banks, which means:
   - They will be the partner/backer for local community banks on infrastructure projects for the community, as well as many other types of loans. (for more on community banks, visit the Independent Community Bank Association website: http://www.icba.org/)
   - Being primarily wholesale banks, as is the Bank of North Dakota, they won't need to compete with the local retail banking market , and will strengthen the community banking market in their region.

1.5 What are the various types of public banks?

There are four types of public banks, each based on a different social mission, and therefore resulting in a different bank "charter":

- **Credit unions** provide secure savings and low-cost loans to their members. They are owned by their members (depositors).
- **Cooperative banks** traditionally cater to low and mid-income groups, and small firms and local communities.
- **Savings banks** often redistribute dividends to social organizations, welfare programs and the arts.
- **Development banks** direct funding towards public priorities such as local economic development, social housing, environmental sustainability, health care innovation, and infrastructure renovation.

1.6 How do you choose your bank's "charter"?

Public banks are not a miracle cure and cannot be everything to everyone. They may not be a way of solving problems in the short-term, for example, in cases of foreclosures or municipal bankruptcies. They need to make fiscally-sound decisions to protect public assets, such as pension funds, and private assets, such as deposits and savings.   They need to be well planned and well understood by the state regulators, under which you are applying. They must be created and developed with a clear mission, with long-term goals, and a plan for the steady accumulation of capital and associated deposits.

Here are some of the questions you and your community team must consider when creating your mission-driven public bank:

- Is your purpose is to make low-interest loans to a select group of people such as community associations, employees, or union members?
- Is your purpose is to make money for a County or other public entity?
- Is your purpose is to make money for a goal that may include government, industry and nonprofits?
- Is your focus on lending for a specific purpose?
- Is your intent for the money you loan to stay within the community?

Let's take these possible choices, one at a time, so you can consider in greater detail what the Mission and/or charter of your public bank should be:

1. If your purpose is to make low-interest loans to a select group of people such as community associations, employees, or union members, you may want to start:

    - a credit union, if your intended members are employees or residents located within a specific geographic region. Some credit unions distribute some portion of profits as a matching incentive for savings for young people or minority groups. Other times they provide loans to underserved populations. Profits, called retained earnings, are used at the discretion of the Board of Directors.

    - a cooperative bank, if intended members share a profession or an industry. (Credit unions can also share an industry, i.e. New Mexico's Federal Educators Credit Union (check out the differences between credit unions and co-ops in the US) Cooperative banks are an important source of agricultural finance in India and many developing countries.

2. If your purpose is to make money for a state, county or city, the use of which will be determined by their governing body, you may want to start:

    - a development bank. The Bank of North Dakota is an economic development bank whose mission is "to promote agriculture, commerce and industry" and "be helpful to and assist in the development of financial institutions, within the State." BND functions as a banker's bank, as a mini-Federal Reserve at the state level. It's $2.8B loan portfolio partners with community banks in making loans and is a secondary market for mortgages, freeing up the local banks to make more loans. Locally-owned banks account for 72% of deposits in ND, compared with only 30% country-wide. The BND is a wholesale bank and has no retail arm.

3. If your purpose is to make money for a goal that may include government, industry and nonprofits, you may want to start:

    - a special interest bank. As the BND illustrates, these types of banks are not mutually exclusive. The BND is governed by the Industrial Commission, which includes the governor, attorney general and the commissioner of agriculture. They have a special interest in promoting agriculture and industry, but are also the second-tier bank for 92 community banks, which have many goals. BND profits, equal to $300M in the last decade, go into the general fund for North Dakota. For an excellent overview of the BND, see Stacy Mitchell's 2011 article from the Institute for Self-Reliance.

4. If your focus is lending money for a specific purpose, you may want to start:

    - an investment bank. The UK Green Investment Bank has received £3B in funding from the government to provide financing for offshore wind, energy efficiency, waste recycling and bio-energy, and the UK's "green deal." They are a for-profit bank and invest where conditions meet their "double bottom-line" of sustainability and commercial viability.

5. If your intent is that the money you loan stays within the community, you may want:
    - an infrastructure bank. The California Infrastructure and Economic Development Bank provides low-cost financing for public improvements but doesn't compete with commercial banks to generate funds

1.7 How and when did banking get off-track? A historical perspective of regulation and deregulation of the banking industry

According to a Gallup poll, Americans' confidence in US banks is at a record low. When asked, "Please tell me how much confidence you, yourself, have in banks" only 21% answered "A great deal" or "Quite a lot." This is about half of the 2007 pre-recession level of 41%. In addition, 35% of people reported they have little or no confidence. The only other institutions people had less confidence in were Congress and HMOs. Public distrust in banks was as low as distrust with television news, organized labor and big business - but banks won the prize, hands-down, for the greatest decline of public trust in any institution.[1]

The Huffington Post outlined some of the reasons why, based on factors in 2011 alone:

- Banks lobbied aggressively against higher capital reserves and lower swipe fees;
- The five largest mortgage banks were implicated in foreclosure fraud; and
- Goldman Sachs sold clients junk assets that they themselves bet against.[2]

How did things get so off-track within the banking industry? The answer has to do with de-regulation of banking itself, beginning in the 1970's. An erosion of laws took place over several decades. Wall Street lobbyists pressured Congress to relax the banking laws and neo-conservative economists sang the praises of a "free market" unregulated by government. In 1999, President Clinton changed the law which allowed the mixing of commercial banking and investment banking functions. However this proved to lay the ground for too much manipulation by investment brokers, who packaged and sold groups of diverse securities and loans. The most damaging were the sub-prime mortgage loans.

Sub-prime mortgage loans were developed by mortgage banks as a way to extend credit to Americans who could not otherwise qualify for a home mortgage, but who were then tied into levels of debt they could not actually afford to pay. Several million Americans were foreclosed on as a result, and many communities eroded as houses were boarded up.

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[1] Dennis Jacobe (2012-06-27) "Americans' Confidence in Banks Falls to Record Low," Gallup, http://www.gallup.com/poll/155357/Americans-Confidence-Banks-Fal...

[2] Maxwell Strachan (2011-08-24) "American Distrust of Banks Reaches Highest-Recorded Level: Gallup" Huffington Post, http://www.huffingtonpost.com/2011/06/24/banks-americans-poll-distru

The damage didn't stop in America. Starting in 2007, the sub-prime mortgage scandal created economic shock waves around the world. International investors had trusted the word of Wall Street stockbrokers, private banks and credit ratings, and were deceived. Investors around the world lost enormous sums of money tied to U.S. mortgages while Americans lost their homes and more.

Deregulation of U.S. banking created a nightmare for millions of people.

1.8 Here's a brief history of banking regulation and de-regulation:

Beginning Regulation - Glass-Steagall Act. The 1929 stock market crash and the Glass-Steagall Act were essentially the bookends to the Great Depression. From 1900 to 1929 the Bank of the United States underwrote corporate stocks, artificially inflating the market. This culminated in the crash, when all banks in the United States closed for four days, with over 4,000 never reopening. This led to a run on the banks, which spawned the Great Depression. The Glass-Steagall Act was passed in 1933 in direct response to the Great Depression and helped to stabilize and rebuild the nation's economy. It expanded the regulatory powers of the Federal Reserve, prohibited banks from trading in corporate securities and created the Federal Deposit Insurance Corporation (FDIC).

Beginnings of Deregulation. Until the 1970s banking was governed primarily by state laws, and banks could do business only in their home states. For example, a Nebraska bank solicited customers from Minnesota but charged them Nebraska's higher interest rate. Minnesota's Marquette Bank filed a lawsuit to stop this practice, and the case went to the Supreme Court. In its "Marquette Decision," the Court ruled that banks could export interest rates into other states. This prompted banks to establish headquarters in states that would allow them to charge the highest interest rates, and the tax base of those states grew substantially. To stay competitive, other states raised caps on the interest rates banks could charge. This effectively led to the deregulation of state interest laws, also known as usury law.

The Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA) abolished state caps on interest rates that could be charged for primary mortgages, giving banks the incentive to approve mortgages for people with problematic credit histories. Banks made more money by charging higher rates to riskier customers, and a broader range of people were able to purchase homes.

DIDMCA also allowed the Savings and Loan Institutions to invest 20 percent of their assets in consumer loans, commercial paper and corporate debt securities. In addition, it increased the amount of deposit insurance covered by the FDIC from $40,000 to $100,000. This increase allowed for an increase in risk and "moral Hazard". It is believed that deregulation and "moral hazard" that started in the 1980's lead to the S&L crises.

Alternative Mortgage Transactions Parity Act of 1982 Before the Alternative Mortgage Transactions Parity Act of 1982 (AMTPA), all mortgages were fixed-rate amortizing loans. This legislation opened the doors to nontraditional mortgages, paving the way for adjustable rates, balloon payments, interest-only loans, and optional adjustable rates, which allow borrowers to underpay substantially during the first few years of the loan.

Many believe that this act is the basis for the sub-prime crises of 2007, which led to the financial crises of 2007-2009. Many borrowers were sold a mortgage instrument they did not understand. As borrowers began to default on their loans and house prices spiraled downward because of foreclosures, it became more difficult for people to refinance their homes into more affordable mortgages.

Securitization. In 1988, securitization, or the repackaging of assets as a financial instrument to sell to investors, became legal. Banks were allowed to sell their mortgages to other companies, who sold shares of thee "bundled" mortgages (as they would buy mortgages in bulk). If a lender sold a mortgage, it was no longer their responsibility, so they did not have to have as much liquid funds on hand to support the reserve requirement.

Mortgages were no longer being formulated to hold… but to sell, and lending requirements became substantially more lenient. One example was the NINA loan, [No Income/ No Asset loan] which did not require proof of ability to pay back the loan. Lenders/Loan Brokers were not making loans with any intention of holding them and collecting interest payments, but rather for selling them for commission and service fees.

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (IBBEA) swept away all state barriers to interstate banking. It allowed financial institutions to locate branches in other states and to purchase or merge with banks headquartered in other states.

Gramm-Leach-Bliley Act The Gramm-Leach-Bliley Act (GLBA), also referred to as the Financial Services Modernization Act of 1999, repealed the Glass-Steagall Act, tearing down the walls between banking, insurance and investments. Companies could now merge, partner and operate freely within each other's industries. The act also made it possible for the financial industry to group mortgage and other portfolios, selling them as investments.

Allowing banks to enter multiple banking sectors blurred the line between individual's savings and banks' investments. An investment bank could make investments with people's savings, rather than making loans with a bank's deposit base,& those investments were guaranteed by the Federal Government.

Sponsored Links Read more: http://www.ehow.com/about_5413083_history-bank-deregulation.html#ixzz2dbsrq6Xb

The SEC Ruling. In 2004, the SEC passed a rule that allowed investment banks to declare their own capital, the amount of money they actually had on hand. This was to be carefully monitored by the SEC, but it was not. The result of this deregulation was what investment banks such as Goldman Sachs essentially made up their amounts of available capital by phasing it in financially ambiguous terms such as "deferred tax returns", which is a promise of money in the future but not cash on hand.

This led investment banks to leverage themselves at a financially irresponsible 30 to 1 ratio for investing, for every $1 they had on hand they had a potential of $30 in debt. When some of these investments collapsed in the "shadow banking market", the banks did not have the ready capital to cover their losses and maintain their companies….
The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, made two significant changes as it relates to borrowers and depositors:

- A portion of the Act allows "Derivatives Counter Parties," i.e., buyers & sellers of derivatives, to have a preference over all other creditors/customers of a financial institution, including FDIC depositors.

- On the other hand, the Act exempted private loans, including loans made by students and their parents, from bankruptcy and from the normal business risk of loan default. Lenders could levy whatever terms they wanted on student and parent borrowers, and threaten them with permanent servitude if they didn't pay.

(Other Possible Additions? What about the new Consumer Credit Agency? And the work Elizabeth Warren is doing? Other recent improvements?)

1.8 Where should public banking go from here in a de-regulated environment?

The good news is that in the midst of large private banking industry's issues of deterioration, the social mission of public banking sets it apart. The principles of public banking, e.g., multi-stakeholder governance, transparency in accounting and operations – are the reasons why it is distinct from private banking.

In a deregulated environment, public banking does not change its mission nor its practices. A public bank continues to serve the public good.

As public banks grow in strength and number, they have an opportunity to set the example for the entire banking industry. The American public is tired of being betrayed by the private banking system. People need information and education about public banks to know there is a positive alternative that serves them and their communities.

<u>Self-check:</u>

1) Name 3 ways public banks differ from private banks:
    a. ____________________
    b. ____________________
    c. ____________________

2) List 5 benefits public banks bring to communities:
    a. ____________________
    b. ____________________
    c. ____________________
    d. ____________________
    e. ____________________

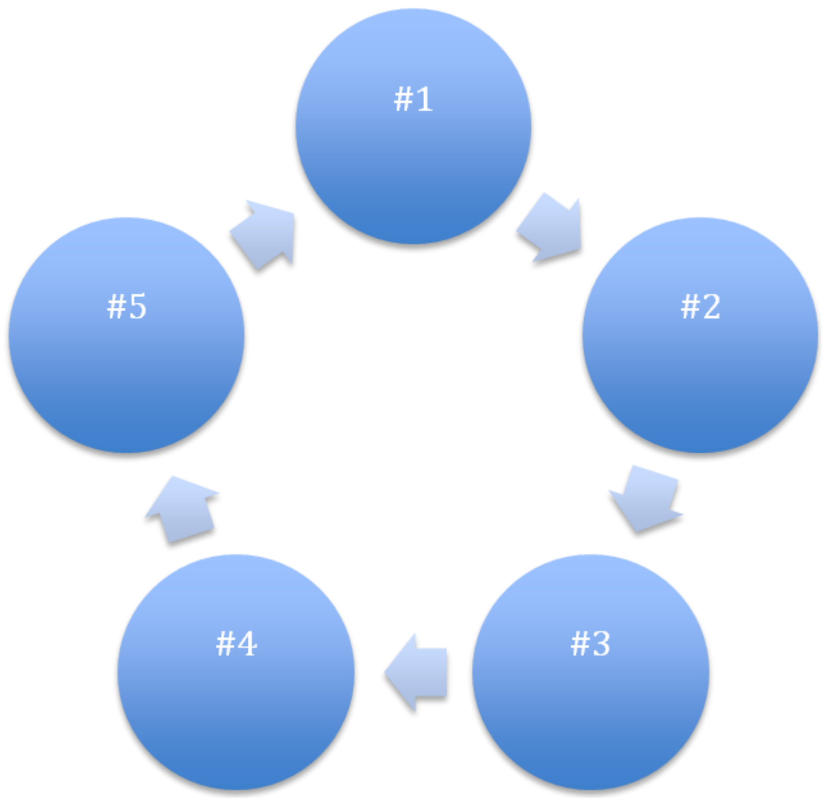
3) What are the four types of public banks listed in the chapter ?
    a. ____________________
    b. ____________________
    c. ____________________
    d. ____________________

4) How has banking deregulation impacted,

   (a) The American public, and
   (b) The global economy?

5) Why is banking regulation necessary to a healthy economy?

6) Add the 5 Key Principles of public banking to the graphic:



Chapter 2 – A Successful Model: the Bank of North Dakota

The Bank of North Dakota was established by legislative action in 1919 to promote agriculture, commerce, and industry in North Dakota. The charter stated that the Bank shall be "helpful to and to assist in the development of state banks, national banks, and corporations within the state and not, in any manner, to destroy or to be harmful to existing financial institutions". Its cooperative charter and service to the public are reasons for its continued success.

Lessons to be Learned in Chapter 2:

1. Why did the Bank of North Dakota (BND) get started?
2. What regional and community needs does BND meet? Examples of "success stories".
3. What is the governance structure of BND?
4. How does BND interface with other financial institutions?
5. What are the major reasons for BND's success for 90+ years?
6. How do BND's practices align with the recommended 5 Key Principles of public banking?
7. How to design lending programs for your own bank, to be phased in as the banks capital accrues.

2.1 The Bank of North Dakota – background

There is only one state-owned bank in America: the Bank of North Dakota. It has existed for over 90 years, and has continued to succeed as a public bank by meeting the long-term needs of the people of North Dakota while ensuring the long-term fiduciary health of the bank. One cannot succeed without the other. This chapter is intended to give you a picture of a successful public bank before you turn to Chapter 3 and begin drafting plans for a public bank in your community.

The Bank of North Dakota (BND) was founded in 1919 to insure a dependable supply of affordable credit for its farmers, ranchers and businesses. The BND website explains: (http://banknd.nd.gov/history)

> *During the early 1900s, North Dakota's economy was based on agriculture. Serious in-state problems prevented cohesive efforts in buying and selling crops and financing farm operations. Grain dealers outside the state suppressed grain prices; farm suppliers increased their prices; and interest rates on farm loans climbed.*

By 1919, popular consensus wanted state ownership and control of marketing and credit agencies. Thus, the state legislature established Bank of North Dakota and the North Dakota Mill and Elevator Association.

The Bank of North Dakota (BND) was charged with the mission of "promoting agriculture, commerce and industry" in North Dakota. It was never intended for BND to compete with or replace existing banks. Instead, Bank of North Dakota was created to partner with other financial institutions and assist them in meeting the needs of the citizens of North Dakota.

2.2 The BND model and its benefits to the public:

The public banking model used by the State of North Dakota is simple – the State of North Dakota is doing business as the Bank of North Dakota. That means the state's assets are used to capitalize the BND. By law, the state's revenues are also deposited in the Bank. Among other advantages, this gives the BND the ability to participate in loans originated and led by private community banks, which then have more flexibility to manage and expand their loan portfolios.

The private banking system makes it difficult to impossible for many Americans to obtain affordable credit. Without affordable credit, average Americans who do not have substantial wealth cannot make the investments in their families and in small businesses necessary to ensure a prosperous future.

In contrast, BND makes low interest loans to students, small businesses, and start-ups. BND partners with private banks to provide a secondary market for mortgages and supports local governments by buying municipal bonds.

As of the spring of 2010, North Dakota was also the only state sporting a major budget surplus; it had the lowest unemployment and lowest default rates in the country. It had the most community banks per capita, suggesting that the presence of a state-owned bank has helped local community banks.

As a public bank, the BND pays its dividend to its only shareholder – the people of the state. In the past decade, despite its small population (573,000) and modest volume of economic activity, the BND has returned over $300 million to the state's general fund, helping to ensure regular annual surpluses and eliminate the need for drastic tax increases or spending cuts for vital public services.

Most states, with the exception of North Dakota, currently deposit their tax revenues (the public's money) in private Wall Street banks, which use these deposits for their own private gain. This money could be deposited in the state's own bank and used to fund projects and programs that benefit the public over the long term – the very same projects/programs that are currently being cut from state budgets.

The BND is only one of many public banking models that have developed historically around the world. For most of the twentieth century in Australia, the publicly-owned Commonwealth Bank of Australia was not only the nation's central bank but engaged in commercial banking, "keeping the other banks honest." In Alberta, Canada, the publicly owned Alberta Treasury Branches connect nearly every town in a shared credit system. Public and private banks operate effectively together in many countries, including Switzerland, Germany, India, China and Brazil.

Clearly, states and municipalities have the potential to leverage their revenues to a much greater degree than is currently practiced. The Public Banking Institute has been set up to explore and educate regarding this potential.

2.3 The Governance of the Bank of North Dakota.

The governance of a public bank has the same chain of command as that of a corporation: Owners, Directors, and Officers. However, in a public bank:

- The Owner is the public entity, city, county, or state.
- Some of the Directors are the elected officials of that public entity
- The Officers are hired bankers, and support personnel.

The BND Board of Directors is made up of the Governor as the CEO, the Attorney General, and the Director of Agriculture for the State.


Jack Dalrymple
Governor


Doug Goehring
Agriculture Commissioner


Wayne Stenehjem
Attorney General

Of special importance are the Advisory Board and the Executive Committee. Because the Directors have the possibility of changing every election, The Advisory Board serves as the long-term memory to the Directors. This is similar to the Aerospace Corporation, the long-term project memory for the Air Force. The Advisors keep the public informed as to the long-term plans of the Bank.

Back L to R: Pat Mahar, Karl Bollingberg, Frank Larson, Gary Petersen
Front L to R: Sue Morton, John Stewart, Pat Clement

BND Advisory Board. According to North Dakota Century Code 6-09, the governor shall appoint an advisory board of directors to Bank of North Dakota consisting of seven persons. Of the seven, at least two must be officers of banks whose majority of stock is owned by North Dakota residents. At least one director must be an officer of a state-chartered or federally chartered financial institution. The governor shall appoint a chairman, vice chairman, and secretary from the advisory board of directors. The term of its director is four years. The Industrial Commission shall define the duties of the advisory board of directors.

BND Executive Committee . The Bank of North Dakota Executive Committee consists of six members:

- Eric Hardmeyer, President and Chief Executive Officer
- Joe Herslip, Chief Business Officer
- Bob Humann, Chief Lending Office
- Lori Leingang, Chief Administrative Officer
- Tim Porter, Chief Financial Officer
- Wally Erhardt, Director of SLND, Lending Services

Back L to R: Joe Herslip, Bob Humann, Wally Erhardt, Eric Hardmeyer
Front L to R: Lori Leingang, Tim Porter

The Steering Committee has a different role, it serves as the planning and advisory committee for the bank officers. This brings transparency to the actions and future planning of the bank.

2.4 The Leadership of the Bank of North Dakota [BND] . The Directors of the Bank are labeled the ND Industrial Commission (North Dakota's name for the Directors) The North Dakota Industrial Commission consists of three members: North Dakota's Governor, Agriculture Commissioner, and Attorney General.

According to North Dakota Century Code 6-09, the Industrial Commission shall operate, manage, and control Bank of North Dakota, locate and maintain its places of business, of which the principal place must be within the state, and make and enforce orders, rules, regulations, and bylaws for the transaction of its business. The powers of the Industrial Commission and the functions of the Bank must be implemented through actions taken and policies adopted by the Industrial Commission.

The Bank Executives are hired for their skills by the Board.

Because governance will be unique for each public bank's geographic location, the choices and assignment of qualified Directors, Officers, Advisory and the Executive Committee Advisory members need to be left with the organizers of that banking location. Because the above number of Executives and Advisory persons is in the range of a minimum of 10-12, it's important for the citizen organizing group to begin lining-up "trusted" officials and banking consultants early in the planning.

2.5 BND demonstrates the 5 Key Principles of Public Banking

Public banking takes the responsibility seriously of safeguarding public assets - such as municipal budgets and government pension funds - and private assets such as deposits, savings and mortgages. This requires the public bank to have fiscally sound business practices and lending policies. The basis for its decision-making must prioritize the long-term goals of the health and future viability of the bank *over* the short-term needs of individuals, groups, or even the community as a whole.

Although waiting for decisions can be difficult when states, municipalities, and/or homeowners are in crisis, the long-term process of building trust, capital, and confidence can't be rushed." The usual beginning and implementing a bank" process requires at least a couple of years.

By adhering to the principles of its public banking charter, BND insulated and protected its state funds, homeowners and community bank depositors from the

Wall Street raids, derivatives scandals and mortgage frauds that plagued millions of Americans.

5 Key Principles of Public Banking

Since 1945 the [Bank of North Dakota] has returned $555 million to the North Dakota general fund, in addition to their mission to promote economic development. Operating as a mini-Fed, they have no branches. This enables them to partner with and support community banks rather than competing with them. Deposits in their partner banks are not insured by the FDIC but instead are backed by "the full faith and credit of the State of North Dakota." In case of a bank failure, this would put North Dakota taxpayers on the hook to make up the losses; therefore, fiduciary responsibility is a must.

Through their fiscally sound decision-making and policies they have prioritized protection of public assets, such as government pension funds. They also serve the need for a trustworthy mortgage holder and a guardian of private assets such as deposits and savings.

ADVANCED LEVEL

Note: some of the material in the rest of this Chapter about BND is at an advanced level of knowledge about banking operations. You may wish to review this material again after you've reviewed subsequent chapters.

2.6 Structure and philosophy of the BND's loan programs.

As a member of the Minneapolis Federal Reserve, the BND maintains reserve requirements, safekeeps Fed book entry securities, and borrows at the Fed window discount rate. Although it would be legally allowed, by practice they don't loan to individuals or corporations who reside outside the state unless a direct benefit to residents can be shown. Most of their lending seeks to include a partner community bank. By using the interest rate strategically, the BND is able to use its reserves to build infrastructure projects and do the most good for the greatest number of residents without depleting its principal.

Here are the types of loan programs the BND offers:

Bank Shares

The BND can loan money for bank shares that help a community acquire or refinance a bank within the state. They will loan a maximum of 85% of the discounted book value of the shares and require a minimum of 51% of outstanding shares as collateral and, potentially, additional collateral or personal guarantees.

Rural Mortgages

The BND will finance rural mortgages to assist financial institutions that don't have Federal Housing Administration (FHA) authorization.

- A rural lender must refer the applicant. The lender can either issue a conventional loan and sell it to the BND or assist the BND in originating the loan through the FHA or USDA.
- The loan must be for a primary owner-occupied home at no more than 80% of the value, not to exceed $300,000.
- The loan can't be covered under private mortgage insurance (PMI), which charges a monthly premium so that up to 95% of the home's value can be borrowed. However the rural lending authority *can* take a second mortgage up to 95% of the home's value.
- The BND will also issue USDA and FHA loans to those who qualify. A USDA loan for low-income rural borrowers is guaranteed, can finance 100% of the

value, and repayment goes up to 38 years. An FHA-insured loan is not restricted to rural residences, has higher credit qualifications, requires a 3.5% equity requirement, and insurance must now be paid for the life of the loan. The BND will originate these types of loans but only for applicants and properties that meet its own tighter guidelines.

- In addition the BND buys mortgages from its partner banks but requires PMI where the loan exceeds 80% of the value.

After the 2011 floods, the BND issued a program called Rebuilders Loans offering up to $30,000 at 1% interest for 20 years. As this program expires, they've added a supplemental program of $20,000 under the same terms. For primary residents, up to 20% can be used to repay other debts and purchase the required flood insurance while the other 80% must be used for direct repairs. No payments are required for the first two years, although interest accrues, and the loan can be used to purchase FEMA housing. For rental units, repayment starts immediately and 100% must be used for repairs.

Revolving Loan Funds

The BND has two revolving funds that make new loans available as the old ones are repaid, and which grow with added interest. They are:

- The Community Water Facility Revolving Loan Fund was established in 1978 to supplement federal funds for community water projects. Backed by the collateral of property tax or revenue bonds, they can fund projects from reservoirs, dams, canals and wells to treatment plants, pipelines, mains and pumps. Interest is 3% and may not exceed 40 years, but both interest and principal may be deferred for three years until the project becomes self-supporting. The loan can't exceed 50% of the project or the available amount in the fund.

- The Health Information Technology Fund is a $10 million revolving loan fund to help healthcare entities improve their information systems. Ten-year loans are available at 1% interest up to $100,000 for an individual practitioner and $400,000 for hospitals and clinics.

Partnership in Assisting Community Expansion (PACE)

Most of the BND's loan programs are in conjunction with community banks:

- PACE (Partnership in Assisting Community Expansion) loans help local lenders to provide for new job development by writing down the interest payments: PACE targets industries like manufacturing, value-added processing, telecommunications, telemarketing, major tourist attractions, and other businesses that bring money into ND. Within one year, at least one job needs to be created for every $100,000 borrowed. Depending on the community's economic ability, the BND will fund from 65-85% of the interest buydown and the community must fund the other 15-35%. The interest rate can go no lower than 1% with a 1% initiation fee shared between the BND and the lead lender. Contingencies for default, by the borrower or the community, are detailed.
- Ag PACE helps farmers invest in nontraditional agricultural activities to supplement farm income.
- Biofuels PACE includes ethanol production, biodiesel production, green diesel production and livestock operations that use biofuel byproducts through a biodigester.
- Flex PACE enables the community to determine their own priorities in business development. One testimonial tells the story of Beulah, ND and their Flex PACE-funded renovation of theater apartments and the expansion of the hospital, along with their help to budding laundries and hardware stores.
- FlexPACE Affordable Housing writes down the interest for affordable multi-family housing up to $25,000 per unit or $300,000 per development. Community participation levels must meet certain requirements and rental relief over the life of the loan must match or exceed the interest write-down. Both the primary mortgage and the attribution of rents are included as collateral.

Business Financing Programs

The BND has many ways in which they help businesses:

- **Export loans to finance large-scale purchases from ND manufacturers:** By partnering with the Import-Export Bank of the United States, the BND finances purchases over $200,000 for up to 4 years and transactions over $350,000 for up to 5 years. The BND charges a $1000 non-refundable application fee, and other charges and rates are contingent on acceptance. The loan amount is paid directly to the manufacturer and so never leaves ND.

- **Commercial Bank Participation Loans for customers whose financing needs have outgrown the exposure limits of the originating bank:** Primary emphasis is placed on a borrower's ability to repay and the soundness of the loan. No more than 15% of the BND's capital can be loaned to one customer, no matter how good their credit.
- **Business Development Loans in partnership with community banks to extend credit to ND enterprises that may be considered too risky for a traditional lender:** BND's portion of the loan is 50-70% and can't exceed one million dollars. BND's portion of the interest is .5% below prime for variable or 2.25% over BND's advance rate.
- **Beginning Entrepreneur Loan Guarantees:** the BND will provide a guaranty for 85% of 5-year loans up to $100,000 or 75% up to $200,000. Start-up costs can be funded up to $5000 and up to $25,000 may not require collateral. The guaranty fee is .5% per year or a one-time 2% of the BND portion, which can be deducted from loan. This allows the lending bank to minimize exposure while encouraging new businesses. The borrower's net worth can't exceed $300,000 or $500,000 for child-care facilities.
- **MATCH** provides extremely low interest rates, at .25-.75% over cost, to companies with excellent credit in order to bring more business into ND.

Farm/Ranch Financing Programs

Farms and ranches are the heart of North Dakota.

- Following the same principles as their business financing, they offer a **Farm and Ranch Participation Loan Program.**
- The **First-Time Farmer Finance Program** is a tax-exempt bond program that enables first-time farmers to acquire land and equipment at lower interest rates.
- **Beginning Farmer Loan Programs** help farmers with less than 15 years of experience to borrow at lower rates. Their farms cannot exceed the average size by more than 30% in the county where they're located.
- The BND also provides **Established Farmer Loans** up to $2 million.
- The **Family Farm Loan Program** allows up to $500,000 at below-market rates to finance or refinance equipment, livestock or real estate purchases. The BND will finance up to 90% of the loan as long as the loan-to-value ratio is 75% for a 30-year mortgage, 75% for 7-year equipment or livestock purchases or 85% for a 5-year debt restructuring. The interest rate for

BND's portion of the loan floats at 1% below their base rate but cannot exceed 11%.

- The **ENVEST Program** **(Value-Added Agricultural Equity Loan Program)** provides a below market interest rate for North Dakota farmers and businessmen to purchase shares in start-up or expanding agricultural processing facilities.

Student Loans

The Dakota Alternative Educational Loan (DEAL) **supplements the Federal aid that students can acquire, but they encourage students to explore other options first.**

For instance, Stafford Loans are better for students with financial needs because the Department of Education subsidizes the interest until the student has graduated (the six-month grace period after has been discontinued.) However, the subsidized loans max out at $23,000 for an undergraduate degree and have been discontinued for graduate or professional degrees. Unsubsidized Stafford loans are available regardless of financial need but interest accrues at all times and is added to the principal. Interest rates for 2013-2014 are 3.86% for undergrads and 5.41% for graduates.

DEAL loans accrue interest at all times, which the BND encourages students to pay down so that it's not added to the principal when they graduate. For ND students going to any school in the country or students from anywhere in the country going to a ND college, the fixed interest rate is 5.7% and the variable interest rate is 1.78% (1.5% over LIBOR) with no fees. Students from the surrounding five states are eligible for the loan program but they pay a 6.7% fixed rate or a 2.78% variable rate (2.5% over LIBOR) with a 3% fee. This fee benefits all students by providing loan forgiveness if they die or become permanently disabled - which is not the case for private student loans.

After graduation the student can consolidate all DEAL loans, federal PLUS loans (Parent Loans for Undergraduate Studies) and private loans under their DEAL Consolidation Loan Program. At that time they can choose a repayment term up to 25 years and decide between a fixed and variable rate at the current terms. The variable rate is capped at 10% no matter what the LIBOR rate goes to.

2.7 Analysis of Bank of North Dakota Lending Programs

The Bank of North Dakota's loan programs demonstrate that it *is* possible to be profitable while fostering healthy communities. The BND mission is "to deliver quality, sound financial services that promote industry, commerce and agriculture in North Dakota." It's overseen by an Industrial Commission that includes the governor, the attorney general and the commissioner of agriculture, in addition to an advisory board appointed by the governor.

The BND is not in the business of giving money away. The sole example of default forgiveness is the extreme case of student loans in the event of death or permanent disability. Even this waiver is self-funding through the 3% fee to out-of-state applicants. When the BND does have profits well above their reserve and lending requirements, as they have with $555 million since 1947, they disburse them to the General Fund of the state. The state can apply them according to their own priorities without the BND becoming a grant-making organization.

The means by which the BND assists residents is through lowering the interest rate on solid loans with a high probability of repayment. With the exception of Beginning Entrepreneur and Student Loans, which max out at $50,000, all other loans are covered by collateral valued 15-25% higher than the borrowed amount. The community banks carry the higher risk because the BND holds the first lien or mortgage, so they have a personal stake in verifying the credit-worthiness of the deal. In addition, the BND imposes a systematic rigor on the community governments within the state. In order to participate, they are required to chip in, do their own risk assessment, and keep their end of the bargain - or be subject to strict but reversible consequences.

The BND's loans for community infrastructure projects improve the level of public control. By virtue of holding the loan contract, the BND becomes a stakeholder with the authority to scrutinize agreements and progress. Having this oversight can avert theft, crony credit, project delays, abusive pricing and other problems in public works. Because projects are in phases, loans can be also released in phases after public bank officials have examined them as part of a transparent process with government accounts.

This strategy of shared risk and well-collateralized debt makes the BND an ideal guardian of state funds including pensions, of private deposits, and of real estate mortgages. The bail-in that robbed Cyprians of their savings, the

interest-rate swap that robbed Detroit of their pension funds, and the mortgage scam that's turned 10 million people out of 4.5 million homes couldn't happen in North Dakota - let's look at why.

- In Cyprus the government attracted foreign investors by providing tax haven privileges. These investment funds were then mixed with the ordinary deposit accounts of Cypriots, as has also happened in private banks in the US since Glass-Steagall was repealed. This puts all US depositors at risk of having their savings partially confiscated under the 2005 Bankruptcy Reform Act, in the event of a derivatives bust.

- At the BND, however, only ND residents are allowed to open checking or demand deposit accounts. Although non-residents can hold savings or CD accounts, they must open them in person and the BND determines how they are invested. Since there is no FDIC insurance to fall back on, any loss would be borne by the BND and the state, which is a strong deterrent to gambling.

- Detroit took out a variable-rate loan to revamp its water infrastructure. They were persuaded, like a multitude of other US cities, that the prudent thing to do was to buy a derivative called an interest-rate swap. It would protect them from a rise in the interest rate but they would pay hefty fees if the already-negligible interest rate fell. It seemed like a safe bet until the bankers got together and agreed to lower LIBOR. Detroit paid a full year of city revenues just to get out of the deal before they declared bankruptcy, which forces them to pay pennies on the dollar for pensions.

- A North Dakota city, on the other hand, could have utilized the Community Water Revolving Loan Fund to get a 40-year loan at a 3% fixed rate with the interest and payments deferred for three years until it was self-supporting. Other community projects could be funded through Flex PACE. In addition, the BND never sells its customers derivatives like interest-rate swaps. The ND pensions, like all state funds, are deposited in the BND so they are secure while receiving comparable interest to other banks.

- Major mortgage servicers who were more concerned with selling loans than being repaid caused the subprime mortgage crisis. These banks initiated the loans but sold the mortgages in tranches of thousands to investment vehicles such as sovereign wealth funds. Once the fees were paid and the assets were off the books, it was no longer the bank's problem whether the homeowner could afford the mortgage.

- The BND assists community banks by purchasing their mortgages, freeing them up to make more loans. However the BND only covers loans as the primary mortgage holder at an 80% loan-to-value ratio. If the community bank that initiates the loan covers it up to 95%, it's at their own risk. The homeowners knows that their mortgage won't leave the state and that the bank that holders the loan wants to keep them from defaulting.

Looking at it this way, it's clear that the $555 million disbursed to the state is merely the icing on the cake. The substance of the BND is that it enables the state's economy to work for the people rather than preying on them. City officials, farmers and ranchers, businesses, families and students can borrow money without worrying about being swindled. It protects pensions, deposits and homes from being undermined by the schemes of big finance. But it doesn't reinvent the economy - which is both good and bad. It makes public banking an easier "sell" and a perfect first step, but it also leaves some vulnerabilities. We'll look at those in subsequent chapters.

One last point:

Because the BND doesn't have retail branches, the proceeds from their loans will typically be deposited somewhere in a commercial bank within ND unless the recipient moves out of state. That will enable their community bank to provide more direct loans on which they earn interest.

There is nothing to prevent counties and municipalities from replicating the BND model on a smaller scale, so that their banks return money to the local government as part of their charters. The hybrid design of the central bank and partner community banks is the best of both worlds - the stability of shared and protected resources with decision-making pushed to the local level. For North Dakota's 700,000 residents, local means 53 counties, a couple of which are under 1000 people. The bank provides the flexibility for counties to govern themselves along with the uniformity of common programs and the discipline of rigorous financial standards.

Self-check:

1) Select one "success story" of how BND met community needs. List 3 reasons why BND was successful in this project:
    a. ____________________
    b. ____________________
    c. ____________________

2) Identify 5 ways BND's organizational structure reflects Key Principle #4 – Multi-Stakeholder Governance
    a. ____________________
    b. ____________________
    c. ____________________
    d. ____________________
    e. ____________________

3) How does BND structure its lending programs to protect public assets and prevent financial disasters?

Conclusion: Now that you have a basic understanding of public banking and have reviewed the successes of BND, you're ready to deepen your understanding of the specific challenges faced by local campaigns to create public banks. A Roadmap has been designed for this purpose in Chapter 3.

Chapter 3. A RoadMap for Getting Started

The RoadMap consists of a **series of steps** necessary to organize a public banking effort, have it authorized by your public entity, city, county or state, and then work through the State application and approval process for a State Chartered Bank. The steps of the RoadMap is not fully linear, but are reasonably sequential.

Lessons to be learned in Chapter 3, The RoadMap.

Step 1 challenges you to clarify why your local movement wants to develop the local bank, and how your effort can be organized

Step 2 encourages you to first survey the politics of your region and identify your community champions for your campaign.

Step 3 requires you to "return to the numbers" to consider capitalization, define the type of bank to be proposed, and draft a feasibility study or proposal.

Step 4 provides the information necessary to hone your strategy for interfacing capitalization and organizing the governance of the public bank proposed.

Step 5 challenges you to complete planning of your presentations while firming up relations with local and regional officials that are critical for approval.

Step 6 reinforces the need for clarity and coordination in the bank application process toward ensuring approval of your application to start a public bank.

Step 7 reminds you to continue to work with government officials before, during and after the application process to ensure a successful bank launch

http://publicbankinginamerica.org/conference-2013.htm.

The RoadMap follows the classic "project development" format, which has been used for projects for over 30 years. The activities within each of the steps will be different for various regions of the country, but the overall seven (7) step process itself should hold fairly true.

Each Public Banking Coalition Chapter or Affiliate will have its method of approaching the establishment of a public banking function in its area. What is planned by the Public Banking Coalition is that the RoadMap will function as a guide coupled with PBI mentoring/consulting for the chapters.

May 2013

The RoadMap for Establishing a Public Bank – 3
Using Standard Development Practices

Banking Task	Development Steps
Step 1. Organize Your Coalition Team and Systematically define the basics of Your Approach	Organize/ Form your Development Team
Step 2. Survey the Politics of your Area Know your People, and choose your Champions	Acquire Stakeholders and build Relationships
Step 3. Gather and Integrate Facts about Public Banking Stand on Firm Ground with your Facts	Gather Details and Design the Banking System
Step 4. Solve the Capitalization Issue and Understand your Bank Governance	Secure required Funding to complete Project
Step 5. Complete Business Planning, Line up your ducks, Prepare for a "Success-Oriented" Presentation	Complete System Documentation and Prepare for Final Review
Step 6. Obtain a "Level of Approval" from the appropriate Government Body and decision Makers	Final Review and Approval for Implementation
Step 7. Gov't Body acquires the Banking License and Moves ahead in collaboration with the Chapter and the Banking System Project Plan	Implementation

[Step 1] Organize Your Public Banking Coalition, Chapter Team. The Roadmap may be started by reviewing/ answering the questions in the "Midwest Academy's Strategy Chart" [Appendix C]

http://mn.gov/mnddc/pipm/curriculumchangechart.html.

The Public Banking Institute may provide resources to help build campaigns to create public banks in your area, but the Roadmap and Midwest Academy´s Strategy Chart are critical for selecting the strategies best suited to your local community and group, and they are required first steps to becoming a chapter under the Public Banking Institute.

1.1) Why is the team developing the Bank - what problem would the public bank solve? An important resource to develop answers on this point may be obtained from Statements from the Rules Change Summit in May of 2013 http://mediagiraffe.org/wiki/index.php/Main_Page. The Summit summary stated, "We are not broke!" End artificial scarcity of credit and create new democratic, financial institutions such as public banks that will:

- return full interest on our public tax deposits so that essential services can be expanded in our region without raising taxes
- partner with and support community banks in putting loans where they belong, in sustainable, worthy job creating, local industries and small businesses
- slash government debt service costs and pay what we owe to ourselves and not to speculators
- redirect investment away from risky derivatives to real goods and services, protecting the value of our savings and pensions
- prop up local economies by increasing loans in times of economic downturn.

While a bank can do many of these things, you might find it easier to sell a narrow and specific vision to the decision makers. Identify a problem and sell a solution for it, rather than try to claim all things to all people. Once an institution is founded, it can grow and address other problems.

1.2) Organizational Questions

- Will the bank be for a State, County, Town, Township or Municipality? What are the annual budget and annual taxes received by your local government?
- What are the geographic boundaries of the entity that will own the public bank?
- Will citizens "own" the bank through voluntary tax assessments?
- Where could the wholesale public bank be physically located? *Note: most likely answer -- in a few cubicles in a state or county office building.*
- Who are the projected primary depositors? *Note: depositors could include any/all of the government and government-hybrid organizations physically located both within and outside of the geographic boundaries of the bank.*
- What are requirements, if any, for the collateralization of government deposits in your state?

1.3) Initial Financing and Marketing Questions for the Bank, i.e.,. Run the numbers and see if it makes sense to start a public bank in your local economy –

- Does the economy within the geographic boundaries of your government entity that will own the bank have enough diversity to have a loan portfolio that would be resilient to economic shocks?
- Does it include both agriculture and commercial production? Technology and traditional light manufacturing? What are the inflows and outflows from the local economy? As an example, do most of the inflows come from federal government (retirement and social security)? Are most of the outflows from consumer spending at national chains?

1.4) A wholesale public bank with a broad loan portfolio would only make sense if **

- the budget for your government entity is greater than $100M
- your region has diverse economies, with existing & diverse productive capacity
- there are citizens with a positive "buy local" sentiment.

If the government you're looking at is too small, perhaps it makes sense to team up with other similar governments in a mutual-bank or cooperative arrangement.

** Without these in place, establishing a public bank will take a very long time.

1.5) Form the Public Banking Coalition chapter/affiliate team in your area:

Where is local or regional support? Who can champion the cause? Could local champions join the team? Has the team gathered a sufficient number of members (4 or 5) follow through? Has the team taken the first steps by working through the Midwest Academy Strategy Chart? Has the team developed a roadmap based on this chapter? Who does the team know in the area that can serve as a "banking advisor" to the campaign team? Does that person have experience in banking?

1.6) Educate the Team, review what is already in written information form

Have Team Members collect and share the articles about Public Banking. Understand as a Team why Public Banking is a necessity for communities. Begin some forms of public awareness in your area such as seminars, talks at local meeting halls, churches and public gatherings.

Develop a 3 minute public forum speech for team members so they are able to convincingly explain the need for Public Banking. Example:

Public banking is all about putting the "public" back into public finance. Did you know that in 49 of the 50 states the State Treasurers deposit public money into private banks? The exception is North Dakota, where the State Treasurer deposits tax revenues into the state owned bank, effectively doubling the impact of the state budget. The state of North Dakota has BOTH a $4.8 billion budget AND a $5 billion loan portfolio in its bank. What's our state/county/city government budget? Imagine creating the same amount in low interest loans to fund important sectors of our economy, from infrastructure to energy conservation programs to production of healthy food? Would that have a positive or negative effect on our economy? Of course it would be positive.

*This is money we are leaving on the table – we're giving it to private banks for them to use for the benefit of their shareholders. This is money that could be used to fund infrastructure projects and help small businesses, effectively lowering our debt servicing costs and creating jobs. North Dakota has zero debt servicing costs from general obligation bonds. Zero – imagine that! Because they issue loans to fund state infrastructure from their own public bank, they effectively pay down interest that they owe - this is certainly **smart** and truly **public,** public finance!*

In 2013, there are two compelling reasons for local governments to establish a public bank.

1. *Because local governments are large depositors with strict collateral requirements for safety, liquidity and interest yield, a significant portion of their funds will have to be placed in a "too big to fail" financial institution; and*
2. *Under the Bankruptcy Reform Act of 2005, Derivatives Counter-parties, ie buyers and sellers, have a preference over all other creditors and customers of a financial institution, including FDIC depositors. Removing deposits from those institutions protects the public's money.*

[Step 2] Survey the Politics of Your Region

Review your Midwest Academy Strategy Chart, formulate/refine your Team Strategy, and begin the process of creating political momentum. After delineating initial goals for your group, and after getting a handle on your public forum speech, reach out and talk to folks in your area, region or county.

Meet informally with your county supervisors, community leaders and champions of local development, sustainability and/or public services. Don't alarm them or disagree with them; listen, understand and learn from them.

Gather your team and correlate **your outreach observances** of the folks in your area. Hopefully some of your team has found champions and a commonality of views on creating funding for your area and the advantages of a public bank.

Solidify the approach of your Team, and line up those who in the community are agreeing to work with you to establish public banking. If your "ducks" aren't lined up by this time, ask for help from PBI.

2.1) Acquire Champions. A champion is a self-directed, self-initiating individual who has succeeded in some aspects of their lives, and now has time, energy, and purpose to pursue their avocation, their second careers. Champions may also be younger people with time and talents!

A champion will readily give you the time of day, will help align objectives, will help shape your team's strategy, will call meetings on your behalf, will advise on who the team should speak to, and in what sequence

The team needs some champions inside government, as well as in the larger community. Champions can include leaders of organizations with public banking as one of their key strategies or objectives. A champion is one whom people enjoy being with.

[Step 3] Complete the numbers (the quantitative) analysis of the feasibility of developing a Public Bank in your Regions

3.1) Work the numbers…. make a complete list of the financials required and acquire initial estimates

- What size capitalization is needed….
- How large does the "deposit base" need to be to reach the break-even point for banking operations
- Does state law (or some other law) require public deposits to be collateralized? What does that mean for the bank design?
- How is the issue of "scaling" the Bank's growth going to be managed, what are the estimates of income and expenses.
- What is the projected Return on Assets (ROA) and the projected Return on Equity (ROE), given the assumptions behind the loan portfolio
- How much money is projected for the Bank to make? 3-yr plan, 5-yr plan

If the numbers fall short, do not despair. Other formats such as finance window or public finance mechanisms may provide more viable first steps that retain many of the advantages of a formal public bank.

3.2) Analyze the types of loans that would be good for the Bank in your area to offer.

- What are the primary loan portfolio sectors, both short and long term?
- To what extent does the loan portfolio address/solve the problems that this public bank is to solve?
- What are some examples of the supporting loan policies, e.g., samples from the Bank of North Dakota….
- How long will it take to fill out the loan portfolio? Your bank will likely lose money until all the loanable money is loaned.

3.3) Prepare the first draft of your team's Planning/Feasibility Study. The nature of the Feasibility Study is to make the project feasible, not to be used as a study to approve or reject the project. This document is used to prepare a logical presentation to the government approval body.

- You might, at this point, consider making an informal visit to your state's bank regulators and talking the design over with them. Regulators should be involved early and often, wherever possible. They tend to be good folks, and interested in banking, which is what you're interested in, so you should get along fine.

[Step 4] Resolve the Capitalization Issue; Understand Bank Governance

4.1) Capitalization is the money and/or fixed assets put up as collateral for investing in the Bank. It is also called "equity capital"… it is put up by the original investors (owners) of the Bank. For a public bank it can be the government agency, state or county, and/or it can be the taxpayers in that governmental region, e.g., a County, who voluntarily participate in a property tax assessment. These are examples: and not an exhaustive list

Initial Capitalization to purchase the Bank would generally be in the \$15M - \$20M range (reflecting at least 10% capitalization).

Startup capital is additional funding required to pay startup operational costs, rent, salaries, software, etc. The Startup capital must also cover the initial operating costs until the bank crosses through the positive cash flow line.

You typically raise the startup capital in precisely the same way you raise the rest of the capital. It's all one pile of money, even though it gets used in different ways.

Deposits from the County, such as County income (fees, etc.) County taxes, etc. need to be placed in the County's public bank, before the public bank's loan and investment programs can be inaugurated …for the public bank to earn money.

4.2) Understand a Public Bank's Approach to Governance and Management

Some understanding of how the public bank is to be governed and managed has to be known. What ideas for governance and management has the team formulated for the public bank? <u>Governance</u> includes determining the public bank charter, making policy, and providing a way for a democratic approach to decision making. <u>Management</u> includes the prioritizing of fiduciary responsibility, establishing a culture that fosters the dedication of public servants, and ensuring that professional banking practices are followed.

Gather folks that support the Coalition team's vision and intent. Bring them into the Coalition and look for possible candidates for "Advisory Members" for your Bank.

Governance and Management. Recall, **the "chain-of-command"** for a Corporation is: Owner, Board of Directors, and appointed Officers of the public bank. The Government Body is the "owner." Identify the potential Board Members and the potential Officers for your Bank, and engage them as identified in the Midwest Academy Strategy Chart.

As an example for a public bank, e.g., North Dakota, the State owns the Bank, under North Dakota Century Code 6-09. Its Board of Directors (called the ND Industrial Commission) are the Governor, Jack Dalrymple, Attorney General, Wayne Stenehjem, & the Agriculture Commissioner, Doug Goehring. They are supported by a four person Advisory Board (non-voting), and have appointed six Officers of the Bank, called the BND Executive Committee, to run the Bank..

At the appropriate time, the Forming Group/ Owner will identify a helpful (not predator) Law Firm and Attorney to incorporate the Bank and to continue as the Law Firm of Record for the Bank.

[Step 5] Complete your Planning Study, Complete your Presentation, and Firm up your Relationships with Regional officials

5.1) Complete the relationship building with the necessary government officials that need to work collaboratively with your team. Have them work with you to complete the Planning Study **Presentation** that quantitatively shows and explains the worth of implementing their Public Bank.

Stand on firm (written) ground. Complete your (draft) banking model business plans (business relationships, funding, revenue, and risk reduction which will show that operating a public bank in your Region is feasible.

From the "Politics in your Area" step in this Roadmap, do a final check that your team has found supportive public officials to work with, public and private advocates for starting a public bank, and "Champions" to speak eloquently for your cause. Firm up your relationships with regional officials

5.2) Complete your Written Planning. Your public banking model should show the financial marketing direction intended by your Bank, & also why the financials work in terms of deposits, reserves, loans, investments, operating expenses, and bank expansion.

The Business Plan needs to show the organization of the Corporation, the method of Capitalization, the amount of funding required, the County/ State requirements of owning the Bank, who and how the Bank will be owned, the agreed upon selected Bank Directors, and the potential list of Bank Officer candidates. This is for the initial investment and for Incorporation.

The Operations Plan will show how the Bank will operate, its staff size, its connection with the necessary IT (Information Technology) software support systems, its budget and profit and loss planning, its startup plan, its categories of loans in its loan portfolio, its marketing approach… etc.

[Step 6] Coordinate/ Acquire a Level-of-Approval from your Designated Governmental Agency, e.g. a County and its County Supervisors. Strategies

6.1) Use Success-Oriented Reviews. One strategy to work is to obtain "positive approval" by a governing board. This is done by engaging them in many prior discussions and answering all of their questions…before an official voting meeting. This is called organizing a "success-oriented" review. If the "reviewing agent" is a City Council or a Board of Supervisors meeting, plan is to get to know the majority of the designated officials very well. Work with them and their staffs individually to understand all of their questions, concerns, doubts, etc. that they might have. Then prepare the presentation that explain all of their questions

Most Groups, Chapters, agree that it doesn't make too much sense to give a presentation where the Chapter "hopes" for a positive response, rather than understands that there is a high probability of success. If you feel you're "pushing on a string,"…… then regroup. If you (1) can't get to know them, or (2) can't get enough time with them to establish a collaborative relationship, or (3) if you can't adjust your verbiage and explanation to their languaging, then you're not going to succeed with this method.

Remember, most elected officials, especially city councilors, are part time and have a "day job". That is why it is critical to develop relationships with their staff who are available during the day to deal with more time consuming discussions.

6.2) Choose a Level-of-Approval. Another strategy is for the Chapter or Affiliate to understand the level of approval that they are shooting for… some examples….

- A final level would be where the Supervisors pass an article or an amendment to establish their government-owned bank, and they use most of your/their plan to acquire capitalization and begin implementation.
- The Supervisors may say - "Your planning and presentation are well received," however "Would you go back and get these questions answered/grounded in fact, and show us how the math works out for a public bank in our Region"…. Showing the financial feasibility would allow us to move forward to approving a public bank"
- A beginning level might be…"We agree in principle and philosophy to work together and mutually design the plans that it takes to approve and then implement a public bank for our region." This is an agreement…"to design together"….

A direction from your government body to …"write a study and then come back, and we'll see if we can approve it or not… <u>is not the way to go</u>… because, "any question or doubt that they may have at that type of approval meeting can be answered about public banking….if the Chapter is allowed to know ahead of time… what the questions or monetary doubts/skepticism might be.

Your targets may be the City Counsel members or the County Supervisors, but your foes are the large private banks and any legal ramifications which affect your success.

6.3) Coordinate the Approval

- **Pre-coordinate** that any official meeting will have a positive approval outcome for establishing the Public Bank…
- **Avoid a "maybe" meeting** or a semi-organized meeting, where the Supervisors are just going to vote their opinions,…. with insufficient collaboration with the Team.
- **Don't bring it to a "no" vote**. If there is suspicion that it may not be a "yes" vote, don't bring it to a vote…. This takes getting to know the Supervisors or Officials that are going to be involved, and gaining a positive consensus with them….

[Step 7] Have the Government Entity acquire its Banking License through application with the State, and move forward with a Bank Operations Plan.

Consulting firms can be used to help your start-up group set-up the bank, write the bank-oriented business plan, and help find executives for your management team. For example, in California, the Department of Corporations and the Department of Financial Institutions have formed the Department of Business Oversight. This department has jurisdiction for issuing licenses to all State-chartered banks.

The Federal Reserve Board advises "How can I start a bank?" as follows on http://www.federalreserve.gov/faqs/banking_12779.htm

"Starting a bank involves a long organization process that could take a year or more, and permission from at least two regulatory authorities. Extensive information about the organizer(s), the business plan, senior management team, finances, capital adequacy, risk management infrastructure, and other relevant factors must be provided to your state approving authorities.
The proposed bank must first receive approval for a federal or state charter. The Office of the Comptroller of the Currency (OCC) has exclusive authority to issue a federal or "national bank" charter, while any state (and the District of Columbia, Guam, Puerto Rico, & the Virgin Islands) issues a state charter. Before granting a charter, the OCC or state must be able to determine that the applicant bank has a reasonable chance for success and will operate in a safe and sound manner.
Next, a private bank must obtain approval for deposit insurance from the Federal Deposit Insurance Corporation (FDIC), however a public bank usually provides its own insurances.
All insured banks must comply with the capital adequacy guidelines of their primary federal regulator (Federal Reserve, FDIC, or OCC). The guidelines require a bank to demonstrate that it will have enough capital to support its risk profile, operations, and future growth even in the event of unexpected losses. Newly established banks are generally subject to additional criteria that remain in place until the bank's operations become well-established and profitable. "

Since most local campaigns for public banks will apply to their state government authorities, consult your State Bank Supervisor via the Conference of State Bank Supervisors

Goals/milestones? Governance? It is expected that members of the supporting Chapter or Affiliate will be assigned "advisory" (non-voting) roles in the new Bank. An idea is to integrate an "Oversight" function (not an audit function) into the governance of the Bank in which Chapter members would participate

Chapter 3 Conclusion

This chapter provided an overview of the strategies and steps necessary to successfully organize a campaign to create a local public bank. Those completing this chapter of the Workbook should now have, in hand, roadmaps for their local campaigns based on completion of the Midwest Academy´s Strategy Chart and answering, in sequence, the sections of this chapter.

- Section 1 challenged you to clarify why your local movement wants to develop the local bank and makes sure your views of how it can be organized, financed and marketed are on track, while also making sure that a wholesale bank makes sense and how to educate and prepare your local team with effective communication.
- Section 2 challenged you to survey the politics of your region and identify and approach community champions for your campaign.
- Section 3 challenged you to return to the numbers to consider capitalization, define the type of bank to be proposed and draft a feasibility study or proposal.
- Section 4 provided the information necessary to hone your strategy for capitalization and organizing the governance of the public bank proposed. Section 5 challenged you to complete planning and presentations while firming up relations with local and regional officials that are critical for approval and success.
- Section 6 reinforced the need for clarity and coordination in the application process toward ensuring approval of your application to start a public bank. Section 7 reminded you to continue to work with government officials during and after the application process to ensure successful launch and prosperous public banking.

PART I Conclusion. Having completed the three introductory chapters of the Workbook, we hope you are now inspired, and prepared, to dive into the details necessary to successfully organize campaigns and perceptions to create public banks in your local community. Part II presents the basic concepts and ideas about accounting and banking itself that are necessary for the following parts of the Workbook that return to the nuts and bolts of organizing campaigns to create public banks.