

A Stakeholders' Case for Public Banking and a Public Cannabis Bank in California

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As our organization, Commonomics USA, is concerned with policies that prioritize the commons, we talk a lot about stakeholders. Stakeholders are also an appropriate place to start in this meeting, because neither a Cannabis Banking Working Group nor a special session on public banking would exist but for strong public demands: for a policy of legal recreational cannabis, for financial protection and security for the MRB industry, and, as we're seeing throughout California, for public banks.

When viewed from the lens of stakeholder needs, the question becomes what banking system creates *security, predictability, opportunity, and sustainability* for the primary stakeholders in California's transition to a new cannabis economy. Those stakeholders are (1) California residents, who voted to regulate rather than prohibit recreational cannabis, but want to be free of crimes, including financial crimes, associated with marijuana-related finance and commerce; and (2), California marijuana-related businesses, of whom many cities are paying special attention to businesses emerging from communities historically victimized by the war on drugs. In Commonomics USA's experience, publicly-owned and maintained systems often do a better job meeting those particular needs--security, predictability, opportunity, and sustainability--than privately-owned systems, for the greatest number of stakeholders, and especially for disadvantaged stakeholders.

California needs a solution to the cannabis banking conundrum by January 2018. As statements to the Working Group have established, private banks are reluctant to "touch" cannabis money absent a prior "first touch" by the State of California. Although it is unclear whether the federal Department of Justice has the resources or political capital to hinder commerce in states that have legalized recreational cannabis, and experts have told this Working Group that the Cole Memorandum and FinCEN guidelines might "prove to be more resilient" than many suppose, federal prohibition is vexing, particularly with respect to financial transactions for MRB money, and especially against the backdrop of a DOJ led by a vocal critic of recreational marijuana.

The legal and policy context for these problems is ambiguous and unpredictable. The federal government has not explicitly asserted that states *cannot* set different controlled substance schedules and policies. As legal scholars have pointed out, certain provisions of the CSA seem to anticipate this. Moreover, the United States Supreme Court declined to hear an objection to state-level legalization from other states. Meanwhile, the state of California collects taxes and fees from California MRBs now and will continue to do so no matter how this Working Group answers the banking questions. The federal government, through the Department of Justice and Department of Treasury, has not seriously questioned the tax and fee revenue from California MRBs and there has not been a distinction between tax and fee revenues from medical and recreational cannabis .

This raises interesting philosophical questions: When the state government touches that money, what is the legal basis for it being clean enough to be deposited in a bank? Is the state compromising its fiduciary responsibilities by assuming that these monies are not at risk of seizure? Is mixing tax receipts between different industries merely perpetuating the obfuscation and lack of transparency of an underground economy? We ask these questions because we believe that the legal basis for the state's ability to legitimize cannabis money needs to be built and made explicit. The federal government has jurisdiction over interstate commerce, but California needs to develop the legal and policy framework for in-state commerce of a product that is federally illegal and, in the case of recreational cannabis, potentially the target of federal hostility. A public bank solution will allow California the opportunity to express the first iteration of the terms of any such answer--by asking the administration and the Federal Reserve banks whether the policy objectives of federal financial crimes and drug laundering laws favor a centralized state bank in the driver's seat, or a continuation of the decentralized, ad hoc, and often surreptitious practices of cash collection and quirky experiments by small private banks.

Rather than looking at this as a cannabis problem, this is really a banking problem--a problem of the inability/unwillingness of the private banking sector to address both a segment of the population and a pressing social need. That's a familiar situation for those of us in the banking and public policy world--particularly those of us interested in public banks. In fact, as California stands at the precipice of a cannabis banking crisis, it is also immersed in two other banking crises, slow-burning problems that hurt the state's communities and its economy. The first is the economic toll that big private banks have taken on the state. California's state and local treasuries have suffered greatly under the interest rates and fees charged by big banks, the costs of financing infrastructure and development, and the reluctance of private finance to fund the kinds of development Californians need. Capital appreciation bonds saddling school districts with interest charges that dwarf the size of the principle are probably the most egregious, but the results are the same: costly public financing, lack of access to financing for public sector goods, and a cynical sense that we can no longer afford to fund good ideas.

The second banking crisis is the unavailability of basic banking services to so many Californians. According to the 2015 FDIC National Survey of Unbanked and Underbanked Households, almost 900,000 residents of the state lack basic banking services, and thousands more -- over 19% of households -- are "underbanked," meaning they subsist financially with short-term and very expensive services. Lack of access to affordable services contributes to financial precariousness and insecurity, which is harmful to the individuals, families, and communities affected, and a barrier to sustainable economic security across the state.

So privately owned banks seem to trip over a number of market failures, of which cannabis revenue is one. The reasons may be different--in the case of cannabis revenue, a heavy-handed federal government--but the common denominator is that the tendency to view banking as merely a business opportunity rather than a public utility has meant and will continue to mean that huge populations are unserved, and huge public needs unmet.

But the State of California stands in a unique position to take on these challenges. California is the sixth largest economy in the world. Policy-wise, it has pushed itself ahead of the federal government and much of the rest of the nation on policies from post-carbon energy to family leave, from struggling to forge a universal health insurance system to protecting immigrant communities. New government-owned, nonprofit JPAs are being formed to produce renewable energy. One might say California is forging a new economy. We think a new economy needs a new bank--a bank of its very own, that leverages the power of banking based on deliberative policy objectives rather than using profit and loss as a *starting point* for financial policymaking.

After studying public banks and public banking campaigns for many years, and listening intently to the discussions in these Cannabis Banking Working Group meetings, as well as several divestment and public banking meetings across the state, we offer this four-stage proposal as a starting point for discussion.

The first phase would be the drafting and legislative enabling of a public bank: The Department of Business Oversight would define a Public Bank Charter for a depository bank serving the unmet banking needs of the California public. California's legislature would pass the enabling laws to support and protect this bank license. In this phase, the state would develop a business plan as part of its application to the Federal Reserve Bank of San Francisco for a master account number. We believe that this phase can begin immediately and, as a matter of fiduciary responsibility, would lower the risk of the subsequent phases. Should the Federal Reserve Bank of San Francisco grant the master account to this public bank without a fight, the landscape dramatically changes.

The first phase also includes capitalization. Many possibilities exist for capitalizing the bank, including debt or equity financing, issuing corporate bond and pension funds with the cannabis industry or the general public stepping forward to participate; or even constrained common stock in the fashion of the ownership of the Green Bay Packers.

In the second phase, the state bank creates depository services for MRBs and the unbanked and underbanked. Limited commercial account services could include demand deposit account services, cash concentration services, depository reporting, and automated payroll deposits for employees. Core, low-cost, retail banking services for the un- and under-banked market could include simple transactional and savings accounts, automated payroll deposit, peer-to-peer money transfer, international remittances, and debit cards. Low-cost methods used to access bank accounts could include online devices, existing ATM/Kiosks, and mobile phones.

In the third phase, the bank develops its capacity for risk management, compliance automation, and payment automation. The objective would be to lower the cost of compliance by using analytics and monitoring software to provide important reports using automated procedures and monitoring products. This Working Group has already heard about these capabilities from other participants. These products will provide greater transparency to the financial system. These

participants have also mentioned payment automation capabilities, and we recommend that this phase includes this important technology. This can be done with an app that would complete payment transactions between cannabis consumers and cannabis businesses with an account at the public bank. If necessary or desirable, it could avoid the VISA, MasterCard and American Express network and transfer funds from the buyer's California bank account to the seller's account in the public bank.

In the fourth phase, the bank provides credit, lowering the cost of public financing, using public credit instead of taxpayer money or municipal bonds for the construction of schools, toll bridges, water and sewer systems, and a sustainable post-carbon energy system. Many additional public goods require financing and have huge social and economic payoffs, from affordable housing loan programs (including loans directed to public employees), that help people live in the same communities where they work, to loans for cooperative startups. The bank could also use its public credit to provide lower costs to wage earners saddled with student loan debt, helping a demographic that has, by many measures, gotten a raw deal in California.

There are four main benefits that a public bank can provide:

1. Satisfies unmet market needs. In the event of market failures, when private banks are not able to meet the needs of the banking market, a public bank is able to be used to fill in the gaps, to provide deposit account and credit services where there are none.
2. Cost savings. A public bank has a lower cost of doing business (no bonuses, no extreme salaries, no dividends, etc.) that can be passed on to borrowers, whether students, businesses or municipalities.
3. Economic sovereignty. A public bank is a democratic approach to public finance, involving both the public and other stakeholders in the loan portfolio decisions.
4. Counter Cyclicity. A public bank's equity is not publicly traded on a stock market and is not subject to the same changes in valuation in as rapid a pace as we saw in 2008 and 2009 stock market, where some banks lost upwards to 80% of their equity. Because of this, public banks have the ability to continue to make loans precisely when private banks are terminating lines of credit, ending loan programs, and not accepting deposits.

Some folks, including a public official or two, are tired of public banking advocates bringing up the Bank of North Dakota. So we will only bring it up to explain that there are many roads to banking democracy. This proposal, as presented, does not suggest transposing the BND model onto the State of California. It isn't a proposal to use California's assets to capitalize the Bank or to seek partnership with or underwriting of the private banking industry. In the wake of natural disasters, BND has the ability to make bridge loans to businesses and homeowners before they are reimbursed by FEMA and suspend mortgage and student loan monthly payments. In 2015,

BND obtained more than \$2.5 billion in public deposits through pledging services for private banks, in addition to providing \$679 million of liquidity through BND's secured and unsecured federal funds lines. Our proposal doesn't preclude any of that, but it doesn't require any of that.

The process outlined in our proposal should occur in tandem with the ongoing effort to relax federal law, consistent with the recommendations of Erwin Chemerinsky, Jolene Forman, Allen Hopper, and Sam Kamin, in their UCLA Law Review article "Cooperative Federalism and Marijuana Regulation." Passage of the SAFE Act, a robust reaffirmation or strengthening of Cole-style and FinCEN guidelines, all as part of the ongoing effort to reach out to rational federal policymakers--who we believe really do outnumber the louder and less reasonable voices in Washington. California is likely to make that request to the federal government anyway. But doing so having created a public bank in the world's sixth largest economy, a bank committed to financial oversight of cannabis banking as a matter of public policy, creates a very different context for the dialogue between the federal government and the states concerning cannabis.

Similarly, if it is to find any "banking"-based solution to MRB revenue's federal illegality, California will inevitably have to face the question of obtaining a Master Account Number from the Federal Reserve Bank of San Francisco. Why not, then, have the State of California itself, on behalf of a state-owned bank with unprecedented control over the cannabis economy, make that application?

Most people in this room understand the general case for public utilities meeting unmet market needs and, specifically, public banking doing the same. As movements in Oakland, here in L.A., and in other parts of the state suggest, there is widespread support for exploring public banking in California. But the reason we're having this conversation, here with the Cannabis Banking Working Group, is that this is a "try or die" moment for the cannabis banking question. Some entity or collection of entities must *inevitably* dialogue with the sources of current federal complications concerning cannabis banking. From a stakeholders' perspective, we believe it makes a lot of sense for that entity to *be the State of California*--affirming the decisions the people of the state have made, owning those decisions.

This is a chess game, with economic sovereignty being the big win for California. Understanding the possible moves that the federal government can make is critical. We assume, for instance, that recreational cannabis tax revenue can be collected and placed in one of the state's accounts in a private bank. What if, in the Attorney General's quest to disallow recreational use of cannabis, this regulation is changed to disallow this recreational cannabis tax revenue from being legally deposited in private banks? California can collect the tax, but it'll end up with the same banking issue now experienced by MRB's. There will be yet another run on pickle barrels, only this time the state will be buying them.

What is needed is a body of state law that creates a Public Bank Charter (or license), defines "municipal affairs" for state charter cities, sets standards for in-state commerce of recreational

cannabis, and protects Californians so that they may conduct safe economic transactions in the currency medium of choice.

A public bank can then be created in order to act as the organizational bulwark, protecting California's interests by meeting unmet market needs and issuing deposit accounts to MRBs and the unbanked, efficiently handling the federally mandated compliance issues, automating payments (including tax payments), and making California's economic sovereignty a reality.

A public bank acting as a necessary public utility that provides banking services to MRBs, to the unbanked and underbanked, and for lower cost infrastructure and commercial financing, can help California use its status as a global economic power, and its huge economies of scale, to create the appropriate financial infrastructure necessary for this undertaking. The decision to create such a bank as a solution to the cannabis conundrum would send an unprecedented signal to the world that California is stepping into a new cannabis economy and a banking economy that meets the needs of all Californians, businesses no matter the industry, and municipalities.