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MEMORANDUM

TO: Hon. Members, Board of Supervisors
Hon. José Cisneros, Treasurer

FROM: Lisa Powell and Moe Jamil
Deputy City Attorneys

DATE: June 29, 2021

RE: Use of the Investment Pool to Capitalize a Public Bank or Municipal Finance Corporation

SUMMARY

In this memorandum we address two specific questions related to limitations on using the City's investment pool to capitalize a public bank or a municipal finance corporation (MFC), in response to questions that arose during the June 3, 2021, meeting of the Board of Supervisors Government Audit and Oversight Committee. "Public bank" means a City-owned depository public bank under California Government Code Section 57600(b)(1). "MFC" means a non-depository lending corporation that is wholly-owned by the City.

In this memorandum we answer the following questions:

1. May the Board of Supervisors direct the Treasurer's investments of investment pool funds?

No. The Treasurer is responsible for investment pool investments subject to state law restrictions including fiduciary obligations.

2. May the Treasurer invest investment pool funds in a public bank or MFC?

The Treasurer may invest investment pool funds in a public bank, provided that it meets the requirement for a public bank under California Government Code Section 57600 and if the investment meets the Treasurer's fiduciary and other state law obligations. But under current state law, the Treasurer may not invest investment pool funds in an MFC.

There may be other options for structuring or funding a public bank, MFC, or alternate public banking/lending arrangement but the scope of this memorandum is limited to the specific questions presented above.

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ANALYSIS

1. May the Board of Supervisors direct the Treasurer's investments of investment pool funds?

No. Under state law, the Board may delegate investment authority over county funds to the Treasurer. *See* Cal. Gov't Code § 27000.1. In San Francisco, the voters have effected that delegation in the Charter: the Charter delegates the deposit and investment of all City funds to the Treasurer. Charter § 6.106. Once delegated, the Treasurer – not the Board – has “assume[d] full responsibility for those transactions until the board of supervisors” revokes or does not renew the delegation, Cal. Gov't Code § 27000.1, which in this case would require a Charter amendment. Under this delegation, the “treasurer shall be the agent of the county with respect to these funds, serve as a fiduciary, and be subject to the prudent investor standard and the board of supervisors shall not be the agent, serve as a fiduciary, or be subject to the prudent investor standard.” *Id.* § 27000.3(a); *see also id.* § 53600.3 (persons “investing public funds . . . are trustees and therefore fiduciaries subject to the prudent investor standard”).

The Board may appropriate funds from the investment pool (as available and subject to restrictions in the Charter). But, with respect to money that remains in the investment pool, the Treasurer has “full responsibility” and authority to invest those funds, subject to fiduciary duties and extensive state regulation.

2. May the Treasurer invest investment pool funds in a public bank or MFC?

In the wake of the Orange County Investment Pool bankruptcy, the state set rigorous requirements for the investment of county surplus funds, which place first priority on the safety and liquidity of investments. California Government Code Section 53601 restricts investment pool investments to specific permissible types of investments. Section 53601 further prescribes the term, credit rating, and amount of certain types of investment pool investments. *See id.* § 53601; *In re Cty. of Orange*, 31 F. Supp. 2d 768, 783 (C.D. Cal. 1998) (describing these restrictions). The Government Code directs that the “primary objective of the county treasurer . . . shall be to safeguard the principal of the funds under the treasurer's [] control.” Cal. Gov't Code § 27000.5; *id.* § 53600.5. The secondary objective is liquidity, followed by yield. *Id.* §§ 27000.5, 53600.5.

Regarding a public bank, among the investments permitted under Section 53601 is investment in a “public bank, as defined in [Government Code] Section 57600.” Cal. Govt. Code § 53601(r). A public bank under Section 57600 must obtain a certificate of authorization to transact business under the Division 1.1 of the California Financial Code, must have deposit insurance provided by the Federal Deposit Insurance Corporation, and must meet other requirements for its formation and operation. If the City's public bank met the definition of a public bank under Section 57600, and if investing in the public bank would be consistent with the Treasurer's state law trustee, fiduciary, and prudent investor obligations, the Treasurer may invest investment pool funds in a public bank.

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The Treasurer may not invest investment pool funds in an MFC (or any public bank that is not a “public bank” as defined in Section 57600). Even assuming that investing in an MFC would be consistent with the Treasurer’s state law trustee, fiduciary, and prudent investor obligations, an MFC, in any form, is not among the specific investments authorized by Section 53601.

The Budget and Legislative Analyst (BLA) has suggested that it would be legally permissible to “work around” these investment restrictions by setting up a “conduit entity” in which the City could invest, which in turn would provide funding for the MFC. Any structure designed to evade or work around these investment restrictions would likewise be legally impermissible. If the City could set up a conduit legal entity and then invest indirectly in the MFC, the City could invest in any impermissible investment via a conduit entity, and the restrictions in Section 53601 would be meaningless. The structure of Section 53601 is expressly intended to limit investment options to prioritize the safety of municipal funds, and in the conduit entity proposal, the City would bear the risk of loss in the event the MFC failed.

Additionally, as proposed in the BLA’s report, the conduit entity would provide the investment pool below market returns in order to achieve the policy goal of shifting money to the MFC. Although this would be a determination for the Treasurer, it is unlikely that such an investment would satisfy the Treasurer’s trustee, fiduciary, and prudent investor obligations under state law.