COMMONWEALTH GROUP

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A Common Bank Holding Company
For States, Counties & Cities: A Solution for Our Economic Problems

As attractive as public banking[1] might be to a state, county or city, some might not want, or be able to establish a bank on their own. For example, a clause in Michigan's constitution states "*No state money shall be deposited in any bank, savings and loan association, or credit union, in excess of 50 percent of the net worth of the bank, savings and loan association, or credit union*."[2]

This clause makes it difficult for Michigan to form a wholly owned bank through which it processes all its revenues. Other entities may have concerns about risking their assets, or face high legislative hurdles.

A Simple Solution

Bank ownership falls into two generic categories:

- Stand-alone banks, i.e. banks owned directly by one or more individual stockholders. This is the way that most states and other government entities would probably prefer to own their own banks, provided they have the ability to create one without complication and delays. For example, the Bank of North Dakota is a DBA of the state and would most closely fit under this category.
- Banks owned by a bank holding company,[3] which in turn is owned by one or more stockholders (stockholders can be individuals, partnerships, corporations, LLCs, or even government entities, etc.). Holding companies are companies that own all, or portions of other things, which could be real estate, airplanes or other companies. In this case the companies would be one or more banks. Thus a bank holding company owns an interest in one or more banks and the holding company is owned by shareholders.

This second option provides our solution. A bank holding company (commonly known as a BHC) would allow multiple government entities to join forces so that they can collectively own an interest in one or more banks for their mutual benefit and the benefit of society. Such a BHC could be jointly owned by a state, one or more of its counties or cities, bodies like utility districts, school districts and agencies that manage government pension funds, etc., and even non-profit organizations, which collectively represent ***the public*** as the ultimate owners.[4]

That jointly owned bank holding company would, in turn, own one or more banks in whole or in part. If the former, then the bank holding company would need to establish a bank from scratch or take over one or more as described below. Alternatively, the BHC can acquire a minority interest by investing in an existing bank. There are benefits to both approaches, and the BHC could do one or both.

[1] See *Public Banking – A Tool For Fixing The Economy And The Means to Achieve It* http://www.commonwealthgroup.net/docs/PublicBanking.pdf and *Public Banking and L3Cs* http://www.commonwealthgroup.net/docs/PublicBankingAndL3Cs.pdf. See also www.webofdebt.com.
[2] Article IX, section 20
[3] http://en.wikipedia.org/wiki/Bank_holding_companies
[4] Issue: open to regulation by the Fed – see http://www.commonwealthgroup.net/docs/StateBanksDBAvs.Corp.pdf

Paths to Bank Ownership

There are two general ways to become the owner of a bank – build one from scratch or buy one.

Establish a Bank: Establishing a brand new bank (called a de novo bank) is a time-consuming and difficult task, a complicated process that includes fundraising, business plan development, definitions of policies and procedures, establishment of a board of directors and senior management team, acquisition of land, building, equipment and all the other elements required to set up and run a bank. That is followed by a difficult bank "charter" (a special license to be a bank) [5] application process that involves multiple government agencies, any one of which can slow or even stop the process. Given the current economy, very few new bank charters are being granted at this time.

Buy a Bank: As in real estate, where one can buy a home in good condition or a fixer-upper, one can acquire a healthy bank or a bank with problems. Increasingly more good banks are getting in trouble, so more troubled banks are potentially available for purchase, or at a minimum need help in getting back to health. That may entail both a capital infusion and other contributions. More on that below.

There are a number of ways that a BHC can acquire a bank. All require government approvals in addition to the business negotiations required to put together a sale. Nonetheless the approval process tends to be easier and quicker for an acquisition than for a de novo application.

One way to acquire a bank is to negotiate a purchase agreement whereby the current owners are paid in cash or other assets in exchange for their ownership in the bank. Thereafter they have no continuing interest in the bank and the BHC is the sole owner.

Another way is for the BHC to negotiate with the current owners to exchange their ownership interest in their bank(s) for an ownership interest in the BHC. Thereafter the BHC becomes the sole owner of the bank(s) and the former owners are then part-owners in the BHC.

Lastly it is possible to acquire the assets of a failed bank that has been seized by regulators and turned over to FDIC for disposition. The BHC would need to have an existing bank charter to take advantage of this approach (failed banks lose their charter upon seizure), but complete banks (sans charters) can be purchased from FDIC, along with a substantial customer base.

Regardless of the acquisition method, once the BHC has a bank with a charter, it can proceed with developing a state-wide solution. Initially, all the BHC need do is establish one bank charter for the whole state (and thus for the benefit of all the partners), and then it would be able to open up as many branches[6] as necessary without having to get additional bank charters.

Branches in turn can be operated under the name of the chartered bank, e.g., the Bank of Michigan could have as many branches as it chose throughout the state. Individual branches could also be operated as a DBA[7] of the chartered bank, depending on state laws (not all allow it).

Investing in Existing Banks

The main alternative to acquiring a bank is to become a part-owner in someone else's bank. A BHC is not constrained by law to being a sole owner of a bank. It may own one or more banks outright as well as partly own others. Becoming an investor in an existing bank is substantially easier than buying one.

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[5] A charter is analogous to a liquor license – without one you cannot be in that business. Bank charters can be "granted" by either the state where the bank is located, or by an agency of the federal government, and the owners of the bank can select which agency they want to provide them with their charter.

[6] http://en.wikipedia.org/wiki/Branch_%28banking%29

[7] http://en.wikipedia.org/wiki/Doing_business_as

As before, regulators will probably be engaged in the process, but in comparison with establishing a new bank or buying an existing one, this process is the least complex and time consuming, and is in fact usually welcomed by regulators because it means that banks are getting more resources that help to make them healthier and safer for their customers – the primary goal of regulation. Thus investments in existing banks can be one of the fastest ways for our BHC to be involved with public banking. And yet the BHC need not have the majority ownership interest of that bank to produce its desired outcomes, as the terms of their investment can restrict the kinds of loans the bank may generate with the use of that capital.

With such an investment, the BHC and the owners of the existing bank are largely free to enter into any agreement that makes sense for both. If the BHC is the sole owner, it is in a position to exclusively determine priorities and objectives. However, even if it is not the majority owner, the terms of the investment can still be structured to guarantee that the goals of the BHC are pursued as though the BHC were the sole owner with respect to the use of the funds provided by the BHC. Thus the larger goals of the BHC from a societal standpoint can still be pursued.

Leveraging Money for the Public Benefit

Banks, with their unique ability to create money with each loan,[8] are the prime engine for fueling our economy. When they stop lending our economy stalls. Today lending is at a near standstill. Getting commercial lending (not consumer lending) flowing again is **the** critical ingredient to fixing the economy, creating jobs and pulling us out of the recession. So how can banking do that?

International banking convention lets banks create money as a multiple of the bank's assets.[9] The more liquid the assets, the greater the multiple. For every dollar in cash capital owned by a bank, it is allowed to create up to $25 in loans – known as Tier 1 capital – without having to do anything with that one dollar but hang on to it. For every dollar in value in less liquid assets (like the bank building) – Tier 2 capital – the bank still can create at least 5-8 times that value in new loans. No other institution has the ability to take a certain amount of financial resources and multiply them many times over like banks can. Using government resources to back public banking efforts, allows those governments to multiply those resources many times over, for the direct benefit of the public.

Thus one can see that capital in a bank is key to creating money. However, the money so created initially just sits in the checking accounts of the borrower, which in reality is nothing more than just digital entries on a computer of the bank where the loan was created. If the borrower wants to use some or all of those funds to pay someone who banks with another bank or withdraw the funds as real cash, the bank needs to have actual funds to carry out those transactions.

The key to moving that newly created money out into the community (i.e. writing checks that are deposited in other banks or withdrawing cash) is liquid resources (think cash versus computer entries) to transfer those funds between banks or for withdrawals. That is where deposits from the bank's customers comes in with respect to checking accounts, savings accounts, CDs, etc. Such deposits give the bank the liquid resources needed to transfer money out of the bank. Thus a bank needs both capital (assets) and deposits (liabilities) to generate money and inject it into the economy.

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8 Robert B. Anderson, Secretary of the Treasury under Eisenhower, said in an interview reported in the August 31, 1959 issue of *U.S. News and World Report:* [W]hen a bank makes a loan, it simply adds to the borrower's deposit account in the bank by the amount of the loan. *The money is not taken from anyone else's deposit; it was not previously paid in to the bank by anyone. It's new money, created by the bank for the use of the borrower.* See Dollar Deception: How Banks Secretly Create Money http://www.webofdebt.com/articles/dollar-deception.php

9 http://en.wikipedia.org/wiki/Basel_II

Governments (states, counties, cities, special districts, ports, etc.), foundations, pension funds, unions and others have accrued very substantial amounts of physical assets and cash which could serve as the source of capital for the BHC and as deposits in the banks that receive an investment from the BHC.

The Mechanics

Bank holding companies can be corporations or LLCs and can be privately or publicly held (corporations only, listed on a stock exchange). A BHC formed as an LLC will probably afford states and their partners the greatest flexibility in structuring something to match the requirements of each. Certain states like Michigan have a special type of LLC called an L3C,[10] created to bridge the gap between non-profit and for-profit investing, that might be the preferred vehicle. An L3C exists primarily for the public benefit, similar to a non-profit organization, and thus makes the most sense for a BHC dedicated to the public benefit. With the exception of its public purpose, in all other ways the L3C is like a conventional LLC, and the LLC is ideal for our BHC purposes.

The key is that the LLC provides a legally well-established vehicle that is extremely flexible when it comes to adding owners (much more so than with corporations) under terms that are customizable for each and every investor, as agreed to by the other owners. This would allow each participant (government entity) to determine what kind of resources (and of what value) that it can "invest" into the BHC, and negotiate what it would receive in return. The greater their contribution and thus ownership, the greater their return.

Likewise individual partners can add additional resources over time. This would allow any partner to get involved on a limited basis in the beginning, and as time and conditions allow, increase their involvement within the context of their constitutional, statutorial and administrative rules limitations and preferences.

And since LLCs are "pass through" vehicles from a profit and tax standpoint, any gains realized by their banking operations may be freely distributed to the owners, on the agreed upon pro-rata basis. In addition, owners can be added or leave at any time, provided both conditions are clearly defined in the LLC's organizational documents and in the agreements signed by all.

The practical ramification of this approach is that a limited group (say the state and one or two counties) could launch the enterprise to get the process rolling, and others could join at a later date.

The process could be kicked off by a couple of small cities or counties and subsequently expanded across the state, to include at a later date the state and others, thereby allowing public banking advocates the maximum flexibility possible to get public banking going without having to wait for the state to initiate the process. And as each partner joins the BHC, it increases the total economic resource base available for lending throughout the state. With such additional resources, other banks and other financial institutions can be added to the mix, thereby increasing the overall economic benefit to the entire state.

Priorities, Policies and Procedures

Partners may have different priorities, but the policies and procedures should be common. It is recommended that an advisory board be established that serves the interests of all the state's citizens, without consideration of any particular political, business or other interests that might restrict its activities. That advisory group could be formed by a non-profit public interest group that is interested in advancing public banking within their state and may in fact initiate the effort by forming a BHC and recruiting its first partners.

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[10] See *Public Banking and L3Cs* http://www.commonwealthgroup.net/docs/PublicBankingAndL3Cs.pdf and http://en.wikipedia.org/wiki/L3C