



CALIFORNIA COMMUNITY BANKING NETWORK



April 19, 2021

The Honorable Miguel Santiago  
Member, California State Assembly  
State Capitol, Room 6027  
Sacramento, CA 95814

**RE: Opposition to Assembly Bill 1177: California Infrastructure and Economic Development Bank**

Dear Assembly Member Santiago:

The organizations above representing the financial services and the business sector in California and across the nation write to share our opposition to Assembly Bill 1177, the California Public Banking Option Act. AB 1177 creates an unwieldy government banking system that carries exorbitant risk and cost to the state of California, without any real benefit. This measure establishes the BankCal program within the state treasurer’s office, to provide financial services to California residents. The purported need for this program is to help unbanked residents who lack access to traditional banks. The measure creates a mandate for all employers with five or more employees, even if they do not already offer direct deposit, to provide direct deposit into the BankCal fund as an option for payment of wages. The mandate is accompanied by a new civil penalty for employer non-compliance.

Defining the Problem

According to the measure, this bill is needed to address California’s unbanked population and relieve California borrowers of reliance on high-cost payday lenders. We strongly agree with the public policy goal of giving all Californians access to safe, affordable banking products at insured depository institutions. Indeed, the latest FDIC and Federal Reserve data shows that efforts to bring households into the banking system are making progress, but more must be done. According to the Federal Reserve’s Report on the Economic Well-Being of U.S. Households in 2018 - May 2019, six percent of adults are unbanked, with 16 percent utilizing non-traditional, high-cost loan products. The Federal Deposit Insurance Corporation’s most recent biennial report is consistent, showing that 5.4 percent of American households do not have a bank account (2020 How America Banks: Household Use of Banking and Financial Services, FDIC).

However, according to AB 1177, the number of Californians lacking access to banking services surpasses 40 percent. We question the validity of this data, which is inconsistent with highly regarded federal data, and strongly caution against passing such a dramatic policy change based on the misleading statistics presented in the bill. Public banking proponents often conflate the term “unbanked” and “underbanked” thereby making the assertion that California residents lack adequate access to financial services. The FDIC itself has raised definitional concerns about the term “underbanked,” which is inconsistently applied. In fact, the FDIC removed the term “underbanked” from its study title because of these definitional issues. This is a critical distinction that must be made; individuals who utilize payday lenders and other high-cost loan products do so because they have inadequate cash flow, not because they lack access to banking services. Even payday lenders require a consumer to be banked to use their services. BankCal and its proposed network of public banks will not remedy this problem because being underbanked isn’t about not having a bank account; rather, it’s the result of an individual’s economic condition. Nor is it the case that individuals are unbanked simply because they utilize alternative payment systems such as Zelle or Venmo as there must be a bank account on either side of the transaction when using these services. Yet, it is not uncommon for public bank advocates to assert that individuals utilizing these products are underbanked, resulting in a vastly inflated estimate of “underbanked” households.

#### Alternative Solutions

Californians do not lack access to financial services. Californians are served by 150 banks and nearly 290 credit unions, the overwhelming majority of which offer low, or no-cost banking account options specifically designed to assist the unbanked. Additionally, there is a network of more than 100 Certified Community Development Financial Institutions, supported by the U.S. Treasury and commercial banks, structured specifically to serve low-income communities. If the Legislature truly wishes to address the issue of non-traditional bank products, then policymakers should focus on more narrowly tailored solutions, rather than mandating an expensive and risky new banking program that will not resolve the problems stated in the measure.

We agree that bringing Californians who do not have bank accounts into the financial mainstream is of utmost importance which is why banks and credit unions are joining the BankOn program. Run by the Cities for Financial Empowerment Fund the BankOn initiative works to ensure everyone has access to a safe, affordable transaction account. BankOn certified accounts must meet robust National Account Standards, developed by consumer advocates and based on the FDIC’s Safe Account pilot in 2011. These accounts must have low monthly fees, no overdraft fees, robust transaction capabilities such as a debit or prepaid card, online bill pay, and free and unrestricted customer service. All the major banks and credit unions with a California presence participate in the BankOn program and offer a geographically expansive network of free ATMs. The BankOn movement also emphasizes local coalitions that bring together banks, nonprofits and government agencies to help guide unbanked households into an account that meets their needs and will help them succeed. Building a strong, collaborative California BankOn coalition would be enormously consequential, and the legislature could play a supporting role in helping to promote both bank and consumer adoption of BankOn accounts by supporting development of a strong coalition. Doing so will invariably be less expensive and risky than the proposed banking structure contemplated by AB 1177.

Relative to other financial products, there exist an array of less costly, less risky alternatives. Community Development Financial Institutions (CDFI) are private financial institutions with a primary focus on developing low-income and low-wealth communities by providing personal and business lending and investing opportunities. CDFIs often receive federal funding from the U.S. Department of the Treasury but their primary source of capital comes from commercial banks. The legislature could choose to pursue legislation to help capitalize CDFI's with an appropriation rather than creating BankCal, which would be redundant to the existing network of financial offerings.

There are additional legislative opportunities for existing loan products already supported by California. The California Infrastructure and Development Bank's Small Business Loan Guarantee Program has provided \$509.6 million in capital to California businesses and the California Capital Access Program helps small businesses who have a difficult time obtaining traditional financing.

### This Measure is Premature

If the intent of AB 1177 is to provide California residents access to banking, the aforementioned opportunities are more effective, less costly and pose far fewer risks to taxpayers than creating a new state bank. However, if the purpose of AB 1177 is to create a deposit base for public banks, we must ask the question, why now? In 2019, the Legislature passed AB 857 (Chiu) (Chapter 442, Statutes of 2019) to allow local governments to apply for a public bank charter. Doing so requires municipalities to complete a business plan, apply for and receive regulatory approval from the Department of Financial Protection and Innovation and the Federal Reserve Bank and obtain approval for FDIC insurance. AB 1177 creates a Public Bank Options Board as the primary governance structure for the program and relies on a network of public banks to be a receptacle for deposits flowing from BankCal. Yet, to date not a single municipality has developed a business plan - the first step in applying for a public bank charter. Local governments are years away from receiving approval for a public bank charter, which requires sizeable collateral and capitalization. Until such time as a network of public banks are operating and proven financially viable, AB 1177 should not be considered for legislative approval.

### The Risk to Californians

In addition to the questionable need for this measure, there will be sizeable costs and risk associated with creating and supporting the BankCal program. The magnitude of the proposed endeavor contemplated by AB 1177 puts taxpayers on the hook for what will assuredly be exceedingly high start-up and operations costs; this coming on the heels of news that California taxpayers will soon be asked to backfill potentially \$30 billion dollars in fraud cost associated with improper verification of unemployment claims. The banking industry spent nearly \$300 billion in 2020 on technology, primarily on front-end customer-interfacing systems. As California's primary face for banking, BankCal will not escape these operational costs. Fee-free banking products are not free at all to the bank offering those products and California taxpayers will be forced to bear the burden of these expenses.

### More Questions Than Answers

The measure acknowledges that it must rely on at least one major financial institution to issue debit cards. By definition, a debit card is a payment card that deducts money directly from a consumer's deposit account when it is used. It is clear, however, that BankCal will broker deposits out to public banks, not the partner bank issuing the debit cards. This is incongruous to how debit cards work. Additionally, the measure appears to make BankCal the brand for the front-end customer experience, relying on its banking partners for account fulfillment. In this case, which entity is responsible for the Know Your Customer (KYC) regulatory obligations under the U.S.A. Patriot Act? The KYC rules dictate an institution's acceptance policy and customer identification procedures at the time of application, yet AB 1177 is proposing to accept applications with no government identification. Additionally, does BankCal also have the duty to adhere to the California Consumer Protections and Privacy Act like commercial banks? How will BankCal safeguard customer information? The measure also prohibits participating merchants from charging debit card swipe fees to a customer using debit cards, but it is unclear to us what this means. Debit card surcharges are already prohibited under federal law. The measure prohibits participating banks from charging fees for specified transactions, yet these services come at a cost to a participating institution. Is BankCal going to absorb these costs by virtue of its contract with participating lenders? The measure proposes to interface with state and local agencies to be California's premier payment network for the State Department of Social Services, Office of Systems Integration, Employment Development Department, and other applicable government agencies. Does AB 1177 also contemplate that BankCal will bear the expense of updating the legacy computer systems that have plagued these agencies and departments?

### Violates Prior Agreement

Finally, this measure violates the principles agreed to in 2019's AB 857 (Chiu). When that measure was presented to legislators the sponsors claimed that no state funds would be used, and that municipalities could create a self-sustaining public bank without using general fund dollars. Now, a mere two years later, proponents are back to ask the legislature to create liquidity, at the expense of the general fund and taxpayers, by developing a guaranteed deposit base for public banks. Given the fact that, to date, every public bank feasibility study indicates a public bank will sustain significant losses, will legislators next be asked to backfill those losses? The result could be an endless drain on the general fund for the foreseeable future. Additionally, legislators specifically required that if a public bank was chartered under the provisions of AB 857, that it not compete directly with credit unions and community banks. Section 4, 100126 (b) of AB 1177, however, specifically allows a public bank to engage in retail activities in competition with local financial institutions if it is taking deposits from BankCal.

For these reasons we must respectfully oppose AB 1177.

Sincerely,

California Bankers Association  
American Bankers Association  
Bay Area Council

*The Honorable Miguel Santiago*

*Opposition to AB 1177*

*April 19, 2021*

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California Chamber of Commerce  
California Community Banking Network  
California Credit Union League  
Card Coalition  
Credit Union National Association  
Independent Community Bankers of America  
National Federation of Independent Businesses

Cc: All members, Assembly Banking & Finance Committee  
Luke Reidenbach, Consultant, Assembly Banking & Finance Committee  
Elizabeth Enea, Consultant, Assembly Republican Caucus  
Manuel Alvarez, Commissioner, Department of Financial Protection & Innovation  
Fiona Ma, Treasurer, Office of the State Treasurer

JL:la